Balancing the Checkbook: Re-allocating Economic Power Between Banks and Depositors

INTRODUCTION

Checking and savings accounts enable consumers to accomplish a wide variety of transactions[1] — from writing checks at grocery stores to safely depositing their paychecks.[2] Banks[3] meet consumers' needs by offering a package of services, including check writing and cashing privileges as well as overdraft protection, designed to facilitate these transactions. Consumers and the commercial world depend upon the consumer's access to bank services.[4] The bank account, as one of the

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[1] The number and value of checking and savings accounts demonstrate their pervasive character. *See* BLUEPRINT FOR REFORM: THE REPORT OF THE TASK GROUP ON REGULATION OF FINANCIAL SERVICES 8 (1984) [hereafter BLUEPRINT FOR REFORM]. This report states that "[T]he American financial market is the central nervous system of the economy . . . [for] virtually every consumer and community is directly affected by the availability and cost of financial services." *Id.* The report continues by remarking that "[W]ith over 50,000 banks handling over $5 trillion in private assets, financial services are [sic] a major industry in its own right." *Id*; *see also* Symons, *The Bank-Depositor Relation*, 100 BANKING L.J. 220, 220 (1983) ("The bank-customer relation is one of the most common volitional relations in our society."). *See generally* BANK ADMINISTRATION INSTITUTE, 1983 SURVEY OF THE CHECK COLLECTION SYSTEM 1 (1983) (checks are primary payment method in United States).

[2] "The banking service occupies a central place in the life of the typical American family." Testimony of Emma Coleman Jordan before the California Senate Committee on Banking and Commerce (Feb. 8, 1984). The public demand for bank services is growing:

> At the personal level, the bank is no longer seen as the place where money can be deposited or withdrawn when needed. The public today is demanding the presence and assistance of the bank at all times and all places; during the evening social hours, on weekends at the seaside or mountain resort, during the week at the supermarket or the local grocery store, to cite only a few cases.

D. CHORAFAS, MONEY: THE BANKS OF THE '80'S ix (1982); *see infra* note 4.

[3] *See* CAL. FIN. CODE § 102 (West 1988) (term "bank" includes any incorporated banking institution engaged in accepting deposits as regular business).

[4] The Supreme Court, quoting a Congressional debate, recently emphasized the importance of banking to the public. Federal Deposit Ins. Corp. v. Philadelphia Gear

most common forms of consumer contracts, enables consumers to gain this vital access.

Completion of the signature card[5] formalizes a contractual relationship between the bank[6] and the customer.[7] The traditional view is that debtor-creditor law controls the banking relationship arising from this contract.[8] However, under debtor-creditor law, a customer's recovery for breach of this contract is limited to her economic damages.[9] This limit is inappropriate in the wake of fundamental changes in both the banking industry[10] and contract law. The growing movement toward

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Corp., 106 S. Ct. 1931 (1986):

> The public . . . demand of you and me that we provide a banking system worthy of this great Nation and banks in which citizens may place the fruits of their toil and know that a deposit slip in return for their hard earnings will be as safe as a Government bond.

Id. at 1935 (remarks of Rep. Steagall, 77 CONG. REC. 3837, 3838, 3849 (1933)).

> Any and every man, woman, or child who puts a dollar in any bank can absolutely know that he will under no circumstances lose a single penny of it.

Philadelphia Gear, 106 S. Ct. at 1935-36 (remarks of Rep. Green, 77 CONG. REC. 3837, 3924 (1933)).

See Okura v. United States Cycling Fed'n, 186 Cal. App. 3d 1462, 1467, 231 Cal. Rptr. 429, 431 (1986) (discussing the public interest in banking transactions); Commonwealth v. Wilsbach Distrib., Inc., 519 A.2d 397, 401 (Pa. Commw. 1986) (noting that bank regulations promote public's health, safety and welfare); *see also* City of Pittsburgh v. Allegheny Valley Bank of Pittsburgh, 412 A.2d 1366, 1369-70 (Pa. Commw. 1980) (commenting that "[T]he Great Depression is a stark reminder that the economic fate of our Commonwealth is tied to the soundness and progress of its banking institutions.").

[5] The California Supreme Court recognized that the cases "unanimously agree" that the signature card constitutes a contract between the bank and the customer. Perdue v. Crocker Nat'l Bank, 38 Cal. 3d 913, 922, 702 P.2d 503, 509, 216 Cal. Rptr. 345, 351 (1985). In *Perdue* the California Supreme Court handed down a "revolutionary" decision permitting depositors to bring a class action alleging unconscionable bank charges. *See* B. CLARK, THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS S2-14 (rev. ed. supp. 1988); *see also infra* notes 97-99 and accompanying text.

[6] *See supra* note 3; *see also* CAL. COM. CODE § 4105 (West 1964) (listing the various functions banks perform).

[7] A customer is any person with an account at a bank. CAL. COM. CODE § 4104(e) (West 1964). This Comment limits the use of "customer" to individuals depositing and withdrawing funds from a checking or savings account.

[8] *See, e.g.*, J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 17-1 (2d ed. 1984); *see also infra* notes 99-102 and accompanying text.

[9] *See infra* notes 45-68 and accompanying text (discussing contract damages).

[10] An anecdote vividly describes the hostility to change prevalent in the banking industry:

deregulation of the banking industry threatens to remove many existing laws that safeguard customers.[11] More significantly, the rapid development[12] of the law on the implied covenant of good faith and fair dealing (implied covenant)[13] has fundamentally changed contract law.

Under California's implied covenant analysis, a customer may recover tort damages for noneconomic injuries if she successfully estab-

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> As a 90-year-old semi-retired bank president relaxed contentedly after a meeting he had attended, the speaker of the evening was introduced to him. The speaker said, "You must have seen alot of changes in banking in your day." "Yes, and I fought every one of them," the old man replied.

P. NADLER & R. MILLER, THE BANKING JUNGLE: HOW TO SURVIVE AND PROSPER IN A BUSINESS TURNED TOPSY TURVY 4 (1985).

[11] The banking industry has recently experienced substantial changes. K. COOPER & D. FRASER, BANKING REGULATION AND THE NEW COMPETITION IN FINANCIAL SERVICES 1 (1984). Several commentators argue that the present trend toward deregulation of the banking industry will continue and expand. *See, e.g.*, K. COOPER & D. FRASER, *supra*, at 17 (stating that several factors are pushing deregulation forward); J. HAWKE, *Is Banking the Next Candidate for Deregulation?*, in COMMENTARIES ON BANKING REGULATION 245 (1985); P. ROSE, THE CHANGING STRUCTURE OF AMERICAN BANKING 375 (1987) (citing inflation, public concern, and technological innovations as several of the multiple causes for the current trend). Rose predicts growing public dissatisfaction with financial institutions' ability to meet business and household demands for services. *Id.* at 351. He then lists the major deregulatory acts and decisions of the past two decades. *Id.* at 365-66.

[12] The implied covenant doctrine is continually growing: "The doctrine for tortious breach of the implied covenant is . . . being expanded to include more and more types of contracts and more varieties of 'bad faith' behavior." Comment, *A Proposed New Tort Cause of Action in Missouri for Breach of the Implied Covenant of Good Faith and Fair Dealing in Commercial Contracts*, 31 ST. LOUIS U.L.J. 433, 439 (1987); *see also infra* note 15.

[13] "California cases have applied [the implied covenant and tort remedies] only in the areas of insurance, employment and banking." *In re* Vylene Enter., Inc., 63 Bankr. 900, 905 (1986).

In the landmark decision on the implied covenant doctrine, Seaman's Direct Buying Service, Inc. v. Standard Oil Co., 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984), the California Supreme Court stated:

> It is well settled that, in California, the law implies in *every* contract a covenant of good faith and fair dealing. Broadly stated, that covenant requires that neither party do anything which will deprive the other of the benefits of the agreement. California courts have recognized the existence of the covenant, and enforced it, in cases involving a wide variety of contracts . . . . In the seminal case of *Comunale v. Traders & General Ins. Co.*, this court held that a breach of the covenant of good faith and fair dealing by an insurance carrier may give rise to a cause of action in tort as well as in contract.

Id. at 768, 686 P.2d at 1166, 206 Cal. Rptr. at 362 (citations omitted)(emphasis in original).

lishes that she and the defendant are in a "special relationship".[14] A California appellate court re-examined the bank-customer relationship in light of the implied covenant explosion.[15] The "special relationship" approach lead the court in *Commercial Cotton Co., Inc. v. United California Bank*[16] to permit the customer to recover tort damages. This recovery, the court stated, logically followed from California insurance cases developing the implied covenant of good faith and fair dealing.[17] Confusion also followed, for the *Commercial Cotton* court chose to characterize the bank-customer relationship as "quasi-fiduciary,"[18] thus leading to fears of injecting fiduciary principles into the relationship.[19]

A bank customer's potential tort recovery for her bank's bad faith actions imposes an effective economic disincentive against breach not available under debtor-creditor law.[20] Because of the implied covenant's ability to balance the economic power between the parties, mere cries of "traditionalism" as supporting continued application of debtor-creditor law do not justify denial of tort recovery permitted under implied covenant analysis.[21] While the traditional view of the bank-customer con-

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[14] *See infra* notes 75-83 and accompanying text.

[15] As one recent writer notes, "The tort of breach of the implied covenant of good faith and fair dealing has grown explosively in Montana." Hubble, *Survey: Good Faith and Fair Dealing: An Analysis of Recent Cases*, 48 MONT. L. REV. 193, 193 (1987) (examining, in part, the covenant's application in the bank-customer context). One court stated: "California courts have recognized the existence of this covenant and enforced it, in cases involving a wide variety of contracts." Goodrich v. General Tel. Co. of Cal., 195 Cal. App. 3d 675, 682, 241 Cal. Rptr. 640, 644 (1987). Another court simply observed: "California law in this area is in a great state of flux." Inforex Corp. N.V. v. MGM/UA Entertainment Co., 608 F. Supp. 129 (C.D. Cal. 1984); *see also* Paul v. State Farm Fire & Casualty Co., ___ Cal. App. 3d ___, ___, 238 Cal. Rptr. 428, 431 (1987) (observing that the law on insurer-insured relationship is in "continuing development") (ordered not published).

[16] 163 Cal. App. 3d 511, 516, 209 Cal. Rptr. 551, 554 (1985), *petition for hearing denied.*

[17] *See infra* notes 70-76 and accompanying text.

[18] *See infra* notes 109-10 and accompanying text.

[19] *See* Comment, *The Fiduciary Controversy: Injection of Fiduciary Principles into the Bank-Depositor and Bank-Borrower Relationships*, 20 LOY. L.A.L. REV. 795, 797 (1987).

[20] *See* Note, *Damage Measurements for Bad Faith Breach of Contract: An Economic Analysis*, 39 STAN. L. REV. 161 (1985) [hereafter Note, *Damage Measurements*] (advocating extra-contractual damages as a means of enforcing contracts arising from special relationships).

[21] Those opposing tort recovery for breach of the implied covenant in banking relationships cling to the "traditional" debtor-creditor characterization as support. *See, e.g.*, Comment, Commercial Cotton Co. v. United California Bank: *California's Newest Extension of Bad Faith Litigation into Commercial Law*, 16 SW. U.L. REV. 645, 649

tract restricts injured customers to ordinary contract damages, the banking contract's special relationship qualities justify tort recovery.[22]

The quasi-fiduciary characterization, however, raises valid criticisms because of the overly expansive duties it may impose upon banks.[23] This hostility does not detract from the *Commercial Cotton* court's recognition that the bank-customer relationship is "special."[24] The quasi-fiduciary characterization should be dropped.[25] Courts should focus on whether a special relationship exists between the customer and the bank as a prerequisite to tort recovery for breach of the implied covenant.

Part I of the Comment presents the factual background to the *Commercial Cotton* decision.[26] Part II examines both ordinary commercial contract damages[27] and tort recovery arising from breach of the implied covenant.[28] Part III examines the opposition to the quasi-fiduciary characterization.[29] This part criticizes the court's unfortunate choice of the term quasi-fiduciary because it creates unnecessary confusion about the nature of the bank-customer relationship. Since the *Commercial Cotton* court established that a special relationship can exist between

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(1986) (discussing the "traditional relationship" between bank and customer). Tradition as an unreasoned basis for inertia is not new:

> Because of our traditions,
> We've kept our balance for many, many years. . .
> You may ask how this tradition got started
> I'll tell you, I don't know—But it's Tradition
> Tradition, Tradition!

"Tradition", *Fiddler on the Roof* (Liberty/United Records 1971).

[22] *See infra* notes 142-47 and accompanying text.

[23] *See infra* notes 133-39 and accompanying text.

[24] *See infra* notes 42-43 and accompanying text.

[25] *See infra* note 149 and accompanying text. Professor Symons contends that contract principles define the bank-customer relationship. Symons, *supra* note 1, at 222. The "fiduciary" and "debtor-creditor" labels distract attention from these contract principles, thus causing courts to either overly expand or restrict the bank's duties. *Id.* at 224. As Symons says, "claims of debtor-creditor on the one hand and fiduciary on the other obscure the contract principles applicable to middle ground relations." *Id.* at 221. His analysis recognizes that the traditional debtor-creditor approach fails to fully encompass the bank-customer relationship. *Id.* at 222.

[26] *See infra* notes 30-44 and accompanying text.

[27] *See infra* notes 45-68 and accompanying text.

[28] *See id. See generally* Comment, *Bad Faith Revisited: An Examination of Tort Law Remedies For Commercial Contract Disputes*, 34 U. KAN. L. REV. 315, 316 (1985) [hereafter Comment, *Bad Faith Revisited*] ("Courts around the country, following the lead of the California Supreme Court, have recognized an independent tort of 'bad faith'. . . .").

[29] *See infra* notes 110-32 and accompanying text.

the customer and bank, this Comment contends that the term quasi-fiduciary is an unnecessary part of the analysis. Rather, a court considering a customer's claim for tort damages arising from breach of the implied covenant should simply determine whether the customer has in fact established that a special relationship existed. Tort recovery will follow only when the customer satisfies the special relationship test. This focus will prevent the injection of fiduciary principles into every banking relationship and still permit a balancing of economic power between the bank and the customer.

I. California's Recognition of the Special Relationship Features of the Bank-Customer Relationship

In *Commercial Cotton Co., Inc. v. United California Bank*, the California appellate court found that breach of the implied covenant in a bank-customer relationship may give rise to tort damages.[30] In this case, Commercial Cotton, a corporation, maintained a checking account with defendant United California Bank (now First Interstate Bank of California).[31] In 1972, the corporate secretary discovered that a series of checks was missing.[32] She ordered new checks and notified United California Bank personnel of the missing checks, but the account was left open.[33] The bank failed to stop payment on the lost checks.[34]

Four and one half years later, the bank cashed one of the lost checks, which bore two unauthorized signatures, and charged the amount to Commercial Cotton's account.[35] As the plaintiff's account was largely dormant, the corporate president failed to discover the $4000 check until he reviewed the bank statements in preparing tax returns one and a half years later.[36] While admitting its mistake, the bank refused to credit Commercial Cotton's account because the applicable one-year statute of limitations had run.[37]

The plaintiff's tort claims, based in negligence, also alleged that the bank improperly presented its statute of limitations defense.[38] Eleven days prior to officially rejecting the plaintiff's demand, the bank's gen-

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[30] 163 Cal. App. 3d, 511, 516, 209 Cal. Rptr. 551, 554 (1985).
[31] *Id.* at 514, 209 Cal. Rptr. at 553.
[32] *Id.*
[33] *Id.*
[34] *Id.*
[35] *Id.*
[36] *Id.*
[37] *Id.*
[38] *Id.*

eral counsel learned that the California Supreme Court had held the one-year limitation inapplicable when a plaintiff alleges bank negligence.[39] The plaintiff argued that this constituted a breach of the implied covenant of good faith and fair dealing.[40]

The appellate court upheld the trial court's award of tort damages.[41] The court stated that the characteristics of the bank-customer relationship evidenced a "special relationship."[42] These features include the unequal bargaining positions held by the bank and customer and the customer's noneconomic motivation for entering the contract.[43] The special relationship features of the bank-customer contract enable the customer to recover tort damages for breach of the implied covenant of

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[39] Sun 'N Sand v. United Cal. Bank, 21 Cal. 3d 671, 582 P.2d 920, 148 Cal. Rptr. 329 (1978). One of plaintiff's employees embezzled by using forged checks. *Id.* at 678, 582 P.2d at 926, 148 Cal. Rptr. at 335. The California Supreme Court found, in part, that the one-year statute of limitations does not apply when a plaintiff claims that the bank acted negligently. *Id.* at 698-99, 582 P.2d at 938-39, 148 Cal. Rptr. at 347-48.

[40] *Commercial Cotton*, 163 Cal. App. 3d at 516, 209 Cal. Rptr. at 554.

[41] The appellate court disallowed the damages for emotional suffering on the basis of the facts presented. *Commercial Cotton*, 163 Cal. App. 3d at 519, 209 Cal. Rptr. at 555. *See generally* CAL. COM. CODE § 4103(5) (West 1964) ("The measure of damages for failure to exercise ordinary care in handling an item is the amount of the item reduced by an amount which could not have been realized by the use of ordinary care, and where there is bad faith it includes other damages, if any, suffered by the party as a proximate cause."); CAL. COM. CODE § 4103 Cal. comment 4 (West 1964) (stating that the standard for ordinary care in this context is the one used in tort law).

[42] *Commercial Cotton*, 163 Cal. App. 3d at 516, 209 Cal. Rptr. at 554. The court stated:

> [B]anking and insurance have much in common, both being highly regulated industries performing vital public services substantially affecting the public welfare. A depositor in a noninterest-bearing checking account, except for state or federal regulatory oversight, is totally dependant on the banking institution . . . and depends on the bank's honesty and expertise to protect them. While banks do provide services for the depositor by way of monitoring deposits and withdrawals, they do so for the very commercial purpose of making money by using the deposited funds. The depositor allows the bank to use those funds in exchange for the convenience of not having to conduct transactions in cash and the concomitant security in having the bank safeguard them. The relationship of bank to depositors is at least quasi-fiduciary.

Id.; *see also* Comment, *Implied Covenants of Good Faith and Fair Dealing: Loose Cannons of Liability for Financial Institutions?*, 40 VAND. L. REV. 1197, 1220 (1987) (examining the quote above); *see infra* notes 75-83 and accompanying text (discussing the special relationship doctrine).

[43] *See supra* note 42; *see also infra* notes 91-95 and accompanying text (applying the special relationship doctrine to the bank-customer contract).

good faith and fair dealing.[44]

II. Contracts Creating a Special Relationship

A. *Contract Law in the Ordinary Commercial Transaction*

To appreciate the necessity of potential tort recovery for breach of the implied covenant in special relationship contracts, one must first consider the rationale behind contract damages. In the ordinary commercial contract, two parties of roughly equal bargaining strength enter into a mutually advantageous agreement.[45] Both parties seek economic gain.[46] This gain may be in the form of money, goods, or services received.[47] Failure to perform a contractual duty constitutes a breach of contract.[48]

Breach of an ordinary commercial contract gives rise to a claim for compensatory damages as a remedy for economic injuries.[49] Damages

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[44] *See infra* notes 75-106 and accompanying text.

[45] *See, e.g.*, A. Farnsworth, Contracts § 1.2 (1982). Each party to a contract seeks to improve her economic position in a manner agreeable to the other party. *Id.* Suppose a farmer agrees to sell a grocer a bushel of apples for $10. The farmer values the money more than the apples; the grocer values the apples more than the money. Each has improved her economic position.

[46] *See id.* (each party attempts to maximize economic advantage at terms agreeable to the other).

[47] *See id.* at § 1.10 (noting that parties enter contracts for variety of reasons).

[48] *See, e.g.*, 4 A. Corbin, Corbin on Contracts § 943 (1951) (breach of contract always a nonperformance of duty); 1 S. Williston, A Treatise on the Law of Contracts § 1290 (3d ed. 1968) (noting that failure to perform constitutes breach of contract).

[49] Contract damages provide recovery of the *economic* harm the injured party suffers. *See* Cal. Civ. Code § 3300 (West 1970) ("For the measure of damages arising from contract, the measure of damages, except where otherwise provided by this Code, is the amount which will compensate the party aggrieved for all the detriment proximately caused thereby . . . ."); *see id.* at § 3333 ("For the breach of an obligation not arising from contract, the measure of damages . . . is the amount which will compensate for all the detriment proximately caused thereby, whether it could have been anticipated or not."); *see, e.g.*, 11 S. Williston, *supra* note 48, at § 1338. The general purpose of contract law "is, and should be, to put the plaintiff in as good a position as he would have been in had the defendant kept his contract." *Id.* For a breach of contract, damages put the injured party in the economic position she would have held had the contract been fully performed. *Id*; *see also* Cal. Com. Code § 1106 (West 1964) (damages awarded so that "aggrieved party may be put in as good a position as if the other party had fully performed."); J. Calamari & J. Perillo, The Law of Contracts 521 (2d ed. 1977) [hereafter Calamari & Perillo] (law of damages seeks to place aggrieved party in position she would have held had promisor performed); 5 A. Corbin, *supra* note 48, at § 992 (contract damages intended to put injured party in as

for breach of contract must be both foreseeable[50] and certain[51] to permit recovery. The foreseeability requirement enables the parties to accurately assess the risks undertaken at the contract's formation.[52] The certainty requirement limits recovery to economic damages, such as lost profit and costs.[53] By limiting an injured party's recovery to economic damages, foreseeability and certainty prohibit recovery under contract theory for noneconomic harm.[54] Tort law's proximate causation stan-

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good a position as if performance had been rendered as promised), § 1002 (damages traditionally seen as compensation for harm done).

[50] Damages must be foreseeable in the sense that, at the time of contract formation, they were within the parties' contemplation as a probable result of a breach. Hadley v. Baxendale, 9 Ex. 341, 156 Eng. Rep. 145 (1854). In *Hadley* a grist mill operator hired a carrier to transport a broken shaft to a repair shop. *Id.* at 342, 156 Eng. Rep. at 146. Due to the carrier's delay, the mill reopened later than expected. *Id.* at 343, 156 Eng. Rep. at 146. The mill operator sued to recover lost profits. *Id.* The court denied recovery, reasoning that the loss must be "such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it." *Id.* at 341, 156 Eng. Rep. at 151; *see also* A. FARNSWORTH, *supra* note 45, at § 12.14 (remarking on current trend in narrowing the *Hadley* limitations).

[51] *See, e.g.*, A. FARNSWORTH, *supra* note 45, at § 12.15. Contract law limits recovery to damages established with reasonable certainty. *Id*; *see also* Griffin v. Colver, 16 N.Y. 489 (1858) (leading case stating that contract damages must be certain); RESTATEMENT (SECOND) OF CONTRACTS § 352 (1981) ("Damages are not recoverable for loss beyond an amount that the evidence permits to be established with reasonable certainty.").

[52] R. POSNER, THE ECONOMICS OF LAW 94 (2d ed. 1977) (contending that foreseeability requirement forces a party knowing of risk to either take precautions herself or tell other party if she can more effectively guard against the particular danger). *See supra* note 50.

[53] *See supra* note 51.

[54] A tort is a "civil wrong, other than a breach of contract, for which the court will provide a remedy in the form of an action for damages." W. KEETON, D. DOBBS, R. KEETON & D. OWEN, PROSSER & KEETON ON THE LAW OF TORTS 2 (5th ed. 1984) [hereafter PROSSER]. Tort law imposes obligations upon parties wholly separate from those expressly agreed upon. *Id.* at 655. These obligations function as a means of discouraging conduct that may lead to another's injury. *Id.* This injury may be of several types, including economic, mental and emotional. *Id*; *see also* RESTATEMENT (SECOND) OF CONTRACTS § 353 (1981) ("Recovery for emotional disturbance will be excluded unless the breach also caused bodily harm or the contract or the breach is of such a kind that serious emotional disturbance was a particularly likely result."); *see id.* § 355 ("Punitive damages are not recoverable for a breach of contract unless the conduct constituting the breach is also a tort for which punitive damages are recoverable"); *see, e.g.*, Quigley v. Pet, Inc., 162 Cal. App. 3d 885, 887, 208 Cal. Rptr. 394, 399 (1984) (damages for pain and suffering not allowed for breach of commercial contract); Sawyer v. Bank of Am., 83 Cal. App. 3d 135, 145 Cal. Rptr. 623 (1978) (punitive damages disallowed when only theory of liability is breach of contract).

dard permits recovery regardless of the injury's foreseeability.[55] Certainty is not a bar to recovery for noneconomic damages despite the inability to place an exact monetary value on emotional suffering or mental distress. Thus, recovery for emotional damages resulting from a breach of contract are possible only when the breach amounts to a tort.[56]

Under most commercial contracts, contract damages correspond with both parties' expectations and with economic realities.[57] At the outset of the contractual relationship, each party expects that the other will act as promised in the agreement.[58] As a general rule, contract law disregards fault.[59] Courts award contract damages as a means of placing the injured party in the economic position she would have held had the contract been fully performed.[60] Punitive damages are prohibited because they generally place the injured party in a better economic position than she would have otherwise held.[61] The desire to limit contract

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Generally, both foreseeability and certainty must be proven to recover for torts in a contract action. *See* A. FARNSWORTH, *supra* note 45, at § 12.17 (denying recovery of emotional damages in contract cases follows from the requirements of foreseeability and certainty in contract damages; citing *Crisci v. Security Insurance*, 66 Cal. 2d. 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1964), for proposition that breach amounting to a tort gives rise to tort recovery); CALAMARI & PERILLO, *supra* note 51, at 528 (stating that foreseeability and certainty required in breach of contract action).

[55] *See* RESTATEMENT (SECOND) OF CONTRACTS § 352 (1981) ("Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made."); *see also* RESTATEMENT (SECOND) OF TORTS § 435 (1965) (finding foreseeability irrelevant when actor a substantial factor in the injury), *see id.* § 353 comment a (damages for emotional disturbance usually not permitted in contract actions because these damages are not foreseeable and are difficult to establish and measure); PROSSER, *supra* note 54, at 263 (an essential element in tort law is proximate cause, which is the "reasonable connection between the act or omission of the defendant and the damage the plaintiff has suffered").

[56] *See* Comment, *Exemplary Damages in Contract Cases*, 7 WILLAMETTE L. REV. 137 (1971) (noting complainants attempt to state a cause of action sounding in both tort and contract as means of recovering tort damages); *see supra* note 54.

[57] *See infra* notes 48 & 49.

[58] *See* A. FARNSWORTH, *supra* note 45, at § 8.1 (parties assume each will perform).

[59] *See generally* A. FARNSWORTH, *supra* note 45, at § 12.1.

[60] *Id.*

[61] *See* CAL. CIV. CODE § 3294 (West 1970) (disallowing punitive damages awards in contract cases); CAL. COM. CODE § 1106(1) (West 1964) (in breach of contract action, "neither consequential or special nor penal damages" are available); RESTATEMENT (SECOND) OF CONTRACTS § 355 (1981) ("Punitive damages are not recoverable for a breach of contract unless the conduct constituting the breach is also a tort for which punitive damages are recoverable."); A. FARNSWORTH, *supra* note 45, at § 12.8 (no matter how reprehensible the breach, punitive damages not ordinarily awarded for

damages to economic injury arises from the belief that nonperformance achieving economically superior results is preferable to performance.

Nonperformance, because it may achieve economic benefits superior to those possible through full performance, is usually treated as a faultless act giving rise only to contract damages.[62] Economically efficient breach arguably deserves society's approval rather than its condemnation.[63] Efficient breach puts economic resources to their best use, and the injured party receives full compensation for her economic damages.[64] Limiting contract damages to economic loss allows parties to choose economically efficient breach.[65] Noneconomic and punitive damages would discourage some economically efficient breaches in ordinary

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breach of contract); R. POSNER, *supra* note 52, at 143 (since some breaches of contract are economically efficient, permitting punitive damages in contract cases would discourage breaches beneficial to society); Coleman, *Punitive Damages for Breach of Contract: A New Approach*, 11 STETSON L. REV. 250 (1981) (arguing that an "implied in law" duty, such as good faith, fair dealing, and reasonable care, must be violated in a willful and malicious manner for tort damages to arise from contract). *See generally* Kornblum & Olson, *California Leads the Way in Bad Faith But No One Wants to Follow-Recent Trends in California First Party Bad Faith Law*, 14 W. ST. U.L. REV. 37, 38-39 (1986) (observing that denial of punitive damages under California Civil Code § 3294 in contract actions causes plaintiffs to include a related cause of action sounding in tort).

[62] Nonperformance of this type represents an economically efficient breach of contract. *See, e.g.*, R. POSNER, *supra* note 52, at 88-93. Contract law should encourage performance unless an inefficient use of resources would result. *Id.* Suppose a supplier agreed to produce 100 radios for $10 each. She later learns it will cost her $15 to produce each radio. If other suppliers can provide the purchaser with radios at $10 each, economic efficiency results from a breach of the original contract. The purchaser receives the radios and the original supplier does not lose money. *See also* Diamond, *The Tort of Bad Faith Breach of Contract: When, If At All, Should It Be Extended Beyond Insurance Contracts?*, 64 MARQ. L. REV. 425, 437 (1981) ("Were legal liability to exceed the promisee's pecuniary injuries, an efficient reallocation of resources would be discouraged at societal expense.").

See generally RESTATEMENT (SECOND) OF CONTRACTS § 344 (1981) (economically efficient breach of contract encouraged); Barton, *The Economic Basis of Damages for Breach of Contract*, 1 J. LEGAL STUD. 277 (1972) (applying a series of economic formulas to demonstrate, in part, that damages in ordinary commercial contracts should operate to encourage the breaching party to honor the contract when economically efficient and permitting breach when performance inefficient); Diamond, *supra*, at 436-37 (observing that intentional breach of contract furthers social policy in some circumstances).

[63] *See* Diamond, *supra* note 62, at 437 (intentional breach often promotes society's economic efficiency).

[64] *See* R. POSNER, *supra* note 52, at 90 (economic breach maximizes resources' value and recoverable damages compensate expectation interest).

[65] *See* Diamond, *supra* note 62, at 440.

commercial contracts.[66] The benefits of economic efficiency usually justify limiting damages recoverable from a breach of an ordinary commercial contract.[67] The traditional approach to contract damages, however, fails to account for bad faith violation of the implied covenant of good faith and fair dealing.[68]

B. The Implied Covenant of Good Faith and Fair Dealing

Every contract contains an implied covenant of good faith[69] and fair dealing.[70] Breach of the implied covenant occurs whenever a party acting in bad faith injures the other's expectations under the contract.[71]

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[66] *See id.* at 444.

[67] *See* R. POSNER, *supra* note 52, at 88-90. *But see* Diamond, *supra* note 62, at 440-43 (other factors may make breach unjust to injured party and society).

[68] *See* A. FARNSWORTH, *supra* note 45, at § 12.8 (damages in excess of expectation interest not ordinarily allowed for breach regardless how "reprehensible"); *see also* Diamond, *supra* note 62, at 440-41 (damages limited even when breach violates moral and economic concepts of justice). Inadequacy of damages, either in amount or as a deterrent "is, of course, a cornerstone of the judicial policy supporting a tort remedy for violation of the covenant of good faith and fair dealing." Gomez v. Volkswagen of Am., Inc., 169 Cal. App. 3d 921, 928-29, 215 Cal. Rptr. 507, 511 (1985).

[69] *See* CAL. COM. CODE § 1203(19) (West Supp. 1988) (defining good faith as honesty in fact in the transaction or conduct involved); *see also* CAL. COM. CODE § 1203 (West Supp. 1988) ("Every contract or duty . . . imposes an obligation of good faith in its performance or enforcement.").

[70] California law firmly establishes the implied covenant's existence in every contract. CAL. COM. CODE § 1203 (West 1964) ("Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement."); Comunale v. Traders Ins. Co., 50 Cal. 2d 654, 328 P.2d 198 (1958). *See, e.g.*, Coleman v. Gulf Ins. Group, 41 Cal. 3d 782, 718 P.2d 77, 226 Cal. Rptr. 90 (1986); Commercial Cotton Co., Inc., v. United Cal. Bank, 163 Cal. App. 3d 511, 209 Cal. Rptr. 551 (1985); RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981); 3 A. CORBIN, *supra* note 48, at § 541; 5 S. WILLISTON, *supra* note 48, at § 670; 1 B. WITKIN, SUMMARY OF CAL. LAW - CONTRACTS § 576 (8th ed. 1973); Diamond, *supra* note 62, at 425 (covenant implied as matter of law in every contract); Louderback & Jurika, *Standards for Limiting the Tort of Bad Faith Breach of Contract*, 16 U.S.F. L. REV. 187, 193 n.27 (1982) (advocating an expanded application of the implied covenant and its tort remedies); Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195 (1968); *see also* Amos v. Union Oil Co. of Cal., 663 F. Supp. 1027, 1029 (D. Or. 1987) (stating that "Oregon law implies a covenant of good faith and fair dealing as a condition in contracts."); Hubble, *supra* note 15 (discussing Montana's use of the implied covenant); Comment, *Proposed New Tort*, *supra* note 12 (analyzing Missouri's application of the implied covenant). *But see* Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666 (1963) (arguing that an objective standard of good faith should be applied to contracts).

[71] *See* Diamond, *supra* note 62, at 425. A promisor's bad faith conduct endangers

Express violation of the contract is not necessary for a cause of action under the implied covenant.[72] A breach of the implied covenant potentially gives rise to recovery for injuries traditionally recognized under tort theory.[73] However, despite the existence of an implied covenant in every contract, plaintiffs usually cannot recover tort damages for bad faith breach of an ordinary commercial contract.[74] Tort recovery for the implied covenant's breach arises only from contracts creating special relationships.[75]

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the promisee's anticipated benefits. *Id*; *see also*, Summers, *supra* note 70, at 234 (noting that breach of an agreement may be in bad faith and evade the spirit of agreement even though the conduct may be within the contract's terms); Note, *Damage Measurements*, *supra* note 20, at 161. Breach of implied covenant has also been called " 'bad faith' breach of contract." *Id.* A "good faith" breach of contract should not give rise to extra-contractual damages. *Id.* at 181. Ordinary contract damages adequately deter "good faith" breaches. *Id.* at 182. Only "bad faith" breach deserves special treatment. *Id.* at 181.

[72] Breach of the implied covenant occurs whenever the stronger party engages in "bad faith action extraneous to the contract." Khanna v. Microdata Corp., 170 Cal. App. 3d 250, 262, 215 Cal. Rptr. 860, 867 (1985) (quoting Shapiro v. Wells Fargo Realty Advisors, 152 Cal. App. 3d 467, 478-79, 199 Cal. Rptr. 613, 619 (1984)); *see* Diamond, *supra* note 62, at 425 (promisor may breach implied covenant without violating express provisions of contract); Summers, *supra* note 70, at 234 (conduct within letter of agreement may constitute breach of the covenant).

[73] One California court succinctly stated: "While the duty of good faith and fair dealing arises out of a contractual relationship between the parties, breach of the duty and ensuing damages are governed by tort principles." California Casualty Gen. Ins. Co. v. Superior Court, 173 Cal. App. 3d 274, 283, 218 Cal. Rptr. 817, 823 (1985). The California Supreme Court agrees:

> It is well established in this state that if the cause of action arises from a breach of a promise set forth in the contract, the action is ex contractu, ***but if it arises from a breach of a duty growing out of the contract it is ex delicto.***

Tameny v. Atlantic Richfield Co., 27 Cal. 3d 167, 175, 610 P.2d 1330, 1334, 164 Cal. Rptr. 839, 843-44 (1980) (quoting Eads v. Marks, 39 Cal. 2d 807, 811, 249 P.2d 257, 260 (1952))(emphasis in original); *see* Silberg v. California Life Ins., 11 Cal. 3d 452, 460-62, 521 P.2d 1103, 1108-10, 113 Cal. Rptr. 711, 716-18 (1974); Note, *Damage Measurements*, *supra* note 20, at 161 (observing that breach of implied covenant gives rise to both tortious and contractual liability). *See generally* Comment, *Sailing the Uncharted Seas of Bad Faith*: Seaman's Direct Buying Service Inc. v. Standard Oil Co., 69 MINN. L. REV. 1161, 1166-67 (1985) (damages for tortious breach of implied covenant not limited by foreseeability and certainty).

[74] *See supra* note 54 and accompanying text.

[75] In the seminal case of *Comunale v. Traders Insurance Co.*, the California Supreme Court stated that the implied covenant imposes an extra-contractual duty on each party to a contract. Comunale v. Traders Ins. Co., 50 Cal. 2d 654, 328 P.2d 198 (1958). This duty prohibits each party from acting in a manner that will injure the other's rights under the contract. *Id.* at 658, 328 P.2d at 200; *see* Note, *"Contort":*

The special relationship approach to limiting tort recovery for breach of the implied covenant first appeared in *Egan v. Mutual of Omaha Insurance Co.*[76] The *Egan* court focused upon: 1) the public interest in insurance coverage; 2) the insurer's fiduciary responsibilities;[77] 3) the

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Tortious Breach of the Implied Covenant of Good Faith and Fair Dealing in Noninsurance, Commercial Contracts-Its Existence and Desirability, 60 NOTRE DAME L. REV. 510, 513 (1985) [hereafter Note, *Contort*] (stating that California Supreme Court in "seminal" *Comunale* decision found that tort recovery flowed from breach of implied covenant); Note, *The New Tort of Bad Faith Breach of Contract*: Christian v. Home Assurance Corp., 13 TULSA L.J. 605, 608 (1978) (citing *Comunale* as "premier" case in implied covenant's development).

Later California insurance cases expanded upon the *Comunale* court's consideration of the implied covenant. *See* Crisci v. Security Ins. Co., 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1964). In *Crisci*, a tenant sued her landlord alleging negligence. *Id.* at 427, 426 P.2d at 175, 58 Cal. Rptr. at 15. The defendant-insurer rejected settlement offers. *Id.* at 428, 426 P.2d at 175, 58 Cal. Rptr. at 15. The plaintiff-landlord lost the suit, resulting in a jury verdict far larger than the settlement proposals. *Id.* at 428, 426 P.2d at 176, 58 Cal. Rptr. at 16. Her financial losses induced physical and mental harm. *Id.* at 433, 426 P.2d at 179, 58 Cal. Rptr. at 19. The California Supreme Court found that the defendant's rejection of reasonable settlement offers constituted a breach of the implied covenant. *Id.* at 431, 426 P.2d at 176, 58 Cal. Rptr. at 16-17. This covenant requires that "neither party will do anything which will injure the right of the other to receive the benefits of the agreement." *Id.* at 429, 426 P.2d at 176, 58 Cal. Rptr. at 16; *see also* Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973). The plaintiff brought an action against his insurer for failure to pay benefits following a fire at his business. *Id.* at 571, 510 P.2d at 1035, 108 Cal. Rptr. at 483. The defendant-insurer claimed that the plaintiff committed arson. *Id.* The court stated that "[T]he duty violated . . . is a duty imposed by law, not one arising from the terms of the contract itself. In other words, this duty . . . is nonconsensual . . . . Breach of this duty is a tort." *Id.* at 574, 510 P.2d at 1037, 108 Cal. Rptr. at 485; *see also* Jarchow v. Transamerica Title Ins. Co., 48 Cal. App. 3d, 917, 936, 122 Cal. Rptr. 470, 486 (1975) (recognizing that insured seeks the peace of mind and security that insurance provides). *See generally* Hudson v. Moore Business Forms, Inc., 609 F. Supp. 467, 482 (N.D. Cal. 1985) (stating that *Seaman's* "describe[s] the circumstances under which special contractual relationships may justify tort liability, again using the insurance relationship as the paradigm."); Comment, *Expectation of Peace of Mind: Basis for Recovery of Damages for Mental Suffering Resulting from the Breach of First Party Insurance Contracts*, 56 S. CAL. REV. 1345 (1983) (contending that, because mental security represents an essential reason for buying insurance, the expectancy measure of contract damages should be broadened to include recovery for mental suffering damages).

[76] 24 Cal. 3d 809, 817, 598 P.2d 452, 456, 157 Cal. Rptr. 482, 485 (1979) (plaintiff insured argued that defendant insurer failed to properly investigate claim before refusing to pay disability benefits).

[77] *See infra* notes 139-40 and accompanying text (discussing fiduciary principles and the special relationship doctrine).

unequal bargaining powers[78] of the insurer and the insured; and 4) the adhesive nature[79] of the insurance contract.[80] These factors provided the original basis for finding a special relationship between contracting parties in the insurance context.[81]

In Wallis v. Superior Court the California appellate court set forth the five predicate features[82] of a special relationship:

> For purposes of serving as predicates of tort liability, we find that the following "similar characteristics" must be present in a contract: (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 action, 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.[83]

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[78] *See* Amos v. Union Oil Co. of Cal., 663 F. Supp. 1027, 1029 (D. Or. 1987) (implying covenant "where one party has traditionally held superior bargaining power.").

[79] *See infra* notes 88-90.

[80] *Egan*, 24 Cal. 3d at 820, 598 P.2d at 457, 157 Cal. Rptr. at 487.

[81] *Id*; *see also* Louderback & Jurika, *supra* note 70, at 220:

> The tort of breach of the implied covenant of good faith and fair dealing should apply to contracts where there is a marked disparity of bargaining power between the parties resulting in an adhesion contract. A breach of this standardized contract is likely to affect parties other than those in this particular contract. The contract is entered into by the weaker party to secure financial security or peace of mind instead of profit. The contract is personal in nature and involves parties in a quasi-fiduciary relationship in marked contrast to an arm's length transaction. Finally, the object being contracted for is a basic service or necessity.

[82] As one California appellate court recognized:

> The court in *Wallis* also set out the criteria by which a noninsurance contract could be evaluated to determine whether the breach of the implied covenant of good faith and fair dealing gives rise to tort damages. . .

Rogoff v. Grabowski, ___ Cal. App. 3d ___, ___ Cal. Rptr. ___ (1988). *See also* Hudson v. Moore Business Forms, Inc., 609 F.Supp. 467, 482 (N.D. Cal. 1985) (stating that "*Wallis* spells out the factors that must be present to permit a finding of tort liability in a breach of contract and covenant of good faith and fair dealing case.").

[83] Wallis v. Superior Court, 160 Cal. App. 3d 1109, 1118, 207 Cal. Rptr. 123, 129 (1984). One author contends that tort damages do not follow even though a bank customer can establish the existence of an adhesionary contract, a nonprofit motivation, and that contract damages may be inadequate. Comment, *supra* note 21, at 686. This author rejects possible application of the implied covenant doctrine in all banking cases because the plaintiff in *Commercial Cotton* arguably did not demonstrate vulnerability. *Id.* This fact-specific contention would seem to indicate that a customer proving vulner-

A special relationship is a prerequisite to tort recovery under implied covenant analysis.[84] Tort recovery for bad faith breach of the implied covenant arising from a special relationship balances the parties' economic power.[85] Tort damages are appropriate when money damages are an inadequate deterrent to bad faith breach.[86] The balancing of economic power discourages the inefficient, unfair breach likely to occur when one party possesses greater economic power.[87] The special relationship approach also eliminates the inequities arising from "con-

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ability should be able to recover under implied covenant analysis.

[84] Recent case law recognizes that "California law requires as a threshold showing, proof of a special relationship between the parties." Premier Wine & Spirits v. E.J. Gallo Winery, 644 F. Supp. 1431, 1436 (E.D. Cal. 1986) (denying tort recovery in supplier-distributor case). Satisfying the *Wallis* factors meets the threshold requirement. *Hudson*, 609 F. Supp. at 482 ("*Wallis* spells out the factors that must be present to permit a finding of tort liability in a breach of contract and covenant of good faith and fair dealing case."); *see* Gibson v. Government Employees Ins. Co., 162 Cal. App. 3d 441, 208 Cal. Rptr. 511 (1984). In *Gibson*, an insured sued his insurer to recover unreimbursed losses, claiming that the insurer breached its fiduciary duty by failing to tell insured about underinsured motorist coverage and of the inadequacy of his medical coverage. *Id.* at 443, 208 Cal. Rptr. at 512. The court stated that "California law requires, as a threshold showing, proof of a 'special relationship' between the parties characterized by elements of public interest, adhesion and fiduciary responsibility." *Id.* at 446, 208 Cal. Rptr. at 514; *see also* Amos v. Union Oil Co. of Cal., 663 F. Supp. 1027, 1029 (D. Or. 1987) (defendants "must show that the special relationship existed between the parties."); Gianelli Distrib. Co. v. Beck & Co., 172 Cal. App. 3d 1020, 1035, 219 Cal. Rptr. 203, 208 (1985) (California Supreme Court decision noting that implied covenant cases "carefully limit application of the covenant of good faith and fair dealing to situations in which there is a special relationship due to unequal bargaining power or a special element of reliance.") (citing Triangle Mining Co. v. Stauffer Chem. Co., 753 F.2d 734 (9th Cir. 1985)).

[85] *See generally* Note, *Damage Measurements*, *supra* note 20 (examining breach of contract from economic standpoint and concluding that extra-contractual damages enable weaker parties to deal with economically stronger parties on equal basis).

[86] One commentator argues that the influx of mass contracts, which are standardized contracts used in virtually countless transactions, has proven traditional contract damages an inadequate remedy. Slawson, *Mass Contracts: Lawful Fraud in California*, 48 S. CAL. L. REV. 1 (1975). Slawson states: "the traditional measures of damages are insufficient to compensate a consumer who has been the victim of a breach of contract by a mass contractor and are also insufficient to deter a mass contractor from engaging in other breaches of the same kind." *Id.* at 7.

[87] *See* Diamond, *supra* note 62. An injured party may abandon her claim or settle it for an amount far below her actual damages because of the high cost of litigation compared to the amount of the claim. *Id.* at 441; *see also* Note, *Damage Measurements*, *supra* note 20, at 168-69. The failure of traditional contract damages to consider noneconomic loss may increase the stronger party's incentive to breach because of the lower costs involved. *Id. See generally* Louderback & Jurika, *supra* note 70 (contending that tort recovery necessary for proper enforcement of special contracts).

tracts of adhesion" and "standardized contracts."[88] The economically stronger party offers the standardized contract as a preprinted, nonnegotiable form on a take-it-or-leave-it basis.[89] The contract between the bank and customer is a standardized contract.[90]

The *Commercial Cotton* court recognized that the bank-customer contract arises from special relationship features. First, the customer, except for government regulation, is "totally dependant" upon the bank's honesty and expertise.[91] Second, noneconomic motives, primarily convenience and security, encourage customers to open bank accounts.[92]

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[88] California courts have long defined the contract of adhesion as a standardized contract providing the subscribing party one of two choices: adherence or rejection. Neal v. State Farm Ins. Co., 188 Cal. App. 2d 690, 694, 10 Cal. Rptr. 781, 784 (1961), *cited with approval in* Graham v. Scissor-Tail Inc., 28 Cal. 3d 807, 623 P.2d 165, 171 Cal. Rptr. 604 (1981); *see also* Perdue v. Crocker Nat'l Bank, 38 Cal. 3d 913, 925, 702 P.2d 503, 511, 216 Cal. Rptr. 345, 353 (1985) (California Supreme Court Decision stating that "the signature card, drafted by the bank and offered to the customer without negotiation, is a classic example of a contract of adhesion; the bank concedes as much."); Security Pac. Nat'l Bank v. Adamo, 142 Cal. App. 3d 492, 191 Cal. Rptr. 134 (1983). In *Adamo*, a bank brought suit to collect on a promissory note. *Id.* at 495-96, 191 Cal. Rptr. at 136. The court described a contract of adhesion as one drafted and imposed by the party possessing superior bargaining power. *Id.* at 497, 191 Cal. Rptr. at 138. Contracts of adhesion were found unenforceable because they defeat the reasonable expectations of the adhering party. *Id.* The guaranty contract before the court did not meet the court's definition of a contract of adhesion. *Id.* at 498, 191 Cal. Rptr. at 138; *see also* R. POSNER, *supra* note 52, at 84-85 (commenting that preprinted contracts offered on a take-it-or-leave-it basis are often necessary given the large number of contracts the offerer enters into daily); Sybart, *Adhesion Theory in California: A Suggested Redefinition and its Application to Banking*, 11 LOY. L.A.L. REV. 297 (1978) (noting that contract offered by bank to customer possesses all characteristics of contract of adhesion); Tobriner & Grodin, *The Individual Public Service Enterprise in the New Industrial State*, 55 CALIF. L. REV. 1247, 1252 (1968) (stating that contracts of adhesion form part of an individual's "economic environment" and must be accepted by consumers wishing to enter transactions).

[89] *See supra* note 88.

[90] *See infra* notes 97-98.

[91] *Id.*

[92] *Id.* Bank customers rank convenience as the most important motivation for choosing a particular bank. BANK ADMINISTRATION INSTITUTE, CHECKING ACCOUNT USAGE IN THE UNITED STATES: A RESEARCH AND LITERATURE SURVEY 52 (1979). Other important factors include recommendations, helpful personnel, and reputation. *Id.* at 53. *See generally* Note, *Emerging Theories of Bank Liability - The Breach of the Covenant of Good Faith and Fair Dealing*, 103 BANKING L.J. 80, 83-84 (1986) (discussing the "quasi-fiduciary" characterization); Note, *Reviving the Law of Substantive Unconscionability: Applying the Implied Covenant of Good Faith and Fair Dealing to Excessively Priced Consumer Credit Contracts*, 33 UCLA L. REV. 940, 970 (1986) [hereafter Note, *Reviving the Law*] (noting that *Commercial Cotton* court set out "spe-

Third, banks offer "vital" services to the public.[93] The array of federal and state regulation, while currently undergoing dramatic changes, attempts to ensure the availability of these vital services.[94] Breach of the bank-customer contract often denies an individual full access to these essential services.[95]

Despite these special relationship features, critics continue to argue that debtor-creditor contract law governs banking contracts. Debtor-creditor law fails to consider the bank-customer relationship's special

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cific criteria" necessary for allowing tort recovery). While the *Commercial Cotton* court mentions depositors in noninterest-bearing checking accounts, the relatively low amount of interest paid on many accounts, when compared to these noneconomic motives, should not dissuade a court from fulfilling the *Wallis* factors.

[93] Knickerbocker Life Ins. Co. v. Pendleton, 115 U.S. 339 (1885). *See* 1 J. MITCHIE, MITCHIE ON BANKS AND BANKING § 2 (1970) (stating banks are "quasi public" institutions); *see also* Guthrie v. Harkness, 199 U.S. 148 (1905) (stating that banks are public institutions for some purposes even though they may be privately owned); Kruger v. Wells Fargo Bank, 11 Cal. 3d 352, 365, 521 P.2d 441, 448, 113 Cal. Rptr. 449, 456 (1974) (focusing on amount of bank regulation, essential functions banks perform, and influence banks have upon economy in stating that banks are "affected with a public interest") (citing Hiroshima v. Bank of Italy, 78 Cal. App. 362, 248 P. 947 (1926)); Jacques v. First Nat'l Bank of Md., 307 Md. App. 527, 515 A.2d 756 (1986) (stating that the public places enormous trust in banks). *See generally* CAL. FIN. CODE § 362(a) (West 1968) (requiring prospective banks to provide for public convenience and advantage).

The California Supreme Court enumerated the elements of a contract affecting public interest in Tunkl v. Regents of the Univ. of Cal., 60 Cal. 2d 92, 383 P.2d 441, 32 Cal. Rptr. 33 (1963). The *Tunkl* court listed six elements of a public interest contract: 1) business in question generally suitable for public regulation; 2) one party performs service of great importance to public; 3) one party holds itself out as willing to perform service for anyone meeting set requirements; 4) service often of practical necessity to public; 5) party seeking to limit liability through contract has superior bargaining position; and 6) contract offered is one of adhesion. *Id.* at 98-100, 383 P.2d at 445-46, 32 Cal. Rptr. at 37-38.

[94] *See, e.g.*, 1 J. MITCHIE, *supra* note 93, at § 3. Banks come under both federal and state regulation. *Id.*; BLUEPRINT FOR REFORM, *supra* note 1, at 8. Three federal agencies — the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve — and their state counterparts regulate banks. BLUEPRINT FOR REFORM, *supra* note 1, at 8.

[95] *See* Note, *Damage Measurements*, *supra* note 20. A bank may wrongfully deduct one dollar from each depositor's account. *Id.* The bank will profit because it is unlikely that each customer will discover and recover the missing dollar. *Id.* Government regulation does not effectively guard against this type of injury. *Id.*; *see also* Perdue v. Crocker Nat'l Bank, 38 Cal. 3d 928, 702 P.2d 503, 216 Cal. Rptr. 345 (1985). The plaintiff-customers brought a class action against defendant bank. *Id.* They alleged that the bank's six dollar service charge on bounced checks was unconscionable and represented a breach of the implied covenant of good faith and fair dealing. *Id.*

features of the bank-customer relationship.[96] Rather, the traditional view holds that the injured customer is limited to recovery of ordinary contract damages.

C. The Bank-Customer Contract and its Special Relationship Character

The signature card the customer signs upon opening her account and making a deposit[97] represents a standardized contract between herself and the bank.[98] The majority view traditionally holds that a debtor-creditor relationship arises from this contract.[99] Under debtor-creditor

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[96] *See infra* notes 102-05.

[97] A "deposit" in the banking context is the "placing of money, checks, and the like with a bank." 5A J. MITCHIE, MITCHIE ON BANKS AND BANKING § 3 at 15 (1983).

[98] *See* Blackmon v. Hale, 1 Cal. 3d 548, 556, 463 P.2d 418, 422, 83 Cal. Rptr. 194, 198 (1970), *cited with approval in* Bullis v. Security Pac. Nat'l Bank, 21 Cal. 3d 801, 811, 582 P.2d 109, 114, 148 Cal. Rptr. 22, 27 (1978) ("The bank is authorized to honor withdrawals from an account on the signatures authorized by the signature card, which serves as a contract between the depositor and the bank for the handling of the account"); Fleming v. Bank of Va., 343 S.E.2d 341, 344 (Va. 1986) (signature card is a contract); *see also* TEX. REV. CIV. STAT. ANN. ART. § 342-701 (Vernon 1988) ("The depository contract between a bank and a depositor, whether evidenced by deposit tickets, signature cards . . . or otherwise shall be deemed a contract in writing for all purposes.").

[99] Early treatises state the common law view that the debtor-creditor characterization applies to the bank-customer relationship. *See, e.g.*, 2 J. MITCHIE, BANKS AND BANKING § 119 (1913). The depositor becomes a creditor upon placing a sum of money with the bank. *Id.* The bank as debtor owes a duty to return the sum to the customer upon demand. *Id.*; *see also* J. MORSE, TREATISE ON THE LAW OF BANKS AND BANKING § 289 (4th ed. 1903).

The majority viewpoint still adheres to the debtor-creditor characterization. *See, e.g.*, Bank of Marin v. England, 385 U.S. 99, 101 (1966) (stating that "[t]he relationship of bank and depositor is that of debtor and creditor, founded on contract."); Basch v. Bank of Am., 22 Cal. 2d 316, 321, 139 P.2d 1, 5 (1943) ("It is settled law that a bank in receiving ordinary deposits becomes the debtor of the depositor."); Morse v. Crocker Nat'l Bank, 142 Cal. App. 3d 228, 232, 190 Cal. Rptr. 839, 842 (1983) (stating "it is axiomatic that the relationship is debtor-creditor"); ALA. CODE § 5-1A-9 (Supp. 1986) ("A deposit to a bank . . . creates the relationship of debtor and creditor between the depositor and the depository institution."); TENN. CODE ANN. § 45-1-103(7) (1988) (definition of "deposit" states that a debtor-creditor relationship arises from a deposit to a bank).

Additionally, many states — including New York, Wyoming, Texas, and South Dakota - directly follow the official Uniform Commercial Code approach discussed below. RESTATEMENT (SECOND) OF PROPERTY § 12 comment e (1954) ("a general deposit of money in a bank does not create a trust, but a relation of debtor and creditor, . . . the depositor having in addition to his rights as creditor certain contract rights against the bank."); *see also* B. CLARK, BANKS AND BANKING 231 (rev. ed. 1981):

law, the bank simply owes a duty to return the deposited funds upon demand.[100] Bad faith refusal to honor a check drawn on the customer's account, failure to stop payment upon request, or dispersal of funds to an unauthorized person breaches the bank-customer contract.[101] A breach of this duty by the bank enables the injured customer to recover only those damages available under contract theory.[102]

By restricting recovery to contract damages, the debtor-creditor characterization fails to accord with implied covenant law.[103] The *Commercial Cotton* court, by recognizing the special relationship character of the bank-customer relationship, demonstrates the inadequacy of the traditional debtor-creditor analysis.[104] The traditional view fails to

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> The legal rights and duties imposed by the [bank-customer] relationship are governed primarily by Part 4 of Article 4, sections 4-401 through 4-407 of the Uniform Commercial Code (UCC). Although Article 4 does not say so it is fundamental that the relationship is, at bottom, one between creditor and debtor.

Contra Symons, *supra* note 1, at 222 ("The statutorily elaborated rights and duties found in Part 4 of Article 4 of the Uniform Commercial Code further evidence that this common bank-customer relation typically encompasses more than the rights and duties commonly connoted as the substance of debtor-creditor."). *See generally* CAL. FIN. CODE § 953 Notes of Decisions (West 1968) (citing cases limiting bank's liability for unauthorized withdrawal to that arising from the debtor-creditor relationship); 5A J. MITCHIE, *supra* note 93, at § 1 (including an extensive list of cases from every American jurisdiction supporting the debtor-creditor characterization); 1 A. SCOTT, THE LAW OF TRUSTS § 12.9 (4th ed. 1987) ("In the case of an ordinary general deposit the relation between the bank and the depositor is that of debtor and creditor. . . ."); Friedman & Friesen, *A New Paradigm for Financial Regulation: Getting from Here to There*, 43 MD. L. REV. 413, 460 n.252 (1984) ("The basic rule established by the case law is that the relationship between a bank and its depositors is that of debtor-creditor, not of agent and principal.").

[100] *See* 5A J. MITCHIE, *supra* note 93, at § 1. The contract between the bank and its customer requires return of the deposit upon demand. *Id.* Typically, this demand takes the form of a check, a withdrawal slip, or use of an automatic teller. *Id.*; *see also Basch*, 22 Cal. 2d at 321, 139 P.2d at 5 ("settled law" that bank as debtor to depositor relieves its contractual duty by discharging its indebtedness upon demand).

[101] *See* L. SIMPSON, HANDBOOK ON THE LAW OF CONTRACTS 377 (2d ed. 1965) (unjustified failure to perform when required constitutes breach of contract entitling injured party to damages).

[102] *See* 5A J. MITCHIE, *supra* note 93, at § 1; *see also supra* note 49 (discussing damages recoverable under contract theory and prohibition against tort recovery for breach of ordinary commercial contract).

[103] *See supra* notes 49-56.

[104] *Commercial Cotton*, 163 Cal. App. 3d at 511, 209 Cal. Rptr. at 551. Two earlier California decisions applied the implied covenant to the bank-customer contract in a limited fashion. Sawyer v. Bank of Am., 83 Cal. App. 3d 135, 145 Cal. Rptr. 623 (1978); Wagner v. Lloyd's Bank, 101 Cal. App. 3d 27, 161 Cal. Rptr. 516 (1980). In

account for the special relationship doctrine. One commentator opposing the implied covenant's application in this context concedes that the bank-customer relationship may fulfill the *Wallis* factors.[105]

Tort recovery flows from a bad faith breach of the implied covenant in the bank-customer relationship because of its special relationship character.[106] The potential recovery of tort damages in addition to contract damages discourages banks from committing a bad faith breach of the bank contract.[107] The added measure of damages gives the customer the economic means of ensuring continued availability of fair banking

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Sawyer, the court stated that tort recovery for bad faith breach of the implied covenant becomes available only when the bank acts with the intent to frustrate the customer's enjoyment of her contract rights. *Sawyer*, 83 Cal. App. 3d at 139, 145 Cal. Rptr. at 625. Here, the bank resisted its liability in good faith. *Id.* at 139, 145 Cal. Rptr. at 626. The dissent, however, stated that breach of the implied covenant constitutes a separate tort. *Id.* at 141, 145 Cal. Rptr. at 627.

In *Wagner*, the court recognized the implied covenant's existence in the borrower-lender relationship. *Wagner*, 101 Cal. App. 3d 33, 161 Cal. Rptr. at 520. The court noted that other courts restricted tort recovery for bad faith breach of the implied covenant to insurance cases. *Id.* (citing Glendale Fed. Sav. & Loan v. Marina View Heights Dev. Co., 66 Cal. App. 3d 101, 135 Cal. Rptr. 802 (1977)). The *Wagner* court found the bank's actions nontortious. *Id.*

The California Supreme Court's discussion of the implied covenant in *Seaman's Direct Buying Service, Inc. v. Standard Oil Co.* provided the link between insurance contracts and other agreements. Seaman's Direct Buying Serv., Inc. v. Standard Oil Co., 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984). In *Seaman's*, the defendant refused to acknowledge a contract between itself and the plaintiff. *Id.* at 762, 686 P.2d at 1167, 206 Cal. Rptr. at 358. This contract was essential to plaintiff's bid on a marina development project. *Id.* at 759, 686 P.2d at 1161, 206 Cal. Rptr. at 356. The California Supreme Court permitted recovery under a bad faith breach of contract action and reversed judgment for breach of the implied covenant. *Id.* at 769, 686 P.2d at 1172, 206 Cal. Rptr. at 362. The court noted that

> in holding that a tort action is available for breach of the [implied covenant], we have emphasized the *special relationship* between the insurer and insuree, characterized by elements of public interest, adhesion and fiduciary duty . . . No doubt there are other relationships with similar characteristics and deserving of a similar treatment.

Id. at 768-69, 686 P.2d at 1167, 206 Cal. Rptr. at 362. *See generally* Note, *Reviving the Law*, *supra* note 42, at 967 (stating that the *Seaman's* decision demonstrates that courts refuse to limit tort recovery for bad faith breach of implied covenant to insurance cases). *But see* Comment, *Bad Faith Revisited*, *supra* note 29, at 331 (stating that *Seaman's* created tort of bad faith denial of contract rather than an extension of implied covenant).

[105] *See* Comment, *supra* note 21, at 686 & n.394.

[106] *Id.* at 517, 209 Cal. Rptr. at 554.

[107] *See supra* notes 62-66 and accompanying text.

services.[108] Controversy arose quickly, however, because the *Commercial Cotton* court chose to characterize the bank-customer special relationship as "quasi-fiduciary."[109]

III. Opposition to the Quasi-Fiduciary Characterization

In recognizing that a bank and its customer may enter into a special relationship, the *Commercial Cotton* court balances the parties' relative economic power. Unfortunately, the court chose to call this special relationship a quasi-fiduciary one. The threatened injection of fiduciary principles into every bank-customer relationship has generated opposition to the *Commercial Cotton* holding.[110]

At first glance, the fears of disastrous liability resulting from the quasi-fiduciary characterization are understandable. While attempts to define "fiduciary" have failed to "pin down" its exact nature, several features of a fiduciary's role have emerged.[111] A fiduciary assumes onerous duties because of the trust and confidence the beneficiary, the weaker party, places in her.[112] As a result, the fiduciary must act in the best interests of the beneficiary[113] and with "strict honesty and candor."[114] Hostility to the quasi-fiduciary characterization stems from

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[108] *See supra* note 66 and accompanying text.

[109] *Id.* at 516, 209 Cal. Rptr. at 554. *Accord* Barrett v. Bank of Am., 178 Cal. App. 3d 960, 224 Cal. Rptr. 76, 80 (1986) (relationship of bank to customer at least "quasi-fiduciary"). *See generally* Schechter, *The Principal Principle: Controlling Creditors Should be Liable for Their Debtor's Obligations*, 19 U.C. Davis L. Rev. 875, 940 n.223 (1986) (mentioning that *Commercial Cotton* court termed relationship "quasi-fiduciary" because banks hold vital position in economy and come under high degree of regulation; author suggests, however, that rule of case limited to facts before *Commercial Cotton* court); Tobriner, *supra* note 88, at 1253.

[110] *See* 5A J. Mitchie, Mitchie on Banks and Banking § 1 (Supp. 1986) (contending that no fiduciary relationship exists between bank and customer as matter of law).

[111] J. Shepherd, Law of Fiduciaries 3 (1981). *See* G. Bogert, Trusts (6th ed. 1987); A. Scott & W. Fratcher, The Law of Trusts (4th ed. 1987); E. Vinter, History and Law of Fiduciary Relationships and Resulting Trusts (3d ed. 1955); Hagedorn, *Fiduciary Aspects of the Bank-Customer Relationship*, 34 Mo. B.J. 406 (1978) [hereafter Hagedorn, *Fiduciary Aspects*]; Hagedorn, *The Impact of Fiduciary Principles on the Bank-Customer Relationship in Washington*, 16 Willamette L. Rev. 803 (1980) [hereafter Hagedorn, *Impact*].

[112] *See* Comment, *supra* note 19, at 797 (stating that fiduciary duties arise "whenever confidence is reposed on one side, and domination and influence on the other.") (citing Black's Law Dictionary 563 (5th ed. 1979)).

[113] *See* Restatement (Second) of Trusts § 2 comment b (1959) (fiduciary "is under a duty not to profit at the expense of the other.").

[114] G. Bogert, *supra* note 111, at 2. Chief Judge Cardozo, in an often quoted

concerns that banks will be forced to carry out overly burdensome duties.[115]

Judicial opposition to the quasi-fiduciary characterization exists both outside and inside California.[116] Other jurisdictions refuse to follow *Commercial Cotton*'s lead in redefining the bank-customer relationship as quasi-fiduciary.[117] Many of these same jurisdictions statutorily define the bank-customer relationship as being one of debtor and creditor.[118] Commentators generally agree that the traditional debtor-creditor approach imposes lighter duties upon banks.[119]

Disagreement over the correct characterization exists within California as well. A split of opinion between the first and the fourth appellate districts surfaced following *Commercial Cotton*.[120] The first district maintains the traditional debtor-creditor approach[121] while the fourth

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passage, described a fiduciary's duties:

> Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd.

Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928) (citation omitted); *see* Scott, *The Fiduciary Principle*, 37 CALIF. L. REV. 539, 555 (1949).

[115] *See, e.g.*, Comment, *supra* note 19; Comment, *supra* note 21.

[116] *See infra* notes 118-21 and accompanying text.

[117] *See, e.g.*, Barnett Bank of West Fla. v. Hooper, 498 So. 2d 923, 925 (Fla. 1986) ("the usual relationship between a bank and its customer is one of debtor to creditor"); Green Property Corp. v. O'Callaghan, Saunders & Stumm, P.C., 340 S.E.2d 652, 654 (Ga. App. 1986) ("A deposit of money in a bank on general deposit creates the relation of debtor and creditor between the bank and depositor.") (citing White v. Georgia R.R. Bank & Trust Co., 30 S.E.2d 118, 120 (Ga. App. 1944)); Moore v. State Bank of Burden, 729 P.2d 1205, 1210 (Ka. 1986) ("It is well recognized that the relationship between a general depositor and his or her bank is that of creditor and debtor."); Texas Bank & Trust Co. v. Spur Sec. Bank, 705 S.W.2d 349, 352 (Tex. App. 1986) ("Ordinarily, funds placed with a bank become general deposits owned by the bank, and create a debtor-creditor relationship between the bank and the customer.").

[118] *See supra* note 99.

[119] *See, e.g.*, B. CLARK, THE LAW OF BANK DEPOSITS § 2.1 (1981) (stating that Article 4 of U.C.C. holds the relationship to be debtor-creditor); NORTON & WHITELY, BANKING LAW MANUAL § 11.04(2) (1986) (citing *Bank of Marin* to support contention relationship is debtor-creditor).

[120] *See infra* notes 121-22 and accompanying text.

[121] *See, e.g.*, Estate of Davis, 171 Cal. App. 3d at 854, 858, 217 Cal. Rptr. 734, 736

now accepts the quasi-fiduciary characterization.[122]

Reluctance to recognize the recharacterization stems from a desire to limit the damages flowing from a breach of contract.[123] Moreover, some courts and commentators fear that the recharacterization bridges tort recovery and ordinary commercial contracts.[124] This extension of tort recovery, the opposition contends, would hinder contract formation,[125] discourage efficient breach of contract in good faith,[126] and subsume contract law.[127] These concerns fail to recognize that tort recovery, hinged upon finding a special relationship, cannot flow from breach of the ordinary commercial contract.[128] As the *Commercial Cotton* court recognized, special relationship features distinguish the bank-customer contract from the ordinary commercial contract.[129]

Legislative proposals opposing the quasi-fiduciary characterization compound rather than resolve the debate.[130] Following *Commercial Cotton*, California State Senator Beverly introduced a bill that origi-

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(1st Dist. 1985) (Justice Reynoso favored granting the petition) ("On the deposit of funds in a bank, the relation between the bank and depositor is that of debtor and creditor; the contract of the bank is to pay the money deposited only to the depositor."). A recent first district decision suggests that this district may soon accept *Commercial Cotton*'s recharacterization. Multiplex Ins. Agency, Inc. v. California Life Ins. Co., 189 Cal. App. 3d 925, 235 Cal. Rptr. 12 (1987) (arguing that special relationship finding in *Commercial Cotton* valid but unnecessary, as defendant bank's acts clearly tortious).

[122] *Commercial Cotton* 163 Cal. App. 3d 511, 209 Cal. Rptr. 551 (4th Dist. 1985).

[123] *See, e.g.*, Note, "*Contort*", *supra* note 75, at 529 (arguing that courts should only allow tort recovery when defendant committed an independent intentional tort; otherwise business contracts will be discouraged because of uncertain potential liability); Comment, *supra* note 42, at 1198 (favoring a reshaping of traditional contract damages rather than permitting tort liability). *See generally* Note, *Tort Remedies for Breach of Contract: The Expansion of Tortious Breach of the Implied Covenant of Good Faith and Fair Dealing into the Commercial Realm*, 86 COLUM. L. REV. 377 (1986) (supporting a broadening in scope of traditional contract damages).

[124] *See generally* G. GILMORE, DEATH OF CONTRACT (1972) (positing a merging of tort and contract law).

[125] *See* Diamond, *supra* note 62, at 523 (arguing that tort recovery for bad faith breach of ordinary commercial contracts would severely restrict contract formation), 447 (fear of tort recovery hinders entering of contracts parties would have formed in good faith).

[126] *Id.* at 447 (fear of tort liability should not be so great as to dissuade efficient breach in good faith).

[127] *See* Note, "*Contort*", *supra* note 75, at 523 (extension of tort recovery to ordinary commercial contracts would replace breach of contracts as theory of recovery), 526 (courts often cannot distinguish between bad faith and breach of contract actions).

[128] *See supra* note 84 and accompanying text.

[129] *See supra* notes 42-44 and accompanying text.

[130] *See infra* notes 131-32 and accompanying text.

nally would have defined the bank-customer relationship as one of debtor and creditor.[131] This proposal, however, never made its way out of committee because of an inherent contradiction in later versions of the proposal.[132]

The bill, by focusing on the court's characterization of the relationship as quasi-fiduciary rather than on the underlying special relationship analysis, epitomizes the flaw in the opposition's logic.

A. The Special Relationship Test Correctly and Adequately Identifies Those Bank-Customer Relationships Potentially Giving Rise to Tort Recovery

The opposition to the *Commercial Cotton* ruling quarrels with its quasi-fiduciary characterization.[133] Later courts have exacerbated the controversy by adopting the quasi-fiduciary characterization without explanation.[134] *Commercial Cotton's* critics contend that imposing fiduciary duties upon a bank is rarely appropriate.[135] Although attorneys

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[131] Proposed SB 1924 (1986). This proposal stated:

> Under existing law, in the absence of an agreement establishing a different relationship, the courts have generally held that relationship between a financial institution and its depositors to be that of debtor and creditor. However, in certain instances the courts have held this relationship to impose more duties upon the bank than those applicable to a mere debtor.
>
> This bill would specify that in the absence of a written agreement to the contrary, the relationship of a bank . . . to its customers, as defined, is that of debtor and creditor.
>
> The bill would state that it is declaratory of existing law, but intended to abrogate contrary rules of existing judicial decisions, as specified. *The bill would state that [it] does not impair or restrict causes of action based on breach of contract or tort, or foreclose actions for breach of express fiduciary duties.*

Id. (emphasis in original).

[132] Proposed SB 1924 (amended May 14, 1986). Later versions of the bill excepted causes of action arising from breach of the implied covenant. *Id.*; *see also* MEMORANDUM, GOOD FAITH DUTY SUB-COMMITTEE, FINANCIAL INSTITUTIONS COMMITTEE OF THE BUSINESS LAW SECTION OF THE STATE BAR OF CALIFORNIA (June 19, 1986) (noting that amended language permitting *Commercial Cotton*'s rejection of debtor-creditor approach to stand while expressly approving debtor-creditor characterization in same document).

[133] *See supra* notes 110-32.

[134] Several California courts have adopted the quasi-fiduciary characterization without discussion. *See, e.g.*, Multiplex Ins. Agency, Inc., v. California Life Ins. Co., 189 Cal. App. 3d 925, 235 Cal. Rptr. 12 (1987); Barrett v. Bank of Am., 183 Cal. App. 3d 1362, 229 Cal. Rptr. 16 (1986).

[135] "Certainly banks and other lenders are often held to fiduciary duties, even though

are the fiduciaries of their clients, and trustees are the fiduciaries of their beneficiaries, bankers arguably do not owe the same loyalty to depositors.[136]

It is unclear whether banks are the fiduciaries of their ordinary depository customers. While some of the features of fiduciary status—disparate economic power, nonprofit motivation, and reposing of trust and confidence[137]— are present in the bank-customer relationship, other features are not.[138] Despite both *Commercial Cotton*'s quasi-fiduciary characterization and recent commentary,[139] a finding of a fiduciary relationship is not a prerequisite to establishing tortious breach of the implied covenant.

Fiduciary principles are inappropriate as part of implied covenant analysis for two reasons. California law does not require a showing of a fiduciary relationship under implied covenant analysis. The employer-employee relationship gives rise to tort recovery for breach of the implied covenant even though the employer is not the fiduciary of the employee.[140] Rather, the employment relationship comes under the ru-

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they are seldom called fiduciaries." J. SHEPHERD, *supra* note 111, at 31. Even those writers who recognize that fiduciary duties may arise from banking relationships limit application of these principles to bank-borrower situations. *See, e.g.*, Hagedorn, *Fiduciary Aspects*, *supra* note 111; Hagedorn, *Impact*, *supra* note 111; Tettenborn, *The Fiduciary Duties of Banks*, 1980 J. BUS. L. 10; Comment, *Trust and Confidence and the Fiduciary Duty of Banks in Iowa*, 35 DRAKE L. REV. 611, 612-13 & n.16 (1985-86).

[136] Attorneys and doctors comprise the two groups generally associated with fiduciary duties. *See, e.g.*, J. SHEPHERD, *supra* note 111; Hageborn, *Impact*, *supra* note 111.

[137] *See supra* notes 111-14 and accompanying text.

[138] The similarity between the *Wallis* features and fiduciary relationships may also add to the confusion. Shepherd lists the following among the features of a fiduciary relationship: (1) one party has sufficient power to create unequal bargaining positions; (2) the existence of reasonable reliance on the advice of another; and (3) one party holds superior information. J. SHEPHERD, *supra* note 111, at 35-42.

[139] *See, e.g.*, Comment, *supra* note 19; Comment, *supra* note 21.

[140] Next to the insurer-insured relationship, the employer-employee relationship has generated the greatest application of the implied covenant doctrine. A trilogy of cases, Tameny v. Atlantic Richfield, Pugh v. See's Candies, and Cleary v. American Airlines, form the foundation for the tort's extension into the employment context. Tameny v. Atlantic Richfield Co. 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980); Pugh v. See's Candies, 116 Cal. App. 3d 311, 171 Cal. Rptr. 917 (1981); Cleary v. American Airline, Inc., 111 Cal. App. 3d 433, 168 Cal. Rptr. 722 (1980). In Khanna v. Microdata Corp., 170 Cal. App. 3d 250, 262, 215 Cal. Rptr. 860, 867 (1985), the court, in laying out a detailed history of the implied covenant's application in the employment context, stated that "several cases subsequent to *Cleary* have acknowledged the implied covenant . . . is implied by law in employment contracts."

See generally Haggerty, *Breach of the Implied Covenant of Good Faith and Fair*

bric of implied covenant law because of its special relationship features.[141] The two relationships, insurance and employment, in which tort recovery for breach of the implied covenant is unarguably permitted do not uniformly impose fiduciary duties on the stronger party. Thus, the criticism that the bank-customer relationship does not possess a fiduciary component should not prevent tort recovery for breach of the implied covenant.

The special relationship test, as defined by the *Wallis* factors, highlights the second basis for disregarding the quasi-fiduciary controversy. The *Commercial Cotton* quasi-fiduciary characterization, while inaccurately describing the relationship, does not negate the fact that the court applied and satisfied the special relationship test.[142] Apparently, the court attempted to strengthen its decision by including discussion of the three features—public interest, adhesionary contract, and fiduciary duty—mentioned in the California Supreme Court's landmark case on implied covenant doctrine, *Seaman's Direct Buying Service, Inc. v. Standard Oil Co.*[143] These three factors are not the *sine qua non* of implied covenant analysis: the *Seaman's* court recognized as much when it stated that "no doubt there are other relationships with similar characteristics and deserving of similar treatment."[144] *Commercial Cotton*'s gesture to *Seaman's* three factors was unnecessary, as the post-*Seaman's* cases demonstrate.[145] California courts should not, and do not, require customers to establish a fiduciary relationship as a predicate to tort recovery. Rather, the courts recognize that the plaintiff

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Dealing in Employment Contracts: From Here to Longevity and Beyond, 14 W. ST. U.L. REV. 445 (1987); Lempert, *California's Other Lottery: Tort Actions on the Implied Covenant of Good Faith and Fair Dealing*, 7 GLENDALE L. REV. 169, 181-86 (1987) (examining implied covenant and wrongful discharge); Comment, *Proposed New Tort*, *supra* note 12, at 437-39 (discussing California's application of implied covenant to employment cases).

[141] *See supra* note 140.

[142] *See supra* note 42 (describing *Commercial Cotton*'s application of the special relationship test).

[143] The *Seaman's* court stated: "In holding that a tort action is available for breach of the covenant in an insurance contract, we have emphasized the 'special relationship' between insurer and insured, characterized by elements of public interest, adhesion, and fiduciary responsibility." Seaman's Direct Buying Serv., Inc. v. Standard Oil Co., 36 Cal. 3d 752, 768, 686 P.2d 1158, 1166, 206 Cal. Rptr. 354, 362 (1984) (citing Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 820, 620 P.2d 141, 146, 169 Cal. Rptr. 691, 696 (1979)).

[144] *Seaman's*, 36 Cal. 3d at 769, 686 P.2d at 1166, 206 Cal. Rptr. at 363.

[145] Courts applying the *Wallis* test do not rely on *Seaman's* fiduciary language. *See supra* note 143.

must establish a special relationship.[146] The *Wallis* factors are the method of satisfying this burden. These factors do not mention fiduciary duty as a predicate to recovery.

By describing the bank-customer relationship as quasi-fiduciary, the *Commercial Cotton* characterization muddied the waters. However, this does not detract from the fundamental finding of a special relationship between a customer and her bank. Except under limited circumstances, a bank does not assume fiduciary duties on behalf of a customer.[147] But the *Commercial Cotton* court's special relationship analysis delineates the features that justify tort recovery for customers. As discussed in Part II, ordinary contract damages do not provide the weaker party with an adequate economic weapon to discourage inefficient bad faith breach. Moreover, there is no rational explanation why the weaker party in special relationships arising from insurance and employment contracts should have this economic weapon while bank customers should be limited to contract damages. Furthermore, strong public policy supports giving customers the power necessary to protect their access to fair banking services, for the banking industry is replete with "public interest" qualities.[148]

For these reasons, bank customers satisfying the *Wallis* criteria, and thereby establishing a special relationship with their bank, should be permitted to recover tort damages for breach of the implied covenant of good faith and fair dealing. The quasi-fiduciary characterization is unnecessary under special relationship analysis and leads to unfounded fears of disastrous liability. By simply dropping *Commercial Cotton*'s quasi-fiduciary characterization as unneeded dicta, fears of injecting fiduciary principles into every banking relationship become unwarranted. Similarly, the traditional debtor-creditor characterization should not preclude tort recovery by plaintiffs establishing a special relationship simply because historical contract law denies it.[149]

The correct reading of *Commercial Cotton* and the special relationship test arising from implied covenant doctrine establishes the special relationship test as a prerequisite to tort recovery. If the customer satisfies a court that the *Wallis* factors are present, tort recovery for breach of the implied covenant should follow. Conversely, an inability to make

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[146] *See supra* note 75 (listing cases employing the special relationship test).

[147] *See supra* note 136 and accompanying text.

[148] *See supra* notes 1-4 and accompanying text (discussing importance of banking to public).

[149] *See supra* notes 100-02 and accompanying text (discussing traditional debtor-creditor characterization).

out the *Wallis* factors of a special relationship, not dusty convention and unfounded fears, should limit the bank customer to ordinary contract damages. This method will allow customers to recover for damages to their noneconomic interests and balance the economic power between the bank and the customer, thus discouraging inefficient, bad faith breach of the implied covenant of good faith and fair dealing.

CONCLUSION

Every contract in California contains an implied covenant of good faith and fair dealing under which neither party may act in bad faith to deny the other the benefits of the contract. To dissuade economically stronger parties from committing such breach, California courts permit weaker parties to recover tort damages as a means of compensating their nonprofit motivation for entering certain contracts and to deter inefficient breach of these contracts. However, only contracts that possess "special relationship" characteristics give rise to tort recovery. Although California has firmly established the implied covenant doctrine in insurance and employment cases, the extension of tort recovery to the bank-customer relationship in *Commercial Cotton Co., Inc. v. United California Bank* has generated hostility. By eliminating *Commercial Cotton*'s quasi-fiduciary characterization, the special relationship nature of the bank-customer relationship stands out. Courts should continue to permit plaintiff-customers to prove a special relationship between themselves and the defendant-bank. If the customer can establish the *Wallis* factors, she demonstrates that contract damages are inappropriate in light of her vulnerability, her nonprofit motivation, the adhesionary nature of the banking contract, and the disparate bargaining positions. By balancing the disparate bargaining positions through potential tort recovery for breach of the implied covenant of good faith and fair dealing, California courts will deter deterioration of important banking services and mitigate any harms stemming from the growing trend toward deregulation.

*Terence S. Morrow**

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* To my parents, without whom this author would not have been possible.