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Alisa J. Kim

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SEAMAN'S DIRECT BUYING SERVICE, INC. v. STANDARD OIL CO.: SCALING THE STONEWALL TORT

I. INTRODUCTION

A contract consists of promises to do or not to do something, thereby creating contractual obligations.¹ Failure to perform one's promise under a contract constitutes a breach of a contractual obligation.² A party injured by another's acts or omissions may recover compensation, usually money, which is called damages.³

Breach of a contractual obligation avails the aggrieved party of the contract remedy of suing in an action for damages proximately caused by or the likely result of the breach.⁴ These compensatory damages are measured in the amount necessary to put the aggrieved party in as good a position as if the other party had fully performed.⁵ Contract liability therefore is predicated on the premise that only promises in terms specifically agreed upon and voluntarily given result in duties or obligations which may be breached.⁶

Traditionally, the motive underlying the behavior of the breaching party is not considered in the implementation of the contract remedy, no matter how egregious the breach.⁷ Where breach of a contract is accompanied by malicious or willful and

1. CAL. CIV. CODE § 1549 (West 1982); RESTATEMENT (SECOND) OF CONTRACTS § 1 (1981).

2. RESTATEMENT (SECOND) OF CONTRACTS § 1 (1981); BLACK'S LAW DICTIONARY 170-71 (5th ed. 1979).

3. CAL. CIV. CODE § 3281 (West 1970).

4. CAL. CIV. CODE § 3300 (West 1970).

5. *Id.*; CAL. CIV. CODE § 3358 (West Supp. 1987); CAL. COM. CODE § 1106(1) (West 1964). See also E. ALLAN FARNSWORTH, CONTRACTS § 12.16, at 890 (1982).

6. Kessler & Fine, *Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study*, 77 HARV. L. REV. 401, 409 (1964).

7. CAL. COM. CODE § 1106(1) (West 1964); RESTATEMENT (SECOND) OF CONTRACTS § 355 (1981). See also FARNSWORTH, *supra* note 5, § 12.8, at 842 (1982).

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wanton conduct giving the aggrieved party an action in tort, exemplary damages may be available in addition to compensatory damages.⁸ The breaching party found guilty of oppression, fraud or malice will be liable in tort as a punishment and as a deterrence to others from engaging in similar conduct.⁹ Thus, such damages are also known as punitive damages.¹⁰

A covenant of good faith and fair dealing is implied in every contract governed by California law.¹¹ California courts have recognized this implied covenant since 1942.¹² The covenant requires each party to a contract to insure that its acts and omissions do not prevent the other parties from receiving their benefits under the contract.¹³ Parties injured by a breach of the covenant are entitled to contract remedies, that is, the compensatory damages provided by law or that the parties have negotiated and expressed in their contracts.¹⁴ However, they may also be entitled to tort remedies and the recovery of punitive damages with respect to insurance¹⁵ and employment contracts¹⁶ and, in narrow circumstances, commercial contracts.¹⁷

8. CAL. CIV. CODE § 3294(a) (West Supp. 1987).

9. *Id.* See also J. CALAMARI & J. PERILLO, THE LAW OF CONTRACTS § 14-3, at 520 (2d ed. 1977).

10. CAL. CIV. CODE § 3294(a) (West Supp. 1987). See also C. McCORMICK, HANDBOOK ON THE LAW OF DAMAGES 275-78 (1935).

11. *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 809, 818, 620 P.2d 141, 145, 169 Cal. Rptr. 691, 695 (1979); *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 573, 510 P.2d 1032, 1036, 108 Cal. Rptr. 480, 484 (1973); *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 429, 426 P.2d 173, 176, 58 Cal. Rptr. 13, 16 (1967); *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 658, 328 P.2d 198, 200 (1958); *Brown v. Superior Court*, 34 Cal. 2d 559, 564, 212 P.2d 878, 881 (1949); *Universal Sales Corp. v. California Press Mfg. Co.*, 20 Cal. 2d 751, 771, 128 P.2d 665, 677 (1942). See also RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981); 1 B. WITKIN, SUMMARY OF CALIFORNIA LAW, CONTRACTS § 576 (8th ed. 1973 & Supp. 1984).

12. *Universal Sales Corp.*, 20 Cal. 2d at 771, 128 P.2d at 677.

13. *Egan*, 24 Cal. 3d at 818, 620 P.2d at 145, 169 Cal. Rptr. at 695; *Crisci*, 66 Cal. 2d at 429, 426 P.2d at 176, 58 Cal. Rptr. at 16; *Comunale*, 50 Cal. 2d at 658, 328 P.2d at 200; *Brown*, 34 Cal. 2d at 564, 212 P.2d at 881; *Universal Sales Corp.*, 20 Cal. 2d at 771, 128 P.2d at 677.

14. *Brown*, 34 Cal. 2d at 564, 212 P.2d at 881 (1949) (agreements to make mutual wills); *Osborne v. Cal-Am Fin. Corp.*, 80 Cal. App. 3d 259, 266, 145 Cal. Rptr. 584, 589 (1978) (agreements to sell real property); *Masonite Corp. v. Pacific Gas & Elec. Co.*, 65 Cal. App. 3d 1, 9, 135 Cal. Rptr. 170, 175 (1976) (contracts to provide utility services); *Foley v. U.S. Paving Co.*, 262 Cal. App. 2d 499, 505, 68 Cal. Rptr. 780, 784 (1968) (employee incentive contracts).

15. See *infra* notes 18-20 and accompanying text.

16. See *infra* notes 22-25 and accompanying text.

17. *Seaman's Direct Buying Serv., Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 768-769,

Breaches of insurance contracts may result in contract liability and tort liability for bad faith breach of contract.¹⁸ Insurance contracts are based on a "special relationship," that of insurer and insured, involving the elements of adhesion, fiduciary responsibility and public interest.¹⁹ Therefore, insurers which breach the implied covenant of good faith and fair dealing may be directed to pay their insureds punitive as well as compensatory damages.²⁰

The relationships among parties in banking²¹ and employment contracts²² have been viewed as having some of the special relationship characteristics in common with insurance contracts. Yet most California courts have been unwilling to impose tort sanctions for breach of the implied covenant in banking and employment contracts. In *Tameny v. Atlantic Richfield Co.*,²³ the landmark case concerning wrongful discharge from employment, the California Supreme Court established a cause of action in tort for wrongful termination, but not for bad faith breach of contract.²⁴

686 P.2d 1158, 1166, 206 Cal. Rptr. 354, 362 (1984).

18. See e.g., *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 432, 426 P.2d 173, 178, 58 Cal. Rptr. 13, 18 (1967) (insurer failed to meet the duty to accept a reasonable settlement within the policy limits); *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 663, 328 P.2d 198, 203 (1958) (insurer wrongfully declined to defend its insured and refused to accept a reasonable settlement within the policy limits).

19. *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 809, 820, 620 P.2d 141, 146, 169 Cal. Rptr. 691, 696 (1979).

20. See *supra* note 18.

21. See generally *Wagner v. Benson*, 101 Cal. App. 3d 27, 34, 161 Cal. Rptr. 516, 520 (1980) (assuming that bad faith cause of action may arise from a borrower-lender relationship); *Sawyer v. Bank of Am.*, 83 Cal. App. 3d 135, 141, 145 Cal. Rptr. 623, 627 (1978) (Rattigan, J., concurring in part and dissenting in part) ("The bank's implied covenant of good faith and fair dealing *separately* obligated it, by operation of law, as an incident of the oral contract pleaded and proved.") (emphasis in original).

22. See generally *Pugh v. See's Candies, Inc.*, 116 Cal. App. 3d 311, 322, 171 Cal. Rptr. 917, 922 (1981) (employee terminated after 32 years contended that his discharge by his employer violated fundamental principles of public policy); *Wallis v. Superior Court*, 160 Cal. App. 3d 1109, 1116-19, 207 Cal. Rptr. 123, 127-30 (1984) (employee's written agreement with employer for termination payments in return for employee's covenant not to compete could be tortiously breached due to similar characteristics to those found in insurance contracts).

23. 27 Cal. 3d. 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980).

24. In *Tameny*, the court declined to determine whether or not there was a tort action for the breach of the implied covenant, although it acknowledged the line of insurance contract cases which imposed tort as well as contract remedies:

We do note in this regard, however, that authorities in other jurisdictions have on occasion found an employer's discharge

Only the California Court of Appeal has ventured outside the insurance contract boundary.²⁵

In *Seaman's Direct Buying Service, Inc. v. Standard Oil Co.*,²⁶ the California Supreme Court affirmed its position that an insurance carrier may risk tort liability for breach of the implied covenant of good faith and fair dealing in addition to contract damages.²⁷ Moreover, *Seaman's* enabled the court to explore such liability in the context of an ordinary commercial contract in which "parties of roughly equal bargaining power are free to shape the contours of their agreement."²⁸ The *Seaman's* majority deemed it unnecessary to find tort liability on the breach of the implied covenant issue.²⁹ Instead the court created a more limited area of tort liability — the so-called tort of "stonewalling" — in which the breaching party denies, in bad faith and without probable cause, the existence of a contract to shield itself from liability.³⁰

This narrowly defined tort may well have ramifications on freedom of contract and affect the future of commercial contract negotiation.³¹ The essence of freedom of contract lies in the

of an at-will employee violative of the employer's 'good faith and fair dealing' obligations and past California cases have held that a breach of this implied-at-law covenant sounds in tort as well as in contract.

Id. at 179 n.12, 610 P.2d at 1337 n.12, 164 Cal. Rptr. at 846 n.12.

25. *Cleary v. American Airlines, Inc.*, 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980) (employer held liable for the tort of bad faith breach of contract for wrongful termination of employment). *Accord* *Commercial Cotton Co. v. United California Bank*, 163 Cal. App. 3d 511, 209 Cal. Rptr. 551 (1985) (defendant bank's negligence was deemed to be a breach of the bank's implied covenant of good faith and fair dealing inherent in the contractual relationship with its depositor). *See also* *Louderback & Jurika, Standards for Limiting the Tort of Bad Faith Breach of Contract*, 16 U.S.F. L. REV. 187 (1982) which characterized *Cleary v. American Airlines, Inc.* as "the only California case clearly holding that a plaintiff had stated a cause of action for the tort of bad faith breach of contract outside the insurance field." *Id.* at 212 and as "the only case extending the tort beyond an insurance contract . . ." *Id.* at 215.

26. 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984).

27. *Id.* at 768, 686 P.2d at 1166, 206 Cal. Rptr. at 362.

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

29. *Id.*

30. *Id.* *See also* Traynor, *Bad Faith Breach of a Commercial Contract: A Comment on the Seaman's Case*, 8 BUS. L. NEWS 1, 11 n.28 (1984) ("[T]he court in *Seaman's* recognized a new tort of 'stonewalling' . . .").

31. *See generally*, Traynor, *supra* note 30, at 11-14; Comment, *Reconstructing Breach of the Implied Covenant of Good Faith and Fair Dealing as a Tort*, 73 CALIF. L. REV. 1291, 1299-1331 (1985); Comment, *Seaman's Direct Buying Service, Inc. v. Standard Oil Co.: Tortious Breach of the Covenant of Good Faith and Fair Dealing in a*

parties assuming responsibility for making enforceable contracts.³² This freedom also permits the parties to breach their contracts, resulting in liability to the other party for compensatory damages.³³ Parties in an ordinary commercial contract who have mutually agreed on their obligations and expectations subject to specified covenants, conditions and remedies may not look favorably upon the imposition of tort liability for breach of contract in addition to traditional contract damages.

II. *SEAMAN'S DIRECT BUYING SERVICE, INC. v. STANDARD OIL CO.*

A. FACTS³⁴

Plaintiff, Seaman's Direct Buying Service, Inc. ("Seaman's"), a dealer in ship supplies and equipment, occupied space in an old waterfront area in the City of Eureka ("City"). In 1970, the City decided to condemn the area as part of a redevelopment plan to create a modern marina. Seaman's regarded this as an opportunity to expand and update its operations. It approached the City with a proposal to lease a large portion of the new marina, some of the area for its own operations and the remainder to be profitably sublet. The City agreed initially to the lease of a smaller area. It would permit renegotiation for the additional space if Seaman's could provide evidence of financial responsibility in the form of a binding agreement with an oil supplier.

After negotiating with a number of oil companies, Seaman's reached a satisfactory agreement with the defendant, Standard Oil Co. of California ("Standard"). In October of 1972, Standard presented a letter outlining the terms of the agreement, in response to Seaman's repeated requests for written evidence of a

Noninsurance Commercial Contract Case, 71 IOWA L. REV. 893, 898-911 (1986); Comment, *Sailing the Uncharted Seas of Bad Faith: Seaman's Direct Buying Service, Inc. v. Standard Oil Co.*, 69 MINN L. REV. 1161, 1176-86 (1985); Note, "Contort": *Tortious Breach of the Implied Covenant of Good Faith and Fair Dealing in Noninsurance, Commercial Contracts—Its Existence and Desirability*, 60 NOTRE DAME L. REV. 510, 522-27 (1985); Comment, *Bad Faith Revisited: An Examination of Tort [L]aw Remedies for Commercial Contract Disputes*, 34 U. KAN. L. REV. 315, 330-35 (1985).

32. Kessler & Fine, *supra* note 6, at 409.

33. R. POSNER, *ECONOMIC ANALYSIS OF LAW* § 49, at 88-90 (2d ed. 1977).

34. *Seaman's*, 36 Cal. 3d at 759-62, 686 P.2d at 1160-62, 206 Cal. Rptr. at 356-58.

binding commitment. The letter was executed by both parties. It contemplated (1) Standard and Seaman's entering into a Chevron Marine Dealer agreement for an initial term of 10 years, (2) Standard providing Seaman's with financing for its facilities, (3) Standard discounting costs to Seaman's for fuel and (4) Standard having the right to cure in case of Seaman's default of its obligations to the City.³⁵ Seaman's was then able to finalize its lease with the City for the additional marina property.

The Arab oil embargo and the resultant nationwide fuel shortage erupted within the following months. Standard then instituted a "no new business" policy. During 1973, Standard arranged for a temporary marine dealership agreement to supply Seaman's with fuel during the construction of the new marina, but the Chevron Marine Dealer agreement as proposed in the 1972 commitment letter was not executed.

In November of 1973, Standard advised Seaman's that it could not proceed with the proposed financing and supplying arrangement. The Federal Government had mandated a petroleum products allocation for oil suppliers' existing customers. In the communications that followed, Standard claimed that Seaman's was not an existing customer and that only the federal mandate was preventing it from proceeding with the contract.

Seaman's applied for an exemption from the Federal Government. The application process was expedited as Standard even cooperated by assisting Seaman's with the necessary documentation.³⁶ In February of 1974, Seaman's efforts were re-

35. The letter concluded by stating:

[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. If this approach and proposal meets with your approval, we would appreciate your acknowledgment and acceptance of these terms by signing and returning two copies of this letter. We can proceed further with the drafting of the final agreements

Id. at 760, 686 P.2d at 1161, 206 Cal. Rptr. at 357 (quoting the letter of October 11, 1972).

36. Standard supplied Seaman's with the necessary documentation to request an exemption from the Federal Energy Office and even "helped fill [the forms] out." *Id.* at 761, 686 P.2d at 1161, 206 Cal. Rptr. at 357.

warded with a supply order from the Federal Energy Office.³⁷ Standard then changed its position by asserting that there never had been a binding agreement.³⁸ It appealed the order and received a reversal in its favor.³⁹ Seaman's then appealed and a reversal was granted on the condition that a court order validate the existence of a contract between the parties under state law.⁴⁰

When Seaman's requested Standard to stipulate to the existence of the contract, Standard refused, despite Seaman's explanation that it could not afford to go to trial.⁴¹ In early 1975, Seaman's was forced to discontinue its operations. It filed suit against Standard, charging breach of contract, fraud, breach of the implied covenant of good faith and fair dealing, and interference with Seaman's contractual relations with the city.⁴² The jury awarded compensatory damages for the breach of contract, and compensatory and punitive damages for both the tortious breach of the implied covenant of good faith and fair dealing and for the intentional tort of interference with contractual relations.⁴³ Seaman's consented to a reduction in the punitive damages to counter the conditional granting of Standard's motion for a new trial. Standard appealed from the judgment and Seaman's cross-appealed from the remittitur of punitive damages.

B. THE DECISION OF THE COURT

The court confronted three issues: (1) whether the commitment letter complied with the statute of frauds,⁴⁴ (2) whether the intent necessary to sustain the cause of action for intentional interference with contractual relations had been proven satisfactorily⁴⁵ and (3) whether a tort remedy was available for the

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.*

41. Standard's representative was portrayed as unsympathetic and unresponsive to Seaman's plight: "In reply, Standard's representative laughed and said, 'See you in court.'" *Id.* at 762, 686 P.2d at 1162, 206 Cal. Rptr. at 358. Later, this statement would be construed by the court in its analysis as the "stonewall" position. See *infra* note 91 and accompanying text.

42. *Seaman's* 36 Cal. 3d at 762, 686 P.2d at 1162, 206 Cal. Rptr. at 358. At trial, Seaman's prevailed on all but the fraud cause of action.

43. *Id.*

44. *Id.*

45. *Id.* at 765, 686 P.2d at 1164, 206 Cal. Rptr. at 360.

breach of the implied covenant of good faith and fair dealing in a commercial contract.⁴⁶

The court determined that the commitment letter executed by Standard and Seaman's contained all the essential terms of their agreement, stated the requisite quantity term and therefore constituted a contract.⁴⁷ As a contract, the letter satisfied the statute of frauds requirements under both California Civil Code section 1624⁴⁸ and California Uniform Commercial Code section 2-201 (sale of goods).⁴⁹ To comply with those requirements, an agreement, which is not to be performed within a year from the making thereof, must be in writing, must be signed by the party to be charged and must specify a quantity term. Accordingly, the judgment in Seaman's favor for breach of contract was affirmed.⁵⁰

The judgment for Seaman's on the intentional interference cause of action was reversed and remanded due to prejudicial error in the jury instructions.⁵¹ The judge instructed the jury that it could find intentional interference by Standard if Standard knew disruption of Seaman's contract with the City was "substantially certain" to occur.⁵² The jury was not instructed that Standard must have intended to cause Seaman's breach of its contract with the City.⁵³ In the court's view, there was not

46. *Id.* at 767, 686 P.2d at 1166, 206 Cal. Rptr. at 362.

47. *Id.* at 762-65, 686 P.2d at 1162-64, 206 Cal. Rptr. at 358-60.

48. *Id.* at 763, 686 P.2d at 1163, 206 Cal. Rptr. at 359. That section reads in part: "The following contracts are invalid, unless they, or some note or memorandum thereof, are in writing and subscribed by the party to be charged or by the party's agent: (a) An agreement that by its terms is not to be performed within a year from the making thereof." CAL. CIV. CODE § 1624(a) (West Supp. 1987).

49. *Id.* at 764-65, 686 P.2d at 1163-64, 206 Cal. Rptr. at 359-60. That section reads in part:

[A] contract for the sale of goods for the price of \$500 or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought A writing is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this paragraph beyond the quantity of goods shown in such writing.

CAL. COM. CODE § 2201(1) (West 1964).

50. *Seaman's*, 36 Cal. 3d at 774, 686 P.2d at 1170, 206 Cal. Rptr. at 366.

51. *Id.* at 767, 686 P.2d at 1165-66, 206 Cal. Rptr. at 361-62.

52. *Id.* at 767, 686 P.2d at 1165, 206 Cal. Rptr. at 361.

53. *Id.*

sufficient evidence that Standard acted with the purpose or design primarily to interfere with Seaman's formation of a prospective economic relationship with the City.⁵⁴ Seaman's breach with the City was only "an incidental, if foreseeable, consequence of Standard's action." As Seaman's had failed to carry its burden of proof concerning Standard's intent, the cause was remanded for jury instructions on inferring culpable intent.⁵⁵

The court unequivocally regarded the issue of breach of the implied covenant of good faith and fair dealing as the principal one.⁵⁶ The facts of *Seaman's* did not mandate a finding of such a breach, although Standard's liability could have been predicated on other grounds. For example, Seaman's could have asserted promissory liability against Standard by stressing foreseeability and substantiality of reliance. Standard would be estopped to deny the contract's existence.⁵⁷ Or, in the alternative, Standard's denial of the contract's existence and its refusal to stipulate to its existence might have been held to be anticipatory repudiation.⁵⁸ Instead, the court preferred to carve out a more limited area of tort liability subsumed under the existing tortious breach of the duty of good faith and fair dealing. Where a breaching party seeks to shield itself from liability by denying the existence of a contract, and the denial is made in bad faith and without probable cause, it may give rise to an action in tort.⁵⁹ A denial based on a reasonable belief which is undertaken in good faith does not support a cause of action in tort.⁶⁰

At trial there had been a considerable amount of conflicting

54. *Id.*

55. *Id.* at 767, 686 P.2d at 1165-66, 206 Cal. Rptr. at 361-62.

56. *Id.* at 767, 686 P.2d at 1166, 206 Cal. Rptr. at 362.

57. RESTATEMENT (SECOND) OF CONTRACTS § 90(1) (1981). *See also* Kessler & Fine, *supra* note 6, at 424.

58. *Taylor v. Johnston*, 15 Cal. 3d 130, 137, 539 P.2d 425, 430, 123 Cal. Rptr. 641, 646 (1975). *See also Seaman's*, 36 Cal. 3d at 784, 686 P.2d at 1177, 206 Cal. Rptr. at 367 where Chief Justice Bird asserted: "Standard's denial of the existence of the contract to the federal agency and the subsequent refusal to stipulate were anticipatory breaches." *Id.*

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

60. *Id.* at 770, 686 P.2d at 1167, 206 Cal. Rptr. at 363.

evidence on the bad faith issue.⁶¹ The jury instructions⁶² did not address the requirement for a finding of bad faith.⁶³ The court was concerned that the jury may have imposed liability without deciding whether or not Standard had acted in bad faith.⁶⁴ It reversed the judgment for Seaman's. The claim for breach of the implied covenant was remanded to the lower court with instructions to include jury instructions in accordance with the opinion.⁶⁵

C. CHIEF JUSTICE BIRD'S OPINION

Chief Justice Bird concurred with the majority on the issues of the breach of contract and intentional interference with contractual relations, but dissented on the issue of the implied covenant in a separate opinion.⁶⁶ She criticized the majority's reluctance to include the narrowly defined bad faith denial of contract tort within the existing tortious breach of the duty of good faith and fair dealing.⁶⁷

In Chief Justice Bird's view, since the duty to act fairly and in good faith is inherent in every contract, "under certain circumstances, a breach of contract may support a tort cause of action for breach of implied covenant."⁶⁸ The nature and extent of the duty is dictated by the parties' expectations and the con-

61. *Id.* at 771, 686 P.2d at 1168, 206 Cal. Rptr. at 364.

62. The jury instructions read, in part: "[W]here a binding contract [has] been agreed upon, the law implies a covenant that neither party will deny the existence of a contract, since doing so violates the legal prohibition against doing anything to prevent realization of the promises of the performance of the contract." *Id.* at 770, 686 P.2d at 1167, 206 Cal. Rptr. at 363.

63. *Id.* at 774, 686 P.2d at 1170, 206 Cal. Rptr. at 366.

64. *Id.*

65. *Id.*

66. *Id.*

67. A contracting party should not be able to deny the existence of a valid contract in order to shield itself from liability for breach of that contract. Today, the court holds that an action will lie in tort against such conduct. However, it refuses to acknowledge that its holding is compelled by this court's past decisions analyzing the scope of the implied covenant of good faith and fair dealing. This court should not continue to retreat from its own decisional authority in this area.

Id. at 774-75, 686 P.2d at 1171, 206 Cal. Rptr. at 367 (Bird, C.J., concurring and dissenting).

68. *Id.* at 775, 686 P.2d at 1171, 206 Cal. Rptr. at 367.

tract's purpose.⁶⁹ Citing *Tameny v. Atlantic Richfield Co.*⁷⁰ and subsequent California Court of Appeal cases,⁷¹ she traced the development of imposition of tort liability for breach of the implied covenant to contracts outside of the insurance arena.⁷²

The chief justice considered both parties' conduct in *Seaman's* and observed that "it would be reasonable to conclude that the parties' justified expectations did not include the possibility of a breach."⁷³ She viewed Standard's breach of the contract as a violation of the duty to deal fairly and in good faith and opined that an independent finding of bad faith should not be required.⁷⁴ In her view, the judgment for *Seaman's* on the breach of the implied covenant should have been affirmed.⁷⁵

III. "STONEWALLING" — THE NEW TORT FOR DENIAL IN BAD FAITH IN COMMERCIAL CONTRACTS

In *Seaman's*, the California Supreme Court affirmed that breach of the implied covenant of good faith and fair dealing in an insurance contract gives rise to tort remedies because of the special relationship between the parties.⁷⁶ The majority acknowledged that tort remedies may also arise in noninsurance contracts, where elements of the special relationship between the parties are present and the implied covenant is breached.⁷⁷

The *Seaman's* majority, however, was reluctant to find tort liability in so broad an area as commercial contracts.⁷⁸ This re-

69. *Id.* at 777, 686 P.2d at 1172, 206 Cal. Rptr. at 368.

70. 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980). *See supra* notes 23-24 and accompanying text.

71. *Cleary v. American Airlines, Inc.*, 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980); *Wagner v. Benson*, 101 Cal. App. 3d 27, 161 Cal. Rptr. 516 (1980).

72. *Seaman's*, 36 Cal. 3d at 776, 686 P.2d at 1171, 206 Cal. Rptr. at 367.

73. *Id.* at 781, 686 P.2d at 1175, 206 Cal. Rptr. at 371.

74. *Id.*

75. *Id.* at 784, 686 P.2d at 1177, 206 Cal. Rptr. at 373.

76. *See supra* note 19.

77. *Seaman's*, 36 Cal. 3d at 768-69, 686 P.2d at 1166, 206 Cal. Rptr. at 362.

78. When we move from such special relationships to consideration of the tort remedy in the context of the ordinary commercial contract, we move into largely uncharted and potentially dangerous waters. . . . In such contracts, it may be difficult to distinguish between breach of the covenant and breach of contract, and there is the risk that interjecting tort remedies will intrude upon the expectations of the parties.

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luctance may have been based on the inapplicability of the special relationship standard. A relationship between the parties to an ordinary commercial (noninsurance) contract cannot generally be said to have the characteristics of one found between parties to insurance contracts:

1) Parties to commercial contracts are presumed to have entered into a consensual relationship. Each is contracting for the benefit of the bargain. Since the legal rights or liabilities of the public generally are not affected, the public interest element is not present.⁷⁹

2) Parties to commercial contracts have the freedom to draft their provisions and to negotiate them to their mutual satisfaction. They may provide specific remedies in the event of breach of the contract in accordance with their understanding. It would be very rare indeed for such an agreement to take the form of a standardized "take it or leave it" contract which is the basis for the adhesion element.⁸⁰

3) Parties to commercial contracts generally have equal bargaining power. Each is presumably acting in its own best interests. One party is not held to a higher standard of conduct with respect to the other because the relationship is not one where either is acting primarily for the other's benefit or interests. A commercial contract therefore lacks the fiduciary responsibility element.⁸¹

The majority was constrained to create a new tort cause of action in the event that a party not only breaches the contract, but denies in bad faith and without probable cause the contract's existence, to shield itself from liability. Thus the stone-

Id. at 769, 686 P.2d at 1166-67, 206 Cal. Rptr. at 362-63.

79. Aside from its incidental public benefit, the contemplated contract in *Seaman's* would have had no effect on the community at large. *Id.* at 759-60, 686 P.2d at 1160-61, 206 Cal. Rptr. at 356-57.

80. Although the language used in the *Seaman's* commitment letter may have been customary in Standard Oil's business practices, both sides participated in the pre-commitment letter negotiations. *Id.* at 760, 686 P.2d at 1161, 206 Cal. Rptr. at 357.

81. In *Seaman's*, both parties were considered sophisticated in business transactions. The fact that *Seaman's* was a small entity (close corporation consisting of three shareholders) in relation to Standard was not significant, since it had dealt previously with another large oil supplier, Mobil Oil Company. *Id.* at 759, 686 P.2d at 1160, 206 Cal. Rptr. at 356.

wall tort emanated from the court's analysis which was limited to the *Seaman's* facts.⁸²

The majority applied principles enunciated in *Adams v. Crater Well Drilling, Inc.*,⁸³ an Oregon Supreme Court tort case, to develop this new area of tort.⁸⁴ In that case, the plaintiff ("Adams") brought suit against the drilling company for an overcharge for services. The defendant had "threatened to bring action against [the] plaintiff" even though the defendant "knew that the amount claimed exceeded the amount plaintiff owed for the work done."⁸⁵ The defendant's purpose was viewed by the Oregon court as plainly coercive.⁸⁶ The court found Adams's payment was made under protest and in response to the defendant drilling company's threat of civil proceedings.⁸⁷ The jury assessed punitive damages on finding bad faith in the defendant's threat.⁸⁸ On the basis of the jury's finding that the defendant's threat was made "without probable cause and with no belief in the existence of the cause of action,"⁸⁹ the Oregon Supreme Court characterized the defendant drilling company as "a wrongdoer in a tortious sense."⁹⁰

The majority in *Seaman's* analogized in principle the behavior of the defendant in *Adams* to that of "a contracting party seeking to avoid all liability on a meritorious contract claim by adopting a 'stonewall' position ('see you in court') without probable cause and with no belief in the existence of a defense."⁹¹ Imposition of tort liability and assessment of punitive damages were appropriate under the *Adams* circumstances because the breach of the implied covenant was readily distinguishable from the mere breach of the contract.⁹² The significance of this dis-

82. *Id.* at 769-70, 686 P.2d at 1167, 206 Cal. Rptr. at 363.

83. 276 Or. 789, 556 P.2d 679 (1976).

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

85. *Adams*, 276 Or. at 791, 556 P.2d at 681.

86. *Id.*

87. *Id.*

88. *Id.*

89. *Id.* (quoting RESTATEMENT OF RESTITUTION § 71 (1937)).

90. *Id.*

91. *Seaman's*, 36 Cal. 3d at 769-70, 686 P.2d at 1167, 206 Cal. Rptr. at 363. The majority expressed its disapproval of these practices in its subsequent comments: "Such conduct goes beyond the mere breach of contract. It offends accepted notions of business ethics." (citing *Jones v. Abriani*, 169 Ind. 556, 350 N.E.2d 635 (1976)).

92. *Adams*, 276 Or. at 791-92, 556 P.2d at 681-82. See also *Seaman's*, 36 Cal. 3d at

tion justified applying tort remedies in addition to awarding compensatory damages.⁹³

The majority sought to distinguish the circumstances leading to the creation of the stonewall tort in *Adams* from those in *Seaman's*. In *Seaman's*, Standard contended that no binding agreement had ever been reached.⁹⁴ Because the jury instructions on the breach of the implied covenant did not mention bad faith, the jury may have held Standard liable simply because of its denial of a valid contract, without regard to a conclusive finding of bad faith.⁹⁵ Moreover, the jury was not advised that if Standard had believed in good faith no contract existed, it did have the right to refuse to stipulate to the evidence of a contract and to force *Seaman's* into litigation.⁹⁶ In the majority's view, Standard's behavior was not clearly enough defined to be tortious, if the denial of the existence of a binding contract had been made in good faith.⁹⁷ Consequently, the *Seaman's* court was not willing to find Standard liable in tort for breach of the implied covenant, especially under a commercial contract.⁹⁸

This unwillingness was, perhaps, tacit acknowledgment by the court that, under commercial contracts between parties of equal bargaining power, the parties should realize there is always the risk that one party will breach should it become economically advantageous to do so. Moreover, great deference has always been given to the principle of freedom of contract. Giving parties the freedom to deal at arm's length and to self-regulate their contracts means giving them the freedom to breach as well. Broad application of tort remedies in this area would nullify those freedoms by allowing an injured party to recover not only compensatory damages but also to punish the breaching party by recovering punitive damages.

770, 686 P.2d at 1167, 206 Cal. Rptr. at 363.

93. The majority further observed: "Acceptance of tort remedies in such a situation is not likely to intrude upon the bargaining relationship or upset reasonable expectations of the contracting parties." *Seaman's*, 36 Cal. 3d at 770, 686 P.2d at 1167, 206 Cal. Rptr. at 363.

94. *Id.* at 761, 686 P.2d at 1161-62, 206 Cal. Rptr. at 357-58.

95. *Id.* at 774, 686 P.2d at 1170, 206 Cal. Rptr. at 366.

96. *Id.* at 771, 686 P.2d at 1168, 206 Cal. Rptr. at 364.

97. *Id.* at 770, 686 P.2d at 1167, 206 Cal. Rptr. at 363.

98. *Id.* at 774, 686 P.2d at 1170, 206 Cal. Rptr. at 366.

IV. THE NEW TORT'S RAMIFICATIONS

A. ON NEGOTIATION

The California Supreme Court's analysis of the concept of breach of the implied covenant in a commercial contract and its conclusion that there must be an independent finding of bad faith for a tort remedy is persuasive. Chief Justice Bird's examination of Standard's acts,⁹⁹ and her dissenting view that no independent showing of bad faith should be required,¹⁰⁰ suggest an area of tort liability unrestrained by the nature of the contract. The majority was disinclined to extend the limits of its newly created tort that far. Nevertheless, the court's willingness to consider the imposition of tort remedies for breach of the implied covenant in a commercial contract must be regarded with circumspection.

The court's affirmation that there was a binding contract focused on the parties' respective situations and exigencies as evidenced by the terms of the commitment letter.¹⁰¹ Seaman's claimed that Standard's breach of the letter's terms was not only a breach of contract but also a breach of the implied covenant enabling it to recover in tort.¹⁰² Standard asserted that it had never viewed the commitment letter as a binding contract.¹⁰³ The implication was that it intended to subsequently negotiate and possibly enter into a more definitive agreement. This is a not uncommon practice in commercial transactions.

Although the court analyzed the commitment letter and determined it satisfied the statute of frauds under California Civil and Uniform Commercial Codes,¹⁰⁴ it failed to focus on the letter's apparent contemplation of a future agreement. This failure may have stemmed from the inherent ambiguity of how the par-

99. After being ordered by the Federal Energy Office to supply fuel to Seaman's, Standard denied the existence of a binding contract and attempted to counteract Seaman's endeavors to obtain an exemption from the new federal regulations. *Id.* at 781-82, 686 P.2d at 1175-76, 206 Cal. Rptr. at 371-72.

100. *Id.* at 781, 686 P.2d at 1175, 206 Cal. Rptr. at 371.

101. *See supra* notes 47-50 and accompanying text.

102. *See supra* note 46.

103. *Seaman's*, 36 Cal. 3d at 771, 686 P.2d at 1168, 206 Cal. Rptr. at 364.

104. *See supra* notes 48-49 and accompanying text.

ties perceived the letter's role in the formation of the desired contract.

Providing the written letter evidencing Seaman's binding commitment with an oil supplier was the prerequisite which led to the City's approval for leasing the larger area to Seaman's. Standard cooperated with Seaman's requests by writing the letter. Seaman's reasonably assumed that the commitment letter was the definitive agreement in the interim, one on which it could rely until the Chevron Dealer Agreement was executed. That agreement was to be the formal memorialization of the parties' financing and supplying arrangement.

The concluding language of the letter¹⁰⁵ seemed to indicate both parties were anticipating further negotiation before finalizing their agreement. Standard may have perceived the commitment letter as an intermediate step not necessarily binding on either itself or Seaman's, despite its "binding terms" language.¹⁰⁶ In light of *Seaman's*, parties who require commitment letters during the negotiation of commercial contracts should draft them if possible without any ambiguities. Careful consideration should be given to attempts to modify or deny the existence of terms to prevent such attempts from being construed as dealings in bad faith. The limited holding of *Seaman's* emphasizes that commitment letters are binding and enforceable contracts, notwithstanding the parties' intents, such as Seaman's belief that the letter was merely an agreement to agree. Parties to commitment letters or contracts are free to breach. However, should they deny the existence of a contract in bad faith and without probable cause they may be liable to the other party for punitive damages as well. Parties taking a more conservative approach may be unwilling to initiate pre-commitment negotiations without the utmost certainty of contract consummation.

B. ON COMMERCIAL BUSINESS PRACTICES

Under good faith and fair dealing principles, contracting parties have the freedom to make business judgment decisions.

105. See *supra* note 35 and accompanying text.

106. See Kessler & Fine, *supra* note 6, at 412. "What may still seem to be a phase of preliminary negotiations to one of the parties may be regarded by the law as a binding commitment in the interest of fair dealing."

Furthermore, they may discontinue negotiations or breach their contract and be subject only to contract remedies.

Standard's conduct may have arisen from permissible business decisions or strategies. It was attempting to counter the effects of the government allocation mandate on its operations. As it instituted its "no new business policy," other oil suppliers probably also initiated stringent measures to compensate for the oil shortage. Thus, Standard may have viewed the oil embargo as presenting a propitious opportunity to make a profit. By aggressively pursuing its existing customers and aggressively divesting itself from its nonprofitable ventures, it may have seen greater opportunity to build a more productive customer base, a likely concern of any business entity.

A business strategy to balance conflicting interests may have resulted, under the circumstances, in Standard's decision that it was economically sound to breach its contract. If, after *Seaman's*, Standard and others will be deterred from doing so out of concern there will be exposure to tort liability and punitive damages, *Seaman's* result is an encroachment on commercial parties' autonomy to freely contract in business transactions. Legal scholars have cautioned against "any overenthusiastic and indiscriminate embracing of good faith notions. . . . Judicial intervention in the name of fairness must find its limit when it impinges too greatly on private autonomy."¹⁰⁷ The predictable effect of this is to curtail economic freedom since parties may now be compelled to remain in unprofitable transactions to their detriment and be unwilling to take part in speculative ventures because the option to breach is no longer a viable economic alternative.

V. CONCLUSION

The decision in the *Seaman's* case strongly suggests that parties to commercial contracts must take exemplary precautions during their negotiations to avoid the risk of having to defend against tort damages. It essentially places constraints on contracting parties who previously had self-governing authority to make their own enforceable contracts. Contract law has

107. *Id.* at 449.

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evolved to facilitate commercial transactions and to promote economic exchange. Should the decision of *Seaman's* find ready acceptance, parties to commercial contracts will be forced to surmount precipitous grades whenever this new "stonewall tort" is implicated.

*Alisa J. Kim**

* Golden Gate University School of Law, Class of 1988.