Good Faith Revisited

Extra-contractual duties in Texas.

BY T. RAY GUY

The imposition of a duty of good faith and fair dealing into a relationship otherwise defined by a contract is generally perceived as a development favorable to the potential plaintiff. First and perhaps most obvious, it may give the plaintiff an additional common law cause of action, in tort, separate and apart from contract or statutory claims. Second, the duty owed by the defendant may sound amorphous and plaintiff-friendly in a jury instruction as compared to the specific obligations owed under the applicable contract. Third, the tort remedy won't be subject to contractual restrictions that limit the contract claims. Fourth, with the addition of a common law cause of action the measures of recoverable damages expand beyond those that would be available for breach of contract, and—again—won't be subject to contractual limitations such as preclusion of consequential damages. Fifth, the tort remedy opens up the potential for *punitive damages*.

Years ago, in *Federal Deposit Ins. Corp. v. Coleman*,[1] the Texas Supreme Court held that the FDIC, as successor to a failed bank, did not owe a duty of good faith to guarantors of a secured loan and therefore was not liable for allegedly unreasonably delaying foreclosing on the collateral in a declining market—and accordingly affirmed summary judgment for the FDIC.

Has anything changed in the almost three decades since the *Coleman* decision?

The Texas Supreme Court and "Special Relationships"

In Texas, breach of a contract ordinarily brings about only contract, rather than tort, liability and damages. Although the Texas Supreme Court held long ago that every contract includes "a common-law duty to perform with care, skill, reasonable expedience and faithfulness the thing agreed to be done …" and that "a negligent failure to observe any of these conditions is a tort …"[2] the court later clarified that holding by stating that a breach of contract would support recovery in tort only if the conduct in question would give rise to liability even in the absence of a contract.[3] "[A] party to a contract is free to pursue its own interests, even if it results in a breach of that contract, without incurring tort liability."[4]

Courts in other states read into every contract an implied covenant or duty of good faith and fair dealing, such that "neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract …"[5] The Second Restatement of Contracts pronounces that "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and enforcement."[6]

When first given the opportunity, the Texas Supreme Court declined to impose such a duty:

> "This concept is contrary to our well-reasoned and long-established adversary system … To adopt the laudatory sounding theory of 'good faith and fair dealing' would place a party under the onerous threat of treble damages should he seek to compel his adversary to perform according to the contract terms as agreed upon by the parties. The novel concept … would abolish our system of government according to settled rules of law and let each case be decided upon what might seem 'fair and in good faith,' by each fact finder. This we are unwilling to do."[7]

Thereafter, the Supreme Court found it appropriate to impose such a duty in certain specific relationships deemed "special" because of the circumstances existing between the parties. First came *Manges v. Guerra*,[8] involving the relationship between non-executive working interest owners and the holder of the executive right in a mineral lease. Without explicitly calling the relationship "special," the court found that Texas common law required the executive to exercise "utmost good faith" toward the non-executive owners.[9] *Arnold v. National County Mut. Fire Ins. Co.*[10] and *Aranda v. Ins. Co. of North America*[11] followed, in which the court held that a duty of good faith was owed by insurer to insured:

> In the insurance context a special relationship arises out of the parties' unequal bargaining power and the nature of insurance contracts which would allow unscrupulous insurers to take advantage of their insureds' misfortunes in bargaining for settlement or resolution of claims. In addition, without such a cause of action insurers can arbitrarily deny coverage and delay payment of a claim with no more penalty than interest on the amount owed.[12]

Next came *Coleman*. The 8th Court of Appeals in El Paso, "Assuming the existence of a duty of good faith …,"[13] found a material issue of fact whether the FDIC's delay in foreclosing on the collateral amounted to a breach of that duty. Reversing, the Supreme Court summarized: "The Court has consistently held … that a duty of good faith is not imposed in every contract but only in special relationships marked by shared trust or an imbalance in bargaining power."[14] The court found that neither the mortgagor-mortgagee nor

the creditor-guarantor relationship ordinarily imported a duty of good faith.

The Supreme Court has not further extended the common law duty of good faith and fair dealing. In *City of Midland v. O'Bryant*,[15] the court declined to impose a duty of good faith and fair dealing on employers. Thus, as far as our Supreme Court is concerned, the only relationships deemed "special" and meriting the imposition of such a duty remain that of insurer to insured and executive rights holder to non-executive mineral interest owners. Various courts of appeals have observed the same limitation, declining to find special (for example) the relationships between parties to a development agreement,[16] between franchisor and franchisee,[17] between lender and borrower,[18] and between insurance company and insurance broker.[19]

UCC Obligation of Good Faith Distinguished

Texas *does* recognize the obligation, imposed by the uniform commercial code, or UCC, of "good faith in [the] performance and enforcement" of every contract or duty governed by the UCC.[20] "Good faith" for purposes of the UCC was initially defined simply as "… honesty in fact in the conduct or transaction concerned …" With the 2003 amendments,[21] the definition became more expansive: "… honesty in fact and the observance of reasonable commercial standards of fair dealing."[22]

Obviously, "honesty in fact" is a lower standard than honesty coupled with "reasonable commercial standards of fair dealing." For example, in *Coleman*, the Supreme Court rejected the guarantors' UCC duty of good faith claim as failing to allege lack of honesty in fact: "The guarantors' complaint in this case is not that the FDIC was dishonest, but that it was not diligent. The UCC does not require diligence for good faith."[23] The result might not have been different under the 2003 amended language absent an express obligation in this guaranty for the lender to promptly foreclose. The Section 1.304 duty of good faith differs from the common law duty applicable to Texas special relationships in that its violation does not amount to a separate cause of action in tort; rather, it aids in determining whether the conduct in question contravenes an existing contractual obligation, supporting a claim for breach of contract.[24]

In short, the UCC duty of good faith is more broadly applicable, but the common law duty of good faith more significantly alters the litigation landscape in the context of the limited relationships in which it applies.

Fiduciary Duties Distinguished

A second distinction is between the duty of good faith and fair dealing, on the one hand, and *fiduciary* duties, on the other. The breach of a fiduciary duty is a tort and will support tort remedies including, in appropriate circumstances,

punitive damages. Fiduciary duties are imposed as a matter of law in certain relationships, such as attorney-client or trustee-beneficiary or among partners.[25] But a fiduciary relationship can also arise "… informally from 'moral, social, domestic or purely personal' relationships. … The existence of the fiduciary relationship is to be determined from the actualities of the relationship between the persons involved."[26] It is the possibility of imposing an extra-contractual duty *based on the facts of the individual case* that starkly differentiates breach-of-fiduciary-duty claims from claims based on the duty of good faith and fair dealing.

Unfortunately, courts sometimes confuse the two doctrines and analyze a breach-of-good-faith claim by purporting to determine whether a special relationship existed between the particular parties before the court.[27] But a careful reading of the Supreme Court pronouncements makes clear that a duty of good faith and fair dealing is imposed on specific *types* of relationship—such as, again, insurer-insured—rather than case-by-case based on the peculiar facts of the connection between the individual parties to a case at hand.[28]

The bar for proving an individual-relationship fiduciary duty is high. *Coleman*, for example, involved the relationship between parties to a commercial loan transaction. By the time the case was argued to the Supreme Court, Texas courts had shown themselves reluctant to find a fiduciary relationship between borrower and bank or other lender, even under circumstances sympathetic to the borrower—for example, a "long-standing banker-depositor relationship" in which the bank officer testified that the banker-customer relationship involved a "kind of trust relationship,"[29] or the relationship between illiterate immigrant farm workers and a creditor they had known for years and who had collected rents for them.[30] Conversely—and appropriately—the *consequences* of imposing a fiduciary duty are greater than those that accompany the "special relationship" duty of good faith and fair dealing: "The duty of good faith and fair dealing merely requires the parties to 'deal fairly' with one another and does not encompass the often more onerous burden that requires a party to place the interest of the other party before his own, often attributed to a fiduciary duty."[31]

Conclusion

The duty of good faith and fair dealing remains an outlier in Texas common law, imposed only in specific relationships deemed by our Supreme Court as "special" and therefore appropriate for the implication of such a duty for the protection of the disadvantaged party. **TBJ**

Notes

1. *Federal Deposit Ins. Corp. v. Coleman*, 795 S.W.2d 706 (Tex. 1990).
2. *Montgomery Ward & Co. v. Scharrenbeck*, 146 Tex. 153, 204 S.W.2d 508, 510 (1947).
3. *Southwestern Bell Telephone Co. v. DeLanney*, 809 S.W.2d 493, 494-95 (Tex. 1991).
4. *Crim Truck & Tractor Co. v. Navistar Intern. Transp. Corp.*, 823 S.W.2d 591, 595 (Tex. 1992).
5. *Kirk La Shelle Co. v. Paul Armstrong Co.*, 263 N.Y. 79, 87 (1933).
6. Restatement (Second) of Contracts § 205 (1979).
7. *English v. Fischer*, 660 S.W.2d 521, 522 (Tex. 1983). The dissent, 660 S.W.2d at 525, cited and quoted Restatement § 205; the majority did not.
8. *Manges v. Guerra*, 673 S.W.2d 180 (Tex. 1984).
9. *Id.* at 183-84. The court also characterized the duty—arising from the relationship between the parties, rather than by contract—as a fiduciary duty.
10. *Arnold v. National County Mut. Fire Ins. Co.*, 725 S.W.2d 165 (Tex. 1987).
11. *Aranda v. Insurance Co. of North America*, 748 S.W.2d 210, 215 (Tex. 1988) (workers' compensation carrier owes a common law duty of good faith and fair dealing to an injured worker), *overruled, Tex. Mut. Ins. Co. v. Ruttiger*, 381 S.W.3d 430, 446 (Tex. 2012) (duty no longer owed in light of 1989 amendments to the Workers' Compensation Act).
12. *Arnold*, supra n.10, 725 S.W.2d at 167.
13. *Coleman v. Federal Deposit Ins. Corp.*, 762 S.W.2d 243, 244 (Tex. App.—El Paso 1988), *rev'd*, 795 S.W.2d 706 (Tex. 1990).
14. 795 S.W.2d at 708-09.
15. *City of Midland v. O'Bryant*, 18 S.W.3d 209, 216 (Tex. 2000).
16. *Affiliated Capital Corp. v. Southwest, Inc.*, 862 S.W.2d 30, 34 (Tex. App.—Houston [1st Dist.] 1993, writ denied).
17. *Barrand, Inc. v. Whataburger, Inc.*, 214 S.W.3d 122, 139 (Tex. App.—Corpus Christi-Edinburg 2006, writ denied).
18. *UMLIC VP LLC v. T&M Sales*, 176 S.W.3d 595, 612 (Tex. App.—Corpus Christi-Edinburg 2005, writ denied) (citing *Coleman*).
19. *Casteel*, 3 S.W.3d 582, 590 (Tex. App.—Austin 1997), *rev'd in part and aff'd in part on other grounds*, 22 S.W.3d 378 (Tex. 2000).
20. Tex. Bus. & Comm. Code § 1.304.
21. Acts 2003, 78th Leg., ch. 542, eff. Sept. 1, 2003.
22. Tex. Bus. & Comm. Code § 1.201(b)(20).
23. *Federal Deposit Ins. Corp. v. Coleman*, 795 S.W.2d at 708. *See also Powell v. Stacy*, 117 S.W.3d 70 (Tex. App.—Fort Worth 2003, no pet.) ("[T]here is no evidence that the Stacys or their attorney acted dishonestly." *Id.* at 74).
24. *See* Tex. Bus. & Comm. Code § 1.304 cmt. 1. "In the absence of a specific duty or obligation in the contract to which the good-faith standard can be tied, the obligation of good faith under the UCC will not support a claim for damages." *Apache Corp. v. Dynegy Midstream Services*, 214 S.W.3d 554, 563 (Tex. App.—Houston [14th Dist.] 2006), *aff'd in part and rev'd in part on other grounds*, 294 S.W.3d 164 (Tex. 2009).
25. *Thigpen v. Locke*, 363 S.W.2d 247, 253 (Tex. 1962).
26. *Id.*
27. *See, e.g., Security Bank v. Dalton*, 803 S.W.2d 443, 449 (Tex. App.—Fort Worth 1991, writ denied); *Affiliated Capital Corp.*, 862 S.W.2d 30, 34 (Tex. App.—Houston [1st Dist.] 1993, pet. denied).
28. *See, e.g., Arnold*, 725 S.W.2d at 167 ("*In the insurance context* a special relationship arises out of the parties' unequal bargaining power and the nature of insurance contracts which would allow unscrupulous insurers to take advantage of their insureds' misfortunes in bargaining for settlement or resolution of claims.") (emphasis added).
    In *FDIC v. Perry Brothers, Inc.*, 854 F. Supp. 1248 (E.D. Tex. 1994), *aff'd in part and vacated in part*, 68 F.3d 466 (5th Cir. 1995), the district court ruled that a bank was liable to its borrower for violation of a supposed duty of good faith and fair dealing, holding that, "The answer to the question whether such a duty exists *in a particular case* depends on the factual setting …" 854 F. Supp. at 1259 (emphasis added). The 5th Circuit reversed this portion of the judgment: "Although … this particular relationship between Perry Brothers and Nationsbank may have been infused with elements of trust and confidence that arguably surpassed the customary relationship between a bank and its customers … we cannot say that any inherent feature of this *or any other lender-debtor relationship* marks it as 'special,' as the Texas cases have used this term." 68 F.3d 466 (emphasis added).
29. *Consolidated Bearing and Supply Co. v. First Nat. Bank at Lubbock*, 720 S.W.2d 647, 650 (Tex. App.—Amarillo 1986, no writ).
30. *Trevino v. Sample*, 565 S.W.2d 93 (Tex. Civ. App.—El Paso 1978, writ ref'd n.r.e.).
31. *Crim Truck*, *supra* n.4, 823 S.W.2d at 594.

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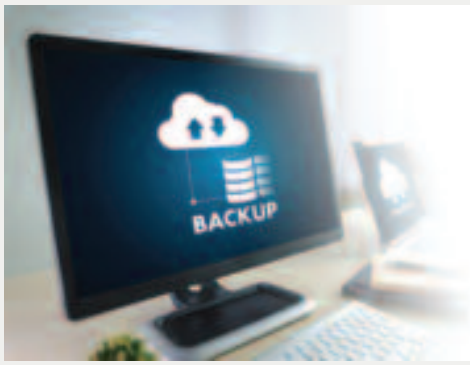

How to Restore and Backup—Your Firm

Plan your backup with the restore in mind

The first and most important data to target for backup is data your firm uses daily. Consider this from the point of view of restoring business as usual: *if all my data were lost, what data will I need today, this week, to meet my clients' needs?* Secondly, target supporting data like logos and advertising along with mandatory archives like financial data and historical data. Targeting the essential data makes the restoration process faster and more efficient, shortening your down time. Old school full backup of everything feels reassuring, but it's a time-consuming mess to restore.

Choose the ideal place to store the backup—with the restore in mind

Backups protect you from daily mishaps, viruses, and worst-case "total loss" scenarios like ransomware attacks and natural disasters. The backup should be safely out of harm's way, but also accessible from anywhere in case you need to relocate temporarily. Traditional tape and drive backup solutions require hands-on handling and storage logistics. Over the past decade these have been replaced by fully automated, offsite backup service providers.

Pick the right backup (and restore) provider

Look at the provider like any other new business partner. Is their website professional and does it provide answers to your questions? Are the basics like physical address, email, and phone number easy to find? Do they answer the phone and without hesitation and advise you on the best way to backup and restore your data?

Focus on restoration. Anyone can make a backup (copy) of your data, but few have the knowledge and processes in place to build an easily restorable data set. Remember, you have time to plan and execute your backup, but restoration is urgent, so pick a backup provider with a restore-focused mission.

Compare cost, but don't get cheap

Your data is your business, your business is your data! How do you value your data? Very simple, imagine coming to work tomorrow and everything is gone, every single computer is empty. Like anything else, you get what you pay for, so pick the provider and solution that focuses on the swift restore of your business rather than just storing your data at a low cost. The cost of securing the restoration of your business is minuscule compared to the alternative, so choose wisely.

Use your gut feeling

This is about protecting your business and putting its restoration in the hands of a partner that you trust and feel good about. Make sure they answer all your questions, explain the solution, and follow up with you. Make them earn your business, don't just give it to them.