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Examining Lender Liability Actions after Foley: Are Tort Damages Still Possible

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Examining Lender Liability Actions After *Foley*: Are Tort Damages Still Possible?

In past years, borrowers in California have sued lenders alleging tortious breach of the implied covenant of good faith and fair dealing.[1] Where liability has been imposed on lenders, the availability of tort damages, including punitive damages, has resulted in substantial awards to borrowers.[2] More recently, however, California appellate courts have criticized cases imposing tort liability on lenders and have refused to extend tort remedies to borrowers.[3] These appellate courts held that the relationship existing between lender and borrower is not sufficiently close to justify tort liability.[4] In so holding, these appellate courts have analogized to the recent California Supreme Court case of *Foley v. Interactive Data Corporation*.[5]

In *Foley*, the California Supreme Court held that an employee could not sue his employer for tortious breach of the implied covenant of good faith and fair dealing.[6] The *Foley* court disallowed tort

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1. *See, e.g.*, Lee v. Bank of America, 218 Cal. App. 3d 914, 267 Cal. Rptr. 387 (1990); Security Pacific Nat'l Bank v. Williams, 213 Cal. App. 3d 927, 262 Cal. Rptr. 260 (1989) (decertified pursuant to California Rules of Court, Rule 976, Dec. 21, 1989); Price v. Wells Fargo Bank, 213 Cal. App. 3d 465, 261 Cal. Rptr. 735 (1989); Mitsui Manufacturers Bank v. Superior Court, 212 Cal. App. 3d 726, 260 Cal. Rptr. 793 (1989); Barrett v. Bank of America, 183 Cal. App. 3d 1362, 229 Cal. Rptr. 16 (1986).

2. *See, e.g.*, Commercial Cotton Co. v. United California Bank, 163 Cal. App. 3d 511, 514, 209 Cal. Rptr. 551, 552 (1985) (tort remedies awarded to depositor arising out of breach of the implied covenant of good faith and fair dealing were $100,000).

3. Price v. Wells Fargo Bank, 213 Cal. App. 3d 465, 261 Cal. Rptr. 735 (1989); Mitsui Manufacturers Bank v. Superior Court, 212 Cal. App. 3d 726, 260 Cal. Rptr. 793 (1989).

4. *Price*, 213 Cal. App. 3d at 478, 261 Cal. Rptr. at 741; *Mitsui*, 212 Cal. App. 3d at 731, 260 Cal. Rptr. at 796.

5. 47 Cal. 3d 654, 765 P.2d 373, 254 Cal. Rptr. 211 (1988). *See Price*, 213 Cal. App. 3d at 478; *Mitsui*, 212 Cal. App. 3d at 731.

6. Foley v. Interactive Data Corp., 47 Cal. 3d at 700, 765 P.2d at 401, 254 Cal. Rptr. at 239-40.

remedies in the employment context because the relationship existing between employer and employee is not sufficiently close to warrant such remedies.[7] According to the *Foley* court, tort remedies are only justified for breach of the implied covenant of good faith when the relationship between plaintiff and defendant is "sufficiently similar" to that existing between an insurer and an insured.[8] Thus, *Foley* requires borrowers seeking tort remedies for breach of the implied covenant of good faith to show sufficient similarities between the lending and the insurance relationship to warrant extension of tort remedies to the lending relationship.[9]

The California Supreme Court has not yet considered a lender liability suit seeking tort remedies. It is interesting to note, however, that the supreme court has declined to hear two cases on this issue,[10] decertifying one which held in favor of the borrower.[11] Such actions by the court have led some writers to question whether lender liability actions continue to be viable.[12] The position advanced in this Comment is that tort liability for breach of the implied covenant of good faith and fair dealing in the lender/borrower context is not precluded by the *Foley* decision. Under certain fact situations, the relationship existing between lender and borrower will be of sufficient similarity to that existing between insurer and insured to justify tort remedies under the guidelines set forth by *Foley*.[13]

Part I of this Comment discusses the relationship found to exist between insurer and insured which justifies tort damages for the insurer's breach of the implied covenant of good faith and fair

7. *Id.* at 693, 765 P.2d at 396, 254 Cal. Rptr. at 234-35 (1988).

8. *Id.* The relationship between an insurer and an insured was termed a "special relationship" by the California Supreme Court in *Egan v. Mutual of Omaha*, 24 Cal. 3d 809, 820, 598 P.2d 452, 457, 157 Cal. Rptr. 482, 487 (1979). *See infra* notes 32-44 and accompanying text (discussing *Egan* and the special relationship test).

9. *See Foley*, 47 Cal. 3d at 693, 765 P.2d at 396, 254 Cal. Rptr. at 234-35.

10. Security Pac. Nat'l Bank v. Williams, 213 Cal. App. 3d. 927, 262 Cal. Rptr. 260 (1989) (decertified pursuant to California Rules of Court, Rule 976, Dec. 21, 1989); Price v. Wells Fargo Bank, 213 Cal. App. 3d 465, 261 Cal. Rptr. 735 (1989).

11. Security Pac. Nat'l Bank v. Williams, 213 Cal. App. 3d. 927, 262 Cal. Rptr. 260 (1989) (decertified pursuant to California Rules of Court, Rule 976, Dec. 21, 1989).

12. *See, e.g.*, Rice, *Lender Liability Litigation Wave May Be Cresting*, Los Angeles Daily Journal, Jan. 12, 1990, at 1, col. 1 (lender liability lawsuits, which looked for a time like the big-money wave of the 1980s, may be waving goodbye in the 1990s).

13. *See infra* notes 136-201 and accompanying text (discussing fact situations which give rise to such a relationship). *See also* Lee v. Bank of America, 218 Cal. App. 3d 914, 922-29, 267 Cal. Rptr. 387, 392-96 (1990) (Johnson, A.J. concurring and dissenting) (Justice Johnson's dissenting opinion argues that when the fact situation is sufficient, a bank depositor may maintain a cause of action against a bank for tortious breach of the implied covenant of good faith and fair dealing).

dealing.[14] Part II discusses the *Foley* decision and the factors that led the California Supreme Court to determine that tort damages are not justified for an employer's breach of the implied covenant of good faith and fair dealing.[15] Part III of this Comment will apply the *Foley* factors to certain fact situations to demonstrate that tort damages are appropriate in some lender/borrower cases.[16]

I. The Insurance Cases: Existence of a Special Relationship

In California, tort damages for breach of the implied covenant of good faith and fair dealing were first allowed in the insurance context.[17] Subsequent California cases analogized to the insurance context in allowing tort damages for breach of the implied covenant in the employment[18] and lending contexts.[19] It is thus logical to begin the discussion of the tort of breach of the implied covenant of good faith and fair dealing with an examination of the tort in the insurance context.

The California Supreme Court's first application of tort remedies in an insurance context came in *Comunale v. Traders & General Insurance Co.*[20] The *Comunale* court held that an insurance company's wrongful refusal to accept a third party's reasonable settlement offer within policy limits was a violation of its duty to consider the interests of the insured in good faith.[21] Such a failure to settle gave the insured the option of suing the insurance company in tort or in contract.[22]

The rationale behind the imposition of tort damages in the insurance context was more fully developed in *Crisci v. Security Insurance Co.*[23] The *Crisci* court awarded tort damages to compensate the plaintiff for the mental suffering proximately caused by the insurance

14. *See infra* notes 17-44 and accompanying text.
15. *See infra* notes 45-105 and accompanying text.
16. *See infra* notes 108-214 and accompanying text.
17. *See infra* notes 20-44 and accompanying text (discussing tortious breach of the implied covenant of good faith and fair dealing in the insurance context).
18. *See infra* notes 45-105 and accompanying text (discussing tort damages for breach of the implied covenant of good faith and fair dealing in the employment context).
19. *See infra* notes 108-214 and accompanying text (discussing tort damages for breach of the implied covenant of good faith and fair dealing in the lending context).
20. 50 Cal. 2d 654, 328 P.2d 198 (1958).
21. Comunale v. Traders & General Ins. Co., 50 Cal. 2d at 661, 328 P.2d at 202.
22. *Id.* at 663, 328 P.2d at 203.
23. 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

company's breach of the covenant of good faith.[24] The court stressed that the insurer's breach of contract did not, by itself, constitute tortious conduct.[25] Rather, the tortious conduct consisted of the insurer's failure to meet its duty to accept a third party's reasonable settlement offer, "a duty included within the implied covenant of good faith and fair dealing."[26] In reasoning that recovery of tort damages for breach of the implied covenant of good faith was appropriate in the insurance context, as opposed to every breach of covenant case, the *Crisci* court emphasized the nature of the relationship existing between insurer and insured.[27] Unlike contracts entered into for commercial advantage, insureds enter into contracts with insurers for protection against the risk of accidental losses and the mental suffering that often accompanies such losses.[28] Further, insurers are well aware that insureds purchase liability insurance specifically for the peace of mind provided by the insurance.[29] The *Crisci* court concluded by stressing that where the contract directly concerns the comfort, happiness, or personal esteem of one of the parties, damages for mental suffering will be permitted.[30]

In *Egan v. Mutual of Omaha*,[31] the California Supreme Court confronted the issue of whether, in addition to compensatory damages and damages for emotional distress, an insured could recover punitive damages for an insurer's breach of the implied covenant of good

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24. In *Crisci*, the plaintiff, a 70-year old widow, was found liable for $101,000 as the defendant in a previous personal injury action brought by a third party. *Id.* at 427-28, 426 P.2d at 176, 58 Cal. Rptr. at 16. Mrs. Crisci had a policy with Security providing for $10,000 worth of coverage. *Id.* at 428, 426 P.2d at 176, 58 Cal. Rptr. at 16. Although the plaintiff's attorney in the previous case reduced his settlement demands from $400,000 to $9,000, and although Mrs. Crisci offered to pay $2,500 of that amount, Security refused to settle, believing the injuries were only worth $3,000. *Id.*, 426 P.2d at 175-76, 58 Cal. Rptr. at 15-16. Counsel retained by Security, as well as Security's general claims manager, believed that a jury verdict on the personal injury action could result in a verdict of not less than $100,000. *Id.* The plaintiff in the previous suit was awarded $101,000, of which Security paid $10,000, the amount of its policy. *Id.* at 428-29, 426 P.2d at 176, 58 Cal. Rptr. at 16. Mrs. Crisci became indigent in paying off the remaining amount. *Id.* at 429, 426 P.2d at 176, 58 Cal. Rptr. at 16. Mrs. Crisci's physical and mental health also declined, and she made several suicide attempts. *Id.* As a result of her action against Security, Mrs. Crisci was awarded $91,000 for the insurance company's failure to settle, and $25,000 for emotional distress. *Id.* at 427, 426 P.2d at 175, 58 Cal. Rptr. at 15.

25. *Id.* at 430, 426 P.2d at 177, 58 Cal. Rptr. at 17.

26. *Id.*

27. *Id.* at 434, 426 P.2d at 179, 58 Cal. Rptr. at 19.

28. *Id. See infra* notes 164-167 and accompanying text (discussing the purpose of certain lenders in entering into borrowing contracts).

29. *Id.*

30. *Id.*

31. 24 Cal. 3d 809, 598 P.2d 452, 157 Cal. Rptr. 482 (1979).

faith and fair dealing.[32] The *Egan* court allowed the insured to recover punitive damages for the insurer's breach of the implied covenant.[33]

In *Egan*, the tortious conduct consisted of the insurer's failure to properly investigate the plaintiff's insurance claim.[34] *Egan* thus expanded the scope of tort liability beyond that allowed in *Comunale* or *Crisci* by holding that tort liability could be imposed not only for wrongful refusal to accept a third party's reasonable settlement offer, but also for failure to meet obligations imposed by the implied covenant with respect to the insured.[35] In supporting this expansion of the tort, the *Egan* court stressed that the insurer's duty to third parties and to the insured "are merely two different aspects of the same duty,"[36] requiring each party to the contract to refrain from actions which would impair the right of the other to obtain the benefits of the contract.[37] Benefits to the insured include protection

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32. *Id.*

33. *Egan*, 24 Cal. 3d at 819, 598 P.2d at 457, 157 Cal. Rptr. at 487. In *Egan*, the plaintiff purchased a health and disability insurance policy from Mutual, providing for lifetime benefits in the event the plaintiff became totally disabled as a result of either an accident "independent of sickness and other causes" or sickness of sufficient severity as to confine the plaintiff to his home. *Id.* at 815, 598 P.2d at 454, 157 Cal. Rptr. at 484. Benefits for a nonconforming illness were to be paid for no more than three months. *Id.* In 1970, after the plaintiff had been compensated for three separate back-related injuries, he made a fourth claim for an accidental back injury sustained in the course of employment. *Id.* This injury was compensated under the policy's provisions for three months after the injury. *Id.* Plaintiff attempted to extend the compensation for this injury beyond three months, stating that he was unable to return to work and that he would submit to an examination by a doctor of Mutual's choice. *Id.* Seven months after the accident, the plaintiff underwent back surgery. *Id.* at 816, 598 P.2d at 454, 157 Cal. Rptr. at 484. Doctors for the hospital where the surgery took place told Mutual's field investigator that about 50% of the plaintiff's injuries were due to the natural progression of a genetic defect in the plaintiff's spine. *Id.* at 816, 598 P.2d at 455, 157 Cal. Rptr. at 485. The field investigator, after a review of the medical records, reclassified the plaintiff's injury as a nonconforming illness, and one year after the injury issued the plaintiff a check for medical costs and three months of disability payments. *Id.* The plaintiff testified that the field investigator offered him a larger check if he would surrender his policy. *Id.* Two years after the injury, the plaintiff received a 73 percent disability rating on his worker's compensation claim. *Id.* The plaintiff, after further inaction by Mutual, sued Mutual and the field investigators for compensatory and punitive damages, alleging that the defendant's failure to have the plaintiff examined by a doctor of their choice, or to consult with his treating physicians, violated the implied covenant of good faith and fair dealing. *Id.*

34. *Id.* at 817, 598 P.2d at 456, 157 Cal. Rptr. at 486.

35. *Egan*, 24 Cal. 3d at 817-18, 598 P.2d at 455-56, 157 Cal. Rptr. at 485-86. Mutual had argued that, in an insurance context, the implied covenant was violated only when the insurer wrongfully refused to settle a claim while knowing it had no reasonable basis for doing so. *Id.* *See supra* notes 20-30 and accompanying text (discussing tort liability in *Comunale* and *Crisci* for wrongful refusal to settle).

36. *Id.* (citing Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 572, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973)).

37. *Id.* (citing Murphy v. Allstate Ins. Co., 17 Cal. 3d 937, 940, 553 P.2d 1584, 132 Cal. Rptr. 424, (1976); Crisci v. Security Ins. Co., 66 Cal. 2d 425, 429, 426 P.2d 173, 58 Cal. Rptr. 13 (1967); Comunale v. Traders & General Ins. Co., 50 Cal. 2d 654, 658, 328 P.2d 198, 68 A.L.R.2d 883 (1958)).

from calamity, as well as peace of mind and security.[38] Thus, the *Egan* court concluded that the insurer must protect the insured's interests in the contract by fully inquiring into the insured's claim, and denying payments only after making a thorough, reasonable, and good faith investigation of the claim.[39]

The *Egan* court awarded the plaintiff punitive damages pursuant to California Civil Code section 3294,[40] the purpose of which is to deter "acts deemed socially unacceptable and, consequently, to discourage the perpetuation of objectional corporate policies."[41] In the insurance context, public policy supports punitive damages to further this legislative purpose, since the *Egan* court found a special relationship between insurers and their insureds.[42] This special relationship is the result of two factors: (1) insurers hold themselves out as fiduciaries in fulfilling a vital "quasi-public" service and, as such, assume an obligation to place the public's interest before their own in maximizing gains and limiting disbursements; and (2) insurers and insureds stand in an inherently unbalanced relationship, the adhesive nature of which puts the insurers in the dominant bargaining position.[43] The concurrence of these two factors justified the imposition of punitive damages as an appropriate attempt to restore balance in the contractual relationship when the insurer was guilty of oppression, fraud, or malice.[44]

38. *Id.* at 819, 598 P.2d at 456, 157 Cal. Rptr. at 486 (citing Crisci v. Security Ins. Co., 66 Cal. 2d 425, 434, 426 P.2d 173, 58 Cal. Rptr. 13 (1967)).

39. *Id.* at 819, 598 P.2d at 456-57, 157 Cal. Rptr. at 486-87.

40. Civil Code section 3294 provides: "In an action for breach of an obligation not arising from contract, where it has been proven by clear and convincing evidence that the defendant has been guilty of oppression, fraud, or malice, express or implied, the plaintiff, in addition to actual damages, may recover damages for the sake of example and by way of punishing the defendant." CAL. CIV. CODE § 3294(a) (West Supp. 1990).

41. *Egan*, 24 Cal. 3d at 820, 598 P.2d at 457, 157 Cal. Rptr. at 487. The *Egan* court found that Mutual of Omaha had acted with malice, intent to oppress, and conscious disregard for the plaintiff's rights based on the following facts: Mutual's benefits department manager, McEachen, accused the plaintiff of fraud for accepting the insurance benefits instead of working, although McEachen was aware of the plaintiff's efforts to find work. *Id.* at 821, 598 P.2d at 458, 157 Cal. Rptr. at 488. Even worse, McEachen responded to the plaintiff's concerns for money during the Christmas season by laughing, thereby reducing the plaintiff to tears before his wife and child. *Id.*

42. *Id.* at 820, 598 P.2d at 458, 157 Cal. Rptr. at 487.

43. *Id.*

44. *Id.* (citing Hirsch, Carpenter & Carpenter, *Strict Liability: a Response to the Gruenberg-Silberg conflict Regarding Insurance Litigation Awards*, 7 SW. U.L. REV. 310, 326 (1975); Comment, Egan v. Mutual of Omaha Insurance Co.*: The Expanding Use of Punitive Damages in Breach of Insurance Contract Actions*, 15 SAN DIEGO L. REV. 287, 298-301 (1978); Note, *Contracting for Punitive Damages:* Fletcher v. Western National Life Insurance Company, 4 LOY. L.A.L. REV. 208, 219-24 (1971)). In *Egan*, Justice Clark vigorously dissented to the

II. Breach of the Implied Covenant of Good Faith in the Employment Context: *Foley*'s Denial of Tort Remedies.

A. *The Pre-Foley* Cases

After tort damages for breach of the implied covenant of good faith and fair dealing were allowed in insurance cases, plaintiffs in employment cases began seeking tort remedies, including punitive damages, in cases involving wrongful discharge.[45] A California court of appeals first allowed punitive damages for breach of the implied covenant in an employment context in *Cleary v. American Airlines*.[46] In *Cleary*, the plaintiff alleged that his discharge was a result of his involvement in union activities.[47] The *Cleary* court held that when an employer discharges an employee for participation in union activities, public policy will allow the employee to bring a cause of action sounding both in contract and in tort for breach of the implied covenant of good faith and fair dealing.[48]

The public policy rationale behind the *Cleary* court's holding that termination of an employee for union activities gives rise to a tort

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holding that punitive damages were justified. *Egan*, 24 Cal. 3d at 824, 598 P.2d at 460, 157 Cal. Rptr. at 490 (Clark, J., concurring and dissenting). Justice Clark focused on five elements in determining that punitive damages were improper: (1) an action for breach of the implied covenant must be considered a contract action, and thus Civil Code section 3294 will not be triggered to allow punitive damages; (2) because the plaintiff is made whole by the award of compensatory damages, any award of punitive damages amounts to a windfall or unjust enrichment for the plaintiff; (3) the deterrence provided by punitive damages against further wrongs is marginal, because the risk of liability for compensatory damages is sufficient deterrence; (4) by imposing punitive damages on the insurance company, the public punishes itself because future premiums will reflect the imposition of punitive damages on the industry; (5) case law holds that a mere breach of the implied covenant of good faith is insufficient to justify an award of punitive damages. *Id.* at 825-28, 598 P.2d at 461-62, 157 Cal. Rptr. 491-92 (Clark, J., concurring and dissenting). Justice Clark found that the conduct by Mutual's adjusters was not sufficiently egregious to warrant an award of punitive damages. *Id.* at 829, 598 P.2d at 463, 157 Cal. Rptr. at 493 (Clark, J., concurring and dissenting). Despite the determination that punitive damages were proper in this case, the court determined that the jury award was excessive as a matter of law. *Id.* at 824, 598 P.2d at 460, 157 Cal. Rptr. at 490. The court noted that the punitive damages award was more than 40 times larger than the "not-insubstantial" compensatory damage award of $123,600. *Id.* Further, the award represented two and one-half times Mutual's net income in 1973, the year in which the action was commenced. *Id.*

45. *See* Tameny v. Atlantic Richfield Co., 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980); Cleary v. American Airlines, 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980).

46. 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980).

47. Cleary v. American Airlines, 111 Cal. App. 3d at 454, 168 Cal. Rptr. at 729.

48. *Id.* at 455, 168 Cal. Rptr. at 729.

cause of action for breach of the implied covenant was based on *Petermann v. International Brotherhood of Teamsters*[49] and *Tameny v. Atlantic Richfield Co.*[50] In *Petermann*, an employee sued in contract for wrongful discharge after he was fired for refusing to commit perjury at the request of his employer.[51] The *Petermann* court allowed the employee to sue in contract for wrongful termination, notwithstanding the fact that the employment relationship was terminable at will.[52]

In *Tameny v. Atlantic Richfield Co.*, the California Supreme Court considered the case of an employee who was discharged for refusing to commit an illegal act at his employer's request.[53] In *Tameny*, the employee was allowed to bring a tort cause of action for wrongful discharge, a violation of California common law.[54] In light of the fact that wrongful discharge constitutes a tort in California, the *Tameny* court did not consider the plaintiff's claim that the discharge also constituted a breach of the implied covenant of good faith and fair dealing.[55] The *Tameny* court did, however, note that there was support from other jurisdictions for the theory that wrongful discharge in violation of the implied covenant of good faith may sound in tort as well as in contract.[56] *Cleary* relied on this dictum from

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49. 174 Cal. App. 2d 184, 344 P.2d 25 (1959).

50. 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980). *See Cleary*, 111 Cal. App. 3d at 454, 168 Cal. Rptr. at 729.

51. Petermann v. Int'l Brotherhood of Teamsters, 174 Cal. App. 2d at 187-88, 344 P.2d at 26.

52. *Id.*, at 188, 344 P.2d at 27. The *Petermann* court recognized an exception to California Labor Code section 2922, which provides: "An employment, having no specified term, may be terminated at the will of either party on notice to the other." *Id. See* CAL. LAB. CODE § 2922 (West 1989). According to the court, an exception to the at-will provision of section 2922 arises when an employee is discharged in contravention of public policy. *Petermann*, 174 Cal. App. 2d at 188, 344 P.2d at 27. The *Petermann* court defined public policy as "that principle of law which holds that no citizen can lawfully do that which has a tendency to be injurious to the public or against the public good . . . ." *Id.* (quoting Safeway Stores v. Retail Clerks etc. Assn., 41 Cal. 2d 567, 575, 261 P.2d 721, 726 (1953). The *Cleary* court thus used the *Petermann* decision to support the right of an employee to sue his employer for wrongful termination, despite the fact that the employment relationship is terminable at will. *Cleary*, 111 Cal. App. 3d at 450-51, 168 Cal. Rptr. at 726.

53. Tameny v. Atlantic Richfield Co., 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980).

54. *Id.* at 176, 610 P.2d at 1335, 164 Cal. Rptr. at 844 (citing Kouff v. Bethlehem-Alameda Shipyard, 90 Cal. App. 2d 322, 324, 202 P.2d 1059, 1061 (1949); Glenn v. Clearmann's Golden Cock Inn, Inc., 192 Cal. App. 2d 793, 796-97, 13 Cal. Rptr. 769, 771 (1961); Wetherton v. Growers Farm Labor Assn., 275 Cal. App. 2d 168, 174-75, 79 Cal. Rptr. 543, 546-47 (1969); Montvalo v. Zamora, 7 Cal. App. 3d 69, 76, 86 Cal. Rptr. 401, 405 (1970)).

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

56. *Id.* (citing Fortune v. Nat'l Cash Register Co., 373 Mass. 96, 364 N.E. 2d 1251, 1257 (1977); Monge v. Beebe Rubber Co., 114 N.H. 130, 316 A.2d 549, 551-52 (1974)).

Tameny, allowing the plaintiff in a wrongful discharge action to sue in tort for breach of the implied covenant of good faith and fair dealing.[57]

Having found support in *Petermann* and *Tameny* for a tort cause of action arising out of a breach of the implied covenant of good faith in the employment context, the *Cleary* court held that the particular facts of the case demonstrated a breach of the implied covenant of good faith and fair dealing after considering two factors.[58] First, the plaintiff had satisfactorily been employed by the defendant for over eighteen years.[59] After such a length of time, the *Cleary* court deemed the discharge of the plaintiff, without legal cause, to be a violation of the implied covenant of good faith and fair dealing.[60] Second, the *Cleary* court considered the existence of company regulations which regulated employee conduct and which set forth the specific procedures for adjudicating employee disputes, such as the one in controversy.[61] According to the *Cleary* court, the existence of such a regulation demonstrated that the employer recognized its obligation to deal fairly and in good faith with all of its employees.[62] The existence of these two factors were found to "operate as a form of estoppel" which precluded the employer from discharging the employee for less than good cause.[63] As a result, the

57. Cleary v. American Airlines, Inc., 111 Cal. App. 3d 443, 445, 168 Cal. Rptr. 722, 729 (1980).

58. *Id.*

59. *Id.*

60. *Id.* This covenant is implied in every contract. *See* Comunale v. Traders & General Ins. Co., 50 Cal. 2d 654, 658, 328 P.2d 198 (1958). The implied covenant of good faith and fair dealing, as noted above in the insurance context, obliges the employer to do nothing to deprive the plaintiff of the benefits of the employment bargain. *Cleary*, 111 Cal. App. 3d at 455, 168 Cal. Rptr. at 729. While a discharge for union participation would violate the covenant, the *Cleary* court acknowledged that the employer may discharge an employee for economic reasons if justified by "judicial balancing of the competing equities." *Id.* (citing Note, *Implied Contract Rights to Job Security*, 26 STAN. L. REV. 335, 369 (1974)) (stating that "[t]he conflict between an employee's right to job security and an employer's right to fire for cause or with economic justification should be resolved by judicial balancing of the competing equities."). *See supra* notes 20-43 and accompanying text (discussing the implied covenant of good faith and fair dealing in the insurance context).

61. *Cleary*, 111 Cal. App. 3d at 455, 168 Cal. Rptr. at 729. The plaintiff failed to include the regulations in the complaint, thus foreclosing an opportunity to examine them. *Id.* at 447 n.2, 168 Cal. Rptr. at 724 n.2. The plaintiff alleged that, although required to do so by the regulations, the defendants did not afford him a fair, impartial, and objective hearing to enable him to protest his discharge. *Id.* at 447-48, 168 Cal. Rptr. at 724.

62. *Id.* at 455, 168 Cal. Rptr. at 729.

63. *Id.* at 456, 168 Cal. Rptr. at 729. It is interesting to note that the *Cleary* court found the discharge of the plaintiff without "legal" cause, after 18 years of employment, to violate the implied covenant, while the estoppel notion described by the court prohibited discharge for less than "good" cause. *Id.* The *Cleary* court did not explain any distinction between "legal cause" and "good cause." *Id.*

plaintiff was allowed to sue in tort for discharge in violation of the implied covenant of good faith and fair dealing.[64]

In relying on this estoppel notion to justify the imposition of tort damages in the employment context for breach of the implied covenant, the *Cleary* court departed from the rationale established in the insurance context.[65] The *Cleary* court did not base the imposition of a tort remedy for discharge in violation of the implied covenant on the existence of a "special relationship," nor did the court contend that employers perform a vital "quasi-public" service, or hold themselves as fiduciaries with respect to their employees.[66] The court did, however, recognize that an employee in a wrongful discharge action may bring a cause of action for tortious breach of the implied covenant of good faith.[67] *Cleary*, however, provided courts with little guidance in determining the consistent application of tort damages for a breach of the implied covenant.[68] It was hoped that the California Supreme Court would resolve the difficulties presented by *Cleary* with their decision in *Foley v. Interactive Data Corp.*[69]

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64. *Id.* at 456, 168 Cal. Rptr. at 729.

65. *See supra* notes 20-44 and accompanying text (discussing tort recovery in the insurance context for an insurer's breach of the implied covenant of good faith). While the *Cleary* court did not analogize wrongful discharge to breach of an insurance contract, such an analogy was made in *Wallis v. Superior Court*, 160 Cal. App. 3d 1109, 1116, 207 Cal. Rptr. 123, 127 (1984). *Wallis* found support for this extension in language from *Seaman's Direct Buying Serv., Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984) which "intimated" that tort recovery was possible where the relationship at issue had "similar characteristics" to those found in insurance contracts. *Wallis*, 160 Cal. App. 3d at 1116, 207 Cal. Rptr. at 127. The *Wallis* court adopted a five factor test, based on the characteristics of insurance cases, which is designed to show that an action in tort will lie in most employment relationships. *Id.* at 1116 n.2, 207 Cal. Rptr. at 127 n.2. To impose tort liability, *Wallis* requires the satisfaction of the following factors:

> (1) the contract must be such that the parties are in inherently unequal bargaining positions; (2) the motivation for entering the contract must be a nonprofit motivation, i.e., to secure peace of mind, security, future protection; (3) ordinary contract damages are not adequate, because (a) they do not require the party in the superior position to account for its actions, and (b) they do not make the inferior party "whole"; (4) one party is especially vulnerable because of the type of harm it may suffer and of necessity places trust in the other party to perform; and (5) the other party is aware of this vulnerability.

Id. at 1118, 207 Cal. Rptr. at 129. After applying this test, the Wallis court found the employment contract at issue was sufficiently similar to an insurance contract to allow the imposition of tort remedies. *Id.* at 1119, 207 Cal. Rptr. at 129. Where these factors have been established, the dominant party has a duty to consider the interests of the other party before its own. *Id.* at 1118, 207 Cal. Rptr. at 129.

66. Cleary v. American Airlines, 111 Cal. App. 3d 443, 456, 168 Cal. Rptr. 722, 729 (1980).

67. *Id.*

68. Levine, *Judicial Backpedaling: Putting the Brakes on California's Law of Wrongful Termination*, 20 PAC. L.J. 993, 1008 (1989).

69. 47 Cal. 3d 654, 765 P.2d 373, 254 Cal. Rptr. 211 (1988); Levine, *supra* note 68, at 1009.

B. *Foley v. Interactive Data Corp.*

In *Foley*, the California Supreme Court disallowed tort remedies to employees alleging discharge in violation of the implied covenant of good faith.[70] In turning to a discussion of the *Foley* decision, this Comment will focus on the application of *Foley* to the implied covenant of good faith and fair dealing generally, and not focus specifically on wrongful termination, in order to clarify issues which will be developed in the following discussion of lender liability.[71] As will be shown below, courts working with lender liability issues have analogized to the *Foley* court's reasoning in denying borrowers tort remedies for breach of the implied covenant.[72]

Prior to the 1988 decision in *Foley*, a relationship sufficient to justify the imposition of punitive damages for breach of the implied covenant of good faith and fair dealing had been found to exist in insurance,[73] employment,[74] and banking cases.[75] *Foley* denied tort recovery to the plaintiff in an employment case, leaving the dilemma of adopting a remedy for wrongful discharge to the legislature.[76] In so doing, the *Foley* court expressly disapproved of *Cleary*'s allowance of a tort cause of action for an employer's breach of the implied covenant.[77]

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70. Foley v. Interactive Data Corp., 47 Cal. 3d 654, 700, 765 P.2d 373, 401, 254 Cal. Rptr. 211, 239-40 (1988).

71. For a more detailed examination of the decision as it relates to wrongful discharge, see Levine, *supra* note 68.

72. *See infra* notes 108-214 and accompanying text (discussing lender liability actions).

73. *See supra* notes 32-44 and accompanying text (discussing *Egan v. Mutual of Omaha* and imposition of punitive damages for breach of the implied covenant of good faith and fair dealing in the insurance context).

74. *See supra* notes 46-69 and accompanying text (discussing *Cleary v. American Airlines* and imposition of punitive damages for breach of the implied covenant of good faith and fair dealing in the employment context).

75. *See infra* notes 110-121 and accompanying text (discussing *Commercial Cotton Co. v. United California Bank* and *Barrett v. Bank of America* regarding the imposition of punitive damages for breach of the implied covenant of good faith and fair dealing in the banking context).

76. Foley v. Interactive Data Corp., 47 Cal. 3d 654, 700, 765 P.2d 373, 401, 254 Cal. Rptr. 211, 239 (1988).

77. *Id.* at 700 n.42, 765 P.2d at 401 n.42, 211 Cal. Rptr. at 240 n.42. Though the *Foley* decision mentions the test proposed by *Wallis* to determine the existence of a special relationship, the opinion does not expressly disapprove of that test as a means of determining the existence of a special relationship between two parties. *Id.* at 691 n.29, 765 P.2d at 395 n.29, 254 Cal. Rptr. at 233 n.29.

1. Facts of the *Foley* Decision

The plaintiff, Daniel Foley, began working for Interactive Data Corporation (IDC) in 1976.[78] Between the time he was hired, and 1983 when he was discharged, Foley's salary increased from $18,000 to over $56,000.[79] In that time he had received several bonuses, awards, and superior performance evaluations.[80] In January of 1983, Foley met with his former supervisor and privately informed him that his new supervisor, Robert Kuhne, was being investigated by the Federal Bureau of Investigation for embezzling from Bank of America, Kuhne's former employer.[81] Foley was told to forget about such rumors.[82] In March of that year, Kuhne had Foley transferred from IDC's Los Angeles office to another division in Massachusetts.[83] One week later, Kuhne met with Foley in Massachusetts and gave him the option of resigning or being fired.[84]

2. The *Foley* Court's Treatment of the Implied Covenant of Good Faith and Fair Dealing

Although Foley's written agreement with IDC made no reference to the grounds upon which he might be terminated, Foley alleged that his supervisors orally assured him of job security so long as he performed adequately.[85] Additionally, Foley alleged that he reasonably believed that IDC's "Termination Guidelines," which set forth a seven step pre-termination procedure, were applicable to him.[86] The plaintiff alleged that the discharge thus constituted a tortious breach of the implied covenant of good faith and fair dealing.[87]

The *Foley* court concluded that the relationship existing in the employment context is not sufficiently similar to that existing in the

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78. *Id.* at 663, 765 P.2d at 375, 254 Cal. Rptr. at 213.
79. *Id.*
80. *Id.* Two days before his discharge, Foley received a $6,762 merit bonus. *Id.*
81. *Id.* Kuhne later pleaded guilty to a felony count of embezzlement. *Id.* at 664 n.1, 765 P.2d at 375 n.1, 211 Cal. Rptr. at 213 n.1.
82. *Id.* at 664, 765 P.2d at 375, 254 Cal. Rptr. at 213-14.
83. *Id.* at 664, 765 P.2d at 375-76, 254 Cal. Rptr. at 214.
84. *Id.* The opinion does not state whether the plaintiff resigned or was discharged.
85. *Id.* at 664, 765 P.2d at 375, 254 Cal. Rptr. at 214.
86. *Id.* at 664, 765 P.2d at 375, 254 Cal. Rptr. at 213.
87. *Id.* at 682-83, 765 P.2d at 389, 254 Cal. Rptr. at 227.

insurance context to justify tort remedies.[88] In reaching its conclusion, the *Foley* court expressly disapproved of the holding in *Cleary* allowing for imposition of tort damages for an employer's breach of the implied covenant of good faith and fair dealing.[89] The *Foley* court disapproved of *Cleary* for two reasons.[90] First, although *Cleary* relied on decisions from the insurance context in arguing that tort and contract damages were appropriate for breach of the implied covenant in an employment relationship, the *Cleary* court did not compare the employment context to the insurance context to determine whether the relationships were sufficiently analogous to warrant expansion of tort damages to employment cases.[91] Second, the *Foley* court stated that *Cleary* relied too heavily on the *Tameny*[92] dictum which suggested the possibility of tort remedies for an employer's breach of the implied covenant of good faith and fair dealing.[93] The dictum in *Tameny* was based on insurance cases from California and two out-of-state employment cases.[94] Neither of the out-of-state employment cases permitted tort damages to the plaintiff.[95] According to the *Foley* court, the imposition of tort remedies in insurance cases represented a "major departure" from traditional principles of contract law, and great care must, therefore, be exercised to ensure that any extension of the tort of breach of the implied covenant is appropriate.[96]

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88. *Id.* at 693, 765 P.2d at 396, 254 Cal. Rptr. at 234-35. As will be discussed below, the *Foley* court also determined that there is no special relationship existing between employer and employee. *See infra* notes 96-104 and accompanying text (considering the *Foley* court's discussion of the relationship existing between employer and employee).

89. *See supra* notes 46-69 and accompanying text (discussing *Cleary* and tortious breach of the implied covenant of good faith and fair dealing in the employment context). The plaintiff in *Foley* relied on the *Cleary* holding in asserting that the California Supreme Court should recognize tort remedies for breach of the implied covenant of good faith and fair dealing occurring in an employment termination. *Foley*, 47 Cal. 3d at 682-83, 765 P.2d at 389, 254 Cal. Rprt. at 227.

90. *Foley*, 47 Cal. 3d at 687, 765 P.2d at 392, 254 Cal. Rptr. at 230.

91. *Id.* at 685, 765 P.2d at 390, 254 Cal. Rptr. at 228-29. Tort damages for breach of the implied covenant in the insurance context were affirmed by the *Foley* court. *Id.*

92. Tameny v. Atlantic Richfield Co., 27 Cal. 3d 167, 179 n.12, 610 P.2d 1330, 1337 n.12, 164 Cal. Rptr. 839, 846 n.12 (1980). *See supra* notes 53-56 discussing *Tameny*).

93. *Foley*, 47 Cal. 3d at 685-86, 765 P.2d at 391, 254 Cal. Rptr. at 229.

94. *Id.*

95. *Id.* at 686, 765 P.2d at 391, 254 Cal. Rptr. at 229. One of the out of state cases upon which the *Tameny* dictum was based was *Monge v. Beebe Rubber Co.*, 114 N.H. 130, 316 A.2d 549 (1974). In *Monge*, the court permitted an action for wrongful discharge, but limited the plaintiff's recovery to contract damages. *Monge*, 316 A.2d at 551-52. The second case, *Fortune v. National Cash Register Co.*, 373 Mass. 96, 364 N.E.2d 1251 (1977), allowed a cause of action to be sustained for breach of the implied covenant; however, the plaintiff's recovery was limited to benefits already earned under the contract. Fortune v. Nat'l Cash Register Co., 364 N.E.2d at 1256.

96. *Foley*, 47 Cal. 3d at 690, 765 P.2d at 394, 254 Cal. Rptr. at 232.

The *Foley* court denied the imposition of tort remedies for discharge in violation of the implied covenant of good faith and fair dealing on two separate grounds. First, the court considered the "special relationship" test and its applicability to the employment relationship.[97] After considering several commentators' discussions of the usefulness of the special relationship test, the court determined that there is not a special relationship existing in the usual[98] employment relationship.[99] In determining that the relationship existing between employer and employee is not a "special relationship,"[100] the court reasoned that: (1) the employee who suffers an employer's breach is not put in the same economic dilemma as an insured faced with an insurer's breach because the insured, unlike the employee, cannot turn to the marketplace to cover the loss already sustained,[101] (2) the employer does not provide a "quasi-public" service as does the insurer, who contracts with insureds for the purpose of protecting them from economic harm,[102] (3) the employee is seeking the same kind of financial security as a person entering a typical commercial contract where contract law governs, and (4) the insurer and insured are at financial odds as a result of the insurer wanting to maintain

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97. *Foley*, 47 Cal. 3d at 690-93, 765 P.2d at 394-96, 254 Cal. Rptr. at 232-34. The special relationship test was discussed in *Egan v. Mutual of Omaha*, 24 Cal. 3d 809, 157 Cal. Rptr. 482, 598 P.2d 452 (1979). *See supra* notes 32-44 and accompanying text (discussing *Egan*).

98. The *Foley* court did not define the "usual" employment relationship.

99. *Foley*, 47 Cal. 3d at 690-93, 765 P.2d at 394-96, 254 Cal. Rptr. at 232-24. *See, e.g.*, Louderback & Jurika, *Standards for Limiting the Tort of Bad Faith Breach of Contract*, 16 U.S.F. L. Rev. 187, 227 (1982) (stating that tort remedies for bad faith breach of contract should only be applied to commercial contracts if the following features characteristic of insurance bad faith actions are present: (1) one of the parties to the contract is in a superior bargaining position and is able to dictate the terms of the contract; (2) the weaker party enters the contract to secure an essential service or product, financial security or peace of mind, not for profit; (3) the weaker party places its trust and confidence in the stronger; and (4) the defendant's conduct indicates an intent to frustrate the weaker party's enjoyment of the contract rights); Putz & Klippen, *Commercial Bad Faith: Attorney Fees—Not Tort Liability—Is the Remedy for Stonewalling*, 21 U.S.F. L. Rev. 419, 480 (1987) (stating that although the "special relationship" test is purported to extend the tort of bad faith beyond insurance and employment only slightly, the test may clear the way for pleading a tort cause of action for nearly every breach of contract, creating a jury question as to whether or not the parties had a "special relationship"); Comment, *Reconstructing Breach of the Implied Covenant of Good Faith and Fair Dealing as a Tort*, 73 Calif. L. Rev. 1291, 1299-1301 (1986) (stating that the special relationship test fails because (1) the test does not explain why tort liability is justified for otherwise legal conduct, or for conduct which may give rise only to contract damages; (2) the test is inadequate as a definition for the scope and application of the tort duty of good faith and fair dealing; (3) the test does not differentiate between breach of the implied covenant of good faith and fair dealing and bad faith breach of contract; and (4) the test provides no justification for imposing punitive damages and may thus unfairly chill legitimate conduct).

100. *Foley*, 47 Cal. 3d at 692-93, 765 P.2d at 396, 254 Cal. Rptr. at 234.

101. *Id.* at 692, 765 P.2d at 396, 254 Cal. Rptr. at 234.

102. *Id.*

resources and the insured expecting to be compensated for his losses.[103]

Second, after noting that there is not a special relationship between employer and employee, the *Foley* court denied tort recovery to the employee because the employment context is not sufficiently similar to the insurance context to justify the imposition of tort remedies.[104] The court stated three factors that set the employment context apart from the insurance context: (1) the countervailing concerns about economic policy and stability; (2) the traditional separation of tort and contract law; and (3) the numerous protections against improper terminations already afforded employees.[105]

Clearly, then, *Foley* places restrictions on the imposition of tort damages for breach of the implied covenant of good faith and fair dealing. As mentioned above, *Foley* disallowed tort recovery in the employment context for two reasons: lack of a special relationship between the employer and employee, and lack of sufficient similarity between the employment context and the insurance context.[106] Because the *Foley* court emphasized that test as the means of determining whether tort damages should be extended beyond the insurance context, this Comment will use the "sufficient similarity" test in determining the appropriateness of extending tort damages for breach of the implied covenant to the lender/borrower context.[107]

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

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

105. *Id. See infra* notes 136-201 and accompanying text (discussing the applicability of these factors to the lender/borrower context).

106. *See supra* notes 97-105 and accompanying text.

107. *See infra* notes 163-188 and accompanying text (applying the special relationship test to determine liability in the lender/borrower context). The *Foley* court stated "[w]e therefore conclude that the employment relationship is not sufficiently similar to that of insurer and insured to warrant judicial extension of the proposed additional tort remedies . . . ." *Foley*, 47 Cal. 3d at 693, 765 P.2d at 396, 254 Cal. Rptr. at 234-35. On the other hand, the *Foley* court stated that even assuming the appropriateness of the special relationship model for determining whether to expand tort recovery, the employment relationship is not a special relationship. *Id.* at 692, 765 P.2d at 395-96, 254 Cal. Rptr. at 234. That the *Foley* court did not consider the special relationship test as the sole criterion for extension of tort remedies for breach of the implied covenant is further demonstrated by the commentaries cited by the court exposing the frailties of the special relationship test. *See supra* note 99 (discussing the commentaries cited by the *Foley* court in determining the inappropriateness of using the special relationship test as a model for determining the appropriateness of tort remedies for breach of the implied covenant in the employment context). This is not to say, however, that the special relationship test is of no use in determining the appropriateness of extending tort remedies for breach of the implied covenant to the lending context. The special relationship test is a factor which will be considered in ascertaining whether a substantial similarity exists between the insurance and lending contexts during the discussion of the traditional separation of tort and contract. *See infra* notes 161-188 and accompanying text (applying the special relationship test in determining the appropriateness of extension of tort remedies to the lender/borrower context).

III. THE LENDER/BORROWER CONTEXT

In turning now to a discussion of the lender/borrower context, this Comment will consider the history of lender liability cases, and then analyze the imposition of tort damages on lenders for breach of the implied covenant of good faith and fair dealing after *Foley*. Contrary to the holdings of some California appellate courts,[108] this Comment proposes that tort damages, including punitive damages, may be imposed on lenders for some breaches of the implied covenant. The appropriateness of tort damages will depend on a showing of substantial similarity between the lending and insurance contexts, as dictated by the factors set forth in *Foley*.[109]

A. *History of Lender Liability*

The history of tortious breach of the implied covenant of good faith and fair dealing in the lending context began with a case arising from an action brought by a depositor, *Commercial Cotton Co. v. United California Bank*.[110] In *Commercial Cotton*, a bank depositor was awarded punitive damages for the bank's tortious breach of the implied covenant.[111] The Fourth District Court of Appeals found that the bank's use of spurious, unjustified legal defenses in an effort to prevent an innocent depositor from recovering funds lost through the bank's negligence violated the implied covenant.[112] To justify the

108. *See* Price v. Wells Fargo Bank, 213 Cal. App. 3d 465, 261 Cal. Rptr. 735 (1989); Mitsui Manufacturers Bank v. Superior Court, 212 Cal. App. 3d 726, 260 Cal. Rptr. 793 (1989).

109. *See infra* notes 133-214 and accompanying text (applying the *Foley* factors to determine that there is a substantial similarity between the lending and insurance contexts).

110. 163 Cal. App. 3d 511, 209 Cal. Rptr. 551 (1985).

111. Commercial Cotton Co. v. United California Bank, 163 Cal. App. 3d at 514, 209 Cal. Rptr. at 552.

112. *Id.* at 516, 209 Cal. Rptr. at 554. In *Commercial Cotton*, four years after the checks from Commercial Cotton's account with United California Bank (UCB) were reported missing and replaced with checks of a different color and number series, one of the missing checks bearing unauthorized signatures was negligently paid by UCB for $4,000. *Id.* at 514, 209 Cal. Rptr. at 553. Two years later, when Commercial Cotton noticed the error and reported it to UCB, the bank admitted it had erred but refused to pay, stating that the claim was barred by a one year statute of limitations. However, only eleven days before, the California Supreme Court, in a case directly involving UCB, held that a three year statute of limitations applies when a customer sues a bank alleging negligence. *Id.* at 515, 209 Cal. Rptr. at 553. *See* Sun 'N Sand, Inc. v. United California Bank, 21 Cal. 3d 671, 699, 582 P.2d 920, 939, 148 Cal. Rptr. 329, 348 (1978). The *Commercial Cotton* court found that UCB must have been aware

award of tort damages in the bank/depositor relationship, the court in *Commercial Cotton* analogized to the special relationship found to exist between insurers and insureds in *Egan v. Mutual of Omaha.*[113] The *Commercial Cotton* court found that insurance and banking have much in common because they are both highly regulated and both perform "vital public services substantially affecting the public welfare."[114] This commonality formed the basis for finding the relationship of bank to depositors to be at least "quasi-fiduciary."[115] Where such a relationship exists, the court concluded, tort recovery for breach of the implied covenant of good faith and fair dealing is proper.[116]

The extension of tort liability to the lender/borrower relationship was made in *Barrett v. Bank of America.*[117] In *Barrett,* the plaintiff requested jury instructions on constructive fraud.[118] Constructive fraud usually arises from a breach of duty when a relation of trust and confidence exists.[119] In considering whether such instructions

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of the decision regarding the statute of limitations and, thus, UCB's "hard line" in attempting to avoid reimbursement to Commercial Cotton Co. constituted unjustifiable stonewalling. *Commercial Cotton,* 163 Cal. App. 3d at 516, 209 Cal. Rptr. at 554.

113. *Commercial Cotton,* 163 Cal. App. 3d at 516, 209 Cal. Rptr. at 554. *See supra* notes 32-44 (discussing *Egan*). By analogizing to the insurance context, the *Commercial Cotton* court took a different tack than the *Cleary* court took in the employment context. *See supra* notes 58-68 and accompanying text (discussing the *Cleary* court's determination that tort damages for an employer's breach of the implied covenant of good faith was based on a form of estoppel).

114. *Commercial Cotton,* 163 Cal. App. 3d at 516, 209 Cal. Rptr. at 554.

115. *Id.*

Finding the quasi-fiduciary relationship in *Commercial Cotton* was a significant departure from prior law. *See* Morse v. Crocker Nat'l Bank, 142 Cal. App. 3d 228, 232 (1983) (stating that it is obvious that the relationship created by a deposit id that of debtor-creditor, and not a fiduciary relationship); Umbaugh Pole Bldg. Co. v. Scott, 58 Ohio St. 2d 282, 286, 390 N.E.2d 320, 323 (1979) (stating that unless the parties understand that a special trust or confidence has been reposed, the relationship of a debtor and creditor is not a fiduciary relationship; Bank of Marin v. England, 385 U.S. 99, 101 (1966) (finding that the bank and depositor have a relationship founded upon contract"). *See also* Comment, *Commercial Cotton Co. v. United California Bank: California's Newest Extension of Bad Faith Litigation into Commercial Law,* 16 Sw. L.J. 645, 681 (1986) (stating that the "quasi-fiduciary" bank-depositor relationship is an inadequate foundation for extending tort damages for breach of the implied covenant good faith into a new area of commercial law).

116. *Commercial Cotton,* 163 Cal. App. 3d at 516, 209 Cal. Rptr. at 554.

117. 183 Cal. App. 3d 1362, 229 Cal. Rptr. 16 (1986).

118. Barrett v. Bank of America, 183 Cal. App. 3d at 1366, 229 Cal. Rptr. at 18.

119. *Id.* (citing Darrow v. Robert A. Klein & Co., Inc., 111 Cal. App. 310, 315-16, 295 P. 566, 568 (1931)). Confidential and fiduciary relations are synonymous. *Id.* at 1369, 229 Cal. Rptr. at 20 (citing Estate of Cover, 188 Cal. 133, 143, 204 P. 583, 588 (1922)). The *Barrett* court noted that the relationship between bank and depositor is at least "quasi-fiduciary." *Id.* at 1369, 229 Cal. Rptr. at 20 (citing Commercial Cotton Co. v. United California Bank, 163 Cal. App. 3d 511, 516, 209 Cal. Rptr. 551, 554 (1985)). The *Barrett* court also noted that "other jurisdictions recognize a similar relationship of trust and confidence

were appropriate, the *Barrett* court looked at the nature of the relationship existing between Barrett and Bank of America.[120] The court found substantial evidence to support the existence of a relationship of trust and confidence between the plaintiff and Bank of America, and thus granted the plaintiff's request for jury instructions on constructive fraud.[121]

In 1989, California appellate courts considered two cases involving claims of tortious breach of the implied covenant of good faith and fair dealing in the lender/borrower context: *Price v. Wells Fargo Bank*[122] and *Mitsui Manufacturers Bank v. Superior Court of San*

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exists between a bank and its loan customers which gives rise to a duty of disclosure of facts which may place the bank or a third party at an advantage with respect to the customer." *Id.* (citing Klein v. First Edina Nat'l Bank, 293 Minn. 418, 196 N.W.2d 619, (1972); First Nat'l Bank in Lenox v. Brown 181 N.W.2d 178 (Iowa 1970); Stewart v. Phoenix Nat'l Bank 49 Ariz. 34, 64 P.2d 101 (1937)).

120. *Id.* at 1369, 229 Cal. Rptr. at 20-21.

121. *Id.* at 1369-70, 229 Cal. Rptr. at 20-21. The court held the following facts supported the constructive fraud theory: Barrett perceived his relationship with Bank of America's loan officer (Chaffee) as very close; Barrett relied on Chaffee for financial advice and advice on the business merger which led to the controversy; Barrett confided information concerning confidential and unfavorable business developments with Chaffee; Chaffee told Barrett that merging Barrett's corporation with another would release Barrett's personal guarantees for loans with Bank of America; Chaffee told a consultant for the company Barrett was considering merging with that a merger would not result in release of Barretts' guarantees; Barrett did not find out about this conversation until three years after the merger was finalized; and finally, Bank of America stood to benefit from the merger. *Id.* at 1369, 229 Cal. Rptr. at 20-21.

122. 213 Cal. App. 3d 465, 261 Cal. Rptr. 735 (1989). In *Price*, Ernest and Maxine Price approached Wells Fargo requesting a five year loan. Price v. Wells Fargo Bank, 213 Cal. App. 3d at 471, 261 Cal. Rptr. at 736. On February 28, 1983, Wells Fargo extended three loans to the Prices with a combined value of $370,000. *Id.* Contrary to the Prices' request for a five year loan, Wells Fargo made the loans payable on October 31, 1983, eight months after they were extended. *Id.* The Prices were surprised to learn of the October 31, 1983, maturity date and notified Wells Fargo that they would not be able to meet the payment schedule. *Id.* at 472, 261 Cal. Rptr. at 737. According to Maxine Price, Wells Fargo agreed to reschedule the loans on the five year plan as originally contemplated. *Id.* After several attempts to make accommodations on the payment schedule with Wells Fargo, Ernest Price received an assurance from Wells Fargo that the loan schedule would be reorganized. *Id.* The case does not describe the terms of this alleged agreement. *Id.* With this agreement, the Prices let the October 31 date pass without making any payments towards the principal of the loans. *Id.* After the October 31 date passed, the Prices began receiving letters announcing that their loans were past due. *Id.* The Prices conceded that their loans were due, and made further attempts to initiate discussions to restructure the loans. *Id.* In March of 1984, the parties agreed upon a new repayment schedule requiring a final payment to be made in March of 1985. *Id.* at 472-73, 261 Cal. Rptr. at 737. The Prices could not meet this revised payment schedule and, again, fell behind in their payments. *Id.* at 473, 261 Cal. Rptr. at 737. In September of 1984, Wells Fargo filed a notice of default and initiated foreclosure proceedings. *Id.* at 473, 261 Cal. Rptr. at 738. After negotiating with the Prices' attorney, the defendant issued a modified ultimatum on February 19, 1985, which stated that the bank would forbear on publishing notice of trustee's sale on condition that the Prices agreed, *inter alia*, to make a payment of $50,000 on February 20, 1985, and pay all amounts due by June 10, 1985. *Id.* On March 1, 1985, the Prices paid $50,000. *Id.* at 474, 261 Cal. Rptr. at 738. The Prices made a further payment of $90,000 on June 10, 1985. *Id.* Despite this effort by the Prices, Wells Fargo published a notice

Diego.[123] Each case held that the relationship existing between the lender and borrower was not sufficiently similar to the fiduciary relationship existing between an insurer and insured to warrant tort recovery for breach of the implied covenant of good faith and fair dealing.[124] In reaching this conclusion, both courts interpreted the holding in *Foley* as precluding tort recovery for breach of the implied covenant of good faith and fair dealing in commercial contracts.[125]

In interpreting *Foley* to preclude tort recovery by borrowers for breach of the implied covenant, both the *Price* and *Mitsui* courts refused to follow *Commercial Cotton* and find a tortious breach of the implied covenant of good faith and fair dealing in the lender/borrower context.[126] The *Price* court criticized both *Commercial Cotton* and *Barrett* for basing tort liability for breach of the implied covenant upon a quasi-fiduciary relationship between bank and customer, finding the existence of such a quasi-fiduciary relationship to be "inconsistent with past authority and current trends in the law."[127] The *Mitsui* court, on the other hand, found that *Commercial Cotton* did not concern the relationship between lender and borrower because

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of trustee's sale to be held on July 9, 1985. *Id.* On June 28, 1985, the Prices paid the balance owing on all three loans with money borrowed from two friends. *Id.* In July of 1985, the Prices filed an action in the Superior Court of Merced County, stating five causes of action: fraud, tortious breach of the covenant of good faith and fair dealing, contractual breach of the covenant of good faith, intentional infliction of emotional distress, and negligent infliction of emotional distress. *Id.* at 470, 261 Cal. Rptr. at 736. The trial court granted Wells Fargo's motion for summary judgment on all issues. *Id.*

123. 212 Cal. App. 3d 726, 260 Cal. Rptr. 793 (1989). In *Mitsui*, the defendant borrower, Squidco, borrowed approximately $1,650,000 in short-term loans from Mitsui, with the understanding of both parties that long-term loans would replace the short-term loans. Mitsui Manufac. Bank v. Superior Court, 212 Cal. App. 3d at 728, 260 Cal. Rptr. at 794. The short-term loans were occasionally renewed while Squidco unsuccessfully searched for long-term financing. *Id.* Eventually, Squidco defaulted on all the Mitsui loans and rejected Mitsui's proposal for long-term financing. When Mitsui's demand for full payment went unanswered, Mitsui sued for payment due, enforcement of the continuing guaranties, and foreclosure of the security interest. *Id.* Squidco cross-complained alleging that Mitsui tortiously breached the covenant of good faith and fair dealing by (1) reneging on an alleged oral promise to renew Squidco's short-term credit until Squidco obtained long term financing, and (2) by reneging on an oral promise to provide long-term financing without requiring a blanket deed of trust. *Id.* at 728-29, 260 Cal. Rptr. at 794. Mitsui moved for summary judgment on the grounds that the ordinary arms-length commercial lender/borrower relationship was insufficient, as a matter of law, to justify tort damages for breach of the implied covenant of good faith and fair dealing. *Id.* at 729, 260 Cal. Rptr. at 794. This motion was denied in the trial court. *Id.*

124. *Price*, 213 Cal. App. 3d at 478, 261 Cal. Rptr. at 741; *Mitsui*, 212 Cal. App. 3d at 732-33, 260 Cal. Rptr. at 797.

125. *Price*, 213 Cal. App. 3d at 478, 261 Cal. Rptr. at 741; *Mitsui*, 212 Cal. App. 3d at 731, 260 Cal. Rptr. at 796.

126. *Price*, 213 Cal. App. 3d at 478, 261 Cal. Rptr. at 741; *Mitsui*, 212 Cal. App. 3d at 731, 261 Cal. Rptr. at 796. *See supra* notes 110-116 and accompanying text (discussing *Commercial Cotton* in greater detail).

127. *Price*, 213 Cal. App. 3d at 476, 261 Cal. Rptr. at 740.

Commercial Cotton "was based upon a bank's reimbursing a depositor for monies it had negligently disbursed."[128]

While both *Price* and *Mitsui* denied plaintiffs recovery for tortious breach of the implied covenant of good faith, *Price* took a stronger approach in holding that the *Foley* decision "surely precludes" use of a "quasi-fiduciary" relationship as a basis for tort recovery.[129] The *Mitsui* court, by contrast, held that the facts of the case before it established only a breach of contract action, insufficient to establish a fiduciary relationship that would justify tort recovery.[130] *Mitsui* was, therefore, similar to *Barrett* in that both looked to the factual nature of the relationship to determine whether any fiduciary obligations exist.[131] The question then is whether a fact situation may arise in which tort damages will be appropriate for a lender's breach of the implied covenant of good faith. As will be argued below, the facts of the relationship between lender and borrower will determine whether the lender will be able to sue in tort for breach of the implied covenant of good faith and fair dealing.[132]

B. Justifying Tort Damages on Lender's Breach of the Implied Covenant of Good Faith: The Substantial Similarity Test

In *Foley*, the California Supreme Court held that the usual employment relationship did not warrant extension of tort remedies for breach of the implied covenant of good faith and fair dealing.[133] To reach its decision, the court compared the employment context to the insurance context.[134] The *Foley* court based its comparison on

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128. *Mitsui*, 212 Cal. App. 3d at 731, 260 Cal. Rptr. at 796.

129. *Price*, 213 Cal. App. 3d at 478, 261 Cal. Rptr. at 741.

130. *Mitsui*, 212 Cal. App. 3d at 731-32, 260 Cal. Rptr. at 796-97. According to the *Mitsui* court, the six factors to consider in deciding whether to impose tort damages for breach of the implied covenant of good faith and fair dealing are whether: (1) the contract is the product of the unequal bargaining strength of the parties; (2) ordinary contract damages are adequate; (3) adverse impact on the damaged party results from the adhesiveness of contract provisions which are neutral or beneficial to the other party; (4) there is public concern over the manner in which the parties to the contract conduct themselves; (5) the reasonable expectations of the parties have been violated; and (6) there was a fiduciary relationship in which the damaged party entrusted financial dependence or personal security to the other. *Id.* Squidco had cited no fact that would remove the transaction at issue from the ordinary commercial context. *Id.*

131. *See* Barrett v. Bank of America, 183 Cal. App. 3d 1362, 1369, 229 Cal. Rptr. 16, 20-21 (1986); *Mitsui*, 212 Cal. App. 3d at 731-32, 260 Cal. Rptr. at 796-97.

132. *See infra* notes 133-201 and accompanying text.

133. Foley v. Interactive Data Corp., 47 Cal. 3d 654, 692, 765 P.2d 373, 234, 254 Cal. Rptr. 211, 394 (1988).

134. *Id.*

three factors: (1) concerns about economic policy and stability, (2) the traditional separation of tort and contract law, and (3) the numerous protections against improper terminations already afforded employees.[135] Each of these three factors will now be analyzed in the lender/borrower context to determine the fact situations under which a breach of the implied covenant should give rise to tort damages.

1. Concerns About Economic Policy and Stability

The *Foley* court described the need for predictability in employment contracts as important to commercial stability.[136] In the employment context, stability is enhanced by the predictable damages available in a breach of contract action,[137] and by allowing employers discretion to dismiss employees without subjecting themselves to tort litigation.[138]

Because *Foley* continues to allow tort recovery for breach of the implied covenant of good faith and fair dealing in the insurance context, tort recovery in the insurance context must not be so disruptive of economic stability as to make tort damages inappropriate. As applied to the lender/borrower context, the issue becomes whether allowing borrowers to recover in tort when a bank breaches

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135. *Id.* at 693, 765 P.2d at 396, 254 Cal. Rptr. at 234-35 (1988).

136. *Id.* at 696, 765 P.2d at 398, 254 Cal. Rptr. at 237.

137. *Id.* 696 n.33, 765 P.2d at 398 n.33, 254 Cal. Rptr. at 237 n.33. In support of its contention that tort damages in the employment context are disruptive of economic stability, the *Foley* court cites commentaries which suggest continued application of tort damages in wrongful discharge actions could have deleterious effects. *Id.* at 695-96, 795 P.2d at 397-98, 254 Cal. Rptr. at 236-37. One such commentator observed that rapidly rising jury awards is of concern to the business community, as such awards often exceed settlement demands by as much as 187 percent. Gould, *Stemming the Wrongful Discharge Tide: A Case for Arbitration* 13 EMP. REL. L.J. 404, 405-406 (1988). Excessive jury awards in wrongful termination actions also threaten the prerogative of management in controlling the workplace and retaining only the most qualified employees, and restrict firms' ability to meet changing economic conditions flexibly. Note, *Protecting At Will Employees*, 93 HARV. L. REV. 1816, 1834-35 (1979).

138. *Id.* at 696, 765 P.2d at 398-99, 254 Cal. Rptr. at 237. *See also* Putz & Klippen, *Commercial Bad Faith: Attorney Fees—Not Tort Liability—Is the Remedy for "Stonewalling"*, 21 U.S.F. L. REV. 419, 430 (1987). Putz and Klippen discuss Posner's theory that economic stability is increased by limiting wrongful discharge awards to the amount due under the contract because the employer may then determine the most efficient allocation of resources. *Id.*

> [Posner's] analysis evolves from the central notion that when the benefit to the breaching party exceeds the detriment to the nonbreaching party, breach of contract is economically more efficient than performance. Breach, in these instances, promotes the efficient allocation of resources and benefits society as a whole. The obvious corollary of this premise is that when the injured party's losses exceed the breaching party's gains, breach is economically inefficient and society loses.

Id. at 430-31 (citing R. POSNER, ECONOMIC ANALYSIS OF THE LAW (3d. ed. 1986)).

the implied covenant would be so disruptive of economic stability as to make tort damages an inappropriate remedy for the breach. Phrased another way, the question is whether economic policy and stability will be compromised to an even greater extent than already allowed by the insurance decisions if wronged borrowers are allowed to recover in tort when a bank engages in conduct that impairs the right of the borrower to enjoy the benefits of the contract.[139] Such impairment may occur, for example, when a bank takes a "hard line" in repayment negotiations.[140] Contract damages are not primarily designed to prevent banks from engaging in such practices.[141] Rather, they are designed to redress the breach by awarding the plaintiff the benefit of the bargain, putting the plaintiff in the position he would have been in had the contract not been entered into, or requiring the breaching party to disgorge the benefit obtained through the contract to the injured party.[142]

Banks are important to economic stability. Indeed, should bank profitability decline, general monetary policy and economic stability will be seriously affected.[143] While there is a concern for the stability and economic soundness of banks, there is also a need to protect the public against imprudent banking.[144] The issue is whether tort damages, including punitive damages, so adversely affect the economic stability of the banking industry as to make such damages an inappropriate measure to protect the public. An exact analysis of the effect tort damages for breach of the implied covenant of good faith may have upon the banking industry is beyond the scope of this Comment. However, the position advanced by this Comment is that

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139. The test determining that one party violates the implied covenant of good faith when that party impairs the right of the other party in obtaining the benefits of the contract is derived from *Egan v. Mutual of Omaha*. *See supra* notes 32-44 and accompanying text (discussing *Egan* and breach of the implied covenant of good faith in the insurance context).

140. *See* Price v. Wells Fargo Bank, 213 Cal. App. 3d 465, 479, 261 Cal. Rptr. 735, 742 (1989) (plaintiffs alleged that Wells Fargo breached the covenant of good faith and fair dealing by taking a "hard line" in repayment negotiations).

141. FARNSWORTH, CONTRACTS, 812-14 (1982). Farnsworth refers to these three types of remedies as "expectation interest," "reliance interest," and "restitution interest." *Id.*

142. *Id.*

143. Isaac & Fein, *Facing the Future—Life Without Glass Steagall*, 37 CATH. U.L. REV. 281, 297 n.75 (1988) (citing *Structure and Regulation of Financial Firms and Holding Companies: Hearings Before the Subcomm. of the House Comm. on Government Operations*, 99th Cong., 2d Sess. (1986) at 121-22) (statement of Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System); FEDERAL RESERVE BANK OF NEW YORK, RECENT TRENDS IN COMMERCIAL BANK PROFITABILITY: A STAFF STUDY at 1 (1986).

144. Keley *ex rel.* Slay v. Michigan Nat'l. Bank, 377 Mich. 481, 141 N.W.2d 73, 80 n.1, (1966) (Adams, J., concurring) (citing Moran v. State Banking Comm'r, 322 Mich. 230, 243, 33 N.W.2d 772, 778 (1948).

the imposition of tort damages in the lending context is consistent with the policy allowing for the imposition of tort damages in the insurance context.

In the insurance context, tort damages, including punitive damages, are permitted in an effort to prevent the insurer from breaching its duties to the insured.[145] Such "leverage" on insurers is consistent with public policy demands placed on insurers as entities occupying superior bargaining positions over their insured.[146] In the lender/borrower context, this disparity in bargaining positions is often reflected in adhesion contracts, which borrowers must enter into in order to obtain a loan.[147] This disparity in bargaining positions is further reflected by the practical inability of many borrowers to obtain funds in the face of a lender's breach.[148] In obtaining a loan, borrowers usually post some form of security with the lender. When the lender breaches the implied covenant, the borrower may be left without funds to cover the loan payments, and, because the borrower has no security to cover another loan, may suffer foreclosure on the posted security.[149] Similarly, in the insurance context, when an insurer breaches, the insurer cannot obtain indemnity from another insurer for the loss already incurred.[150] The positions borrowers and insureds find themselves in after a breach, however, is markedly different from that of an employee who is wrongfully discharged: the employee can mitigate his damages by turning to the marketplace for alternative employment.[151]

The insurance and banking contexts are thus similar in that the weaker party necessarily depends upon the stronger to fulfill its obligations. A breach in such a situation can have devastating and

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145. Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 820, 598 P.2d 452, 457, 157 Cal. Rptr. 482, 487-88 (1979) (citing Hirsch, *Strict Liability: A Response to the Gruenberg-Silberg Conflict Regarding Insurance Litigation Awards*, 7 Sw. U.L. Rev. 310, 326 (1975)).

146. *Id.*

147. *See infra* notes 183-86 and accompanying text (discussing adhesion contracts as an element of the special relationship existing between insurer and insured).

148. *See* Price v. Wells Fargo Bank, 213 Cal. App. 3d 465, 474, 261 Cal. Rptr. 735, 738 (1989) (borrower was forced to borrow money from friends to pay off outstanding loans).

149. *See* Mitsui Manufacturers Bank v. Superior Court, 212 Cal. App. 3d 726, 728, 260 Cal. Rptr. 793, 794 (1989) (breach by the lender resulted in foreclosure on the borrower's security).

150. Foley v. Interactive Data Corp., 47 Cal. 3d 654, 692, 765 P.2d 373, 396, 254 Cal. Rptr. 211, 234 (1988).

151. *Id. But see id.* at 718, 765 P.2d at 415, 254 Cal. Rptr. at 253 (Kaufman, J., dissenting) (Justice Kaufman's dissent argued that the majority was naive in its determination that discharged employees may turn to the marketplace to mitigate their losses: "What market is there for the factory worker laid off after 25 years of labor in the same plant, or for the middle-aged executive fired after 25 years with the same firm?").

uncoverable consequences to the weaker party. Therefore, because in both contexts the weaker parties are similarly affected by a breach, and because public policy has allowed the imposition of tort damages in the insurance context as an effort to "restore balance to the contractual relationship,"[152] a similar allowance of tort damages in the lender context is warranted to restore balance to that relationship. It is important to note, however, that tort damages are only appropriate where the relationship between lender and borrower is unbalanced—economically powerful borrowers may not require tort damages to restore balance to the contractual relationship. Imposition of tort damages in the lender/borrower context, depending on the circumstances of the relationship, may be consistent with the public policy supporting tort damages in the insurance context. Unless future experience reveals that tort damages in the lending context are more disruptive of the economy than the imposition of tort damages in the insurance context, the "economic policy and stability" factor proposed in *Foley* should be deemed satisfied in the lending context where the bargaining strength of the parties is unbalanced.

2. *Traditional Separation of Tort and Contract Law*

Damages in breach of contract actions are limited to the amount that will compensate the plaintiff for the harm proximately caused by the breach, or which would naturally result from the breach.[153] In a contract action, the plaintiff may not recover damages for emotional distress,[154] nor may he recover punitive damages.[155] Indeed,

152. Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 820, 598 P.2d 452, 457, 157 Cal. Rptr. 482, 487 (1979).

153. CAL. CIV. CODE § 3300 (West 1970).

154. *See, e.g.*, Westwater v. Grace Church, 140 Cal. 339, 342, 73 P. 1055, 1057 (1903). *See also* 5 A. CORBIN, CONTRACTS § 1076 (1960); C. MCCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 145 (1935); 11 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1341 (3d ed. 1961); Comment, *Recovery of Mental Anguish for Breach of Contract: The need for an Enabling Statute*, 5 CAL. W.L. REV. 88 (1968) (arguing that while early common law did not allow damages for mental distress arising out of a breach of contract, today such awards are possible, although difficult to determine). Exceptions to this rule can be found when the primary purpose of the contract is to assure the promisee's peace of mind, for example in funeral arrangements. *See, e.g.*, Chelin v. Nieri, 32 Cal. 2d 480, 481-82, 196 P.2d 915, 916 (1948).

155. *See* 5 A. CORBIN, CONTRACTS § 1077 (1960); Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145, 1146 (1970); Mallor & Roberts, *Punitive Damages: Toward a Principled Approach*, 31 HASTINGS L.J. 639, 658 (1980); Simpson, *Punitive Damages For Breach of Contract*, 20 OHIO ST. L.J. 284, 284 (1959); Sullivan, *Punitive Damages for Breach of Contract: The Reality and the Illusion of Legal Change*, 61 MINN. L. REV. 207, 207 (1977); Comment, *Exemplary Damages in Contract Cases*, 7 WILLAMETTE L. REV. 137, 138 (1971); Annot., 84 A.L.R. 1345 (1933).

the theories behind contract remedies are largely unconcerned with whether the breach occurred in good or bad faith.[156] Tort remedy theories, by contrast, seek to compensate the injured party for the injury sustained, and additionally seek to deter future actions that cause such injury.[157] Tort remedies are, thus, not limited to compensation for economic harm, but may extend to damages for emotional distress[158] and, when malice or oppression is shown, punitive damages.[159]

Because of the traditional separation of tort and contract law, assessment of damages in a given dispute is, in theory, very simple: the court assesses tort damages for tortious conduct, and contract damages for breach of contract. The implied covenant of good faith and fair dealing was developed in the contract "arena."[160] Thus, to assess tort damages in what is fundamentally a contract action is not in keeping with tradition. Nonetheless, tort damages for breach of the implied covenant in the insurance context were approved in *Egan*.[161] Consequently, in determining whether tort damages should also be applied in a lender/borrower context, the reasoning behind *Egan* must be analyzed. The *Foley* court noted that in addition to satisfying the *Egan* requirements before tort remedies may be granted for a breach of the implied covenant, there must be some rule assuring that only "deserving" cases of breach of the implied covenant receive tort relief.[162]

Egan found a special relationship on which to base tort liability for breach of the implied covenant of good faith and fair dealing as a result of two factors: (1) insurers hold themselves out as fiduciaries in fulfilling a vital "quasi-public" service; and (2) insurer and insured stand in an inherently unbalanced, adhesive relationship.[163] The issue

156. Diamond, *The Tort of Bad Faith Breach of Contract: When, If At All, Should It Be Extended Beyond Insurance Transactions?*, 64 MARQ. L. REV. 425, 434 (1981).

157. *See* RESTATEMENT (SECOND) OF TORTS § 901 (1977).

158. *See* RESTATEMENT (SECOND) OF TORTS § 905(b).

159. *See* RESTATEMENT (SECOND) OF TORTS § 908.

160. Foley v. Interactive Data Corp., 47 Cal. 3d 654, 683, 765 P.2d 373, 389, 254 Cal. Rptr. 211, 227 (1988). *See also* Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 371 (1980) (stating that the good faith doctrine is employed by courts for the purpose of effectuating the parties intentions, or protecting their reasonable expectations).

161. *See supra* notes 32-44 and accompanying text (discussing *Egan*'s extension of tort damages for breach of the implied covenant).

162. *Foley*, 47 Cal. 3d at 697, 765 P.2d at 399, 254 Cal. Rptr. at 237. *See infra* notes 199-201 and accompanying text (discussing the formulation of a rule that assures only deserving breaches of the implied covenant are given tort recovery in the lender/borrower context).

163. Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 820, 598 P.2d 452, 457, 157 Cal. Rptr. 482, 487 (1979).

here is whether the lender/borrower relationship is sufficiently similar to that of insurer/insured to be termed a "special relationship" such that tort liability for breach of the implied covenant of good faith and fair dealing is appropriate.[164]

a. Vital "Quasi-Public" Service

According to *Egan*, an activity performs a "vital quasi-public service" if it is "affected with a public interest."[165] The beneficiary of an insurance contract does not seek commercial gain by entering the contract, but rather seeks the protection insurance provides against calamity—specifically, a source of income when, due to disability, the insured is unable to work.[166] As insurers are well aware, the purchase of insurance provides the insured with peace of mind and security concerning a need basic to the insured's economic survival.[167] While borrowers do not seek protection from calamity when entering into a loan agreement, in many cases the borrower desires funds to obtain a home or business.[168] In these situations, the borrower is not seeking commercial advantage, but rather the procurement of necessities basic to survival: home and income. Because a breach by the lender in such situations can result in foreclosure on the home or business, the effect may be no less a calamity than would occur if an insurer had breached his obligations to an insured. In such narrow circumstances, it seems consistent with the rationale of *Egan* to describe the lender as a purveyor of a quasi-public service.

Insurers assume the responsibilities of, and hold themselves out as, fiduciaries when providing the "vital quasi-public" service.[169] This is so because they are obliged to go beyond meeting the reasonable expectations of coverage, putting the insured's interest before their own when necessary.[170] A fiduciary has been defined as a person

164. *See supra* notes 42-44 and accompanying text (discussing the elements of a "special relationship").
165. *Egan*, 24 Cal. 3d at 820, 598 P.2d at 457, 157 Cal. Rptr. at 487.
166. *Id.*
167. *Id.*
168. *See* Price v. Wells Fargo Bank, 213 Cal. App. 3d 465, 471, 261 Cal. Rptr. 735, 736 (1989) (plaintiffs borrowed funds to pay off existing loans on cattle ranch); Barrett v. Bank of America, 183 Cal. App. 3d 1362, 1365, 229 Cal. Rptr. 16, 17 (1986) (plaintiffs' small business loans were secured by their home and another residence).
169. Egan v. Mutual of Omaha, 24 Cal. 3d 809, 820, 598 P.2d 452, 457, 157 Cal. Rptr. 482, 487 (1979).
170. *Id.* (citing Goodman & Seaton, *Forward: Ripe for Decision, Internal Workings of the California Supreme Court*, 62 CALIF. L. REV. 309, 346-47 (1974)).

having a duty, created by his undertaking, to act primarily for another's benefit in matters connected with such undertaking.[171] The issue of whether a fiduciary relationship exists between lender and borrower has influenced recent California courts in refusing to extend tort damages to borrowers for a lender's breach of the implied covenant.[172] The relationship in most lender/borrower situations, as compared to the insurance context, has been found to be that of debtor and creditor, not fiduciary.[173] In determining that no fiduciary relationship exists between lender and borrower, many courts have focused on language from cases in the bank/depositor context.[174] The existence of a debt between a bank and a depositor does not create a fiduciary relationship because no trust and confidence is placed in the bank.[175] The principle that a fiduciary relationship does not exist

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171. BLACK'S LAW DICTIONARY, 564 (5th ed. 1979). *See also* BAJI No. 12.36 (1986) (providing that "[a] fiduciary or confidential relationship exists whenever under the circumstances trust and confidence reasonably may be and is reposed by one person in the integrity and fidelity of another.").

172. *See, e.g.*, Price v. Wells Fargo Bank, 213 Cal. App. 3d 465, 478, 261 Cal. Rptr. 735, 741 (1989) (finding that *Foley* precludes extending tort recovery to the lender/borrower context based on the "quasi-fiduciary" relationship described in *Commercial Cotton v. United California Bank*); Mitsui Manufacturers Bank v. Superior Court, 212 Cal. App. 3d 726, 731, 260 Cal. Rptr. 793, 796 (1989) (finding no fiduciary relationship in a commercial transaction because the parties were of equal bargaining strength).

173. Generally the relationship between a bank and its depositors and borrowers is creditor/debtor, not fiduciary, and as such there is no duty of disclosure upon the bank. *See, e.g.*, Lee v. United Federal Sav. & Loan Ass'n, 466 So.2d 131, 134 (Ala. 1985); Citizens and Southern Nat'l Bank v. Arnold, 240 Ga. 200, 40 S.E.2d 3, 4 (1977); Delta Diversified v. Cit. & South. Nat'l Bank, 171 Ga. App. 625, 320 S.E.2d 767, 776 (1984); Limoli v. First Georgia Bank, 147 Ga. App. 755, 250 S.E.2d 155, 157 (1978); Farmer City State Bank v. Guingrich, 139 Ill. App. 3d 416, 487 N.E.2d 758, 764 (1985); Dewitt Cty. Public Bldg. Comm'n v. DeWitt Cty., 128 Ill. App. 3d 11, 469 N.E.2d 689, 700 (1984); Bank Computer v. Continental Ill. Nat'l Bank, 110 Ill. App. 3d 492, 442 N.E.2d 586, 594 (1982); McElrean v. Union Nat'l Bank of Chicago, 90 Ill. App. 3d 1141, 414 N.E.2d 128, 134 (1980); Kurth v. Van Horn, 380 N.W.2d 693, 696 (Iowa 1986); First Bank of Wakeeney v. Moden, 235 Kan. 260, 681 P.2d 11, 13 (1984); Denison State Bank v. Madeira, 230 Kan. 684, 640 P.2d 1235, 1243 (1982); Dugan v. First Nat'l. Bank in Wichita, 227 Kan. 201, 606 P.2d 1009, 1014 (1980); Centerre Bank of Kansas City v. Distributors, Inc., 705 S.W.2d 42, 53 (Mo. App. 1985); Umbaugh Pole Bldg. Co., Inc. v. Scott, 58 Ohio St. 2d 282, 390 N.E.2d 320, 323 (1979); Federal Land Bank of Baltimore v. Fetner, 269 Pa. Super. 455, 410 A.2d 344, 348 (1979); Burwell v. South Carolina Nat'l Bank, 288 S.C. 34, 340 S.E.2d 786, 790 (1986).

174. *See* Price v. Wells Fargo Bank, 213 Cal. App. 3d 465, 476, 261 Cal. Rptr. 735, 740 (1989) (citing Morse v. Crocker Nat'l Bank, 142 Cal. App. 3d 228, 232, 190 Cal. Rptr. 839 (1983); Downey v. Humphreys, 102 Cal. App. 2d 323, 332, 227 P.2d 484 (1951)) (stating that it is inconsistent with "past authority and current trends in the law" to regard the relationship between bank and depositor as fiduciary in nature because it is "axiomatic" that the relationship between banker and depositor is of debtor and creditor).

175. Downey v. Humphreys, 102 Cal. App. 2d 323, 332, 227 P.2d 484, 490 (1951). *But see* Lawrence v. Bank of America, 163 Cal. App. 3d 431, 437, 209 Cal. Rptr. 541, 545 (1985) (stating that the facts of the transaction may support a finding that a fiduciary relationship existed between bank and depositor).

between bank and depositor has been extended by courts to apply "with even greater clarity" to the relationship between lender and borrower.[176]

While lenders may not hold themselves out as fiduciaries to the general population, for over fifty years courts have accepted the position that the particular facts of a transaction between bank and customer may give rise to a fiduciary relationship.[177] In *Stewart v. Phoenix National Bank*,[178] the Arizona Supreme Court noted two factors that gave rise to a "confidential relationship" between a bank and a depositor. First, the bank had acted as the depositor's financial advisor for twenty-three years.[179] Second, the depositor had relied on the bank's advice.[180] Decisions from other jurisdictions support the contention that a fiduciary relationship may arise from the facts of the particular relationship between bank and customer, relying primarily on the same two factors advanced in *Stewart*.[181] Indeed, the particular facts of a lender/borrower relationship have also been held to give rise to a fiduciary relationship.[182]

The position advanced by this Comment is not that the lender/borrower relationship is an inherently fiduciary relationship. Rather, the lender and borrower, through the course of their dealings, may form a relationship in which the borrower reposes faith, confidence, and trust in the judgment and advice of the lender. When this occurs, it is perfectly consistent with prior case law and common sense to treat the relationship as fiduciary in nature.[183]

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176. *Price*, 213 Cal. App. 3d at 476, 261 Cal. Rptr. at 740. *See supra* notes 110-121 and accompanying text (discussing the pre-*Foley* decisions which found a fiduciary relationship in the bank/depositor context and the lender/borrower context).

177. *See* Stewart v. Phoenix Nat'l Bank, 49 Ariz. 34, 64 P.2d 101 (1937).

178. 49 Ariz. 34, 64 P.2d 101 (1937).

179. Stewart v. Phoenix Nat'l Bank, 64 P.2d at 106.

180. *Id.* In *Stewart*, the plaintiff alleged that not only was he a customer of the bank and relied on the bank as a financial advisor, but further, that the bank's officers and directors repeatedly told him of their friendship for him, giving the plaintiff the belief that they would not take financial advantage of him. *Id.*

181. *See* Deist v. Wachholz, 678 P.2d 188, 193-94 (Mont. 1984) (finding a fiduciary relationship where the bank acted as the customer's financial advisor for twenty-four years and the customer relied on the bank's advice); Dolton v. Capitol Federal Sav. & Loan Ass'n., 642 P.2d 21, 23-24 (Colo. App. 1981) (finding a fiduciary relationship when there is a repose of trust by the customer along with an acceptance or invitation of such trust on the part of the lending institution).

182. Dolton v. Capitol Federal Sav. & Loan Ass'n., 642 P.2d 21, 23-24 (Colo. App. 1981).

183. A fiduciary "relationship exists when there is a reposing of faith, confidence and trust, and the placing of reliance by one upon the judgment and advice of the other." BLACK'S LAW DICTIONARY, 564 (5th ed. 1979).

b. Adhesive Nature of Banker/Borrower Relationship

Under *Egan*, once a fiduciary relationship has been established, an adhesion contract must also be shown before tort remedies for breach of the implied covenant of good faith and fair dealing are appropriate in the insurance context.[184] Adhesion contracts have been defined as contracts offered for goods or services on an essentially "take it or leave it" basis; the weaker party, who is denied the opportunity to bargain, may obtain the product only by acquiescing to the form contract.[185] In an adhesion contract, the only choices available to the consumer are complete adherence, or outright rejection.[186] Whether the contract entered into by a borrower is adhesive will depend largely on the amount being borrowed and the sophistication of the borrower. Typically, larger transactions will be negotiated, while smaller ones will not. Consequently, some borrowing contracts are adhesive, and some are not.[187] Where the borrowing contract is an adhesion contract, the second factor required by *Egan* to show the existence of a special relationship is satisfied.

c. Other Concerns in Extending Tort Remedies to Lender/ Borrower Relationships: The Difficulty in Formulating a Rule

The traditional separation between tort and contract law obviates the need to determine when tort remedies for breach of the implied covenant of good faith and fair dealing are appropriate: under the traditional approach, tort remedies are never appropriate since the action is inherently based in contract.[188] The *Foley* court argued that another reason for denying tort damages to an employee for an employer's breach of the implied covenant is the difficulty in for-

184. *See supra* notes 42-44 and accompanying text (discussing the factors that *Egan* describes as necessary to the existence of a special relationship).

185. Black's Law Dictionary, 564 (5th ed. (5th ed. 1979).

186. Farnsworth, Contracts, 295 (1982).

187. *See* Comment, *Lenders' Liability—The Shift From Contract to Tort Doctrine Deters Banks From Enforcing Unjustified and Detrimental Contract Provisions*, 21 J. Marshall L. Rev. 369, 379-80 (citing Purdue v. Crocker Nat'l Bank, 38 Cal. 3d 913, 702 P.2d 503, 216 Cal. Rptr. 345 (1985)).

188. Foley v. Interactive Data Corp., 47 Cal. 3d 654, 683, 765 P.2d 373, 399, 254 Cal. Rptr. 211, 227 (1988) (stating that the implied covenant of good faith and fair dealing was developed under contract law).

mulating a rule assuring that only "deserving" cases of breach of the implied covenant receive tort relief.[189]

In demonstrating the difficulty in formulating a test to determine when a tortious discharge in violation of the implied covenant of good faith has occurred, the *Foley* court noted a test proposed by one commentator.[190] Under the proposed test, the plaintiff must demonstrate an assertion of a right or denial of an obligation which is unreasonable and made in bad faith, and which inhibits the injured party's ability to find adequate substitution for the value of the agreement.[191] The problem with this test, according to the *Foley* court, is that while it serves to limit the number of recoveries for wrongful discharge, it does not limit the initiation of a claim based on almost any discharge.[192] Further, such claims could rarely be disposed of by demurrer or summary judgment.[193]

In *Khanna v. Microdata Corp.*,[194] a California court of appeals described another test to determine when an employee could sue in tort for violation of the implied covenant of good faith and fair dealing.[195] The *Khanna* court held that a claim that the implied covenant was tortiously breached in the employment context could be sustained when it was shown that the employer had exercised bad faith extraneous to the contract, and had fired the employee with the intention of frustrating the employee's enjoyment of the employment contract.[196] *Foley* expressly disapproved of the test proposed in *Khanna*, stating that the requirement of "bad faith" would not serve to limit the potential reach of tort damages.[197] Further, such a requirement would not distinguish between discharges that are properly remedied by contract damages and discharges for which tort remedies are appropriate.[198] Thus, almost any discharge could give rise to tort litigation.[199]

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189. *Id.* at 697, 765 P.2d at 399, 254 Cal. Rptr. at 237.
190. *Id.* at 697 n.35, 765 P.2d at 399 n.35, 254 Cal. Rptr. at 237 n.35.
191. *Id.* (citing Comment, *Reconstructing Breach of the Implied Covenant of Good Faith and Fair Dealing*, 73 CALIF. L. REV. 1291, 1305 (1986)).
192. *Id.*
193. *Id.*
194. 170 Cal. App. 3d 250, 215 Cal. Rptr. 860 (1985).
195. Khanna v. Microdata Corp., 170 Cal. App. 3d at 262, 215 Cal. Rptr. at 867.
196. *Id.*
197. *Foley*, 47 Cal. 3d at 697-99, 765 P.2d at 399-400, 254 Cal. Rptr. at 237-38 (1988).
198. *Id.*
199. *Id.* at 699, 765 P.2d at 400, 254 Cal. Rptr. at 239. It is interesting to note that the *Foley* court did not disapprove of the test formulated in *Wallis v. Superior Court*, 160 Cal. App. 3d 1109, 207 Cal. Rptr. 123 (1984). In *Wallis*, the Court of Appeals analogized the

As this Comment argues, the relationship between lender and borrower is substantially similar to that existing between insurer and insured. In those fact situations where the relationships are similar, tort damages are appropriate for breach of the implied covenant in the lending context, just as tort damages are appropriate in the insurance context. The concern expressed in *Foley* that any breach of the implied covenant could lead to tort liability is disposed of by requiring that the lender stand in a fiduciary relationship to the borrower.[200] Assuming the facts are not in dispute, claims of a fiduciary relationship between lender and borrower could be disposed of by demurrer and summary judgment.[201] Where a substantially similar relationship has been shown, the standard for tort relief in a lender/borrower relationship should be the same as that in the insurance relationship: whether the bank has given at least as much consideration to the borrower's interest as it has to its own.[202] Thus, it is feasible to formulate a rule which will determine when tort damages for breach of the implied covenant in the lending context are warranted. Further, use of the rule proposed in the insurance context will allow summary judgment and demurrer for claims which do not warrant tort remedies.

C. Protection Already Afforded Against Tortious Conduct

The final element considered by the *Foley* court in refusing to extend tort remedies to the employment context for breach of the implied covenant of good faith and fair dealing is that employees are already afforded numerous protections against improper terminations.[203] *Foley* noted that employees are protected from discriminatory discharges and discrimination resulting from the exercise of rights under workers' compensation law or participation in union

employment context to the insurance context to determine whether tort damages were appropriate for breach of the implied covenant. *See supra* note 64 (discussing the test proposed in *Wallis*).

200. *See supra* notes 132-199 and accompanying text (discussing the situations in which a fiduciary relationship may arise between lender and borrower).

201. *See* David Welch Co. v. Erskine & Tulley, 203 Cal. App. 3d 884, 890, 250 Cal. Rptr. 339, 341 (1988) (stating that the existence of a fiduciary duty is a question of law).

202. *See* Egan v. Mutual of Omaha, 24 Cal. 3d 809, 819, 598 P.2d 452, 456, 157 Cal. Rptr. 482, 486 (1979) (citing Silberg v. California Life Ins. Co., 11 Cal. 3d 452, 113 Cal. Rptr. 711, 521 P.2d 1103 (1974)).

203. Foley v. Interactive Data Corp., 47 Cal. 3d 654, 693, 765 P.2d 373, 396, 254 Cal. Rptr. 211, 235 (1988).

activities.[204] Further, employees may obtain tort damages for discharges in violation of public policy.[205] According to the *Foley* court, additional remedies for employees are for the legislature to enact, not the judiciary.[206]

The banking industry is heavily regulated by both federal and state statutes.[207] Many of these statutes operate for the protection of the banking customer. Federal protections provide for the insurance of depositor's funds with the Federal Deposit Insurance Corporation (FDIC) or the Federal Savings and Loan Insurance Corporation (FSLIC).[208] State regulations in California proscribe the relationship between a bank and its customers.[209] The California Commercial Code describes when a bank may charge a customer's account;[210] a bank's liability to a customer for wrongfully dishonoring a check;[211] and the customer's right to stop payment of a check.[212] Additionally, the California Financial Code regulates the statements banks must make to depositors concerning charges and interest on their accounts,[213] and the liability of the bank for failure to make such statements.[214] While the above provisions operate to protect the bank customer, they do not protect bank borrowers from such breaches of the implied covenant as found in *Barrett* and other cases.[215] Thus, the lender/borrower context is significantly different from the employment context with regard to the statutory provisions provided to

204. *Id.* at 693 n.30, 765 P.2d at 396 n.30, 254 Cal. Rptr. at 211 n.30.

205. *Id.* Discharges in violation of public policy are the type described in *Tameny v. Atlantic Richfield Corp.*, 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980). The *Foley* court approved of *Tameny's* holding that tort damages may be extended for a discharge in contravention of public policy. *Foley*, 47 Cal. 3d at 667 n.7, 765 P.2d at 374 n.7, 211 Cal. Rptr. at 215 n.7.

206. *Foley*, 47 Cal. 3d at 700, 765 P.2d at 401, 254 Cal. Rptr. at 239.

207. *See infra* notes 209-15 and accompanying text (showing examples of regulations imposed on banks).

208. All national banks and all members of the Federal Reserve must carry FDIC insurance. 12 U.S.C. § 1814(b) (1982). The FSLIC is similar to the FDIC in that it provides insurance for the depositors of savings and loan associations. *See* L. RITTER & W. SILBER, PRINCIPLES OF MONEY, BANKING, AND FINANCIAL MARKETS 116 (4th ed. 1983).

209. CAL. COM. CODE §§ 4401-07 (West 1964).

210. *Id.* § 4401.

211. *Id.* § 4402.

212. *Id.* § 4403.

213. CAL. FIN. CODE § 865.4 (West 1989).

214. *Id.* § 865.6.

215. *See, e.g.*, K.M.C. Co. v. Irving Trust Co., 757 F.2d 752, 760 (6th Cir. 1985) (good faith used to impose duty on lender to provide notice before refusing to advance funds, although loan agreement gives bank sole discretion); Reid v. Key Bank of Southern Me., Inc., 821 F.2d 9, 12-13 (1st Cir. 1987) (bank may not capriciously terminate a loan agreement). *See supra* notes 116-20 and accompanying text (describing *Barrett* and tortious breach of the implied covenant of good faith in the bank/borrower context).

curb wrongful actions by the dominant party. As such, it is consistent with *Foley* to permit tort damages for a lender's breach of the implied covenant of good faith and fair dealing.

CONCLUSION

Under *Foley v. Interactive Data Corp.*, California law limited tort remedies for breach of the implied covenant of good faith and fair dealing to insurance cases, and cases resembling insurance cases. As in an insurance case, a borrower seeking to recover tort damages for a bank's breach of the implied covenant must, therefore, show a special relationship between the borrower and the bank. The existence of a special relationship will depend on the facts of the specific case. To establish a special relationship, the plaintiff must show a fiduciary relationship between lender and borrower, and that the contract securing the loan was an adhesion contract. When these two elements are shown, recovery for tortious breach of the implied covenant should be allowed.

Additionally, recovery of tort damages in the banking context should be permitted by *Foley* because such damages comport with the economic policy and need for stability elucidated in *Foley*. In addition, unlike the situation faced in *Foley*, there is a lack of legal protection available to borrowers under current law. The availability of tort remedies for breach of the implied covenant of good faith and fair dealing in the lending context is not precluded by the *Foley* decision. While tort recovery will be heavily fact dependent, California courts after *Foley* should allow borrowers to sue lenders in tort for breach of the implied covenant of good faith and fair dealing.

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