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### California's Detortification of Contract Law: Is the Seaman's Tort Dead

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# CALIFORNIA'S DETORTIFICATION<sup>1</sup> OF CONTRACT LAW: IS THE *SEAMAN'S* TORT DEAD?

## I. INTRODUCTION

Since 1984, when the California Supreme Court crafted the new tort of bad faith denial of contractual existence in *Seaman's Direct Buying Service, Inc. v. Standard Oil Co.*,<sup>2</sup> California courts have grappled with a tort that is fundamentally out of place in the commercial setting.<sup>3</sup> Since the inception of this tort, lower courts have fixed numerous limitations on it in an effort to suppress its punitive damages remedy in commercial contract actions.<sup>4</sup> Recently, the court in *DuBarry International v. Southwest Forest Industries*<sup>5</sup> so severely limited the application of the *Seaman's* tort to commercial contract disputes<sup>6</sup> that the tort almost ceases to exist.

This Comment examines the birth of the tort of bad faith denial of contractual existence<sup>7</sup> and the significance of traditional tort and contract law when applying this tort.<sup>8</sup> Next, this Comment highlights the trend in California law toward limiting the tort's application.<sup>9</sup> Finally,

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1. The "tortification of contract law" is the tendency of contract disputes to "metastasize into torts," giving rise to punitive damages. *Oki Am., Inc. v. Microtech Int'l*, 872 F.2d 312, 315 (9th Cir. 1989) (Kozinski, J., concurring). This tendency was exhibited by the California Supreme Court's decision in *Seaman's Direct Buying Serv., Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984).

California is the leading state involved in the controversy over the *Seaman's* tort of bad faith denial of contractual existence. California's decision regarding the future application of the *Seaman's* tort will undoubtedly affect the treatment of similar torts throughout the nation. See *Consolidated Data Terminals v. Applied Digital Data Sys.*, 708 F.2d 385, 399-400 (9th Cir. 1983). Accordingly, the Ninth Circuit has indicated that district courts should await "further guidance from the California courts" before extending the tort of bad faith. *Id.* at 400.

2. 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984).

3. See, e.g., *Elksi v. Kukje Am. Corp.*, 672 F. Supp. 1294, 1298 (N.D. Cal. 1987); *DuBarry Int'l v. Southwest Forest Indus.*, 231 Cal. App. 3d 552, 571-72, 282 Cal. Rptr. 181, 192-93 (1991); *Rogoff v. Grabowski*, 200 Cal. App. 3d 624, 628-29, 246 Cal. Rptr. 185, 188 (1988).

4. See *infra* notes 79-148 and accompanying text.

5. 231 Cal. App. 3d 552, 282 Cal. Rptr. 181 (1991).

6. Commercial contracts are those into which parties enter for a business or economic advantage. See E. ALLAN FARNSWORTH, *CONTRACTS* § 1.2, at 7 (1982).

7. See *infra* notes 11-35 and accompanying text.

8. See *infra* notes 36-54 and accompanying text.

9. See *infra* notes 71-152 and accompanying text.

this Comment proposes the elimination of the *Seaman's* tort as a means of recovery in commercial contract disputes.<sup>10</sup>

## II. BACKGROUND

### A. *The Seaman's Case*

In 1971 Seaman's Direct Buying Service, Inc. ("Seaman's"), a ship supply dealer, planned to expand its operation by leasing an area in the City of Eureka's new marina for a marine fuel dealership.<sup>11</sup> Under pressure from the City to produce written evidence of a contract with an oil supplier, Seaman's negotiated with Standard Oil Company ("Standard"), explaining its need for a written agreement.<sup>12</sup> In 1972, after reaching an agreement on all major points, Standard wrote Seaman's a letter describing the terms of its proposal.<sup>13</sup> Seaman's presented the letter to the City, and the City granted the lease.<sup>14</sup>

By the end of the year, however, the 1973-1974 oil crisis had abruptly changed the oil industry from a buyer's market to a seller's market.<sup>15</sup> Consequently, the price of oil rose dramatically.<sup>16</sup> In 1973 Standard informed Seaman's that due to a federal allocation program instituted by the Federal Energy Office, Standard would be unable to supply fuel to Seaman's.<sup>17</sup> Seaman's wrote to the federal agency and was

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10. See *infra* notes 189-204 and accompanying text.

11. *Seaman's Direct Buying Serv., Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 759, 686 P.2d 1158, 1160, 206 Cal. Rptr. 354, 356 (1984).

12. *Id.*

13. Standard proposed:

(1) to sign a Chevron Marine Dealer agreement with Seaman's for an initial term of 10 years; (2) to advance Seaman's the cost of the new fueling facilities, or up to \$75,000, which sum was to be amortized over the life of the agreement at the rate of one cent per gallon of oil; (3) to provide a 4.5 cent discount per gallon off the posted price of fuel; and (4) to sign an agreement providing for Standard's right to cure in case of default by Seaman's.

*Id.* at 760, 686 P.2d at 1160-61, 206 Cal. Rptr. at 356-57. Standard's letter concluded: "[T]his offer is subject to our mutual agreement on the specific wording of contracts to be drawn, endorsement and/or approval by governmental offices involved, and continued approval of Seaman's credit status at the time the agreements are to go into effect." *Id.*, 686 P.2d at 1161, 206 Cal. Rptr. at 357. Seaman's considered the signing of the letter by agents of both Seaman's and Standard a "momentous occasion." *Id.*

14. *Id.* After receiving the letter, Seaman's informed Mobil Oil Company that a contract had been signed with Standard and ended negotiations it had been conducting with Mobil. *Id.*

15. See Brian Beedham, *Look Beyond the Oil*, THE ECONOMIST, May 17, 1975, at 7 (discussing nationwide impact of 1973-1974 fuel shortage).

16. *Id.*

17. *Seaman's*, 36 Cal. 3d at 761, 686 P.2d at 1161, 206 Cal. Rptr. at 357. In January of 1973, however, Standard and Seaman's had signed a temporary agreement in which Standard promised to supply Seaman's with all the fuel it needed while the new marina was under construction. *Id.* In telephone conversations with Seaman's, Standard said that the federal

successful in receiving a supply order.<sup>18</sup> Standard, however, changed its position by denying it ever had a binding agreement with Seaman's.<sup>19</sup>

Two appeals to the federal agency followed.<sup>20</sup> First, Standard appealed the supply order and succeeded in reversing it.<sup>21</sup> Seaman's then appealed this reversal, and the federal agency agreed to reinstate the order on the condition that Seaman's file a copy of a court decree stating that a valid contract existed.<sup>22</sup> Seaman's explained to Standard that it could not afford a trial to prove the existence of a contract and asked Standard to stipulate to the existence of one.<sup>23</sup> In response, Standard's representative laughed and said, "see you in court."<sup>24</sup> Without a supply contract, Seaman's could not fulfill its obligation to the City, and the company went out of business.<sup>25</sup>

Seaman's sued Standard for breach of contract and for tortious breach of the implied covenant of good faith and fair dealing.<sup>26</sup> The jury returned a verdict for Seaman's on both counts.<sup>27</sup> Seaman's received the same amount of compensatory damages for breach of contract and for tortious breach of the implied covenant of good faith and fair dealing and received approximately twenty-eight times that amount in the form of punitive damages for tortious breach of the implied covenant of good faith and fair dealing.<sup>28</sup>

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regulations were the *only* barrier to the contract. *Id.* Standard even helped Seaman's by providing the forms necessary for Seaman's to obtain a supply authorization from the federal agency. *Id.* Standard agents also helped Seaman's complete the forms. *Id.*

18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.*, 686 P.2d at 1162, 206 Cal. Rptr. at 358. Seaman's reacted to Standard's appeal by writing to Standard and requesting an explanation of its actions. *Id.* Standard did not write back. *Id.* Instead, internal memoranda revealed that one of Standard's agents reacted to the reversal of the order by exclaiming, "[g]reat!! We are recommending to other div[isions] that they follow your example." *Id.*

22. *Id.*

23. *Id.* at 761-62, 686 P.2d at 1162, 206 Cal. Rptr. at 358.

24. *Id.* at 762, 686 P.2d at 1162, 206 Cal. Rptr. at 358.

25. *Id.*

26. *Id.* Seaman's also sued for fraud and interference with Seaman's contractual relationship with the City. At trial, Seaman's won on all but the fraud cause of action. *Id.*

27. The jury awarded compensatory damages of \$397,050 for breach of contract and compensatory damages of \$397,050 for tortious breach of the implied covenant of good faith and fair dealing. *Id.* The punitive damage award for tortious breach of the implied covenant of good faith and fair dealing amounted to \$11,058,810. *Id.* In addition, the jury awarded compensatory damages of \$1,588,200 for intentional interference with an advantageous business relationship and punitive damages of \$11,058,810 for intentional interference with an advantageous business relationship. *Id.*

28. *Id.*

On appeal, the California Supreme Court found it "unnecessary"<sup>29</sup> to decide the "broad" question of when a breach of the implied covenant of good faith and fair dealing<sup>30</sup> in a commercial contract may give rise to a tort action.<sup>31</sup> Instead, the court created a new tort that occurs if, "in addition to breaching the contract, [a party to the contract] seeks to shield itself from liability by denying, in bad faith and without probable cause, that the contract exists."<sup>32</sup> The court's rationale was that accepted notions of business ethics are offended when a contracting party seeks to avoid all liability on a meritorious contract claim and essentially denies that a contract exists<sup>33</sup> by adopting a "stonewall"<sup>34</sup> position. The court concluded, without explanation, that imposing tort damages in these situations is "not likely to intrude upon the bargaining relationship or upset reasonable expectations [sic] of the contracting parties."<sup>35</sup>

29. *Id.* at 769, 686 P.2d at 1167, 206 Cal. Rptr. at 363.

30. "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement." RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981). The Uniform Commercial Code defines good faith as "honesty in fact in the conduct or transaction concerned." U.C.C. § 1-201(19) (1991). Conduct such as "subterfuge" or "evasion" violates the duty of good faith and fair dealing. *See* FARNSWORTH, *supra* note 6, § 7.17, at 527.

31. *Seaman's*, 36 Cal. 3d at 769, 686 P.2d at 1167, 206 Cal. Rptr. at 363. The court did not provide an explanation for its evasion of this issue, concluding instead that "it is not even necessary to predicate liability on a breach of the implied covenant." *Id.* The California Court of Appeal, by contrast, decided the issue by explaining that no tort cause of action existed for breach of the implied covenant of good faith and fair dealing in a commercial contract. *Seaman's Direct Buying Serv., Inc. v. Standard Oil Co.*, 181 Cal. Rptr. 126, 136 (1982), *vacated*, 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984); *see also* *Air-Sea Forwarders, Inc. v. Air Asia Co.*, 880 F.2d 176 (9th Cir. 1989) (criticizing failure of *Seaman's* court to explain reason new tort was invented).

The *Air-Sea* court explained:

Indeed, the *Seaman's* court's failure to explain why it was not necessary to predicate its holding on the implied covenant of good faith and fair dealing, or to justify the dramatically greater liability for the bad faith denial of the existence of a contract as compared to the bad faith dispute of a contract's terms, undoubtedly spawned the confusion in the appellate division cases . . . .

*Id.* at 184 n.11 (citation omitted).

32. *Seaman's*, 36 Cal. 3d at 769, 686 P.2d at 1167, 206 Cal. Rptr. at 363.

33. *Id.*

34. There has been much discussion among California's appellate courts as to whether the *Seaman's* court intended "stonewalling" to be an example of tortious conduct that breaches the covenant of good faith and fair dealing, or whether it actually intended to create a specific new tort of bad faith denial of the existence of a contract. *See infra* notes 79-130 and accompanying text. Standard's stonewalling was its statement, "[s]ee you in court." 36 Cal. 3d at 762, 686 P.2d at 1162, 206 Cal. Rptr. at 358. The court interpreted this statement as indicating that Standard was seeking to avoid all liability in bad faith, that is, without a belief in the viability of its defense. *Id.* at 770, 686 P.2d at 1167, 206 Cal. Rptr. at 363.

35. *Id.*

### B. Tort and Contract Law Policy Differences

Imposing tort damages upon contracting commercial parties as a result of economically justified business decisions is inconsistent with principles of contract law.<sup>36</sup> The objectives underlying the remedies in tort and contract law are widely divergent.<sup>37</sup> Whereas the goal of contract actions is to enforce the intentions of the parties to the agreement,<sup>38</sup> the goal of tort law is primarily to vindicate "social policy."<sup>39</sup> Thus, punitive damages are traditionally extreme in order to punish and deter the wrongdoer, while contract damages are usually compensatory, allowing the plaintiff to recover only that which he or she has lost.<sup>40</sup> Punitive damages are generally justified if an unsophisticated contracting party reasonably relies on a sophisticated contracting party for the protection of its interests.<sup>41</sup> For this reason, punitive damages attempt to discourage intentional injury to parties that are in a more vulnerable position than the parties with whom they contract.<sup>42</sup> In contract law, however, intentional breach is not discouraged if it provides the promisor a more economically efficient solution.<sup>43</sup>

There are several important reasons for excluding punitive damages from the realm of commercial contracts.<sup>44</sup> First, punitive damages traditionally have been justified when the conduct involved "some element of outrage similar to that usually found in crime."<sup>45</sup> A business acting on behalf of its own self-interest by accepting liability in place of economi-

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36. See RESTATEMENT (SECOND) OF CONTRACTS, *supra* note 30, ch. 16 introductory note at 100.

37. *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 683, 765 P.2d 373, 389, 254 Cal. Rptr. 211, 227 (1988).

38. *Id.*

39. *Id.*; see also WILLIAM L. PROSSER, HANDBOOK OF THE LAW OF TORTS 613 (4th ed. 1971) (stating that duties of conduct that give rise to tort actions are based primarily upon social policy).

40. See RESTATEMENT (SECOND) OF CONTRACTS, *supra* note 30, § 355 cmt. a. "The purposes of awarding contract damages is [sic] to compensate the injured party . . . In exceptional instances, departures have been made from this general policy . . . notably in situations involving consumer transactions or arising under insurance policies." *Id.*; see also PROSSER, *supra* note 39, § 2, at 9 (stating that goals of punitive damages are punishment and deterrence).

41. See Eileen A. Scallen, *Sailing the Uncharted Seas of Bad Faith: Seaman's Direct Buying Service, Inc. v. Standard Oil Co.*, 69 MINN. L. REV. 1161, 1198 (1985); see also RESTATEMENT (SECOND) OF CONTRACTS, *supra* note 30, § 355 cmt. a (noting that punitive damages may be recoverable in situations arising under insurance policies).

42. See Scallen, *supra* note 41, at 1187.

43. See RESTATEMENT (SECOND) OF CONTRACTS, *supra* note 30, ch. 16 introductory note at 100.

44. See *infra* notes 45-54 and accompanying text.

45. RESTATEMENT (SECOND) OF TORTS § 908 cmt. b (1979); see also Thomas A. Diamond, *The Tort of Bad Faith Breach of Contract: When, If at All, Should It Be Extended*

cally inefficient performance can hardly be called criminal.<sup>46</sup> In fact, such conduct is encouraged because "[b]ad faith breach of contract, if defined as an intentional breach motivated by crass economic self-interest, has been, despite a clamoring of moral credos to the contrary, a judicially accepted staple of our system of commercial law."<sup>47</sup> Our system commends "bad faith" breaches of commercial contracts because they may promote economic efficiency: The promisor's pecuniary gains from the breach may exceed its liability to the promisee for its losses the promisor caused.<sup>48</sup> Adding punitive damages to the promisor's liability would discourage the efficient reallocation of society's resources.<sup>49</sup>

Second, a party to a commercial contract normally can turn to the marketplace to replace necessary goods not delivered by a breaching seller.<sup>50</sup> Therefore, the victim of bad faith conduct in a commercial con-

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*Beyond Insurance Transactions?*, 64 MARQ. L. REV. 425, 427 n.7 (1981) (stressing difference between bad faith and malevolent state of mind required for punitive damages).

Professor Diamond explained:

Punitive damages are not an essential concomitant of defendant's tortious conduct. The bad faith required . . . is not necessarily tantamount to the malevolent state of mind required for punitive damages. The terms "good faith" and "bad faith" . . . are not meant to connote the absence or presence of positive misconduct of a malicious or immoral nature—considerations which . . . are more properly concerned in the determination of liability for *punitive* damages. . . . Only when the "bad faith" breach was accompanied by an odious state of mind sufficient to constitute oppression, fraud or malice will punitive damages be allowed.

*Id.* (citations omitted).

46. See Diamond, *supra* note 45, at 433.

47. *Id.*

48. See *id.* at 438.

[I]t is evident why courts have been reluctant to make the bad faith breach of contract a separate tort. Despite its onerous appellation, the bad faith breach, if defined as an intentional, wilful, selfishly induced breach of contract, is often an anticipated, expected and encouraged reality of commercial life. . . . Further, since conduct is generally classified as tortious only when it is sufficiently repugnant to be designated a societal wrong, it would be inappropriate to label an activity that is sanctioned, even encouraged, as tortious.

*Id.* at 438-39 (footnote omitted); see also RESTATEMENT (SECOND) OF CONTRACTS, *supra* note 30, ch. 16 introductory note at 100.

49. See Robert L. Birmingham, *Breach of Contract, Damage Measures, and Economic Efficiency*, 24 RUTGERS L. REV. 273, 284 (1970); see also E. ALLAN FARNSWORTH & WILLIAM F. YOUNG, CASES AND MATERIALS ON CONTRACTS 16-18 (4th ed. 1988) (emphasizing importance of efficient breaches to society).

It is in society's interest that each individual reallocate his resources whenever it makes him better off without making some other unit worse off. Since reallocation through breach will not make the injured party worse off if his expectations are protected by preserving his planned allocation of resources, and will, by hypothesis, make the party in breach better off, it is in society's interest that the contract be broken and the resources be reallocated.

*Id.* at 17.

50. See *Wallis v. Superior Court*, 160 Cal. App. 3d 1109, 1118, 207 Cal. Rptr. 123, 128 (1984).

tract ordinarily does not suffer an injury of such a severe magnitude to render typical contract remedies of compensation for expense and inconvenience inadequate.<sup>51</sup>

Finally, if bad faith conduct in the commercial context is "too harshly sanctioned, there will be a deterrence not only of breach, but of the execution of contracts."<sup>52</sup> The predictability of contract liability plays an important role in the commercial system.<sup>53</sup> The possibility of oppressive damages looming over every commercial contract creates a degree of uncertainty that is inconsistent with the traditional purpose of contract remedies—to give each party its expectancy.<sup>54</sup>

The undisputed exception to the general exclusion of punitive damages from commercial contract disputes is in the insurance context.<sup>55</sup> An insurer who breaches the covenant of good faith and fair dealing is liable

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51. The injury is based on the fungible nature of the goods. In the insurance context, however, the harm may not be mitigated by turning to the marketplace. The insured is placed in a unique "economic dilemma" because "[w]hen an insurer takes such actions, the insured cannot turn to the marketplace to find another insurance company willing to pay for the loss already incurred." *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 692, 765 P.2d 373, 395, 254 Cal. Rptr. 211, 234 (1988).

In *Seaman's Direct Buying Serv., Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984), the plaintiff may not have been capable of turning to the marketplace because an unusually severe oil crisis, combined with a federal allocation program, rendered oil an inaccessible commodity, requiring Seaman's to rely on Standard for its continued operation. However, tort damages were not justified because Seaman's was not barred from finding another oil supplier to the same extent that an insured is barred from finding another insurer to pay for a loss already incurred. See *infra* notes 55-70 and accompanying text.

In Chief Justice Bird's concurrence and dissent in *Seaman's*, she argued that because Seaman's needed the contract with Standard to obtain the lease from the City, and because Standard knew of Seaman's need for a stable commitment, the parties' expectations did not include the possibility of a breach. *Seaman's*, 36 Cal. 3d at 781, 686 P.2d at 1175, 206 Cal. Rptr. at 371 (Bird, C.J., concurring in part, dissenting in part). Thus, Chief Justice Bird reasoned, under these circumstances Seaman's could recover in tort for Standard's bad faith breach. *Id.* (Bird, C.J., concurring in part, dissenting in part). However, Chief Justice Bird's reasoning is flawed because "a party to a commercial contract should recognize that a breach by the other party is always a possibility." Scallen, *supra* note 41, at 1173. See *Rogoff v. Grabowski*, 200 Cal. App. 3d 624, 631, 246 Cal. Rptr. 185, 189-90 (1988), for the proposition that even when the promisee in a noninsurance contract relies upon the promisor to the extent that the promisee has nowhere else to turn when the promisor breaches, tort damages are not justified because the parties' relationship does not possess the characteristics of an insurer-insured relationship.

52. Diamond, *supra* note 45, at 437; see also E. Allan Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145, 1208 (1970) (stating that parties are encouraged to contract because there is freedom to break contracts).

53. *Foley*, 47 Cal. 3d at 683, 765 P.2d at 389, 254 Cal. Rptr. at 227.

54. See RESTATEMENT (SECOND) OF CONTRACTS, *supra* note 30, § 344 cmt. b.

55. See JOHN C. MCCARTHY, PUNITIVE DAMAGES IN BAD FAITH CASES § 1.7, at 25 (5th ed. 1990).



in tort for punitive damages.<sup>56</sup> Courts and commentators perceive the insurer-insured relationship to be special because, while one party is motivated by profit, the other is motivated by different considerations, such as peace of mind.<sup>57</sup> In ordinary commercial contracts, however, profit is the primary motivation of both parties.<sup>58</sup>

The rationale for imposing tort liability on an insurer for breach of the implied covenant of good faith and fair dealing is based on several public policy considerations that arise from the special relationship between insurer and insured.<sup>59</sup> These considerations are: (1) Insurers are subject to special obligations because they are "purveyors of a vital service labeled quasi-public in nature";<sup>60</sup> (2) insurers "hold themselves out as fiduciaries";<sup>61</sup> (3) "the relationship of insurer and insured is inherently unbalanced";<sup>62</sup> (4) "the adhesive nature of insurance contracts places the insurer in a superior bargaining position";<sup>63</sup> and (5) the insured "does

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56. In *Seaman's*, the court cautioned against extending tort liability for breach of the implied covenant of good faith and fair dealing beyond parties with "special relationships" to parties involved in ordinary commercial contracts. For example, in cases involving insurance contracts, the court has emphasized the "'special relationship' between insurer and insured, characterized by elements of public interest, adhesion, and fiduciary responsibility." *Seaman's Direct Buying Serv., Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 768, 686 P.2d 1158, 1166, 206 Cal. Rptr. 354, 362 (1984). In commercial contracts, however, "parties of roughly equal bargaining power are free to shape the contours of their agreement." *Id.* at 769, 686 P.2d at 1167, 206 Cal. Rptr. at 363.

Courts have recognized another reason not to extend tort liability beyond parties with a special relationship. The language in *Seaman's* that defines the new tort has "striking similarities to the language in prior cases which had defined the tort of breach of an implied covenant of good faith and fair dealing as bad faith conduct, *extraneous* to the contract, with the motive intentionally to frustrate the enjoyment of contract rights." *Rogoff v. Grabowski*, 200 Cal. App. 3d 624, 629-30, 246 Cal. Rptr. 185, 188-89 (1988). Thus, the *Seaman's* tort may have been intended to be a subset of the tort of breach of the implied covenant of good faith and fair dealing applicable only to parties with special relationships. Under such a theory, the *Seaman's* court wrongly applied the new tort to parties involved in a commercial, rather than a special, relationship.

57. See MCCARTHY, *supra* note 55, at 25.

58. See *id.*

59. *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 809, 819-20, 598 P.2d 452, 456-57, 157 Cal. Rptr. 482, 486-87 (1979), *cert. denied*, 445 U.S. 912 (1980).

60. *Id.* at 820, 598 P.2d at 457, 157 Cal. Rptr. at 487 (quoting William M. Goodman & Thom G. Seaton, *Foreword: Ripe for Decision, Internal Workings and Current Concerns of the California Supreme Court*, 62 CAL. L. REV. 309, 346-47 (1974)). Because the insurer has the public's trust, it carries the additional responsibility of maintaining that trust. *Id.*

61. *Id.* Inherent in the responsibilities of a fiduciary is the obligation to act with decency and humanity. *Id.*

62. *Id.* Punitive damages are made available in this context in an attempt to restore balance in the relationship between insurer and insured. *Id.*

63. *Id.*; see also *Seaman's*, 36 Cal. 3d at 768, 686 P.2d at 1166, 206 Cal. Rptr. at 362. The *Seaman's* court conceded that the reason a tort action is available for breach of the covenant of good faith and fair dealing in an insurance contract is that the relationship between the con-

not seek to obtain a commercial advantage . . . he seeks protection . . . [.] peace of mind and security.”<sup>64</sup>

Contracts between commercial parties, by contrast, cannot be characterized by any of these considerations.<sup>65</sup> Commercial contracts are not quasi-public in nature.<sup>66</sup> Contracting commercial parties do not owe a fiduciary duty to act in one another's financial interests.<sup>67</sup> Inequality of bargaining power is not common in commercial contracts.<sup>68</sup> Moreover,

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tracting parties is characterized by elements of “public interest, adhesion, and fiduciary responsibility.” *Id.*

64. *Egan*, 24 Cal. 3d at 819, 598 P.2d at 456, 157 Cal. Rptr. at 486.

65. See, e.g., *White v. Western Title Ins. Co.*, 40 Cal. 3d 870, 900-01, 710 P.2d 309, 327-28, 221 Cal. Rptr. 509, 527-28 (1985) (Kaus, J., concurring in part, dissenting in part). Justice Kaus stated:

[I]n my view it would be disastrous if every contract were to be subjected to the same set of rules which we have applied in the context of the insurer-insured relationship. . . . I just cannot see every person who wilfully breaks a contract subjected to almost unlimited liability for punitive damages.

*Id.* (Kaus, J., concurring in part, dissenting in part); see also Charles M. Louderback & Thomas W. Jurika, *Standards for Limiting the Tort of Bad Faith Breach of Contract*, 16 U.S.F. L. REV. 187, 227 (1982).

The tort of bad faith should be applied to commercial contracts only if four of the features characteristic of insurance bad faith actions are present. The features are: (1) one of the parties to the contract enjoys a superior bargaining position to the extent that it is able to dictate the terms of the contract; (2) the purpose of the weaker party in entering into the contract is not primarily to profit but rather to secure an essential service or product, financial security or peace of mind; (3) the relationship of the parties is such that the weaker party places its trust and confidence in the larger entity; and (4) there is conduct on the part of the defendant indicating an intent to frustrate the weaker party's enjoyment of the contract rights.

*Id.*; cf. C. Delos Putz, Jr. & Nona Klippen, *Commercial Bad Faith: Attorney Fees—Not Tort Liability—Is the Remedy for “Stonewalling”*, 21 U.S.F. L. REV. 419, 424 (1987) (“The courts have been understandably reluctant to expand the tort of bad faith beyond insurance contracts.”).

66. See *Egan*, 24 Cal. 3d at 819-20, 598 P.2d at 456-57, 157 Cal. Rptr. at 486-87. When “parties are, at the outset of their dealings, in an adversarial relationship . . . the principal-fiduciary relationship . . . of trust and confidence appears to be lacking.” Louderback & Jurika, *supra* note 65, at 225.

67. *Rickel v. Schwinn Bicycle Co.*, 144 Cal. App. 3d 648, 654, 192 Cal. Rptr. 732, 736 (1983) (“California law is that parties to a contract, by that fact alone, have no fiduciary duties to one another.”).

68. See H. Anthony Miller & R. Wayne Estes, *Recent Judicial Limitations on the Right to Discharge: A California Trilogy*, 16 U.C. DAVIS L. REV. 65, 90-91 (1982). The *Seaman's* court cautioned:

When we move from such special relationships [as that between insurer and insured] to consideration of the tort remedy in the context of the ordinary commercial contract, we move into largely uncharted and potentially dangerous waters. Here, parties of roughly equal bargaining power are free to shape the contours of their agreement and to include provisions for attorney fees and liquidated damages in the event of breach. . . . This is not to say that tort remedies have no place in such a commercial context, but that it is wise to proceed with caution in determining their scope and application.

the commercial parties seek to obtain a commercial advantage.<sup>69</sup> Because the justifications that courts originally used to extend punitive damages into the insurance contract realm do not apply to commercial contracts, the imposition of punitive damages on parties to commercial contracts under *Seaman's* is inappropriate.<sup>70</sup>

### III. TREND TOWARD LIMITING THE *SEAMAN'S* TORT

Although commercial plaintiffs frequently assert *Seaman's* tort claims in commercial contract litigation, the growing trend in the California appellate courts has been to deny recovery for those claims.<sup>71</sup> Nonetheless, courts often perform a detailed analysis of *Seaman's* to adjudicate such claims.<sup>72</sup> Perhaps the courts' recent hostility to *Seaman's* claims is due to the courts' aversion to engaging in lengthy analyses of the *Seaman's* case to interpret the conduct necessary to warrant tort liability.<sup>73</sup> Or, perhaps, the courts dislike the potential for exorbitant punitive damages awards.<sup>74</sup> The cases in this section illustrate that, due to the limitations the courts have placed on *Seaman's*, it is highly unlikely that the case would be decided the same way today.<sup>75</sup>

The elements of the tort of bad faith denial of contractual existence are "(1) an underlying contract, (2) which is breached by the defendant, (3) who then denies liability by asserting that the contract does not exist, (4) in bad faith and (5) without probable cause for such denial."<sup>76</sup> In addition, some appellate courts require that there be a special relation-

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36 Cal. 3d at 769, 686 P.2d at 1167, 206 Cal. Rptr. at 363; cf. Brian F. Berger, Note, *Defining Public Policy Torts in At-Will Dismissals*, 34 STAN. L. REV. 153, 165-67 (1981) (stating that one indicia of unequal bargaining power is use of standardized forms that are not often used in commercial contracts).

69. See *Wallis v. Superior Court*, 160 Cal. App. 3d 1109, 1117, 207 Cal. Rptr. 123, 128 (1984).

70. Extending the law of bad faith, developed in the insurance context, to the noninsurance context would effectively eliminate the distinctions between contract and tort. See *Louderback & Jurika*, *supra* note 65, at 226-27.

71. See *infra* notes 79-148 and accompanying text.

72. See *infra* notes 79-148 and accompanying text.

73. See *Oki Am., Inc. v. Microtech Int'l, Inc.*, 872 F.2d 312, 315 (9th Cir. 1989) (Kozinski, J., concurring).

74. See *id.* (Kozinski, J., concurring).

75. See *Copesky v. Superior Court*, 229 Cal. App. 3d 678, 689, 280 Cal. Rptr. 338, 345 (1991). The *Copesky* court suggested that the California Supreme Court would not decide *Seaman's* the same way today because, since the *Seaman's* decision, the California Supreme Court has been reconstituted and has placed a greater emphasis on the separation of contract and tort remedies. *Id.* at 688, 280 Cal. Rptr. at 344.

76. *Careau & Co. v. Security Pac. Business Credit, Inc.*, 222 Cal. App. 3d 1371, 1401, 272 Cal. Rptr. 387, 404 (1990).

ship between the parties.<sup>77</sup> The primary elements of the *Seaman's* tort that are disputed in the California appellate courts are: (1) the requirement that the contract's existence be denied in bad faith and (2) the requirement of a special relationship.<sup>78</sup>

*A. What Constitutes a Tortious Bad Faith Denial of Contractual Existence?*

The *Seaman's* tort has generated confusion among California courts. Consequently, in recent decisions, almost every court offers a different interpretation of the tort.<sup>79</sup> The one similarity among California decisions, however, is that every court appears to limit the tort's application.<sup>80</sup>

A primary source of confusion created by the *Seaman's* tort is the difficult task of distinguishing between a tortious denial of a contract's existence and a permissible denial of liability under the terms of the contract.<sup>81</sup> In fact, some courts have deemed this task "impossible."<sup>82</sup> As a result, courts have been reluctant to apply the tort if it appears the defendant has only denied liability under the contract.<sup>83</sup>

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77. See *infra* notes 131-52 and accompanying text.

78. *Careau & Co.*, 222 Cal. App. 3d at 1401, 272 Cal. Rptr. at 404.

79. See *infra* notes 84-152 and accompanying text.

80. See *infra* notes 84-152 and accompanying text.

81. *Oki Am., Inc. v. Microtech Int'l, Inc.*, 872 F.2d 312, 315 (9th Cir. 1989) (Kozinski, J., concurring). For example, when a party's actions and words contradict the terms of a contract, they do not constitute a denial of the existence of the contract, but simply a denial of the contract's terms. See *id.* (Kozinski, J., concurring).

82. *Id.* (Kozinski, J., concurring). Judge Kozinski explained that the reason this task is impossible is that "*Seaman's* gives nary a hint as to how to distinguish a bad faith denial that a contract exists, from a dispute over contract terms, from a permissible attempt to rescind a contract, or from 'a loosely worded disclaimer of continued contractual responsibility.'" *Id.* (Kozinski, J., concurring) (quoting *Quigley v. Pet, Inc.*, 162 Cal. App. 3d 877, 890, 208 Cal. Rptr. 394, 401 (1984)).

83. See *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 688-89, 765 P.2d 373, 393, 254 Cal. Rptr. 211, 231 (1988) (clarifying that there is no tort liability for bad faith denial of liability); see also *Quigley v. Pet, Inc.*, 162 Cal. App. 3d 877, 890-92, 208 Cal. Rptr. 394, 401-03 (1984) (holding that *Seaman's* did not require examination of conduct in performance of contract but only required examination of whether denial of contractual existence had been asserted). But see *Koehrer v. Superior Court*, 181 Cal. App. 3d 1155, 226 Cal. Rptr. 820 (1986) (recognizing tort remedy for assertion in bad faith of defense to liability, but not for employer's bad faith denial of employment contract). *Koehrer's* broad application of *Seaman's* was expressly criticized in *Foley*. The *Foley* court stated: "By this broad stroke, made without analyzing the appropriateness of imposing tort remedies in the employment context, the *Koehrer* court broached the possibility of obtaining tort damages for the breach of any term of a contract whether for employment or otherwise." *Foley*, 47 Cal. 3d at 689, 765 P.2d at 393, 254 Cal. Rptr. at 231.

There is one method of bad faith denial of contractual existence that clearly does not impose tort liability. This is the bad faith denial of contractual existence in a pleading.

In *Elxsi v. Kukje America Corp.*,<sup>84</sup> the District Court for the Northern District of California explained that the major difficulty confronting judges trying to apply *Seaman's* is the faithful interpretation of the *Seaman's* passage identifying the new tort as "denying, in bad faith . . . that the contract exists . . . and . . . seeking to avoid all liability on a meritorious contract claim."<sup>85</sup> *Seaman's*, in this passage, described both denial of the *existence of a contract*, and denial of the *existence of liability*.<sup>86</sup> The *Elxsi* court explained that it was difficult to ascertain whether the *Seaman's* court intended to impose tort liability on defendants who threaten to sue on a contract in bad faith and, thus, deny liability under a contract, or on defendants who deny the existence of a contract.<sup>87</sup> Therefore, the *Elxsi* court faced the dilemma of interpreting the passage describing the tort as definitional or descriptive.<sup>88</sup> If the court found the passage to be definitional, the words in the passage would be the elements of the tort.<sup>89</sup> If the passage, were descriptive, however, it would be merely dicta explaining conduct that goes beyond mere breach of a contract.<sup>90</sup> The court found the passage to be descriptive.<sup>91</sup> The court interpreted *Seaman's* as creating a new tort that is "by analogy . . . like stonewalling and goes beyond mere breach of a contract, *but the tortious conduct itself is the denial that the contract exists.*"<sup>92</sup>

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"[O]nce litigation has commenced, the actions taken in its defense are not . . . probative of whether [a] defendant in bad faith denied the contractual obligation prior to the lawsuit." *Oki Am.*, 872 F.2d at 314 (citing *Palmer v. Ted Stevens Honda, Inc.*, 193 Cal. App. 3d 530, 539, 238 Cal. Rptr. 363, 368 (1987)). Although the court in *Air-Sea Forwarders, Inc. v. Air Asia Co.*, 880 F.2d 176 (9th Cir. 1989), *cert. denied*, 493 U.S. 1058 (1990), allowed the cause of action against a defendant who denied the existence of the contract in its answer, this decision was made without recognizing the holding in *Oki America* two months earlier. *Id.* at 189.

84. 672 F. Supp. 1294 (N.D. Cal. 1987).

85. *Id.* at 1296 (quoting *Seaman's Direct Buying Serv., Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 769, 686 P.2d 1158, 1167, 206 Cal. Rptr. 354, 363 (1984)).

86. *Id.* The problem with this "bidefinitonal" description of the tort is that it blurs the analytical distinction between the new tort and bad faith denial of liability under the contract, which is not tortious. *Id.* at 1297.

87. The *Elxsi* court stated that "matters would have been far less complicated" if the California Supreme Court had simply defined the tort as "denying, in bad faith and without probable cause, that the contract exists." *Id.* at 1296. However, the *Elxsi* court explained that the *Seaman's* court supplemented its definition of the tort by "[r]eferring to an Oregon case imposing tort liability on a defendant who used the bad faith threat of suit under a contract to extort payment." *Id.*

88. *Id.*

89. *See id.*

90. *Id.*

91. *Id.*

92. *Id.* (emphasis added). The *Elxsi* court, in this manner, rejected "stonewalling" as sufficient conduct to justify tort liability. Therefore, according to *Elxsi*, Standard's stonewalling

In *Elxsi*, the defendants breached a stock purchase agreement, falsely claiming that they were acting pursuant to an order from the Korean Government to cease all pending transactions.<sup>93</sup> The defendants then stopped payment on a check for stock that the plaintiff had already delivered into escrow.<sup>94</sup> Although the defendants denied *liability* in bad faith, the court held that this denial under the contract was not sufficient to state a *Seaman's* claim.<sup>95</sup>

Since *Seaman's*, several courts have recognized that, although "stonewalling" is made up of words or conduct that constitute an implied denial of contractual existence, it is not enough to warrant recovery of punitive damages.<sup>96</sup> For example, in *Rogoff v. Grabowski*,<sup>97</sup> the California Court of Appeal suggested that although the defendant's "malicious" conduct constituted a breach of the covenant of good faith and fair dealing, the plaintiff's "ordeal" did not entitle him to recover punitive damages.<sup>98</sup> The plaintiff had rented a limousine from the defendant, a limousine service, to drive the plaintiff and his wife to a party and back home.<sup>99</sup> Without notice or good cause, the driver left the plaintiff and his wife at the party "inebriated, clad only in bathing clothes, and with no means to get home."<sup>100</sup> The defendant also stole cash and keys from the wallet that the plaintiff had left in the limousine.<sup>101</sup> Police officers accompanied the plaintiff to the defendant's office where the plaintiff saw his personal belongings thrown about the premises.<sup>102</sup> The defendant re-

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conduct in *Seaman's* would not be sufficient to justify tort liability. *But see* *Multiplex Ins. Agency v. California Life Ins. Co.*, 189 Cal. App. 3d 925, 940, 235 Cal. Rptr. 12, 21 (1987).

The *Multiplex* court interpreted this passage in *Seaman's* as definitional. *See id.* The court stated: "Under *Seaman's* appellant might be liable for tort damages if appellant denied any liability 'in bad faith and without probable cause, that the contract exists' or denied liability 'without probable cause and with no belief in the existence of a defense [(stonewalling)].'" *Id.* (emphasis added) (citations omitted). The "alternative theory" asserted in *Multiplex*, however, has been "seriously undercut" and the reasoning is not followed in the most recent cases. *DuBarry Int'l v. Southwest Forest Indus.*, 231 Cal. App. 3d 552, 571, 282 Cal. Rptr. 181, 193 (1991).

93. *Elxsi*, 672 F. Supp. at 1295.

94. *Id.*

95. *Id.* at 1300; *see also* *Martin v. U-Haul Co.*, 204 Cal. App. 3d 396, 412, 251 Cal. Rptr. 17, 25-26 (1988) (holding that licensor's sudden termination of licensee's independent facility in bad faith and without notice was not bad faith denial of contractual existence).

96. *See, e.g., Elxsi*, 672 F. Supp. at 1297; *DuBarry*, 231 Cal. App. 3d at 574-75, 282 Cal. Rptr. at 196; *Rogoff v. Grabowski*, 200 Cal. App. 3d 624, 246 Cal. Rptr. 185 (1988).

97. 200 Cal. App. 3d 624, 246 Cal. Rptr. 185 (1988).

98. *Id.* at 627, 246 Cal. Rptr. at 187.

99. *Id.*, 246 Cal. Rptr. at 186.

100. *Id.*, 246 Cal. Rptr. at 187.

101. *Id.*

102. *Id.*

fused to return the plaintiff's credit cards until the plaintiff signed the charge slip that included a \$49.00 gratuity for the defendant.<sup>103</sup>

The court held that the plaintiff could not recover punitive damages under *Seaman's*, despite defendant's stonewalling and the plaintiff's unusually high reliance on the defendant.<sup>104</sup> The court did not struggle to apply the *Seaman's* tort. Instead, the court concluded that a tort remedy was not necessary in this case, notwithstanding the defendant's conduct, because the parties had equal bargaining positions.<sup>105</sup> Focusing on the appropriateness of the remedy, rather than on the defendant's conduct, the court declared: "The critical factor is that [the plaintiff] has an adequate remedy for breach of contract."<sup>106</sup>

Recently, the court in *DuBarry International v. Southwest Forest Industries*<sup>107</sup> appears to have further limited the scope of the *Seaman's* tort to apply only in situations in which there has been an *express* denial of a contract's existence.<sup>108</sup> Southwest, a producer of linerboard,<sup>109</sup> retained DuBarry to be its exclusive agent to sell its products to Castle & Cooke, a purchaser of linerboard.<sup>110</sup> DuBarry was to receive a three percent commission on all sales that it consummated with Castle & Cooke.<sup>111</sup> On Southwest's behalf, DuBarry submitted an offer to Castle & Cooke for a five-year contract that Castle & Cooke accepted.<sup>112</sup> Pursuant to this agreement, delivery to Southwest was to be at the port chosen by Castle & Cooke.<sup>113</sup> Before drafting the finalized contract, however, Southwest wrote Castle & Cooke a letter indicating it wanted to ship from a differ-

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103. *Id.*

104. *Id.* at 632, 246 Cal. Rptr. at 190.

105. *Id.*

106. *Id.* at 632-33, 246 Cal. Rptr. at 190-91. In reaching this conclusion, the court stated that the plaintiff's vulnerability in this situation was not a dispositive element because he was not vulnerable "in the sense of having an inadequate opportunity to obtain substitute performance or to cover for a breach." *Id.* at 632, 246 Cal. Rptr. at 190.

107. 231 Cal. App. 3d 552, 282 Cal. Rptr. 181 (1991).

108. Acts of repudiation executed in bad faith and inconsistent with the terms of the contract were not

substantial evidence that there was ever a *denial* by [defendant] of the existence of the [contract]. As the Supreme Court stated in *Seaman's* and repeated in *Foley*, this new tort is of limited scope. . . . [T]he only time that [defendant] even purported to actually deny the agreement was in its answer to the original complaint.

*Id.* at 574-75, 282 Cal. Rptr. at 196.

109. Linerboard is a product that Castle & Cooke used to make corrugated boxes in which its food products were shipped. *Id.* at 556, 282 Cal. Rptr. at 183.

110. *Id.* at 556-57, 282 Cal. Rptr. at 184.

111. *Id.* at 557, 282 Cal. Rptr. at 184.

112. *Id.* at 557-58, 282 Cal. Rptr. at 184. The court of appeal held that DuBarry had "consummated" the deal at this point and was deserving of its commission from Southwest. *Id.* at 561, 282 Cal. Rptr. at 187.

113. *Id.* at 558, 282 Cal. Rptr. at 184.

ent port.<sup>114</sup> Castle & Cooke responded by rejecting the contract and all previous correspondence as "null and void."<sup>115</sup> At trial, the jury found that an exclusive agency agreement existed between Southwest and DuBarry and that DuBarry was entitled to damages for Southwest's breach.<sup>116</sup> It also found that Southwest had denied in bad faith the existence of the agency agreement and awarded punitive damages to DuBarry.<sup>117</sup>

On appeal, the California Court of Appeal found that Southwest breached its agreement with DuBarry and that DuBarry should be awarded its commission.<sup>118</sup> The court conceded that many of Southwest's actions were executed in bad faith.<sup>119</sup> For example, the presence of Southwest's agent at the negotiations and Southwest's attempts to limit the proposals that DuBarry submitted to Castle & Cooke may have been efforts to deny DuBarry its commission.<sup>120</sup> With respect to Southwest's actions, however, the court held: "Even assuming this was all done in bad faith, it amounts to something considerably less than the denial of the existence of the agency agreement with DuBarry."<sup>121</sup> Additionally, the court found that Southwest's telex to DuBarry stating that DuBarry was not authorized to make the offer it made to Castle & Cooke was not "evidence of denial of contract existence."<sup>122</sup> Instead, the court stated, "it is evidence to the contrary."<sup>123</sup> Thus, the court concluded that the *Seaman's* tort is "limited to the bad faith denial of the existence

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114. *Id.*, 282 Cal. Rptr. at 185.

115. *Id.* at 559, 282 Cal. Rptr. at 185.

116. *Id.* at 560, 282 Cal. Rptr. at 186. The jury awarded DuBarry \$1,502,604 for breach of the agency agreement. *Id.*

117. *Id.* The jury found that the denial of the contract was the legal cause of damages for DuBarry's lost commission in the amount of \$1,502,604. *Id.* Punitive damages were awarded in the amount of \$3,800,000. *Id.*

118. *Id.* at 562, 282 Cal. Rptr. at 187. The court of appeal found that the jury's determination of \$1,502,604 as the value of DuBarry's lost commission was reasonable. *See id.* at 563, 282 Cal. Rptr. at 188.

119. *Id.* at 574, 282 Cal. Rptr. at 196.

120. *Id.* at 573, 282 Cal. Rptr. at 195.

121. *Id.* at 574, 282 Cal. Rptr. at 196. According to the *Seaman's* court's rationale, Southwest's actions, completely contrary to the terms of the agency agreement, would probably be considered stonewalling—implied denial of the contract's existence—because Southwest's actions suggest it treated the contract as null and void. Under the *DuBarry* rationale, however, bad faith acts suggesting that one party is treating the contract as null and void are insufficient to constitute a *denial* of the contract's existence. *See id.* To maintain a claim for this tort, the court requires a party to present actual evidence, beyond mere acts, of a denial of a contract's existence. *Id.* Thus, under *DuBarry*, the court appears to require an express denial of contractual existence to merit tort damages.

122. *Id.*

123. *Id.*



of the contract and can not be extended to the assertion of other defenses to liability."<sup>124</sup> The court emphasized the importance of this distinction by warning that without it, DuBarry had a "hunting license to capitalize on every pre-litigation action which Southwest may have taken (1) to limit and control the negotiating activities of DuBarry and (2) to avoid exposure to the risk of an unprofitable long term contract with Castle & Cooke."<sup>125</sup>

Because the *DuBarry* court required "substantial evidence" of Southwest's "denial" of the existence of the agency agreement,<sup>126</sup> the practical effect of *DuBarry* appears to be a refined definition of the *Seaman's* tort as an express denial of the contract's existence.<sup>127</sup> After *DuBarry*, it is logical to infer that sophisticated commercial parties, aware that plaintiffs must provide "substantial evidence" of a bad faith denial of contractual existence to recover in tort, will easily avoid liability for punitive damages by refraining from expressly denying the contract's existence.<sup>128</sup> Thus, the difference between extensive liability for punitive damages and liability for mere compensatory damages may depend on the words the defendant says to the plaintiff rather than on the defendant's conduct.<sup>129</sup> As most prospective defendants will learn to avoid express assertions that the contract does not exist, the *DuBarry* court, by apparently narrowing the *Seaman's* tort to such assertions, has essentially eliminated the tort from commercial contract litigation.<sup>130</sup>

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124. *Id.* at 571, 282 Cal. Rptr. at 193-94. The court went on to say that the discussion of tort liability for a "stonewall" defense in *Seaman's* should not be given too much weight. *Id.* at 567-68, 282 Cal. Rptr. at 191 (citing *Careau & Co. v. Security Pac. Business Credit, Inc.*, 222 Cal. App. 3d 1371, 1397-98 n.22, 272 Cal. Rptr. 387, 400-01 n.22 (1990)). The court explained that the use of stonewalling in the *Seaman's* court's description of the tort was "merely a part of the court's rationale supporting its recognition of the new tort of bad faith denial of contract existence." *Id.* at 568, 282 Cal. Rptr. at 191.

125. *Id.* at 578, 282 Cal. Rptr. at 198.

126. *Id.* at 574-75, 282 Cal. Rptr. at 196. The court stated: "Whatever the state of the record with respect to Southwest's assertions regarding contract terms and performance, there is simply no substantial evidence that there was ever a *denial* by Southwest of the existence of the agency agreement." *Id.*

127. *See supra* notes 107-26 and accompanying text.

128. The *DuBarry* court stated that the jury was only permitted to find tort liability if there was admissible evidence that Southwest had denied the existence of DuBarry's agency contract. *DuBarry*, 231 Cal. App. 3d at 578, 282 Cal. Rptr. at 198.

129. *See supra* notes 121-28 and accompanying text.

130. The *DuBarry* court refused to impose tort damages without evidence of Southwest's denial that the contract existed. *DuBarry*, 231 Cal. App. 3d at 569, 282 Cal. Rptr. at 192.

*B. The Requirement of a Special Relationship*

While the *DuBarry* court narrowed the application of the *Seaman's* tort by requiring "substantial evidence" of a denial of contractual existence in order to expel it from the commercial contract arena, other courts require a special relationship in an effort to limit the number of *Seaman's* claims in this area.<sup>131</sup> The California appellate courts are split with respect to the special relationship requirement for tort remedies under *Seaman's Direct Buying Service, Inc. v. Standard Oil Co.*<sup>132</sup> This division stems from the California Supreme Court's warning in *Seaman's*: "When we move from such special relationships [as that between insurer and insured] to consideration of the tort remedy in the context of the ordinary commercial contract, we move into largely uncharted and potentially dangerous waters."<sup>133</sup>

The First Appellate District in *Multiplex Insurance Agency, Inc. v. California Life Insurance Co.*<sup>134</sup> held that no special relationship is necessary for a party to recover in tort for denial of a contract's existence.<sup>135</sup> The Ninth Circuit similarly held, in *Air-Sea Forwarders, Inc. v. Air Asia Co.*,<sup>136</sup> that there is no requirement of a special relationship.<sup>137</sup> Yet, the Ninth Circuit conceded that the California Supreme Court recently has "dramatically curtailed the expansion of bad faith liability beyond the traditional insurer-insured relationship."<sup>138</sup> The Ninth Circuit appeared to recognize the need to bar the *Seaman's* tort from commercial contract litigation because of its conflict with the policies behind contract law.<sup>139</sup>

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131. See, e.g., *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967); *Wallis v. Superior Court*, 160 Cal. App. 3d 1109, 207 Cal. Rptr. 123 (1984); see also *Story v. City of Bozeman*, 791 P.2d 767, 775 (Mont. 1990) (holding "bad faith tort" applicable only when parties have special relationship).

132. 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984). A special relationship in the contract setting has been articulated as an agreement giving rise to a duty by one or both parties that "neither party will do anything which will injure the right of the other to receive the benefits of the agreement." *Wallis*, 160 Cal. App. 3d at 1117, 207 Cal. Rptr. at 128.

133. *Seaman's*, 36 Cal. 3d at 769, 686 P.2d at 1166-67, 206 Cal. Rptr. at 362-63.

134. 189 Cal. App. 3d 925, 235 Cal. Rptr. 12 (1987).

135. *Id.* at 939-40, 235 Cal. Rptr. at 21; see also *Quigley v. Pet, Inc.*, 162 Cal. App. 3d 877, 890, 894-95 n.7, 208 Cal. Rptr. 394, 401, 404-05 n.7 (1984) (Fifth Appellate District rejecting special relationship requirement). But see *Martin v. U-Haul Co.*, 204 Cal. App. 3d 396, 412, 251 Cal. Rptr. 17, 26 (1988) (Fifth Appellate District requiring special relationship before tort cause of action will lie for breach of implied covenant of good faith and fair dealing).

136. 880 F.2d 176 (9th Cir. 1989) (applying California law), *cert. denied*, 493 U.S. 1058 (1990).

137. *Id.* at 188.

138. *Id.* at 187.

139. See *id.*

It grudgingly held, however, that there is no requirement of a special relationship:

There is only one way this court could [hold] that the denial of the existence of a contract in bad faith requires a special relationship under California law: predict that the California Supreme Court will overrule its holding in *Seaman's*. . . . While we conclude that California law still recognizes a distinct tort for the denial of the existence of a contract in bad faith which does not turn on the presence of a special relationship, our decision should not be interpreted to endorse the usefulness of the distinction between denying the existence of a contract and disputing the terms of a contract. We take California law as we find it.<sup>140</sup>

Courts in the Second Appellate District, by contrast, have willingly imposed a special relationship requirement as a means of "reduc[ing] the potential for turning every breach of contract dispute into a punitive damage action."<sup>141</sup> The Second Appellate District attempted to confine the availability of punitive damages to only those plaintiffs who are in inferior bargaining positions.<sup>142</sup> This district reasoned that the concept of tort remedies in noninsurance cases is problematic because there is no special relationship.<sup>143</sup> The problem with *Seaman's* is that the *Seaman's* court based its decision to award tort remedies in the commercial setting on cases that "relied entirely on insurance cases."<sup>144</sup> Thus, this district suggested that the *Seaman's* court's expansion of the tort to the commercial setting absent a special relationship was inappropriate.<sup>145</sup>

Although most courts concede that requiring a special relationship is an effective way to restrict the availability of *Seaman's* claims,<sup>146</sup> the

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140. *Id.* at 188 & n.13.

141. *Okun v. Morton*, 203 Cal. App. 3d 805, 826, 250 Cal. Rptr. 220, 233 (1988) (rejecting claim for bad faith denial of contractual existence due to parties' relatively equal bargaining power).

142. *See Rogoff v. Grabowski*, 200 Cal. App. 3d 624, 630-33, 246 Cal. Rptr. 185, 188-90 (1988) (refusing to extend *Seaman's* beyond parties with special relationship because *Seaman's* tort is based on principles underlying tort of breach of implied covenant of good faith and fair dealing, which requires special relationship).

143. *See Careau & Co. v. Security Pac. Business Credit, Inc.*, 222 Cal. App. 3d 1371, 1397-98, 272 Cal. Rptr. 387, 401-02 (1990) (holding that bank-borrower relationship is not special relationship).

144. *Id.* at 1396, 272 Cal. Rptr. at 401.

145. *See id.* at 1399, 272 Cal. Rptr. at 402.

146. *See, e.g., Martin v. U-Haul Co.*, 204 Cal. App. 3d 396, 415, 251 Cal. Rptr. 17, 28 (1988) (holding that no special relationship exists in franchise agreement between U-Haul company and franchisee); *Rogoff*, 200 Cal. App. 3d at 632, 246 Cal. Rptr. at 190 (holding that there was no special relationship between limousine company and patrons); *Quigley v. Pet*,

issue is largely unsettled.<sup>147</sup> Requiring a special relationship may be an attempt to restrict tort remedies to insurance contracts, in which the involvement of punitive damages in contract litigation originated.<sup>148</sup>

The California Supreme Court joined this trend to restrict tort remedies in 1988 with its decision in *Foley v. Interactive Data Corp.*<sup>149</sup> The *Foley* court refused to extend the tort remedies available in insurance cases to the employment context in a case in which workers sought punitive damages from their employers, claiming they were fired without cause in violation of the covenant of good faith and fair dealing.<sup>150</sup> Although the court recognized that traditional contract remedies may be inadequate to compensate employees for certain breaches,<sup>151</sup> the court concluded that "the employment relationship is not sufficiently similar to that of insurer and insured to warrant judicial extension of the proposed additional tort remedies in view of the countervailing concerns about economic policy and stability, [and] the traditional separation of tort and contract law."<sup>152</sup>

The *Foley* rationale similarly applies to the commercial setting. If an employment relationship, in which a weaker party relies on a more powerful party for his or her job, is not sufficiently similar to the special relationship between insurer and insured to warrant extension of punitive damages, it follows that a commercial relationship, in which the parties have roughly equal bargaining power, should not be considered a special relationship deserving of tort remedies.

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Inc., 162 Cal. App. 3d 877, 892, 208 Cal. Rptr. 394, 403 (1984) (denying tort remedy due to absence of elements of "public interest, adhesion and fiduciary responsibility").

The Northern District of California has also required plaintiffs to prove a special relationship. See *Elxsi v. Kukje Am. Corp.*, 672 F. Supp. 1294, 1299 (N.D. Cal. 1987). In addition, other states require a special relationship to prevent tort damages from infecting contract litigation. See *infra* notes 182-88 and accompanying text.

147. See *supra* notes 131-46 and accompanying text.

148. See, e.g., *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 432-34, 426 P.2d 173, 178-79, 58 Cal. Rptr. 13, 18-19 (1967); *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 661, 328 P.2d 198, 202 (1958).

149. 47 Cal. 3d 654, 765 P.2d 373, 254 Cal. Rptr. 211 (1988).

150. *Id.* at 693, 765 P.2d at 396, 254 Cal. Rptr. at 234.

Indeed, the court even suggested that *any* extension of tort remedies to noninsurance cases is not justified given (1) the limited purpose and scope of contract damages, (2) the strong need in our commercial system for predictability of the cost of contractual relationships and (3) the difficulty of formulating a workable test for distinguishing between a simple breach of contract and a "tortious" breach . . . .

*Careau & Co. v. Security Pac. Business Credit, Inc.*, 222 Cal. App. 3d 1371, 1399, 272 Cal. Rptr. 387, 402 (1990) (emphasis added) (citing *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 683, 699-700, 765 P.2d 373, 389, 400-01, 254 Cal. Rptr. 211, 227, 238-39 (1988)).

151. *Foley*, 47 Cal. 3d at 694, 765 P.2d at 397, 254 Cal. Rptr. at 235.

152. *Id.* at 693, 765 P.2d at 396, 254 Cal. Rptr. at 234-35.

#### IV. GROWING AVERSION TO PUNITIVE DAMAGES IN CONTRACT ACTIONS

##### A. Recent Limitations on Tort Remedies in the Commercial Context

In 1991 the Fourth Appellate District of California<sup>153</sup> and the Ninth Circuit<sup>154</sup> followed the trend set by *Foley v. Interactive Data Corp.* and refused to extend punitive damages to commercial contracts outside the insurance realm. The Ninth Circuit reasoned that a contract without the element of unequal bargaining power and without fiduciaries involved does not present public policy concerns that would justify allowing additional tort damages under *Foley*.<sup>155</sup>

The Fourth Appellate District viewed *Foley* as a change in direction away from tort recovery for breach of commercial contracts.<sup>156</sup> Although the court in *Copesky v. Superior Court*<sup>157</sup> acknowledged that punitive damages are still arguably recoverable for the *Seaman's* tort, the *Copesky* court insisted that business relationships are no longer amenable to tort actions for any contract breaches outside the insurance context.<sup>158</sup> The *Copesky* court stated:

There is no question but that the decision in *Foley* redirects the course of law in the area of tort recovery for breach of commercial contracts. While some may argue that the *Seaman's* tort of bad faith denial of the *existence* of a contract remains viable, . . . there is only *one* category of business transactions which definitionally is amenable to tort actions for contract breaches, and that is insurance.<sup>159</sup>

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153. See *Copesky v. Superior Court*, 229 Cal. App. 3d 678, 689-90, 280 Cal. Rptr. 338, 345 (1991) (holding that no tort remedy exists for breach of commercial banking contract due to absence of special relationship).

154. See *Harrell v. 20th Century Ins. Co.*, 934 F.2d 203, 207 (9th Cir. 1991) (holding that no tort remedy exists for breach of implied covenant of good faith and fair dealing because of absence of special relationship).

155. *Id.* at 208.

156. See *Copesky*, 229 Cal. App. 3d at 689-90, 280 Cal. Rptr. at 345.

157. 229 Cal. App. 3d 678, 280 Cal. Rptr. 338 (1991).

158. *Id.* at 689, 280 Cal. Rptr. at 345; see also *Price v. Wells Fargo Bank*, 213 Cal. App. 3d 465, 261 Cal. Rptr. 735 (1989) (holding that borrower cannot recover against bank in tort for breach of implied covenant of good faith and fair dealing). "The impact of the *Foley* decision cannot be assessed with certainty. . . . The decision surely precludes the sort of loose extension of tort recovery, based on 'quasi-fiduciary' relationship, sanctioned in [earlier cases]." *Id.* at 478, 261 Cal. Rptr. at 741. In this manner, the relationship between *Seaman's* and Standard cannot be considered different from any other relationship between commercial contracting parties.

159. *Copesky*, 229 Cal. App. 3d at 689, 280 Cal. Rptr. at 345; see also *Oki Am., Inc. v. Microtech Int'l, Inc.*, 872 F.2d 312, 316 (9th Cir. 1989) (Kozinski, J., concurring) (explaining trend toward limiting tort remedies in noninsurance settings). Judge Kozinski declared:

Both the Ninth Circuit and the Fourth Appellate District are changing directions and excluding punitive damages remedies from commercial contract actions.

*B. Growing Aversion to Punitive Damages for Bad Faith Denial of Contractual Existence*

Recently, courts and commentators<sup>160</sup> have expressed serious doubts about the viability of the *Seaman's* tort. In 1989 Judge Kozinski vented his frustration with the application of the *Seaman's* tort: "In inventing the tort of bad faith denial of a contract the California Supreme Court has created a cause of action so nebulous that it more resembles a brick thrown from a third story window than a rule of law."<sup>161</sup> Judge Kozinski viewed the *Seaman's* tort as entangling courts in the negotiations between corporations and other business parties—a role the slow-moving courts are ill-suited to play.<sup>162</sup> In addition, the possibility of a *Seaman's* claim may actually prevent a business from functioning efficiently if every business decision must be carefully weighed against the risk of an "exotic" *Seaman's* claim and "incalculable damages."<sup>163</sup> Moreover, Judge Kozinski asserted that *Seaman's* is a "prime candidate" for reversal by the California Supreme Court.<sup>164</sup>

In 1990 the Second Appellate District lamented the effect the *Seaman's* tort has had on contract litigation. In *Lynch & Freytag v. Cooper*,<sup>165</sup> the plaintiff asserted a claim for bad faith denial of contractual existence in a dispute involving only the construction of the contract between the parties. In this case, the plaintiff, a sublessor of office space, sued the defendant sublessee to recover rent.<sup>166</sup> The defendant disputed a provision in the contract relating to the method of calculating the cost-

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Fortunately, the tide seems to be turning. . . . *Foley* has taken a bite out of *Seaman's* by holding that tort remedies are not available for breach of the implied covenant of good faith and fair dealing in an employment contract. . . . At long last . . . we seem to be moving in the right direction.

*Id.* (Kozinski, J., concurring) (citation omitted).

160. See Putz & Klippen, *supra* note 65, at 499; Scallen, *supra* note 41, at 1197-98.

161. *Oki Am.*, 872 F.2d at 315 (Kozinski, J., concurring) (citation omitted). Judge Kozinski's view was cited with approval in *Copesky*, 229 Cal. App. 3d at 687 n.6, 280 Cal. Rptr. at 343 n.6.

162. 872 F.2d at 316 (Kozinski, J., concurring).

163. *Id.* (Kozinski, J., concurring).

164. *Id.* at 317 (Kozinski, J., concurring).

165. 218 Cal. App. 3d 603, 267 Cal. Rptr. 189 (1990).

166. *Id.* at 606, 267 Cal. Rptr. at 190.

of-living increase in monthly rent.<sup>167</sup> The amount of the dispute was \$7.84 a month.<sup>168</sup> The court complained that due to

the allure of punitive damages . . . [t]he parties . . . have managed to escalate a dispute over \$7.84 a month into a superior court case that has lasted nearly five years, consumed an estimated 400 hours of attorney time, used four days of trial time, produced four volumes of clerk's transcript . . . and resulted in two appeals and five appellate briefs. Something is wrong. At a time when many indigent civil litigants must go without counsel . . . it is unconscionable for highly skilled attorneys to have used their time and resources to litigate a case over \$7.84 a month.<sup>169</sup>

Judge Woods furthered this sentiment in his concurrence. He interpreted the decision in *Foley v. Interactive Data Corp.*<sup>170</sup> as a refusal to extend the *Seaman's* tort to the employer-employee relationship.<sup>171</sup> As a result of the *Foley* decision, he stated, the *Seaman's* tort is not applicable to commercial contract relationships such as those between sublessor and sublessee.<sup>172</sup> Furthermore, Judge Woods asserted that after *Foley*, the "general viability of *Seaman's* . . . appears to be tenuous at best."<sup>173</sup>

In 1991 the Fourth Appellate District also noted that the *Seaman's* tort of bad faith denial of the existence of a contract may no longer be a "viable" tort.<sup>174</sup> In addition, the Second Appellate District's recent holding in *DuBarry International v. Southwest Forest Industries*<sup>175</sup> suggests that the *Seaman's* tort is no longer applicable to commercial contract disputes.<sup>176</sup> The court intimated that even if there had been a bad faith denial of the existence of the contract, there was no evidence that, if such conduct occurred, it caused the plaintiff any damages beyond those

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167. *Id.*

168. *Id.* The sublessee denied the existence of the sublease contract in the complaint. However, the court held that a *Seaman's* claim is not available to plaintiffs when defendants deny the existence of a contract in their answers to complaints. *Id.* at 610, 267 Cal. Rptr. at 193.

169. *Id.* at 614, 267 Cal. Rptr. at 196.

170. 47 Cal. 3d 654, 765 P.2d 373, 254 Cal. Rptr. 211 (1988); see *supra* notes 149-52 and accompanying text.

171. *Lynch & Freytag*, 218 Cal. App. 3d at 616, 267 Cal. Rptr. at 197 (Woods, J., concurring).

172. *Id.* (Woods, J., concurring).

173. *Id.* (Woods, J., concurring).

174. See *Copesky v. Superior Court*, 229 Cal. App. 3d 678, 689, 28 Cal. Rptr. 338, 345 (1991).

175. 231 Cal. App. 3d 552, 282 Cal. Rptr. 181 (1991).

176. See *supra* notes 107-30 and accompanying text.

that were granted for breach of contract.<sup>177</sup> In this case, all of the plaintiff's losses were fully compensated by the award of contract damages.<sup>178</sup> The court held that to recover more than contract damages would wrongly allow the plaintiff to recover twice.<sup>179</sup> Therefore, under *DuBarry*, a plaintiff who sues for breach of contract and bad faith denial of contractual existence may only recover contract damages. Only if the plaintiff can prove completely distinguishable losses on the tort claim may the plaintiff recover additional damages.<sup>180</sup> Given the recent decision in *DuBarry* guarding against double recovery,<sup>181</sup> it is difficult to imagine any commercial contract scenarios in which the recovery of tort damages would be allowed under *Seaman's*.

### C. Little Support for Seaman's Outside California

Montana is the only state besides California that recognizes the tort of bad faith in typical arms-length commercial contracts.<sup>182</sup> Yet, in *Story v. City of Bozeman*,<sup>183</sup> the Montana Supreme Court recently limited the tort of bad faith to disputes between parties with special relationships.<sup>184</sup> The court reasoned that punitive damages for ordinary contracting parties are excessive because the function of a tort remedy is to discourage oppression in contracts that necessarily give one party a superior position.<sup>185</sup> The court recognized that punitive damages contaminate contract litigation because the evidence involved in tort litigation is far more extensive than that involved in traditional contract litigation.<sup>186</sup> The

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177. *DuBarry*, 231 Cal. App. 3d at 563-64, 282 Cal. Rptr. at 188. The court stated: "[I]n this case the *only* damage evidence offered related to lost commissions. There was no attempt to show that Southwest's alleged bad faith denial of the agency contract's existence had caused DuBarry any damages beyond those already claimed for the breach of that contract." *Id.* at 564, 282 Cal. Rptr. at 188-89.

178. *See id.*

179. *See id.*

180. *See id.*

181. *Id.*

182. *Story v. City of Bozeman*, 791 P.2d 767, 773-74 (Mont. 1990). Other states recognize the tort in more limited circumstances. For example, Arizona acknowledges a tort remedy if contracting parties have a special relationship and one party intentionally breaches the covenant of good faith and fair dealing. *See Rawlings v. Apodaca*, 726 P.2d 565, 576 (Ariz. 1986). Idaho recognizes a tort remedy in the insurance contract context because of the special relationship between insurer and insured. *See Hettwer v. Farmers Ins. Co.*, 797 P.2d 81, 84 (Idaho 1990). Alaska does not recognize a tort remedy in any contract case unless a party's conduct rises to the level of a traditionally recognized tort, such as intentional infliction of emotional distress. *See Arco Alaska, Inc. v. Akers*, 753 P.2d 1150, 1154 (Alaska 1988).

183. 791 P.2d 767 (Mont. 1990).

184. *Id.* at 775.

185. *Id.* at 775-76.

186. *Id.* at 774.



court exhorted that the imposition of a bad faith tort on contract litigation affords an opportunity for damages so significantly higher than the damages involved in a garden variety contract case that the "tort tail" has begun to wag the 'contract dog.'"<sup>187</sup> Furthermore, the Montana Supreme Court noted that the Montana state legislature's recent ban on punitive damages in contract actions suggests that such damages are not appropriate in ordinary contract actions.<sup>188</sup>

## VI. PROPOSAL

### A. Eliminate the Seaman's Tort

The *Seaman's* tort should be eliminated from the commercial contract setting. California courts have avoided applying the tort, looking for justifications to restrict its applicability.<sup>189</sup> To decide how to restrict the tort, courts have engaged in detailed analyses of *Seaman's Direct Buying Service, Inc. v. Standard Oil Co.*<sup>190</sup> and its progeny<sup>191</sup> at the expense of judicial efficiency.<sup>192</sup> Courts have spent time and resources trying to distinguish a contract squabble from a tort, although "*Seaman's* gives nary a hint as to how to distinguish a bad faith denial that a contract exists . . . from a permissible attempt to rescind a contract."<sup>193</sup> In fact, the distinction is so difficult to determine that judges are given "license to rely on their gut feelings."<sup>194</sup>

Juries, likewise, are confused. "Instead of concentrating on pertinent issues such as offer, acceptance, breach, and mistake, the jury is faced with evidence of moral wrongdoing and punitive damages—evi-

187. *Id.* at 772.

188. *Id.* at 775.

189. See *supra* notes 79-148 and accompanying text.

190. 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984).

191. See *supra* notes 79-148 and accompanying text.

192. See *Oki Am., Inc. v. Microtech Int'l*, 872 F.2d 312, 316 (9th Cir. 1989) (Kozinski, J., concurring). Judge Kozinski lamented:

But the case drags on, kept alive by Microtech's vain hope of parlaying a business squabble into a \$3.1 million gold mine. The judicial machinery keeps churning, fueled by the energies of the lawyers, the parties . . . and other myriad components of the judicial process. One shudders to imagine the resources that would be consumed in adjudicating a more colorable *Seaman's* case.

*Id.* (Kozinski, J., concurring).

193. *Oki Am.*, 872 F.2d at 315 (Kozinski, J., concurring). In addition, Judge Kozinski explained, "[t]he test—if one can call it such—seems to be whether the conduct 'offends accepted notions of business ethics.'" *Id.* (Kozinski, J., concurring) (quoting *Seaman's Direct Buying Serv., Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 770, 686 P.2d 1158, 1167, 206 Cal. Rptr. 354, 363 (1984)). The ambiguity of this test was also criticized in *Careau & Co. v. Security Pacific Business Credit, Inc.*, 222 Cal. App. 3d 1371, 1401-02 n.27, 272 Cal. Rptr. 387, 404-05 n.27 (1990).

194. *Oki Am.*, 872 F.2d at 315 (Kozinski, J., concurring).

dence that may be misleading and inflammatory in contract litigation.”<sup>195</sup> Juries tend to overlook the traditional contract law concept that parties are free to breach their contracts and pay contract damages whenever performance is not economically efficient.<sup>196</sup> As a result, juries often award damages that are inappropriately excessive.<sup>197</sup>

The *Seaman's* tort not only confuses the courts, it crowds court dockets. The number of potential claims in any contract action has inflated to include not only traditional breach of contract claims,<sup>198</sup> but tort claims that delay and complicate often simple contract litigation.<sup>199</sup> Judge Kozinski declared that

[t]his tortification of contract law—the tendency of contract disputes to metastasize into torts—gives rise to a new form of entrepreneurship: investment in tort causes of action. “If Pennzoil won \$11 billion from Texaco, why not me?” That thought must cross the minds of many enterprising lawyers and businessmen.<sup>200</sup>

To eliminate the *Seaman's* tort from commercial contract actions, the California Supreme Court must overrule *Seaman's*. At least one former member of the California Supreme Court agrees that the *Seaman's* tort should not apply in the commercial setting. Justice Kaus insisted that urgent action should be taken against the “disastrous” application of punitive damages outside the insurance area.<sup>201</sup> Justice Kaus recommended legislation to resolve the *Seaman's* problem.<sup>202</sup> However, despite past legislation prohibiting recovery of punitive damages in contract actions,<sup>203</sup> the courts have continued to regard *Seaman's* and the cases

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195. *Story v. City of Bozeman*, 791 P.2d 767, 774 (Mont. 1990).

196. *Id.*

197. *See id.*

198. *See Oki Am.*, 872 F.2d at 315 (Kozinski, J., concurring).

199. *See id.* (Kozinski, J., concurring).

200. *Id.* (Kozinski, J., concurring).

201. *See White v. Western Title Ins. Co.*, 40 Cal. 3d 870, 900, 710 P.2d 309, 327, 221 Cal. Rptr. 509, 527 (1985) (Kaus, J., concurring in part, dissenting in part).

202. *Id.* at 901, 710 P.2d at 328, 221 Cal. Rptr. at 528.

203. *See CAL. CIV. CODE* § 3294(a) (West Supp. 1992) (punitive damages may not be recovered in action for breach of contract); *see also* RESTATEMENT (SECOND) OF CONTRACTS, *supra* note 30, § 355 cmt. b (punitive damages proper in contract actions only if proper under independent tort law). Section 3300 of the California Civil Code states:

For the breach of an obligation arising from contract, the measure of damages, except where otherwise expressly provided by this Code, is the amount which will compensate the party aggrieved for all the detriment proximately caused thereby, or which, in the ordinary course of things, would be likely to result therefrom.

CAL. CIV. CODE § 3300 (West 1970); *cf.* *Consolidated Data Terminals v. Applied Digital Data Sys.*, 708 F.2d 385, 399 (9th Cir. 1983). The *Consolidated* court asserted: “[P]unitive damages are not available under California law for mere breaches of contract, no matter how

following it as the sole authority, even though a limited one, on the issue of punitive damages for bad faith denial of the existence of a contract.<sup>204</sup> Therefore, the California courts are awaiting an answer from the California Supreme Court, not the California legislature.

### *B. Modify Traditional Rules of Contract Damages*

Commentators have suggested that contract damage awards have been insufficient in cases involving bad faith breaches of commercial contracts, leaving the promisee undercompensated.<sup>205</sup> For example, in *Seaman's Direct Buying Service, Inc. v. Standard Oil Co.*,<sup>206</sup> the jury awarded Seaman's only \$397,050 in compensatory damages for breach of contract.<sup>207</sup> In contrast, the jury awarded Seaman's \$11,058,810 in punitive damages.<sup>208</sup> Awarding punitive damages to a plaintiff who is not made "whole"<sup>209</sup> by ordinary contract damages, however, is going "overboard" in the other direction.<sup>210</sup> Modifying traditional rules of contract damages to include costs of litigation, provable lost profits of a new business and other losses directly resulting from bad faith denial of a contract is more consistent with the policies behind contract law than is the extension of tort remedies into contract law.<sup>211</sup>

Contracting parties who deny—in bad faith—the existence of a contract should be liable for all damages proximately caused and resulting from such conduct. For example, the breaching party should not only be liable for compensatory damages but also for the injured party's attorney's fees because the non-breaching party does not expect to incur attorney's fees from the transaction.

By making the range of liability for a breach foreseeable to the breaching party, commercial parties will not be discouraged from economically efficient breaches that benefit the commercial system and soci-

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gross or willful." *Id.* (citing CAL. CIV. CODE § 3294(a) (West Supp. 1992); *Miller v. National Am. Life Ins. Co.*, 54 Cal. App. 3d 331, 336-37, 126 Cal. Rptr. 731, 733 (1976)).

204. See *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 689 n.28, 765 P.2d 373, 393-94 n.28, 254 Cal. Rptr. 211, 232 n.28 (1988) for Justice Broussard's proposition that by engaging in a new interpretation of *Seaman's*, the California Supreme Court would not need to radically restructure the law.

205. See, e.g., Scallen, *supra* note 41, at 1185-86.

206. 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984).

207. *Id.* at 762, 686 P.2d at 1162, 206 Cal. Rptr. at 358.

208. *Id.*

209. See CAL. CIV. CODE § 3302 (West 1970) (detriment caused by breach of obligation to pay money is amount due under terms of obligation with interest thereon).

210. See *White v. Western Title Ins. Co.*, 40 Cal. 3d 870, 901, 710 P.2d 309, 328, 221 Cal. Rptr. 509, 528 (Kaus, J., concurring in part, dissenting in part).

211. See *supra* notes 36-54 and accompanying text.

ety.<sup>212</sup> In addition, this form of compensation would not disadvantage the victim of the bad faith denial of contractual existence. The victim of the bad faith conduct would be made "whole" and, thus, his or her expectations would be satisfied.<sup>213</sup> Anything more, such as an excessive award of punitive damages, would be a windfall to the plaintiff—far beyond both the plaintiff's and the defendant's wildest expectations.

## VII. CONCLUSION

The presence of the *Seaman's* tort in the commercial contract atmosphere undermines the basic principles behind contract law. Although some non-breaching parties may not be made whole by contract damages alone, awards of punitive damages are not the answer. In fact, the recent decision in *Foley v. Interactive Data Corp.*<sup>214</sup> suggests that the California Supreme Court would be receptive to a challenge asserting that punitive damages for bad faith denial of contractual existence upsets expectations involved in commercial bargaining. *Foley* took the first step toward eliminating punitive damage awards from contract litigation between parties without a special relationship. A growing distaste for the *Seaman's* tort among the California appellate districts, in the Ninth Circuit and in other states mandates that the California Supreme Court take one step further and overrule *Seaman's*.

Dana Rae Landsdorf \*

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212. See *supra* notes 46-49 and accompanying text. If the threat of tort liability prevents commercial parties from efficiently breaching contracts, the additional costs to commercial entities that could be avoided by an efficient breach may be passed on to the consumer. In addition, the funds necessary to satisfy potential punitive damage awards may be collected from consumers through increased prices of goods and services.

213. See RESTATEMENT (SECOND) OF CONTRACTS, *supra* note 30, § 344 cmt. b.

214. 47 Cal. 3d 654, 765 P.2d 373, 254 Cal. Rptr. 211 (1988).

\* To Mom and Robert who encouraged, loved and listened.

