

4.10 BILATERAL CONTRACTS

J. IMPLIED TERMS — COVENANT OF GOOD FAITH AND FAIR DEALING (Approved 9/2009; Revised 12/2011)¹

In addition to the express terms of a contract, the law provides that every contract contains an implied covenant of good faith and fair dealing. This means that, even though not specifically stated in the contract, it is implied or understood that each party to the contract must act in good faith and deal fairly with the other party in performing or enforcing the terms of the contract.²

To act in good faith and deal fairly, a party must act in a way that is honest and faithful to the agreed purposes of the contract and consistent with the reasonable expectations of the parties.³ A party must not act in bad faith,

¹ See Chapter Two, “Employment Law Charges,” for model charge regarding the Covenant of Good Faith and Fair Dealing in the context of an employment contract See Charge 2.15.

² See *Sons of Thunder, Inc. v. Borden, Inc.*, 148 N.J. 396 (1997); *Pickett v. Lloyd’s*, 131 N.J. 457, 467 (1993); *Onderdonk v. Presbyterian Homes*, 85 N.J. 171, 182 (1981); *Bak-A-Lum Corp. v. Alcoa Bldg. Prods. Inc.*, 69 N.J. 123, 129-130 (1976); *Ass’n Group Life, Inc. v. Catholic War Veterans*, 61 N.J. 150, 152 (1972); *Palisades Properties, Inc. v. Brunetti*, 44 N.J. 117, 130 (1965).

³ The *U.C.C.* addresses the issue. “Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.” *N.J.S.A.* 12A:1-203. Good faith is generally defined as “honesty in fact in the conduct or transaction concerned.” *N.J.S.A.* 12A:1-201(19). “Good faith in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.” *N.J.S.A.* 12A:2-103(b). Although the *U.C.C.* governed in *Sons of Thunder, Inc.*, *supra*, the Court stated that the common law duty also influenced the Court’s analysis. *Sons of Thunder, Inc. v. Borden, Inc.*, *supra*, at 420-421.

dishonestly, or with improper motive to destroy or injure the right of the other party to receive the benefits or reasonable expectations of the contract.⁴

There can be no breach of the implied covenant of good faith and fair dealing unless the parties have a contract.⁵ Additionally, the implied covenant of good faith and fair dealing may not override an expressly granted right under the contract. For example, an implied covenant of good faith and fair dealing may not override an express provision in the contract giving one party the right to terminate the contract and the party's motive in terminating the contract under such circumstances may be irrelevant.⁶ A party must still, however, act in good faith in the performance of the contract until the termination actually takes

⁴ *Brunswick Hills Racquet Club, Inc. v. Route 18 Shopping Center Assoc.*, 182 N.J. at 230-231 (2005); *Wilson v. Amerada Hess Corp.*, 168 N.J. 236, 251 (2001) (citations omitted); *Sons of Thunder, Inc. v. Borden, Inc.*, *supra*, at 420. See also *Wade v. Kessler Institute*, 172 N.J. 327 (2002); *Palisades Properties, Inc. v. Brunetti*, *supra*, at 117.

⁵ *Wade v. Kessler Institute*, *supra*, at 345 (expressly emphasizing there can be no breach of the implied covenant of good faith and fair dealing in the absence of a contract).

⁶ See *Sons of Thunder, Inc. v. Borden, Inc.*, *supra*, at 417 (“We agree...that the implied covenant of good faith and fair dealing cannot override an express termination clause”); *Id.* at 423 (“[W]here the contractual right to terminate is express and unambiguous, the motive of the terminating party is irrelevant. . . .As stated previously, we agree with that view of the law”); see also *Prudential Stewart Realty v. Sonnenfeldt*, 285 N.J. Super. 106, 110 (App. Div. 1995), *certif. denied*, 143 N.J. (1996) (party does not breach implied duty of good faith and fair dealing, in exercising contractual right to terminate after six months, regardless of party's motives); *Karl's Sales & Service, Inc. v. Gimbel Bros., Inc.*, 249 N.J. Super. 487, 495 (App. Div. 1991), *certif. denied*, 127 N.J. at 548 (1991).

place.⁷ Thus, even though the party complies with the express contract term entitling him to terminate the contract, he may still be in breach of the covenant of good faith and fair dealing if he fails to act in good faith and deal fairly until the contract is actually terminated.

There are many forms of conduct that might constitute a violation of good faith and fair dealing, but each case is fact-sensitive.⁸ In order for you to find

⁷ *Sons of Thunder, Inc. v. Borden, Inc.*, *supra*, at 419 (although the duty does not trump an express termination clause, the court still “must determine whether ... [party] performed its obligations in good faith.”); *Id.* at 421-424 (party with express termination right must still perform contract in good faith and fairly).

⁸ *Price v. New Jersey Manufacturers Insurance Company*, 182 N.J. 519 (2005) (an insurance company, as the dominant party, has an even greater obligation than the insured to act in good faith; it must not put technical encumbrances or hidden pitfalls in the way of unsophisticated customers that would undermine their reasonable expectations.); *Silvestri v. Optus Software, Inc.*, 175 N.J. 113 (2003) (a subjective standard that governs satisfaction clauses in employment contracts obliges the employer to act honestly in accordance with his duty of good faith and fair dealing, but genuine dissatisfaction of the employer, honestly held, is sufficient for discharge.); *Wilson v. Amerada Hess Corp.*, *supra*, at 251 (in action by gasoline company franchisees against the franchisor and supplier of gasoline products, the plaintiffs alleged that the defendant had breached the implied covenant of good faith and fair dealing in the performance of the parties’ contract provision whereby defendant had the unilateral right and discretion to set the price for the gasoline. The Court held that the discretion afforded to *Hess* under the contract was not “unbridled discretion.” Rather, *Hess*’s performance is tempered by the implied covenant of good faith and fair dealing and the reasonable expectations of the parties. “[A] party exercising its right to use discretion in setting price under a contract breaches the duty of good faith and fair dealing if that party exercises its discretionary authority arbitrarily, unreasonably, or capriciously, with the objective of preventing the other party from receiving its reasonably expected fruits under the contract.”); *R.J. Gaydos Insurance Agency, Inc. v. National Consumer Insurance Company*, 168 N.J. 255 (2001) (a common law cause of action for breach of the implied duty of good faith and fair dealing cannot be brought when that claim is based solely on allegations that the defendant violated the *Fair Automobile Insurance Reform Act*).

See also, *Wood v. New Jersey Manufacturers Insurance Co.*, 206 N.J. 562 (2011) (Plaintiff, a mail carrier, filed the underlying personal injury action after she was attacked and seriously injured by the insureds’ dog. Plaintiff rejected the insurer’s \$300,000 settlement offer, but

that there has been a breach of the implied covenant of good faith and fair dealing in this case, the plaintiff must prove to you that the defendant, with no legitimate purpose: 1) acted with bad motives or intentions or engaged in deception or evasion in the performance of contract; and 2) by such conduct, denied the plaintiff of the bargain initially intended by the parties.⁹

The plaintiff in this case claims that the defendant breached the implied covenant of good faith and fair dealing by [*give brief statement of plaintiff's*

repeatedly asserted that she would have accepted a settlement near the \$500,000 policy limits. Plaintiff, replying on *Rova Farms Resort, Inc. v. Investors Insurance Co. of America*, 65 N.J. 474 (1974), placed the insurer on notice that if she recovered a verdict in excess of the policy limits, she would look to the insurer for the excess. The trial resulted in a verdict in the Plaintiff's favor in excess of the policy limits. The insureds assigned their *Rova Farms* claim to the Plaintiff and she then brought a declaratory judgment action. The Appellate Division did not reach the issue of the right to a jury trial, leaving it on remand to the discretion of the trial court. The Supreme Court granted certification limited to the question of whether an insured's claims of bad faith are to be decided by a judge or jury. The Supreme Court found that regardless of the label that the Plaintiff put on the action, *Rova Farms* bad faith claim was a breach of contract claim and, thus, it was an action at law triable to a jury).

⁹ In *Brunswick Hills Racquet Club, Inc. v. Route 18 Shopping Center Assoc.*, *supra*, the plaintiff, a tennis club tenant, failed to properly exercise the express terms of an option agreement to purchase the occupied premises from its commercial landlord. Plaintiff sued, alleging that the landlord's evasive tactics caused the tenant to lose its option to buy the tennis club under the lease. In finding that the landlord had breached the covenant of good faith and fair dealing, the Supreme Court clarified the proof standards for a breach of good faith and fair dealing claim: "Proof of 'bad motive or intention' is vital to an action for breach of the covenant." *Id.* at 225. The Court also stated that the party claiming a breach "must provide evidence sufficient to support a conclusion that the party alleged to have acted in bad faith has engaged in some conduct that denied the benefit of the bargain originally intended by the parties." *Id.* at *Williston on Contracts*, Sec. 63:22. Finally, the Court sets forth a "general rule" that "'subterfuges and evasions' in the performance of a contract" violate the covenant, even if the actor believes his conduct to be justified." *Id.* at *Restatement (Second) of Contracts*, Sec. 205, comment d (1981).

claim of breach]. To prevail on this claim, the plaintiff must prove each of the following three elements by a preponderance of the evidence:

First, the plaintiff must prove that some type of contract existed between the parties.¹⁰ There can be no breach of the covenant of good faith and fair dealing unless the parties have a contract.

Second, the plaintiff must prove that the defendant acted in bad faith with the purpose of depriving the plaintiff of rights or benefits under the contract.

Third, the plaintiff must prove that the defendant's conduct caused the plaintiff to suffer injury, damage, loss or harm. I will now discuss each of these elements separately.

Was there a contract between the parties?

You must first determine whether some type of contract existed between the plaintiff and the defendant.¹¹

1. Express or Implied Contract

[Instruct the jury on the legal principles that apply to the particular contract. See Model Civil Jury Charge 4.10E.]

¹⁰ For example, the contract could involve the employer's obligation to pay commissions, fringe benefits, bonuses, or other compensation. It could also be a contract to employ the individual for a certain period or a contract arising out of an employee handbook.

¹¹ If the parties agree that a contract existed, the jury should be so instructed.

If you find that a contract existed between the parties, you must then determine whether the defendant violated the implied covenant of good faith and fair dealing.

Did the defendant act in bad faith with the intent to deprive the plaintiff of rights or benefits under the contract?

As to this element, you must decide whether the defendant acted with bad faith to interfere with the plaintiff's right to receive the benefits of the contract. Proof of bad motive or intention is essential to a claim that the defendant has violated the covenant of good faith and fair dealing.

In considering what constitutes bad faith, you should consider a number of factors, including the expectations of the parties and the purposes for which the contract was made. You should also consider the level of sophistication between the parties, whether the parties had equal or unequal bargaining power, and whether the defendant's action involved the exercise of discretion.

Keep in mind, however, that bad faith is not established by simply showing that the defendant's motive for his/her actions did not consider the best interests of the plaintiff. Contract law does not require parties to behave thoughtfully, charitably or unselfishly toward each other.¹²

¹² *Wilson v. Amerada Hess Corp.*, *supra*, at 251.

In order for the plaintiff to prevail on his/her claim, you must specifically find that bad faith motivated the defendant's actions. A defendant who acts in good faith on an honest, but mistaken, belief that his/her actions were justified has not breached the covenant of good faith and fair dealing.¹³

Whether the defendant's conduct caused the plaintiff to suffer injury, damage, loss or harm

The plaintiff must also prove that because of the defendant's actions, the plaintiff was unable to realize the benefits of the contract [*describe the specific losses alleged by the plaintiff*].

In summary, if you find that the plaintiff has proven by a preponderance of the evidence: (1) the existence of some type of contract; (2) that the defendant, although acting consistent with the contract's terms, acted in bad faith with the intent to deprive the plaintiff of his/her reasonable expectations under the contract; and (3) the plaintiff sustained injury or loss as a result of such action, then you must find for the plaintiff.

If you find that the plaintiff has failed to prove any of these elements by the preponderance of the evidence, you must find for the defendant.

¹³ *Silvestri v. Optus Software, Inc., supra.*