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NOTE

TORT LIABILITY FOR BAD FAITH IN MONTANA: THE END OF THE STORY

William V. Roth*

[T]he 'tort tail' has begun to wag the 'contract dog.'

—The Montana Supreme Court[1]

I. INTRODUCTION

In 1990, the Montana Supreme Court stemmed a 5-year rise in bad faith tort claims for breach of commercial contracts. The court's decision in *Story v. City of Bozeman* marked a turning point in Montana's bad faith contract law. The *Story* court moved away from applying the bad faith tort to all contracts by adding a special relationship test.[2] The court's decision in *Story* ended Montana's controversial reign as the only state in the nation to allow tort damages for a bad faith claim arising from a contract between commercial parties dealing at arms length.[3] *Story* signifies not only a return to traditional contract theory, but also the court's attempt to redefine its contract law principles in the face

* Thanks to Christopher J. Flann, M. Scott Regan, and Jon O. Shields for much needed editorial assistance.

1. Story v. City of Bozeman, 242 Mont. 436, 445, 791 P.2d 767, 772 (1990).

2. See *infra* Parts III-IV for a discussion of the *Story* special relationship test and its impact on Montana case law.

3. California, the state credited with developing the bad faith tort, never, in its own estimation, applied the bad faith theory to contracts between commercial parties to the extent that Montana did. Freeman & Mills, Inc. v. Belcher Oil Co., 900 P.2d 669, 677 (Cal. 1995). In *Freeman & Mills*, the California Supreme Court overruled itself and forbade tort damages for breach of the covenant (and bad faith denial of contract) outside of the insurer/insured context. *Id.* at 680. The court also thoroughly discussed the evolution of bad faith contract denial in California case law and gave an overview of the theory's scholarly criticism. *Id.* at 674-79.

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of legislative action preempting the law governing contract disputes.[4]

This Note examines the *Story* decision and its impact on claims for tortious bad faith in Montana from both a legal and theoretical perspective. Part II begins the traditional casenote component of this Note by describing Montana's development of tort damages for bad faith. Part III examines the *Story* opinion and analyzes its substantive changes to the elements of a bad faith tort claim. Part IV concludes the legal analysis of *Story* by summarizing the Montana Supreme Court's handling of post-*Story* bad faith claims and emphasizes the pivotal role of the *Story* special relationship test in subsequent bad faith suits.

Part V begins the theoretical component of this Note. The first half compares the economic implications of the efficient breach model for contract damages with tort liability for bad faith. The second half considers legislative action banning tort damages in certain contracts as a reaction in the political economy to the common law bad faith tort. Finally, Part VI brings together the legal note and theoretical components of this Note. It concludes that the *Story* special relationship test, in conjunction with statutory bans, effectively eliminates tort damages for bad faith in Montana. In light of theoretical arguments, the final part of this Note discusses the desirability of Montana's return to the efficient breach doctrine of contract law and the need for an impartial judiciary to shape a fair, but economically sound, contract law.

II. BACKGROUND

A. *Case Law Developments Before* Story

In the United States, including Montana,[5] courts traditionally follow the famous English decision of *Hadley v. Baxendale* when awarding contract damages.[6] In common law, *Hadley*

4. The tone of legislation covering related areas of the law might influence judicial rulings. Judge Richard A. Posner stated that "[judge's rulings will reflect the] original tenor of legislation . . . . If judges did not decide questions of statutory interpretation so, the independence of the judiciary would cease to perform an essential function . . . and might therefore be reduced by the legislature, with a concomitant loss of judicial power." RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW § 19.7, at 535 (4th ed. 1992). For similar reasons, the court might act to reshape its common law where the legislature consistently acted to preempt the area.

5. Stovall v. Watt, 187 Mont. 439, 451-52, 610 P.2d 164, 171 (1980) (Sheehy, J., dissenting); *see also Story*, 242 Mont. at 450-51, 791 P.2d at 776. Montana codified the *Hadley* rule for contract damages at MONT. CODE ANN. § 27-1-311 (1995).

6. 9 Ex. 341, 156 Eng. Rep. 145 (1854). The Montana Supreme Court de-

stands for the rule that a non-breaching party's contract damages cannot exceed the value of the agreement lost as a result of the breach, in addition to any other damages naturally flowing from, and within contemplation of, the breaching party at the time of contract.[7] *Hadley* damages compensate the non-breaching party's loss resulting from breach, but unlike tort damages, serve no punitive role to deter parties from breaching. In fact, traditional American jurisprudence permits a party to deliberately breach a contract if the party is willing to compensate the other side for the value of the broken agreement.[8] Proponents of *Hadley* justify the cap on damages precisely because it allows parties the freedom to breach, an option which legal theorists term "efficient breach."[9] At least one legal historian, Professor Richard Danzig, has argued that the *Hadley* court revolutionized contract law by extending a special exception to tortious damages for contract breach.[10] Professor Danzig believes that the English Court of Exchequer's decision to limit damages in contract law reflected the impact of laissez-faire industrialism on England's jurisprudence in 1854.[11]

In America, the *Hadley* restriction on the size of damages and the availability of efficient breach fit in well with our juris-

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scribed the codification of the *Hadley* rule in Montana as follows:

> The general rule of Hadley v. Baxendale . . . is embodied in our section 17-301, R.C.M.1947, which provides that the measure of damages in a contract breach is the amount which will compensate the party aggrieved for all the detriment proximately caused thereby, or which, in the ordinary course of things, would be likely to result therefrom.

Laas v. State Highway Comm., 157 Mont. 121, 131, 483 P.2d 699, 704 (1971).

7. The *Hadley* court set out the following rule:

> Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract, or 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.

Hadley, 9 Ex. at 354, 156 Eng. Rep. at 151.

8. *See* Oliver W. Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897) ("The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it,—and nothing else.").

9. *See* POSNER, *supra* note 4, § 4.8, at 118-19.

10. Richard Danzig, Hadley v. Baxendale: *A study in the Industrialization of the Law*, 4 J. LEGAL STUD. 249, 264-65 (1975) *reprinted in* RICHARD DANZIG, THE CAPABILITY PROBLEM IN CONTRACT LAW 88-89 (1978) (describing the influence of a statutory limit for damages against common carriers on the *Hadley* court).

11. *Id.* at 259-60.

prudential scheme[12] until courts recognized certain types of contract breach which offended traditional notions of fair play. The limited scope of *Hadley* contract damages, by definition, did not deter defendants from repeating these types of behavior which courts found offensive.[13] The problem first manifested itself in the area of insurance claims. Courts perceived an inability of *Hadley* damages to deter insurance companies from refusing to settle third-party insurance claims when settlement was clearly in a policyholder's best interests.[14] For example, an insurance company might insist on litigating a claim filed against a policyholder which the third party claimant offered to settle for an amount roughly equivalent to the policy cap. The insurance company's tactics could lead to litigation which unnecessarily put the policyholder at risk of having to pay the difference between a large jury award and the cap on his or her policy coverage. If a jury rendered a huge judgment against the policyholder, the policyholder could look to the insurance company to cover no more than the policy's cap on coverage.[15] Under *Hadley*, the policyholder could not recover the additional loss that the policyholder suffered because the insurance company refused to settle. Realizing that traditional contract damages could not force them to pay more than the value of the policy agreement, insurance companies risked litigating suits knowing that they could only lose by litigating what they had bargained to lose in the first place: the value of the policy. Courts imposed punitive or other tort damages on such insurance companies under the theory that the insurance company had a fiduciary duty to not subject the policyholder to the risk of a huge judicial award which the insurance company's insistence on litigation created.[16] The California

12. *See, e.g.*, Holmes, *supra* note 8, at 462.

13. *See* Sandra Chutorian, 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, 377-78 (1986); *see also* Glenn E. Tremper, Comment, *Commercial Bad Faith: Tort Recovery for Breach of Implied Covenant in Ordinary Commercial Contracts*, 48 MONT. L. REV. 349, 374 (1987).

14. Chutorian, *supra* note 13, at 382.

15. *See* Kerry L. Macintosh, *Gilmore Spoke Too Soon: Contract Rises from the Ashes of the Bad Faith Tort*, 27 LOY. L.A. L. REV. 483, 530 (1994).

16. The above explanation of the bad faith tort's emergence relies on Chutorian, *supra* note 13, at 381-90 and Macintosh, *supra* note 15, at 487-515. This Note, as with much of the discussion on tortious contract damages, uses the term tort damages to signify emotional or mental stress damages as well as punitive damages. It does not, however, distinguish between compensatory and punitive tort damages because the economic impact on the defendant of any award for contract breach above the value of the bargain is economically the same. *See* POSNER, *supra* note 4,

Supreme Court modified a pre-existing action, the bad faith claim, to provide a mechanism for imposing tort damages on insurance companies that refused to settle third-party claims on behalf of policyholders.[17] The court intended that the economic impact of the tort damages discourage insurance companies from litigating claims by making out-of-court settlement the cheapest solution for insurance companies and policyholders alike.[18]

The action which the court used, the bad faith claim, was not originally a tort; it was a type of contract action. Traditionally, contract actions required breach of an express term in the agreement to bring suit; but sometimes parties were denied the benefits of a contract by a counterpart who engaged in behavior that, while harmful, did not violate any express term.[19] In such cases, California courts, as elsewhere in the country, recognized a bad faith claim as a substitute for normal breach of contract. The bad faith claim was a catch-all action that provided a plaintiff with a remedy when the other party's actions violated the spirit of the contract without breaching its written terms. As a matter of public policy, courts implied a covenant of good faith and fair dealing in every contract and ruled that various actions such as "[e]vading the spirit of the deal, slacking off, willful breach, abuse of discretion, failure to cooperate, [and] adopting an overreaching interpretation of the contract" violated the covenant.[20] Thus, bad faith, or breach of the implied covenant of good faith and fair dealing, existed originally as a catch-all contract action for which a plaintiff could only recover traditional contract damages.

The California Supreme Court grafted tort damages to the bad faith claim to create a disincentive to some types of contract breach such as oppression of policyholders by insurance companies that refused to settle third-party claims.[21] The type of activity targeted by the bad faith tort is, however, similar to the kinds of bad faith conduct described above. An insurance company which litigated a third-party claim brought against a policy-

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§ 16.5, at 209-10 (arguing either punitive or restitutionary damages can deter intentional torts).

17. Crisci v. Security Ins. Co., 426 P.2d 173, 177 (1967).

18. *Id.* at 178. Conversely, if the court only awarded compensatory contract damages, i.e. the value of the policy, insurance companies would have no counterincentive to risking their policyholders' fates to the wheels of justice. *Id.* at 177.

19. Macintosh, *supra* note 15, at 486-87.

20. *Id.* at 486.

21. *Crisci*, 426 P.2d at 176-78.

holder did not violate the terms of the policy by doing so and refusing to settle. Because the insurance company's refusal to settle the claim exposed the policyholder to unnecessary financial risk, however, the insurance company's actions violated the spirit of the policy. An insurance company's refusal to settle a claim, thus, undermines the very purpose of buying insurance—protection against pecuniary loss—and falls within the traditional definition of bad faith. But, the California court's tort award for bad faith went further than compensation. The court awarded tort damages to punish insurance companies for not protecting policyholders and to deter other insurance companies from repeating the offensive behavior towards holders of their policies.[22] California's experiment caught on. Courts nationwide came to recognize the availability of tort damages in the third-party-insurance-claim context to prevent insurance companies from abusing their policyholders.[23]

In the 1970s, California embarked on an expansion of its bad faith tort to include several other types of contracts which, like insurance agreements, are characterized by one party's stronger bargaining position.[24] In such contracts, California's judiciary posited that the weaker party's reliance on the benefits of the contract created a quasi-fiduciary relationship between the parties.[25] California found that where the stronger party did not execute the contract in good faith, it violated a duty towards the weaker party for which tort damages were appropriate.[26] The California courts awarded tort damages against insurance companies that failed to pay their policyholders' claims (i.e., first-party policyholder claims as opposed to the third-party claims discussed above),[27] banks that misappropriated clients' funds,[28] and employers who abused their unequal bargaining position vis-

22. *See* Macintosh, *supra* note 15, at 518-19 (explaining need for tort damages in insurance context).

23. *See* Chutorian, *supra* note 13, at 382; Macintosh, *supra* note 15, at 489-90.

24. *See* Seaman's Direct Buying Serv., Inc. v. Standard Oil Co., 686 P.2d 1158, 1166 (Cal. 1984) (listing bad faith suits in various contractual contexts).

25. *See* Chutorian, *supra* note 13, at 392.

26. *Id.*

27. *Id.* at 382-84 & n.32 (discussing Gruenberg v. Aetna Ins. Co., 510 P.2d 1032, 1037 (Cal. 1973)). According to one author, 36 states recognize the tort of bad faith in the first party/insurer context. Steven B. Fillman, Note, Braesch v. Union Insurance Co., *237 Neb. 44, 464 N.W.2d 769 (1991) Policy Rationales of the Bad Faith Cause of Action and Implications to Non-Insurance Commercial Contracts*, 72 NEB. L. REV. 608, 609 (1993).

28. Macintosh, *supra* note 15, at 506 (discussing Commercial Cotton Co. v. United Cal. Bank, 209 Cal. Rptr. 551, 554 (Cal. Ct. App. 1985)).

a-vis employees.[29] However, California stopped just short of recognizing the bad faith tort in all commercial contract disputes.[30] In 1984, California's supreme court held that tort liability for bad faith did not normally arise in commercial contracts, but a party's bad faith denial of the existence of a contract between the parties could rise to the level of tort.[31]

Where California halted, Montana carried on. Montana courts applied the bad faith tort to the same types of insurance, employment, and banking contracts as California.[32] Montana then went a step further, extending the bad faith tort claim to all types of commercial breach.[33] The Montana Supreme Court handed down this landmark decision in *Nicholson v. United Pacific Insurance Co.*[34]

B. *The* Nicholson *Precedent for Tort Damages in Contracts*

The 1985 *Nicholson* decision opened up a new realm of contract liability for the bad faith tort.[35] The *Nicholson* court awarded the plaintiff, Nicholson, bad faith tort damages because, despite the commercial nature of the deal, the defendant acted

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29. Chutorian, *supra* note 13, at 384-86; Macintosh, *supra* note 15, at 490-91 (discussing Cleary v. American Airlines, Inc., 168 Cal. Rptr. 722 (Cal. Ct. App. 1980)).

30. *Seaman's*, 686 P.2d at 1167.

31. *Id.*

32. *See Story*, 242 Mont. at 447, 791 P.2d at 773 (listing non-commercial Montana bad faith tort cases). For insurance cases, see, e.g.:

(1) Britton v. Farmers Ins. Group, 221 Mont. 67, 72, 721 P.2d 303, 306 (1986); (2) Klaudt v. Flink, 202 Mont. 247, 252, 658 P.2d 1065, 1067 (1983); (3) Fode v. Farmers Ins. Exch., 221 Mont. 282, 286, 719 P.2d 414, 416 (1986); and (4) First Sec. Bank v. Goddard, 181 Mont. 407, 420, 593 P.2d 1040, 1047 (1979).

For employer cases, see, e.g.:

(1) Dare v. Montana Petro. Mktg. Co., 212 Mont. 274, 282, 687 P.2d 1015, 1020 (1984); and (2) Gates v. Life of Mont. Ins. Co., 205 Mont. 304, 306-07, 668 P.2d 213, 214-15 (1983).

For banking cases, see, e.g.:

(1) Tribby v. Northwestern Bank, 217 Mont. 196, 211-12, 704 P.2d 409, 419 (1985); and (2) First Nat'l. Bank v. Twombly, 213 Mont. 66, 73, 689 P.2d 1226, 1230 (1984).

33. *See* Tremper, *supra* note 13, at 352; *see also* Jim Hubble, *Survey: Good Faith and Fair Dealing: An Analysis of Recent Cases*, 48 MONT. L. REV. 193 (1987).

34. 219 Mont. 32, 710 P.2d 1342 (1985).

35. Tremper, *supra* note 13, at 349. The *Nicholson* court stated that tort damages do not apply to all types of bad faith; however, the case law shows no discernible pattern of its refusal to hear a tortious bad faith claim before *Story*. *Nicholson*, 219 Mont. at 41, 710 P.2d at 1348; *see also infra* notes 46-47 and accompanying text. *But see Story*, 242 Mont. at 449, 791 P.2d at 774-75 (discussing the Montana Supreme Court's attempts at defining the parameters of the bad faith action).

outrageously in its breach of the agreement.[36] The defendant, United Pacific Insurance Co. (UPI), had commissioned a secret task force that recommended transferring UPI's Helena operations to Salt Lake City. The recommendation obviated UPI's need to rent plaintiff Nicholson's Helena office, which Nicholson had promised to renovate according to UPI's specifications.[37] Nicholson argued successfully that UPI stonewalled him by refusing to agree on renovation plans to force Nicholson to breach the lease.[38] A jury awarded Nicholson tortious damages because UPI's malicious[39] actions breached the covenant.[40] The Montana Supreme Court, in upholding tort damages for breach of the covenant, further explained the theory:

> The nature and extent of an implied covenant of good faith and fair dealing is measured in a particular contract by the justifiable expectations of the parties. Where one party acts arbitrarily, capriciously or unreasonably, that conduct exceeds the justifiable expectations of the second party. The second party then should be compensated for damages resulting from the other's culpable conduct.[41]

Nicholson requires a plaintiff to prove (a) the plaintiff's "reasonable expectations" and (b) the defendant's failure to meet them.[42] The *Nicholson* standard which was highly subjective and easy to meet became the basis for a wide expansion of tort liability in contract actions.[43] Plaintiff lawyers embraced the standard as a gateway to lucrative tort damages,[44] while critics warned that the imposition of tort liability on contract law would blur a traditional legal distinction maintained to allow efficient

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36. Nicholson, the lessor, persuaded UPI to move its Helena office into his building. The parties negotiated a lease conditioned upon Nicholson's renovating the office space to UPI's satisfaction. The parties disputed the interpretation of the renovation plans. Nicholson made consistent efforts to contact UPI officials to discuss and approve proposals for the ongoing renovations, but met antagonism and delay. Finally, UPI rescinded the contract three days before Nicholson promised to complete the renovations and after Nicholson spent $91,783 in remodeling costs. Nicholson filed a complaint requesting specific performance, compensatory damages, and punitive damages for breach of the covenant. *Nicholson*, 219 Mont. at 34-35, 710 P.2d at 1343-44.

37. *Id.* at 34, 710 P.2d at 1344.

38. *Id.* at 35-36, 710 P.2d at 1344-45.

39. Nicholson had the added burden of meeting MONT. CODE ANN. § 27-1-221 (1995). The statute requires proof of oppression, fraud, or malice if the claim requests punitive damages. *Nicholson*, 219 Mont. at 42, 710 P.2d at 1348-49.

40. *Id.* at 36, 710 P.2d at 1345.

41. *Id.* at 41-42, 710 P.2d at 1348.

42. *Story*, 242 Mont. at 447-48, 791 P.2d at 774.

43. *See infra* notes 46-47.

44. *See Story*, 242 Mont. at 449, 791 P.2d at 774.

breach.[45] In fact, the *Nicholson* decision initiated a growth of tortious bad faith claims in Montana that added economic risk for contracting parties.

C. *The Expansion of Tortious Bad Faith Claims after* Nicholson

In the late 1980s, the Montana Supreme Court affirmed tort damages, including punitive and emotional damages, for commercial bad faith claims in accord with *Nicholson*.[46] At least nine times from 1985 to 1990, the Montana Supreme Court refused to reject a tortious bad faith claim. The supreme court affirmed bad faith tort damages five times and remanded four additional cases without invalidating the claims.[47] The bad faith tort's rise attracted the attention of the Montana Legislature, which passed laws in 1987 to prohibit tort damages for bad faith claims in employment and insurance contracts.[48] The legislative history of both bills indicates that business interests lobbied hard for the changes.[49] Plaintiffs could have continued to claim bad faith in other areas, but the *Story* court effectively overruled *Nicholson* in 1990.[50]

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45. Tremper, *supra* note 13, at 350.

46. *E.g.*, First Sec. Bank v. Gary, 245 Mont. 394, 798 P.2d 523 (1990) (holding bank acted in bad faith by forcing loan client to hire bad-risk construction company); Dunfee v. Baskin-Robbins, Inc., 221 Mont. 447, 720 P.2d 1148 (1986) (approving punitive bad faith damages where franchisor refused to allow franchisee to move to better location).

47. The court affirmed the bad faith tort in: Bottrell v. American Bank, 237 Mont. 1, 773 P.2d 694 (1989); Weinberg v. Farmers State Bank, 231 Mont. 10, 752 P.2d 719 (1988); Tynes v. Bankers Life Co., 224 Mont. 350, 730 P.2d 1115 (1987); Dunfee v. Baskin-Robbins, Inc., 221 Mont. 447, 720 P.2d 1148 (1986); Nicholson v. United Pacific Ins. Co., 219 Mont. 32, 710 P.2d 1342 (1985). The court remanded in: First Sec. Bank v. Gary, 245 Mont. 394, 798 P.2d 523 (1990); Zeke's Distrib. Co. v. Brown-Forman Corp., 239 Mont. 272, 779 P.2d 908 (1989) (affirmed, but granted defendants new trial); Hobbs v. Pacific Hide & Fur Depot, 236 Mont. 503, 771 P.2d 125 (1989); Noonan v. First Bank Butte, 227 Mont. 329, 740 P.2d 631 (1987).

48. In 1987, the legislature passed the Wrongful Discharge from Employment Act and the Unfair Trade Practices Act for insurance regulation. The former bans common law bad faith claims for wrongful discharge and the latter forbids any bad faith claims arising from an insurance company's handling of a policy claim. The Wrongful Discharge from Employment Act states: "Preemption of common-law remedies. Except as provided in this part, no claim for discharge may arise from tort or express or implied contract." MONT. CODE ANN. § 39-2-913 (1995).

The Unfair Trade Practices Act for insurance is even more explicit: "An insured may not bring an action for bad faith in connection with the handling of an insurance claim." MONT. CODE ANN. § 33-18-242(3) (1995).

49. See notes 201-211 and accompanying text for further discussion of the lobbying efforts by insurance companies and Montana employers as found in the 1987 minutes of house and senate committee hearings.

50. *See Story*, 242 Mont. at 458, 791 P.2d at 780 (Sheehy, J., dissenting) (stat-

III. STORY V. CITY OF BOZEMAN[51]

A. The Facts and Trial

The Montana Supreme Court heard four separate appeals arising from a water main contract between Mark Story (Story), a construction contractor, and the City of Bozeman (City).[52] In 1990, the City brought the first appeal, asking the court to overturn a damage award for contract breach and bad faith damages in favor of the plaintiff, Story. The court opinion described a litany of problems and complaints arising from delays in Story's installation of the City's water mains.[53] Midway through construction, the City's engineer wrote to Story's surety complaining that Story was not completing his jobs on schedule. The bonding company terminated Story's bond, and Story cancelled the contract.[54] Story brought suit alleging that the City breached the contract, acted in bad faith, and defamed Story in the letter written to the surety. The City counterclaimed for reformation and breach of contract.[55]

At trial, the jury found that the contract contained a mutual

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ing that majority's goal in *Story* was to reverse *Nicholson*). *But see id.* at 450, 791 P.2d at 775 (majority holding that the *Nicholson* reasoning was still sound).

51. 242 Mont. 436, 791 P.2d 767 (1990).

52. The four appeals are the following:

(1) Story v. City of Bozeman, 242 Mont. 436, 791 P.2d 767 (1990); (2) City of Bozeman v. AIU Ins. Co., 262 Mont. 370, 865 P.2d 268 (1993) (dispute over AIU's obligation to represent the City in Story's suit); (3) Story v. City of Bozeman, 259 Mont. at 207, 856 P.2d 202 (1993) (*Story II*); (4) City of Bozeman v. AIU Ins. Co., 272 Mont. 349, 900 P.2d 929 (1995). This note deals mainly with the 1990 *Story* decision in which the Montana Supreme Court set out new guidelines for bad faith claims.

53. First, the City's bid schedule form contained a typographical error which asked for the bidder's price on 120 cubic feet (C.F.) of pipe bedding material. The City intended to collect bids on cubic yards (C.Y.), but the sheet erroneously specified C.F. All contractors except Story bid assuming yards. Story gave the lowest bid in part because his bid reflected the lower cost of only 120 cubic feet of pipe bedding material. The City argued that Story knew of the typo, bid at a cubic yard rate, and then used the typo to demand extra payment. Story countered that the City's engineer refused bad weather extensions to coerce him into accepting the City's position on the pipe bedding materials. *Story*, 242 Mont. at 439-40, 791 P.2d at 769. Second, the City accused Story of shoddy work that needed to be redone. Story replied that the City failed to provide appropriate benchmarks. Third, the City accused Story of moving his team off the job to do other work. Story insisted that wet conditions prevented his team from working in Bozeman, so he moved them temporarily to another site. Finally, the City accused Story's workers of trespassing upon and damaging landowners' property while on the job. Story argued that work easements provided by the City were too narrow for the job. *Id.* at 440, 791 P.2d at 769.

54. *Id.* at 440, 791 P.2d at 769.

55. *Id.*

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mistake, that the parties acquiesced in the mistake, and that the contract should be reformed.[56] The jury rejected the City's claims, but awarded Story $13,236 in contract damages for an unspecified breach of the contract and $360,000 in tort damages for the City's bad faith.[57] The City appealed on two issues: (1) whether the trial court erred by not granting defendant a new trial because the special verdict form was inadequate;[58] and (2) whether bad faith in a contract action gave rise to tort damages.[59]

B. *The Holding*

The *Story* court reaffirmed Montana's implied covenant of good faith and fair dealing, but qualified the circumstances in which the covenant operates. The *Story* court held that every contract contains an implied covenant of good faith and fair dealing.[60] The court defined the standard of compliance to be "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."[61] For most contracts, the court held that a breach of the covenant is merely a breach of the contract to which only *Hadley* contract damages are available.[62] Under exceptional circumstances, the court held that a plaintiff could win tort damages for bad faith by proving the

56. *Id.* at 440-41, 791 P.2d at 769-70.

57. *Story*, 242 Mont. at 439, 791 P.2d at 769.

58. *Id.* On the jury instruction issue, the Montana Supreme Court held that the special verdict form failed to state the law and presented the issues in an inconsistent, confusing, and misleading fashion. *Id.* at 445, 791 P.2d at 772. The issue is not dealt with further in this Note.

59. *Id.* at 439, 791 P.2d at 769.

60. *Id.* at 450, 791 P.2d at 775. The court added that "breach of an express contractual term is not a prerequisite to breach of the implied covenant." *Story*, 242 Mont. at 450, 791 P.2d at 775.

61. *Id.* The court added that the above standard was identical to that applied under the UCC to merchants. The court explained the standard, found at section 28-1-211 of the Montana Code, as follows:

> Each party to a contract has a justified expectation that the other will act in a reasonable manner in its performance or efficient breach. When one party uses discretion conferred by the contract to act dishonestly or to act outside of accepted commercial practices to deprive the other party of the benefit of the contract, the contract is breached.

Story 242 Mont. at 450, 791 P.2d at 775 (interpreting MONT. CODE ANN. § 28-1-211 (1995)). The new standard supplants the *Nicholson* standard of "justified expectations of the parties created by their particular contractual relationship" by redefining the parameters of "justified expectations." *Compare Story*, 242 Mont. at 450, 791 P.2d at 775 *with Nicholson*, 219 Mont. at 42, 710 P.2d at 1348-49.

62. *Story*, 242 Mont. at 450-51, 791 P.2d at 775-76.

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existence of a special relationship between the parties.[63]

C. *The Court's Reasoning*

The court based its holdings on an analysis of the problems associated with the bad faith tort's development in Montana.[64] The court identified four areas, which, taken as a whole, demonstrated the need for a mid-course correction in the bad faith tort.[65]

First, the court pointed out that tort damages awarded in contract cases disrupt the doctrine of efficient breach.[66] The *Story* court recognized that obtaining compensation from a breaching party is rarely efficient, but found that contract provisions for court costs and attorney's fees better allow a prevailing party to recoup the transaction costs of adjudication.[67] The court, therefore, concluded that the specter of tort damages unnecessarily interferes with a party's freedom to breach a contract and pay contract damages whenever performance is not efficient.[68]

Second, the court reasoned that adding a tort action for bad faith expanded the scope of allowable evidence far beyond that of traditional contract issues.[69] The court concluded that evidence brought to prove wrongdoing and intent might prejudice a jury.[70]

Third, the court pointed to its own role in developing the bad faith tort in Montana.[71] Throughout the tort's eleven-year history, the court had continuously redefined and rechanneled the bad faith tort's application in an effort to prevent its overuse by plaintiffs.[72]

Finally, the court took judicial notice of legislative action to curb the application of bad faith tort for employee discharge, to ban non-*Hadley* damages in other areas of contract law, and to

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63. *Id.* at 450, 791 P.2d at 775. See *infra* note 83 and accompanying text for the California special relationship test adopted in *Story*. The court also noted that the independent tort actions of fraud, fraudulent inducement, and tortious interference with contract exist to remedy the oppressive or malicious acts of contract parties. *Story*, 242 Mont. at 451, 791 P.2d at 776.

64. *Id.* at 445, 791 P.2d at 772.

65. *Id.*

66. *Id.* at 448, 791 P.2d at 774.

67. *Id.*

68. *Story*, 242 Mont. at 448, 791 P.2d at 774.

69. *Id.*

70. *Id.*

71. *Id.* at 458-59, 791 p.2d at 774-75.

72. *Id.*

redefine the standard of compliance for the implied covenant of good faith and fair dealing, as evidence of public dissatisfaction with expanded tort liability in Montana.[73] Combined, the above concerns persuaded the court to redefine bad faith and limit the availability of tort damages for it.[74]

D. Analysis of the Story *Opinion*

The *Story* court reworked the bad faith action by adopting three broad changes. First, the court bifurcated bad faith into separate tort and contract claims. Second, the court changed the evidentiary standard for claiming bad faith. Third, the *Story* court established a special relationship test as a prerequisite for allowing a bad faith claim to sound in tort.

Story splits bad faith into a contract action and a tort action, but includes the same elements in each with the exception of the special relationship for tort treated below. As indicated earlier, the standard of conduct for good faith and fair dealing is implied into every contract as a covenant.[75] Under *Story*, a trial judge treats the covenant's breach the same as breach of an express contract term.[76] The contract action for bad faith arises from breach of this implied covenant. In most instances, the court envisions that contract damages awarded for breach of the covenant will adequately compensate a plaintiff. However, *Story* also retains the availability of *Nicholson*-style bad faith tort damages for egregious situations where normal contract damages will not suffice. The tort action shares the same standard of good faith and fair dealing that applies to the contract claim. If the plaintiff can establish a special relationship between the parties, the standard of good faith changes from a covenant to a duty owed by the defendant to the plaintiff.[77] A plaintiff is entitled to tort damages by proving that the defendant breached the duty of good faith and fair dealing arising from the special relationship. Regardless of whether a covenant or duty is at issue, the defendant's conduct must violate the same good faith standard outlined below.

As the bad faith action's standard of compliance, the court adopted the legislature's UCC model of good faith and fair deal-

73. *Story*, 242 Mont. at 449, 791 P.2d at 775.
74. *Id.*
75. *Id.* at 450, 791 P.2d at 775.
76. *Id.*
77. *Id.* at 451-52, 791 P.2d at 776.

ing for merchants, including the UCC "reasonable commercial standards of fair dealing in the trade" for evaluating compliance with the covenant.[78] The UCC standard replaced *Nicholson*'s subjective "reasonable expectation" standard by substantively redefining it.[79] Under *Story*'s UCC standard, the plaintiff must (a) establish the commercial standards of the trade through expert testimony, and (b) show that the defendant's conduct exceeded the standards of a trade which might normally allow *reasonably* dishonest conduct.[80] Compared to *Nicholson*, *Story* raises the evidentiary burden for all bad faith claims.[81]

For the tort claim, the *Story* court added another burden, a special relationship test. The *Story* court concluded that a tort award is appropriate only when the law must discourage a stronger contracting party from oppressing a weaker counterpart. The court restricted the bad faith tort's use to such situations by requiring the plaintiff to establish a quasi-fiduciary relationship between the parties.[82] The test serves as a mechanism for discriminating between contracts for which tort damages are appropriate and those for which only contract damages are due. The *Story* special relationship test provides:

> (1) the contract must be such that the parties are in inherently unequal bargaining positions; [and] (2) the motivation for entering the contract must be a non-profit motivation, i.e., to secure peace of mind, security, future protection; [and] (3) ordinary contract damages are not adequate because (a) they do not require the party in the superior position to account for its actions, and (b) they do not make the inferior party 'whole'; [and] (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 vulnerabili-

78. *Story*, 242 Mont. at 449-50, 791 P.2d at 775.

79. *Id.*; *see also supra* note 61 (explaining how *Story* redefined *Nicholson*'s "justified expectations" standard).

80. *See Story*, 242 Mont. at 450-51, 791 P.2d at 775-76.

81. Of course, the standards set out in *Story* do not affect contracts that fall within one of the areas governed by statute such as the UCC statutes for the sale of goods between merchants and the sale of goods for non-merchants. *Id.* at 450, 791 P.2d at 775.

82. *Id.* at 451, 791 P.2d at 776 (concluding that the tort of bad faith "serves to discourage oppression in contracts which necessarily give one party a superior position"). Many of these exceptions are precluded by the 1987 laws. *Id.*; *see also infra* notes 185-90 and accompanying text.

ty.[83]

The test sets out the indicia of a quasi-fiduciary relationship. The first element of the test defines parties bargaining from a position of power as the class whose bad faith can rise to the level of tort. The second element excludes from that class parties motivated by profit—such as arms-length commercial parties.[84] The third element qualifies the class of powerful parties to those who can impose harm beyond the mere value of the contract on a weaker party and who deserve the extra deterrence of tort awards to prevent such breach. The fourth element further narrows the definition of the weaker party to be only those especially vulnerable to the harm of the stronger party's breach. The fifth element provides a safe harbor for some defendants similar to the *Hadley* requirement that damages flowing from the breach be within the contemplation of the breaching party at the time of contract. The last element would place the parties outside of a special relationship, if a defendant could prove ignorance of the plaintiff's vulnerability to harm from breach.

The criteria as adapted from California case law create a high standard.[85] The *Story* court's inclusion of the bracketed conjunctions underscores the need for a plaintiff to show *every* element of the special relationship. A *prima facie* claim of tortious bad faith must survive the judge's scrutiny for a special relationship between the parties meeting the test, or the claim will not go before the jury.[86]

The court took no stance as to whether Story and the City shared a special relationship, but Justice Sheehy's dissent accused the majority of altering the elements of tortious bad faith

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83. *Story*, 242 Mont. at 451, 792 P.2d at 776 (citing Wallis v. Superior Court, 207 Cal. Rptr. 123, 129 (Cal. Ct. App. 1984)) (brackets in original).

84. Most likely, the second element excludes powerful parties from extracting special relationship damages from weaker contract partners because such stronger parties will enter into the contract to earn a profit.

85. *Wallis*, 207 Cal. Rptr. at 129 (holding that the test serves as a predicate to tort liability).

86. *Story*, 242 Mont. 451, 791 P.2d at 776. The *Story* court pointed out bad faith claims expose the jury to evidence of issues beyond the scope of traditional contract action. *Id.* at 448, 791 P.2d at 774. Where bad faith and breach claims are tried together, the bad faith claim may poison the jury's minds as to the breach claim by introducing evidence of bad intent and wrongdoing. *Id.* The *Story* special relationship renders the issue moot because the tort bad faith claim will almost always fail to reach the jury. However, if the plaintiff offers evidence in support of each element of the special relationship and the defendant presents controverting evidence as to any of the elements, the jury must decide the material issues. *Id.* at 451, 791 P.2d at 776.

to preclude tort damages in any contract dispute.[87] The dissent predicted that Story would lose his tort award on remand,[88] and in fact, Story dropped his bad faith claim at retrial.[89] Despite his loss of the bad faith tort claim, however, Story won $850,000 on remand in large part because he presented expert testimony on issues such as future lost profits and loss of credit and reputation.[90]

Nonetheless, Justice Sheehy's dissent accurately predicts the fate of commercial bad faith tort claims after *Story*. Case law shows that the court has consistently denied bad faith tort claims; the primary reason offered by the court is an absence of a special relationship because the parties entered into the agreement motivated by profit. The discussion below focuses on how the test's second element, excluding parties motivated by profit, seems to disqualify commercial parties in particular from meeting the *Story* special relationship.

IV. THE IMPACT OF STORY

A. *Empirical Evidence of the End of the Bad Faith Tort*

Post-*Story* case law confirms that the court made an about-face on tortious bad faith. In the five years after *Story*, the court rejected tort damages for every commercial bad faith claim contested on appeal.[91] Tort claims failed twelve times because the court denied the existence of a *Story* special relationship between the commercial parties.[92] The following three examples illus-

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87. *Id.* at 461, 791 P.2d at 782 (Sheehy, J., dissenting).

88. *Id.*

89. *Story II*, 259 Mont. at 215, 856 P.2d at 206-07.

90. *Id.* at 215, 856 P.2d at 207.

91. Cases against lending institutions are included in the analysis. Although the Montana Supreme Court recognized the bad faith tort's use against banks before *Nicholson*, the *Story* special relationship governs bad faith tort claims against banking and other financial institutions. See *infra* notes 214-215 for pre-*Nicholson* and post-*Story* bad faith cases involving lending institutions.

92. Listed by type of contract—(1) General Contract: Trad Indust., Ltd. v. Brogan, 246 Mont. 439, 805 P.2d 54 (1991); Keller v. Dooling, 248 Mont. 535, 813 P.2d 437 (1991); Daniels v. Dean, 253 Mont. 465, 833 P.2d 1078 (1992); Haines Pipeline Constr., Inc. v. Montana Power Co., 251 Mont. 422, 830 P.2d 1230 (1991); Beaverhead Bar Supply, Inc. v. Harrington, 247 Mont. 117, 805 P.2d 560 (1991); (2) Employee Contract: Marshall v. State, 253 Mont. 23, 830 P.2d 1250 (1992); Kinniburgh v. Garrity, 244 Mont. 350, 798 P.2d 102 (1990); (3) financial agreements: Citizens First Nat'l Bank v. Moe Motor Co., 248 Mont. 495, 813 P.2d 400 (1991); Richland Nat'l Bank & Trust v. B & J Drilling, 249 Mont. 410, 816 P.2d 1045 (1991); First Sec. Bank & Trust v. VZ Ranch, 247 Mont. 453, 807 P.2d 1341 (1991); Lachenmaier v. First Bank Systems, Inc., 246 Mont. 26, 803 P.2d 614 (1990); (4)

trate how the court has used the *Story* test to preclude tort liability in commercial bad faith claims.

B. No Special Relationship in Commercial Contracts

In *Haines Pipeline Construction, Inc. v. Montana Power Co.*,[93] Montana Power Co. (MPC) entered into a contract with Haines Pipeline Construction, Inc. (Haines) to install a gas pipeline.[94] Haines posted a $750,000 irrevocable letter of credit in lieu of a construction bond.[95] After on-site inspection by MPC, Haines buried the pipeline.[96] After discovering problems with the pipeline, MPC hired agents including Haines to dig up sections of pipe for repair work.[97] Despite reassurances to the contrary, MPC drew upon Haines' letter of credit to help cover the repair costs.[98] The district court ruled that MPC took various actions prior to approval of the pipeline and subsequent to repair negotiations that estopped MPC from holding Haines financially responsible for the pipeline problems.[99] The supreme court affirmed the district court's $502,361 award for breach of contract,[100] but denied Haines a $1,000,000 punitive bad faith tort award because even Haines did not dispute the absence of a *Story* special relationship between the litigants.[101] Justice Trieweiler stated in his dissent that *Haines* exemplified the type of oppression against small businesspersons for which, due to *Story*, the bad faith tort no longer afforded protection.[102]

In *Trad Industries, Ltd. v. Brogan*,[103] the plaintiff (Trad) sued Brogran, the owner of a game farm, for failure to deliver domesticated elk per a sale agreement between the parties.[104] The court held that Brogan failed to show impossibility of performing his contractual obligations and that Brogan breached the sales agreement.[105] The court upheld the trial court's refus-

Insurance Policy: McNeil v. Currie, 253 Mont. 9, 830 P.2d 1241 (1992).

93. 251 Mont. 422, 830 P.2d 1230 (1991).
94. *Haines Pipeline*, 251 Mont. at 424, 830 P.2d at 1232.
95. *Id.*
96. *Id.*
97. *Id.* at 425, 830 P.2d at 1232-33.
98. *Id.* at 426, 830 P.2d at 1233.
99. *Haines Pipeline*, 251 Mont. at 426, 830 P.2d at 1233.
100. *Id.* at 431, 830 P.2d at 1236.
101. *Id.* at 434, 830 P.2d at 1238.
102. *Id.* at 437, 830 P.2d at 1240 (Trieweiler, J. dissenting).
103. 246 Mont. 439, 805 P.2d 54 (1991).
104. *Trad Industries*, 247 Mont. at 442-43, 805 P.2d at 56-57.
105. *Id.* at 446-48, 805 P.2d at 59-60.

al of exemplary damages, reasoning that, even if Trad proved bad faith, Trad could never establish the *Story* special relationship.[106]

Finally, in *Beaverhead Bar Supply, Inc. v. Harrington*,[107] the trial court granted summary judgement in favor of Harrington where no written contract existed to show that Harrington, a supplier, had agreed to supply Beaverhead Bar Supply, Inc. (Beaverhead) with Pepsi products.[108] The supreme court overruled, holding summary judgment improper because a material dispute existed as to whether Harrington had orally agreed to supply Beaverhead.[109] Remanding all other issues, the supreme court foreclosed bad faith tort damages because the parties entered into the supply agreement motivated by profit.[110]

Haines, *Trad Indus. ltd.*, and *Beaverhead Bar Supply, Inc.* show three commercial contexts—a pipeline construction contract, a sale of goods between small merchants, and an oral service agreement—where failure to meet the *Story* special relationship test precluded bad faith tort damages. *Haines* and *Beaverhead Bar Supply, Inc.* are particularly informative. In those cases, the trial court originally awarded bad faith tort damages under the old *Nicholson* bad faith standard, while on appeal the supreme court disallowed the tort claim under *Story*. For instance, in *Haines*, like *Nicholson*, the trial court awarded bad faith damages because the defendant engaged in oppressive conduct by misleading the plaintiff.[111] The *Haines* facts do not appear any less egregious than *Nicholson*, but unlike *Nicholson*, the *Haines* tort claim failed on appeal because the plaintiff did not meet the stringent standards of the *Story* special relationship test.[112] *Haines* demonstrates that the *Story* test, not sympathetic facts, presently determines the outcome of bad faith tort claims.

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106. *Id.* at 449-50, 805 P.2d at 60-61.
107. 247 Mont. 117, 805 P.2d 560 (1991).
108. *Beaverhead Bar Supply*, 247 Mont. at 120, 805 P.2d at 561.
109. *Id.* at 120, 805 P.2d at 562.
110. *Id.* at 124, 805 P.2d at 564.
111. *Haines Pipeline*, 251 Mont. at 428-29, 830 P.2d at 1234.
112. *Id.* at 434, 830 P.2d at 1238.

C. Impact on the Federal Courts

In the federal courts, *Story* dramatically curtailed bad faith tort claims as well.[113] For example, federal lending programs for housing and farming inevitably lead to foreclosures against borrowers in Montana as in other parts of the country. In Montana, the pre-*Story* bad faith claim allowed borrowers to attack foreclosures in federal court[114] because the Federal Tort Claims Act (FTCA) transfers exclusive jurisdiction to the federal courts for all civil tort suits arising under state law if the suit names the federal government or one of its agencies as a defendant.[115] Before *Story*, a Montana plaintiff could sue a federal lending institution in federal court by bringing suit under Montana's bad faith tort law.[116] After *Story*, the bad faith tort claim must pass the federal court's application of the special relationship test. In every post-*Story* case, the absence of a special relationship between a government lender and the borrower has precluded a bad faith tort claim and consequently, federal jurisdiction under FTCA. For example, in *Winchell v. United States Department of Agriculture*,[117] a farmer borrowed from a government lending institution. The federal court ruled out a special relationship due to the profit motive of the contract and dismissed the case.[118]

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113. No federal case citing *Story* found tortious bad faith. *See* Knerr v. Federal Land Bank, 1991 WL 22119 (9th Cir. Feb. 25, 1991) (unpublished); Shupak v. New York Life Ins. Co., 780 F. Supp. 1328 (D. Mont. 1991); Peterson v. Blue Chip Cookies Franch. Corp., 1991 WL 142615 (9th Cir. July 29, 1991) (unpublished); Pennington's Inc. v. Brown-Foreman Corp., 785 F.Supp 1412 (D. Mont. 1991); Winchell v. United States Dep't of Agric., 961 F.2d 1442 (9th Cir. 1992); Fitzgerald v. State Farm Fire & Casualty Co., 1992 WL 280976 (9th Cir. Oct. 14, 1992) (unpublished); Plaza West Dental Group v. Mountain States Tel. & Tel. Co., 1992 WL 280979 (9th Cir. Oct. 14, 1992) (unpublished); Hamilton v. United States, 1993 WL 29207 (9th Cir. Feb. 9, 1993) (unpublished); Johansen v. Airborne Freight Corp., 1993 WL 461162 (9th Cir. Nov. 10, 1993) (unpublished). The only possible, but unlikely exception: Kessner v. First Bank, 1991 WL 216955 (9th Cir. Oct. 25, 1991) (unpublished) (deferring breach issue until covenant's statute of limitations determined).

114. Love v. United States, 915 F.2d 1242, 1245 (9th Cir. 1989) *modified* 60 F.3d 642 (9th Cir. 1995) (citing 28 U.S.C. § 2674 (1994)).

115. *See* 28 U.S.C. §§ 1346(b), 2671-80 (1994). The FTCA reads:

> [T]he district courts . . . shall have exclusive jurisdiction of any civil action or claim against the United States . . . . where the United States, if a private person, would be liable to the claimant in accordance with the law of the place where the act or omission occurred.

28 U.S.C. § 1346(b) (1994). Although the FTCA bans punitive damages, the Montana bad faith tort claim allowed the plaintiff to claim other types of tortious damages. *See Love*, 915 F.2d at 1245.

116. *Id.* (holding that "breach of the duty of good faith is a tort properly brought under the FTCA").

117. 961 F.2d 1442 (9th Cir. 1992).

118. *Winchell*, 961 F.2d at 1444 (distinguishing *Love* as lacking authority due to

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Similarly, in *Hamilton v. United States*,[119] a real estate developer claimed bad faith against government lenders when the developer's mortgaged development scheme went awry. Profit motive barred a *Story* special relationship, and the plaintiff lost jurisdiction under FTCA.[120]

D. *The Dearth of Tort in Post-*Story *Contract Law*

The examples of state and federal case law arising after *Story* unequivocally support the conclusion that the commercial bad faith tort is dead in Montana. The Montana Supreme Court rejected every post-*Story* commercial bad faith tort claim. At the federal level, courts summarily dismissed every bad faith tort claim as well. The post-*Story* case history shows that any contract between commercial parties will fall within the for-profit exclusion of the *Story* special relationship test and that *Story* forecloses the possibility of tortious damages for commercial parties. For contract plaintiffs in general, the special relationship test, its second element, in particular, acts as a final stumbling block to claiming tortious bad faith. Thus, by foreclosing the tort claim, the *Story* test ends any economic incentive to use Montana's bad faith action as opposed to a traditional contract claim.

The bad faith contract action, however, is still viable, and remains available for a plaintiff where the other party violates the spirit of an agreement without breaching an express term. The *Story* court explicitly stated that its special relationship should not interfere with a party's bad faith claim for traditional *Hadley* damages.[121] Indeed, after *Story*, the Montana Supreme Court upheld *Hadley* damages for bad faith in three commercial cases and left open the same possibility on remand in four others.[122] The impossibility of meeting the bad faith tort's special

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Story's changes to Montana tortious bad faith law).

119. 1992 WL 29207 (9th Cir. Feb. 9, 1993) (unpublished opinion).

120. *Hamilton*, 1993 WL 29207, *1.

121. *Story*, 242 Mont. at 450-51, 791 P.2d at 775-76; *accord Haines Pipeline*, 251 Mont. at 434, 830 P.2d at 1238; *Beaverhead Bar Supply*, 247 Mont. at 124, 805 P.2d at 564; *Trad Industries*, 246 Mont. at 449, 805 P.2d at 61.

122. The court upheld the following cases: Fox Grain & Cattle Co. v. Maxwell, 267 Mont. 528, 885 P.2d 432 (1994); Haines Pipeline Constr., Inc. v. Montana Power Co., 265 Mont. 282, 876 P.2d 632 (1994) (second appeal); *Story II*, 259 Mont. 207, 856 P.2d 202 (1993) (second appeal).

The court remanded: Simmons Oil Corp. v. Holly Corp., 258 Mont. 79, 86, 852 P. 523, 527 (1993) (applying California law, but stating that Montana law is identical); Daniels v. Dean, 253 Mont. 465, 833 P.2d 1078 (1992); *Haines Pipeline*, 251

https://scholarship.law.umt.edu/mlr/vol57/iss2/13

relationship test is simply irrelevant to making a bad faith contract claim, and the case law shows that the court continues to affirm bad faith contract claims much as it did before *Story*. In fact, the court's affirmation of bad faith claims for *Hadley* damages reinforces the conclusion that the court deliberately fashioned the special relationship test to reject bad faith tort claims.

V. THE BAD FAITH TORT: ECONOMIC & POLITICAL ISSUES

The period of judicial activism that *Story* ends marks a compelling period in Montana's legal history. From the practitioner's perspective, the *Story* decision is significant for setting out an important precedent for a commercial bad faith claim. The case also deserves attention because it draws to a close the judiciary's expansion of tort into contract damages. This section examines the rise and fall of the bad faith tort in Montana as phenomena which occurred within the state's economic and political landscape.

The reasons proffered by the *Story* court for correcting the bad faith tort midstream warrant a reexamination. The court gave four reasons for restricting the tort's use: (1) to restore the opportunity for efficient breach, (2) to prevent the overuse of the bad faith tort claim by plaintiffs, (3) to keep tort evidence out of contract suits, and (4) to recognize the legislature's discontent with the bad faith tort.[123] The first factor, availability of efficient breach, is clearly an economic consideration for contracting parties because it determines their ability to end less profitable contractual arrangements. The second factor, plaintiff overuse of the bad faith claim, economically influences contracting parties in two ways. First, it increases the size of damages for breach. Second, the threat of indeterminate tort damages makes it impossible to determine the cost of the previous factor, efficient breach. The third factor, introduction of tort evidence into a contract action, is principally a procedural issue; however, bad faith's transformation from contract to tort invokes new issues such as intent and wrongdoing which tend to overshadow traditional contract issues such as offer and acceptance. The bad faith claim's procedural domination by tort issues exacerbates tort damages' economic submersion of contract claims. Finally, the fourth factor, public discontent expressed through the legisla-

Mont. 422, 830 P.2d 1230 (1992); *Beaverhead Bar Supply*, 247 Mont. 117, 805 P.2d 560 (1991).

123. *Story*, 242 Mont. at 448-49, 791 P.2d at 774-75.

ture, arose primarily among contracting parties upset with the impact of the bad faith tort on their business affairs. This political reaction to the tort can be seen as a manifestation of dissatisfaction with the tort's economic impact. Reasoning that these largely economic concerns merited the creation of a special relationship test to limit the applicability of the bad faith tort, the *Story* court explicitly recognized the economic and political repercussions of the bad faith tort's judicially-created existence. This section reexamines those issues, but does so within an analytical framework based upon economic and political theory.

The first part of this section examines the economic factors involved in contract law. The focus is on a comparison of the economic implications of *Hadley* damages with the bad faith tort. The second part introduces a variation of Professor George J. Stigler's theory of regulation.[124] It examines legislative action taken to curtail the rise in tort awards as a reaction in the political economy to the judiciary's strong and, in some instances, negative impact on the cost of doing business. Each section concludes with an application of the principles introduced to the bad faith tort's history in Montana, attempting to gather new insights into the proper role of the bad faith claim in contract law.

A. *Contract Law and the Economic Cost of Breach*

Few scholars would argue that the law in areas such as antitrust, intellectual property, and contract does not principally affect market behavior. Economic issues play, in general, a larger role in contract law than, for example, criminal law; the types of unacceptable behavior which contract law addresses are usually related to business transactions and the chief means of distributing justice in contract law is pecuniary damages, not jail time.[125] Because contract law largely governs business activities and uses pecuniary damages to accomplish justice, it is prime material for economic analysis.[126]

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124. Prof. Stigler's seminal research on regulation theory appeared in George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. OF ECON. & MAN. SCI. 3 (1971). This Note actually relies, however, on a later work expanding upon Prof. Stigler's work, Sam Peltzman, *Toward a More General Theory of Regulation*, 19 J. ECON. & L. 211, 211 (1976).

125. POSNER, *supra* note 4, § 19.7, at 535 (writing that "the implicit economic content . . . may seem straightforward with regard to those areas—contracts mainly . . . where transaction costs are low").

126. Judge Posner describes the purpose of contract law: "[t]hus the fundamental function of contract law (and recognized as such at least since Hobbes's day) is to

Given the economic nature of contract law, it seems appropriate to treat judicial rulings in this area as a type of market regulation. As such, economic principles applicable to market regulation should apply to an analysis of the bad faith tort, a regulation governing breach of contract.[127] The primary economic concept applied in the examination of the bad faith tort is the cost of compliance.[128] This concept highlights an important aspect of judicial rulings. Contract law places a pecuniary burden not only on parties who violate its rules, but also on parties who must change their behavior to comply with new law.[129] For the purposes of this discussion, both aspects of a ruling's impact, the cost of breaking it and the cost of obeying it, are treated together as compliance costs. Furthermore, for the purposes of comparing and contrasting traditional contract damages with the bad faith tort, the inability of *Hadley* damages to provide a remedy for certain types of opportunistic breach which the bad faith tort successfully deters is treated as another type of relative compliance cost inherent in the *Hadley* damages doctrine. This last compliance cost manifests itself as either a risk of opportunistic breach to which some parties will be subject or as a change in such parties' behavior designed to avoid such risk.[130] Accordingly, the three types of compliance costs—cost of breach, cost of obeying, and cost of omission—constitute the criteria for evaluating the *Hadley* rule and the bad faith tort's impact on contract parties.

Judges regularly consider such compliance costs in the course of making a ruling, but a structured approach to these

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deter people from behaving opportunistically toward their contracting parties, in order to encourage the optimal timing of economic activity and (the same point) obviate costly self-protective measures." *Id.* § 4.1, at 91 (footnotes omitted).

127. *But see id.* § 13.1, at 367. The analogy overlooks the difference in litigation incentives for private civil actions and regulatory intervention by state agencies.

128. This Note uses the term, compliance cost, to refer to the transaction costs associated with contracting under a particular contract regime. It derives its definition from the author's reading of RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW (4th ed. 1992); and it also adopts Judge Posner's position that an efficient contract law will create incentives for value-maximizing conduct in the future. *Id.* § 4.1, at 95-96.

129. *See id.* (stating that parties will contract around unfavorable regulations, but that such circumventions drive up the parties' contracting cost).

130. The conduct on the part of private parties who opportunistically breach might appear to be outside the scope of the Hadley rule's compliance cost. The *Hadley* rule, however, fails to deter conduct against which the bad faith tort provides protection. Therefore, the *Hadley* regime enables parties to be hurt or forces them to take steps to avoid being harmed, and these compliance costs related to *Hadley*'s lack of deterrence can properly be grouped together as costs of omission.

concepts falls outside of traditional jurisprudence.[131] Moreover, certain types of compliance costs, most notably the cost of obeying, are invisible to the judiciary because judges only see the parties between whom problems arise; it is easy for judges to underestimate the impact of rulings on those parties who obey the new law. Yet, the political opposition to the bad faith tort after *Nicholson* illustrates that the cost of obeying the law should not be ignored by judges because it was precisely this factor that led businesses to lobby the legislature for statutory bans on the bad faith tort.[132] To minimize the possibility of political backlash to judicial rulings, this section provides guidelines for evaluating all aspects of a ruling's compliance costs. By utilizing this economic analysis, the judiciary can hopefully avoid statutory interference with its contract law such as occurred during the 1987 legislative session.[133]

The idea of minimizing compliance costs fits in with the traditional jurisprudential goal of narrowly tailoring each ruling to accomplish its aims with the least amount of interference to the public.[134] Thus, the economic principles discussed here do not supplant, but supplement traditional notions of justice.[135] When the court's economic analysis leads it to believe that a ruling imposes too high a cost on some parties, the court might reject that solution and use the same economic principles to devise a different answer to the immediate dispute which would impose less burden on those falling within the ruling's scope.[136] In other words, the court can utilize economic principles within its traditional jurisprudence to help discern hidden costs and to refine its rulings to avoid imposing unnecessary burdens on par-

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131. *But see* POSNER, *supra* note 4, § 2.2, at 23 (arguing that judge's rhetoric obscures a commitment to economic efficiency on the part of the courts).

132. This point is substantiated by insurance lobbyists who came before the Montana Senate's Business and Industry Committee to testify in support of the Unfair Trade Practices Act for insurance. The insurance representatives stated that insurance companies feel compelled by the threat of bad faith tort damages to settle low limit claims "for more than what they are really worth," and that, therefore, the insurance industry strongly supported a ban on bad faith tort damages in insurance contracts. *See Minutes of the Meeting: Consideration of H.B. 240 Before the Senate Business and Industry Committee*, 50th Mont. Leg. at 1, (March 9, 1987) [hereinafter *UTPAI Hearings*] (statement of Randy Gray, State Farm Insurance and the National Association of Independent Insurers).

133. *See infra* Section B of Part V.

134. *See* POSNER, *supra* note 4, § 2.2, at 24.

135. *See Id.*

136. *See id.* § 2.3, at 25 (stating that economic analysis can clarify value conflicts and point the way towards the most efficient means of accomplishing a given social goal).

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ties.[137]

The next section begins an examination of the benefits and of the compliance costs inherent in *Hadley* damages and in the bad faith tort. After illustrating the costs and benefits of each damage regime, the discussion moves to Montana's leading commercial bad faith cases, *Nicholson* and *Story*. This section quantifies the costs that each decision imposed on Montana's contracting parties and concludes that the bad faith tort needs to remain a very narrowly-tailored exception to the *Hadley* cap on contract damages.

1. Hadley *Damages and Efficient Breach*

The following begins, on a theoretical level, a discussion of the advantages and disadvantages inherent in a contract regime based upon *Hadley*'s cap on damages.[138] The traditional examination of *Hadley* centers on the ability of parties to breach and pay damages.[139] In modern times, proponents have used the economic concept of efficiency to support the conclusion that *Hadley* provides a benefit in allowing breach of unprofitable agreements.[140] If contract damages are limited to the value of the contract, a party who is later offered a better deal can predict whether the new deal is worth breaching the pre-existing agreement or not. If it is, the party may choose to breach, pay damages to the former partner, and enter into the new, more profitable deal.[141] The efficient breach calculation relies, however, on the breaching party's ability to pre-determine the cost of

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137. *Id.*

138. For the purposes of this section, the foreseeable damages allowed under *Hadley* will be treated as intrinsic to the value of the contract, and the phrase, "value of the contract," will be used as shorthand for the actual value of the bargain as well as any other foreseeable damages covered under *Hadley*.

139. *See* Holmes, *supra* note 8, at 462.

140. *See* POSNER, *supra* note 4, § 4.8, at 119. The following gives a theoretical example of how a party might choose to breach. A contracts with B to sell B 100 widgets costing 9 cents apiece for $1000. A contemplates $100 in profits from the sale. B later receives an offer from C to sell B 1000 widgets for $800 dollars. C's factory can produce the same widget at 7 cents per unit. If B is allowed to breach his contract with A, and pay *Hadley* expectancy damages of $100 to A (the amount of A's profit), B can buy the widgets from C for $800 dollars and save $100. A is no worse off because A receives the $100 profit that he expected to receive, and C is much happier because C can do business. Consequently, the efficient breach allows everyone to be as well off or better off than if A and B executed the original contract—a win-win proposition called *pareto* superior by law and economic theorists. *See* James M. Buchanan, *Positive Economics, Welfare Economics, and Political Economy*, 2 J. L. & ECON. 124, 124-25 (1959) (defining *pareto* optimality).

141. *Seaman's*, 686 P.2d at 1173 (Bird, J., concurring and dissenting).

breach as the value of the contract. Proponents of efficient breach argue that the cumulative effect of encouraging efficient breach will be to galvanize efficient economic arrangements and help boost the economy's efficiency.[142] On the individual level, by capping contract damages, *Hadley* allows a party to pay the cost of breach and move on to better deals.

Efficient breach is both well-supported by legal scholars and roundly criticized as well. Numerous authors have documented problems inherent in the *Hadley* breach doctrine.[143] The primary criticism is that *Hadley* damages undercompensate the non-breaching party.[144] To obtain compensation for breach, the non-breaching party must seek redress in court.[145] A successful litigant's attorney's fees and court costs often significantly subtract from the value of any judgment, rendering a result far less valuable than what execution of the contract would offer. As acknowledged by the *Story* court, parties may provide for court costs and attorney's fees in the contract, but *Hadley* does not provide for such expenses by default.[146] Thus, litigation expenses represent one form of compliance costs of the *Hadley* rule—a cost which is borne by the non-breaching party in contract disputes.

The second criticism of *Hadley* damages is that they do not deter opportunistic parties from trying to avoid the responsibility of compensating the other party for breach.[147] UPI's attempt to avoid its lease obligations in *Nicholson* represents one example of opportunistic breach. Judge Richard Posner describes such behavior as where "the promisor wants the benefit of the bargain without bearing the agreed upon cost, and exploits the inadequa-

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142. *See Freeman & Mills*, 900 P.2d at 676-77 (traditional contract damages encourage efficient breach and a more efficient economy). Efficient breach theory relies on a number of assumptions which may or may not accurate. For example, do parties pre-calculate the cost of breaching? Does the addition of tort damages actually add significantly to the cost of breach when expert testimony on future earnings and lost reputation already significantly increases damages for a breached contract beyond the value of the actual bargain. *Compare Story*, 242 Mont. 436, 791 P.2d 767 *with Story II*, 259 Mont. 207, 856 P.2d 202 (*Story II* jury awards more than *Story* jury despite absence of tort claim.).

143. *See, e.g.*, Barry Perlstein, *Crossing the Contract-Tort Boundary: An Economic Argument for the Imposition of Extracompensatory Damages for Opportunistic Breach of Contract*, 58 BROOK. L. REV. 877 (1992).

144. See Richard Craswell, *Contract Remedies, Renegotiation, and the Theory of Efficient Breach*, 61 S. CAL. L. REV. 629, 637 (1988).

145. *Id.*

146. *Story*, 242 Mont. at 448, 791 P.2d at 774.

147. See Perlstein, *supra* note 143, at 880 (arguing that not deterring opportunism through punitive damages is economically inefficient).

cies of purely compensatory remedies [to avoid fulfilling the financial responsibility for breach]."[148] Another example of such behavior is the insurance company which refuses to settle claims on behalf of its policyholder.[149] As pointed out earlier the inadequacy of *Hadley* damages in deterring such behavior, was the driving force behind development of the bad faith tort.[150] The inability of *Hadley* to deter opportunistic breach can be construed as a second compliance cost imposed on parties who suffer uncompensated loss or who must change their behavior to avoid such loss.

2. The Bad Faith Tort and Protection of Weaker Parties

The second contract damages theory, the bad faith tort, arose as a solution to the failure of *Hadley* damages to deter opportunistic breach by insurance companies.[151] At first, courts created a single exception to the *Hadley* ban on tort damages by allowing punitive and other types of tort damages for policyholder claims against insurance companies that refused to settle third party claims.[152] The courts recognized the inability of policyholders to negotiate the terms of their policies and, at the same time, the overwhelming reliance of the policyholder on the insurance company to protect it from the harm specified in the policy.[153] Thus, from the start, the bad faith tort existed as an exception to *Hadley* damages delimited by the existence of a quasi-fiduciary relationship. However, the quasi-fiduciary limitation was not originally articulated as a special relationship test, but as a bright line rule restricting the tort's use to the third-party insurance claim context.[154] Courts expanded the tort's use to analogous situations where the contracting parties shared some type of quasi-fiduciary relationship.[155] California and Montana selectively recognized the bad faith tort claim in various contractual contexts such as first-party insurance claims,

148. Patton v. Mid-Continent Sys., Inc., 841 F.2d 742, 751 (7th Cir. 1988).
149. Crisci v. Security Ins. Co., 426 P.2d 173 (1967).
150. *See supra* notes 13-18 and accompanying text.
151. *See* Macintosh, *supra* note 15, at 487-97 (describing history and rationale behind the bad faith tort); Chutorian, *supra* note 13, at 391-92 (describing bad faith tort as solution to inherent limitations for traditional contract remedies).
152. *See* Macintosh, *supra* note 15, at 487-88.
153. *See id.* at 502 (arguing that policy reasons for the quasi-fiduciary bad faith tort are two: reliance theory and unequal relationship theory).
154. *Seaman's*, 686 P.2d at 1166.
155. *See* Chutorian, *supra* note 13, at 396-402.

banking, and employee dismissal suits.[156] The courts applied the tort to these types of contracts as a means of penalizing powerful parties who oppress their weaker counterparts.[157] The extra compensation and protection afforded weak contracting parties by the tort is clearly its largest benefit.[158]

An additional benefit of the tort is that it indirectly, but adequately, compensates successful claimants for the adjudication costs of litigating the claim. The tort award potentially brings the court-ordered compensation above the value of the contract, and thereby indirectly can cover the litigation expenses of recovering the loss.[159] Thus, the tort acts as a buffer to absorb the cost of litigating the claim and allows the plaintiff to recover an amount equal or more than the value of the contract. In short, by deterring opportunistic breach and by offsetting adjudication costs, the bad faith tort solves the inadequacies of *Hadley* damages.

Not surprisingly, the tort's tradeoff in solving *Hadley*'s shortcomings is a loss of *Hadley*'s major benefit: efficient breach. When the tort remained an exception to *Hadley* damages, its disruption of efficient breach applied to only the stronger parties in a quasi-fiduciary relationship—originally only insurance companies. Thus, the primary compliance cost of the bad faith tort, loss of efficient breach, applied to only those narrowly targeted stronger quasi-fiduciaries. However, as Montana and California courts recognized the tort in various contexts, the consequences were double-edged. More parties were protected against oppression, but more parties lost the opportunity to breach efficiently.[160] In other words, as the bad faith tort outgrew its status as an exception to *Hadley* damages, the compliance cost spread to more and more contracting parties.[161]

The inevitable question arising from the bad faith tort's growth from an insurance tort into a general contract tort is whether the bad faith tort is an adequate replacement for

156. *See supra* notes 27-29, 32 and accompanying text.
157. *See* Macintosh, *supra* note 15, at 504.
158. *See* Chutorian, *supra* note 13, at 391.
159. While the adjudication costs must still be subtracted from the judgment, the remaining amount will still be more than the value of the contract. Thus, the tort's possibility of a return greater than the value of the contract acts as a legitimate reason, if not an incentive, to invest in the cost of litigation. *See* POSNER, *supra* note 4, § 21.16, at 588 (arguing that investment in litigation services is guided by private benefits).
160. *See Story*, 242 Mont. at 448, 791 P.2d at 774.
161. *Accord Freeman & Mills*, 900 P.2d at 676.

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Hadley damages, or should remain an exception within contract law.[162] The biggest factor in evaluating the expansion of the bad faith tort will be a reassessment of its compliance costs as it interferes with efficient breach for increasing numbers of parties.[163] Magnifying the significance of the tort's growth is its inability to coexist with *Hadley* damages.[164] Efficient breach breaks down in situations where contract damages are indeterminate; therefore, where the bad faith tort and *Hadley* damages apply to the same contract, the latter's efficient breach becomes impractible, and its cap on damages meaningless.[165] In other words, where they overlap, the bad faith tort subsumes *Hadley* damages. Consequently, the bad faith tort must either replace the *Hadley* scheme of damages or remain at most a narrowly tailored exception to it.

3. Nicholson: *The Cost of the Tort*

This Note opened with a discussion of the bad faith tort's spread in Montana and other states, and described how Montana elevated the tort to its zenith by sanctioning its use in commercial contracts.[166] The case responsible for the tort's spread, *Nicholson*, stands out because the *Nicholson* court, by failing to limit the scope of its tort, created the precedent for a line of tortious commercial breach cases unparalleled in Montana, if not the nation.[167] An examination of *Nicholson* and its aftermath indicates that the court's attempt to confine the tort's use to egregious situations was unsuccessful for two reasons. First, the seeds of this unlimited expansion of the tort are found in the *Nicholson* court's abandonment of the quasi-fiduciary restriction

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162. *See* Guido Calabresi, *Transaction Costs, Resource Allocation, and Liability Rules—A Comment*, 11 J. L. & ECON., 67, 68 (1968) (arguing transaction costs can impede parties from negotiating around misallocations). *But see* Craswell, *supra* note 144, at 635 (arguing that regardless of damages doctrine, goods will likely end up in the hands of highest bidder); Ian R. MacNeil, *Efficient Breach of Contract: Circles in the Sky*, 68 VA. L. REV. 947 (1982) (attacking presumptions of efficient breach doctrine).

163. *See* POSNER, *supra* note 4, § 4.1, at 93 (stating that court needs to provide economically efficient means of dealing with contract disputes).

164. *See Freeman & Mills*, 900 P.2d at 677.

165. *See id.* at 682. Suppose that in the example in supra note 140, A sued B for breach and received not only $100 in expectancy damages, but $500 for tort bad faith. Not only is B worse off than if he performed, but how could B predict a jury's award? *See* Craswell, *supra* note 144, at 632 (arguing that courts should give weight to predictability of legal rules).

166. *See supra* Part II.

167. *See* Macintosh, *supra* note 15, at 497.

to the tort's use.[168] Perhaps the facts of the case forced this concession. Nicholson and UPI were both sophisticated parties experienced in arms-length commercial dealings.[169] No relationship exists more antagonistic to the concept of quasi-fiduciaries than an arms-length contractual arrangement between sophisticated commercial parties.

Second, after abandoning the quasi-fiduciary restriction, the *Nicholson* court tried, but failed to avoid the tort's disruption of efficient breach by declaring that bad faith breach could be distinguished from efficient breach through an inspection of the party's "justifiable expectations."[170] However, the court's justified expectations test proved illusory because the tort's larger awards created an economic incentive for plaintiffs to describe every breach as an egregious violation of his or her justified expectations.[171] The test offered no substantive criteria to determine when a breach rose to the level of bad faith. Thus, despite the court's assertion to the contrary, the *Nicholson* test provided no real means of differentiating bad faith from efficient breach in the face of a plaintiff's economic incentive to claim breach in bad faith. The subsequent rise in commercial bad faith contract claims illustrates that *Nicholson* provided no basis for restricting the bad faith tort's use[172] and that the subsequent overuse of the tort by plaintiffs imposed a high compliance cost on commercial contract parties in Montana.[173]

It could be argued that the defendant has the opportunity to present evidence proving that a breach was not made in bad faith. The procedural transformation of the bad faith claim from contract to tort, however, still disadvantages the defendant as the issues move from offer and acceptance to intent and wrongdoing.[174] The procedural transformation also underscores the disruptive effect of tort damages on contract law as the *Hadley*

168. *See Nicholson*, 219 Mont. at 39-42, 710 P.2d at 1347-48.

169. *Id.* at 34, 710 P.2d at 1343.

170. *Id.* at 41-42, 710 P.2d at 1348.

171. *See supra* notes 46-47 and accompanying text. The post-*Nicholson* case law demonstrates a rise in use of the bad faith tort. This rise can be seen as evidence of the economic incentive to make bad faith claims. *See Story*, 242 Mont. at 448-49, 791 P.2d at 774-75; POSNER, *supra* note 4, § 22.1, at 596 (arguing that private fines provide incentive for private enforcers (i.e., plaintiff's lawyers) to seek out violations).

172. To analyze the difference between the post-*Nicholson* and post-*Story* case law, compare *supra* notes 46-47 with *supra* notes 91-92.

173. *See Story*, 242 Mont. at 448-49, 791 P.2d at 774-75 (discussing bad faith tort's interference with efficient breach and court's attempts to prevent the action's overuse).

174. *Id.* at 448, 791 P.2d at 774.

claims are mixed with bad faith claims.[175] By extinguishing the quasi-fiduciary limitation to the bad faith tort's use, *Nicholson* extended the availability of the bad faith claim to any suit for contract breach. The court's revision of the law, in effect, denied the efficient breach option to every commercial contracting party in Montana—a high price to pay for the protection which the tort's expansion afforded.

Three significant points can be drawn from *Nicholson's* impact on Montana's contract parties. First, the decision shows that where the bad faith tort and traditional contract claim overlap, plaintiff incentive to increase the size of the award will drive the tort's usurpation of traditional contract law. Second, a subjective test of egregiousness, such as *Nicholson*'s "justified expectations," will fail to deter plaintiffs from using the tort wherever possible. Third, the consequence of potential tort liability in any contract action is the complete loss of efficient breach in contracting, a large compliance cost for the parties affected.[176]

The *Nicholson* tort may have an additional drawback which deserves illumination. The original quasi-fiduciary tort's restriction served two purposes: (1) to deter oppression of weaker parties by stronger counterparts, and (2) to restrict the tort's use to preserve efficient breach in non-quasi-fiduciary contexts.[177] *Nicholson*, by exceeding the tort's original scope, not only unnecessarily interfered with efficient breach, but may also have imposed another compliance cost: loss of the bad faith tort's special protection for weaker parties. As argued below, this loss derives from the economic cost which the *Nicholson* tort placed on Montana's contract parties.

Needless to say, the *Nicholson* tort maintained the bad faith claim's protection against opportunistic breach; however, the *Nicholson* tort indirectly added a new cost of doing business in Montana which may have disproportionately fallen on the shoulders of weaker contract parties. By discouraging efficient breach, *Nicholson*, at least theoretically, inhibited the efficiency of Montana's businesses.[178] The following explains how sophisti-

175. *See Freeman & Mills*, 900 P.2d at 676.

176. The third point illustrates the intimate connection between the compliance cost of parties who violate and who obey contract law. *See Story*, 242 Mont. at 448, 791 P.2d at 774.

177. *See* Macintosh, *supra* note 15, at 503, 511.

178. Post-*Nicholson*, a jury could award large tort damages for a bad faith claim; therefore, a party contemplating breach of an existing contract in order to pursue a better offer could not accurately estimate the cost of the contemplated breach. In the face of such expensive uncertainty, the party was probably safer sticking with the

cated businesses may have been better able to recognize and avoid the costs of the bad faith tort and that the economic burden placed on contracting parties by *Nicholson* fell heaviest on weaker parties who lacked the sophistication to avoid it.

One would suppose that a bank or insurance company would realize that suits for contract breach and for bad faith would arise within the scope of their normal business activities.[179] Consequently, such a sophisticated party would calculate the actuarial risk of tortious contract suits[180] and take steps to minimize exposure to the added cost of tort liability. A sophisticated business might react to the added risk by moving out of Montana to other markets or by passing the cost of insuring against it to customers and business partners in a weaker bargaining position. It seems reasonable, on the other hand, to believe that small commercial entities and consumers would fail to either perceive or pass off the added cost of potential contractual tort liability. Furthermore, nothing would prevent the banks, insurance companies, and other sophisticated parties from shifting their added tort liability costs to contracting partners who might very well have been one of the few recipients of the quasi-fiduciary tort's restricted protection. In effect, *Nicholson*'s increase in the cost of doing business would fall heaviest on parties lacking the sophistication to recognize and respond to the new cost. It is plausible to posit that many of these businesses bearing the added cost could be the type of business which the bad faith tort was supposed to protect. Such costs would undercut Justice Trieweiler's assertion in his *Haines* dissent that a bad faith tort protects small businesspersons.[181] The tort would, in

less lucrative deal. According to the theory of efficient breach, the overall impact of *Nicholson* should have been to discourage contracting parties in Montana from breaching inefficient contracts and to remain in less profitable arrangements. The net effect of such conduct would be a drag on Montana's economy. *See Freeman & Mills*, 900 P.2d at 6276-77, 782 (both majority and dissent stating that efficient breach encourages an efficient economy).

179. For a discussion of the role of risk taking in business decisionmaking, see RICHARD G. LIPSEY ET AL, ECONOMICS 167-68 (8th ed. 1987).

180. The risk of bad faith tort liability could be estimated by calculating probability distributions for bad faith tort losses combining risk frequency and risk severity predictions. *See* EUGENE F. BRIGHAM & LOUIS C. GAPENSKI, INTERMEDIATE FINANCIAL MANAGEMENT 960-62 (4th ed. 1993).

181. Justice Trieweiler reasoned that consumers and small business people will suffer under the *Story* special relationship test because the court's denial of bad faith tort claims will facilitate oppressive acts on the part of larger corporations. *Haines Pipeline*, 251 Mont. at 437, 830 P.2d at 1240 (Trieweiler, J., dissenting). Justice Trieweiler's comment fails to take into account the negative impact of a rise in contracting costs for the protected group, i.e. their compliance costs. A failure to consid-

fact, disproportionately burden smaller parties and would interfere with the ability of all businesspersons to breach unprofitable economic arrangements.

To summarize the above discussion of *Nicholson*, *Nicholson* did not add a new quasi-fiduciary relationship subject to the bad faith tort, but it eliminated any quasi-fiduciary boundaries to the tort and made it applicable to all contracts. The court did not realize that its justified expectations test would fail to limit the tort's use. The overuse of the bad faith tort after *Nicholson* foreclosed the option of efficient breach for Montana's contracting parties. The resulting economic inefficiency and possibly disproportional costs associated with a risk of contractual tort liability only compounded the compliance cost of the *Nicholson* bad faith tort. If one believes that *Nicholson*'s abandonment of the tort's quasi-fiduciary restriction exceeded the tort's intended role in contract law, the compliance costs for Montana parties contracting after *Nicholson* merely manifest the holding's overbreadth.

The tort's overbreadth can also be equated with the replacement of contract damages by a tort regime for contract breach. Thus, *Nicholson*'s compliance costs can be seen as the costs inherent in a comprehensive contractual tort regime—and indicative of the unsuitability of tort law as a replacement for *Hadley* damages. In conclusion, the failure of *Nicholson* demonstrates that the bad faith tort should remain no more than a limited exception to the *Hadley* cap on contract damages tailored to fit specific situations where public policy requires special protection for weaker parties.

4. Story's *Common Ground*

In light of *Nicholson*'s overbreadth and high compliance costs, the *Story* court attempted to strike a balance between protection of quasi-fiduciaries and the availability of efficient breach.[182] The court restricted most contract actions to *Hadley* damages by foreclosing tort liability with a gauntlet of special relationship conditions. For parties not able to meet its special relationship test, *Story* reestablishes not only efficient breach, but all of its aforementioned inadequacies.[183] On the other

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er indirect external costs of a regulatory policy often leads to false conclusions. RICHARD G. LIPSEY ET AL., *supra* note 179, 22-23.

182. *See supra* Section D of Part III.

183. The inadequacies are opportunistic breach and undercompensation of litigation costs.

hand, a plaintiff who meets the *Story* relationship test can still obtain tort damages. Thus, quasi-fiduciary relationships retain the enhanced deterrence of the bad faith tort. Of course, the stronger parties in such relationships must bear the loss of efficient breach as a compliance cost, but the scope of parties losing the efficient breach option under *Story* is far smaller than under *Nicholson*.

The *Story* decision does not represent a synthesis of the quasi-fiduciary and efficient breach models. Instead, it bifurcates bad faith along lines designed to sever quasi-fiduciary contracts from commercial contracts. It explicitly recognizes the quasi-fiduciary relationship as not only the public policy rationale for allowing tort damages, but uses it as a bright line test to limit the tort's use. Thus, a contract meeting the special relationship test receives the extra protection and extra burdens of tort damages, while the contract with no special relationship receives the advantages and disadvantages of the efficient breach model. *Story* does not solve the problems inherent in either model, but it categorizes contracts in a way which will bring most contract disputes under the regime with remedies best fashioned for resolving disputes of that nature and with compliance costs most appropriate to the economic interests implicated by that class of contracts. For commercial parties, this means that the non-profit element of the *Story* special relationship test will preclude the bad faith tort and bring the dispute within the framework of traditional *Hadley* contract law. Although some parties will be subject to opportunistic breach because of *Story*, for commercial parties, the ability to breach efficiently can be considered a greater benefit overall. Post-*Story* case law shows that, unlike *Nicholson*'s justified expectations, the *Story* test acts as a clear standard for discriminating between contracts which do and do not fall within the scope of its bad faith tort. The same case law reveals that Montana commercial contract parties can conduct themselves secure in the knowledge that their contractual arrangements do not carry the potential cost of tort liability.[184]

By returning the bad faith tort to its role as a narrow quasi-fiduciary exception to *Hadley* contract law, *Story* allows efficient breach in most cases, but affords special protection to some parties. Although the *Story* special relationship test expressly allows insureds and other weaker parties to bring bad faith tort claims against powerful contract parties, the case law is, for the most

184. *See supra* Sections B and C of Part IV.

part, silent on this issue. Legislative actions taken after *Nicholson* preempted the common law governing most contracts possessing the indicia of a quasi-fiduciary relationship. The next part of this section discusses the legislature's actions banning the bad faith tort in certain contractual contexts and how economic interests orchestrated such change in the political arena.

B. The Reaction in the Political Economy to the Bad Faith Tort

Statutes passed in 1987 by the Montana State Legislature create an important parallel to *Nicholson* and *Story*. Those acts, the Unfair Trade Practices Act For Insurance or UTPAI[185] and the Wrongful Discharge from Employment Act (WDEA),[186] like *Story*, banned bad faith tort claims, but only in the areas of insurance claims and employee contracts. UTPAI and WDEA, however, were not in response to *Nicholson*, but to two separate lines of cases[187] which had previously recognized the quasi-fiduciary bad faith tort.[188] The legislature introduced UTPAI in response to the tort's initial appearance in Montana as an action for insurance contract disputes in 1979.[189] WDEA arose from the political reaction to the tort's incremental expansion into the employee discharge context beginning in 1983.[190] The economic impact of these cases' compliance costs were similar to as those outlined for *Nicholson*. The major difference was that the tort applied only to certain types of stronger parties to a quasi-fiduciary contract, i.e., insurance companies and employers. These targeted groups responded to the court's imposition of a new business cost by lobbying the legislature to address the common law bad faith tort as it applied to them[191] and successfully de-

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185. Codified at MONT. CODE ANN. §§ 33-18-101 to -1006 (1995).

186. Codified at MONT. CODE ANN. §§ 39-2-901 to -915 (1995).

187. For insurance bad faith cases, see, e.g.: Britton v. Farmers Ins. Group, 221 Mont. 67, 721 P.2d 303 (1986); Fode v. Farmers Ins. Exch., 221 Mont. 282, 719 P.2d 414 (1986); Klaudt v. Flink, 202 Mont. 247, 658 P.2d 1065 (1983); First Sec. Bank v. Goddard, 181 Mont. 407, 593 P.2d 1040 (1979).

See the following for bad faith employee discharge suits: Dare v. Montana Petro. Mktg. Co., 212 Mont. 274, 687 P.2d 1015 (1984); Gates v. Life of Mont. Ins. Co., 205 Mont. 304, 668 P.2d 213 (1983).

188. In contrast, *Nicholson* removed the quasi-fiduciary limitation on use of the bad faith tort. *See supra* notes 169-70 and accompanying text.

189. *First Sec. Bank*, 181 Mont. at 419-20, 593 P.2d at 1047 (awarding punitive bad faith damages against disability insurer who falsely denied validity of policy).

190. *Gates*, 205 Mont. at 307, 668 P.2d at 215 (awarding punitive damages against employer for acting in bad faith by not returning resignation letter signed under threat of job termination).

191. For example, one insurance representative testified:

manded protection of their economic interests against judicially-created tort damages.[192] The next section explores how these events, parallel, yet connected to the commercial contract cases, *Nicholson* and *Story*, reflect the interplay of politics and economics in the legislative process.

1. *Legislation Theory*

This section relies largely on legislation theory derived from Professor George J. Stigler's economic research on regulatory bodies.[193] The legislative version of regulation theory essentially predicts that legislators draft legislation that will enhance their reelection prospects.[194] The two types of support which a legislator needs to win reelection are money and votes.[195] However, voters' interests are dispersed and voter support is not guaranteed by any particular piece of legislation.[196] Special interest groups, however, will respond favorably to particular pieces of legislation; these lobby groups can influence the legislative process by pledging votes and campaign funds to legislators who support the group's agenda.[197] The ultimate conclusion of legislation theory is that legislators will draft bills distorted in favor of special interest groups able to assert influence within the legislative halls by promising campaign support.[198] This Note makes the assumption that industry groups testifying before Montana legislative committees possess that type of political

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> [T]here has been no single incident in the past five years that has had a greater impact than the development of the tort of bad faith. This has caused markets to seriously consider the continued interest in doing business in the state of Montana and has adversely affected him and many of his clients.

UTPAI Hearings, *supra* note 132, at 2 (statement of Thomas A. Grau, partner, Century Agency).

192. A member of the Montana Liability Coalition stated: "The employer's decision to terminate an employee for a legitimate business reason should not subject [sic] to subsequent ratification by a jury at any time."

Minutes of the Meeting: Consideration of H.B. 241 before the House Judiciary Committee, 50th Mont. Leg. at 1 (Jan. 28, 1987) [hereinafter *WDEA Hearings*] (statement of Jim Robischon, Montana Liability Coalition).

193. *See* Peltzman, *supra* note 124, at 211.

194. POSNER, *supra* note 4, § 19.3, at 525.

195. Peltzman, *supra* note 124, at 214. Of course, the ultimate objective of a politician is to win votes; but the implication of regulation theory is that drafting legislation which attracts campaign funds is more effective than drafting legislation which directly garners voter support. *See* POSNER, *supra* note 4, § 19.3, at 525.

196. Peltzman, *supra* note 124, at 213.

197. *See* POSNER, *supra* note 4, § 19.3, at 525.

198. *Id.*

clout.

Legislation theory makes another interesting prediction about the political process. It identifies the characteristics of groups that should be able to lobby successfully the legislature.[199] The fundamental premise is that a relatively small, homogenous group (i.e., a manufacturing industry with inter-industry links) will be more effective than a diffuse, heterogenous group (such as individual consumers) to (1) recognize its economic interest in favorable legislation, and (2) unite to spend resources on a common agenda.[200] The next part of this section evaluates the evisceration of the bad faith tort in the legislature within the framework of legislation theory.

2. *Legislative History of Statutory Bans on Bad Faith*

An examination of the legislature's actions and the history of UTPAI and WDEA reveal a pattern of lobbying and political action in keeping with theoretical predictions of how legislators and lobbyists interact. First, in regards to UTPAI, the insurer lobby, representing a discrete industry with a monolithic interest in reducing insurer's bad faith tort damages, seems to possess the qualities conducive to an effective lobbying effort. As evidenced by its strong presence at the UTPAI hearings, the insurance lobby represents a fairly small and cohesive industry that presented a concentrated lobbying effort to ban the bad faith tort.[201] On the other hand, UTPAI's legislative history lacks any testimony by insureds on the need or desirability of a ban on bad faith tort damages.[202] One might accept testimony in opposition to such legislation by the Montana Trial Lawyers Association (M.T.L.A.),[203] a plaintiff lawyer lobby, as a surrogate for

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199. Peltzman, *supra* note 124, at 212-13.

200. The first premise can be understood through the following example of how fewness of members provides economic incentive to act:

> [I]f a group of 10 takes $20 from 100 others, the cost per transferor is only 20 [cents] and benefit per transferee is $20; if the size of the groups is reversed, the cost is $2 per transferor and the benefit is only 20 [cents] per transferee.

POSNER, *supra* note 4, § 19.3, at 525. The example makes clear why the smaller group has greater incentive to seek a regulatory transfer of wealth to it than the larger group and greater incentive to prevent a transfer from it. The same holds for legislation protecting the smaller groups' interests by promoting oligopoly through limiting market entry or regulating price competition. *Id.*

201. Out of four UTPAI proponents who testified, three came from the insurance industry. *See UTPAI Hearings*, *supra* note 132, at 1-2.

202. *See generally id.* at 1-4.

203. Two UTPAI opponents testified. One was Carl Englund, M.T.L.A. The other

insured testimony; but, more likely, M.T.L.A. efforts serve as further evidence of the ability of small, relatively homogenous groups to recognize and take action to protect their economic interests. In M.T.L.A.'s case, its interests overlap with the insured's,[204] but at least according to legislation theory, the driving force behind the organization's appearance would be the plaintiff litigator's pecuniary interest in increasing the size of awards for contract breach.[205]

The legislative history for WDEA further supports the legislation theory analysis. Here, the variety and number of employers is much greater than those interests found supporting UTPAI, which introduces the possibility of free-rider problems.[206] Nonetheless, the legislative history reflects a well-coordinated lobbying effort to stop tort damages for at-will employee termination.[207] The ability of employers to unite could reflect that lobbying activities are feasible for even fairly large groups where the common economic interest is readily apparent.[208] A further advantage to the employer's lobby is the complete absence of an opposing employee lobby as evidenced by the lack of testimony by at-will employees at WDEA hearings.[209] It would seem that by definition, the at-will employees exist as unorganized individuals facing significant informational and organizational hurdles to coordinating a lobby against the tort reform. Another explanation for the coordinated response of the employer lobby to employee discharge tort reform is that the insurance

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was John Hoyt, an attorney from Great Falls. *See id.* at 3.

204. M.T.L.A.'s Mr. Englund describes insurance bad faith as "the right to a private cause of action for lawsuit by someone who has been injured by the failure of an insurance company . . . ." *Id.* at 3 (statement of Carl Englund, M.T.L.A.).

205. *See* POSNER, *supra* note 4, § 22.1, at 595-96 (describing how economic incentives can drive law enforcement).

206. No less than twelve different type of businesses and commercial associations, not counting the appearance of defense lawyers, testified in favor of WDEA. *See WDEA Hearings*, *supra* note 192, at 1-3. Free riders are members within a class of beneficiaries who obtain all the advantages of a given entitlement or other benefit without contributing towards its creation or maintenance. For an example of free rider behavior in the retail context, see POSNER, *supra* note 4, § 10.3, at 295.

207. *See WDEA Hearings*, *supra* note 192, at 1-3.

208. Free riders greatly reduce the feasible size of groups attempting to form cartels; but a number of factors ameliorate the free rider problem for lobbying. First, lobbying is legal; therefore, an industry can take concerted and public action to pressure free riders into contributing to their lobby. Second, the increase in free rider problems inherent in larger groups is offset by a larger group's ability to pull votes in support of its agenda, a method besides campaign fund contributions of enhancing political clout. *See* POSNER, *supra* note 4, § 19.3, at 525.

209. *See generally WDEA Hearings*, *supra* note 192, at 1-4.

industry lent its support and organizational capabilities to the employer lobby.[210] Tortious bad faith employee discharge damages implicate liability insurer's interests because these insurers must often take financial responsibility for their policyholders' bad faith torts.[211] To sum up, in both the UTPAI and WEDA legislative histories, clear evidence exists that industry recognized its economic interests in favorable tort reform and that affected businesses coordinated a lobbying effort to push for favorable legislation. Can the fact that the legislature passed pro-industry legislation be seen as merely coincidental?

The absence of a legislative ban on commercial bad faith is the final piece of evidence supporting the legislation theory analysis. That such a void would exist can be inferred from the lack of any cohesive characteristics shared by the successful industrial lobbyists in the group affected by the *Nicholson* version of the bad faith tort. The group, of course, is commercial contracting parties: a disorganized, disparate group stretching across various industries, with probably few common business interests or existing channels of communication.[212] Legislation theory predicts that such a disparate group cannot effectively organize to lobby.[213] The legislature did not pass a ban for commercial bad faith which, by omission, supports the prediction that commercial parties could not organize an effort to ban the commercial bad faith tort. This evidence is by negative implication, however, and subsequent analysis might reveal better explanations.

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210. "Prior to 1987, the case-law development . . . [of the employee discharge bad faith tort] generated a belief among Montana employers and insurance companies . . . that their best hope for changing the direction of the law was through direct legislative action."

LeRoy H. Schramm, *Montana Employment Law and the 1987 Wrongful Discharge from Employment Act: A New Order Begins*, 51 MONT. L. REV. 94, 108 (1990).

211. "[U]npredictability [in employer bad faith law], coupled with what employers perceived as unreasonably large awards to wrongful discharge claimants, led Montana employers and insurance companies (who paid the employment discharge awards) to seek legislative reform."

M. Scott Regan, Tonack v. Montana Bank: *Preemption, Interpretation, and Older Employees Under Montana's Wrongful Discharge from Employment Act*, 56 MONT. L. REV. 585, 588 (1995) (footnotes omitted).

212. See *supra* notes 46-47, 91-92 for contract suits between a wide variety of businesses. It is also worth noting that unlike insurance companies and employers, commercial enterprises were not always the target of the *Nicholson* bad faith tort. Plaintiffs such as Nicholson were commercial parties as well, and were beneficiaries of the tort's expanded damages. Because commercial parties might perceive themselves as potential plaintiffs as well as potential defendants, the economic impact of the *Nicholson* tort would not be as clearly one-sided as for industries affected by a quasi-fiduciary bad faith tort.

213. *See* POSNER, *supra* note 4, at § 19.3, at 525.

For example, one area of the commercial bad faith tort, banking bad faith, which was recognized before *Nicholson*,[214] but not banned until *Story*,[215] extended the quasi-fiduciary relationship to banks. Presumably banks have the characteristics of an industry able to lobby effectively. Banks have a well-defined economic interest in opposing a bad faith tort for lending and credit institutions and should possess the cohesiveness to organize a lobby against the banking bad faith tort. Yet, the legislature never took action on the banking industry's behalf. This omission represents the largest failure of legislation theory to explain the political events surrounding the bad faith tort's rise and fall.

3. *The Political Process Behind Tort Reform*

Regardless of the anomaly presented by the banking industry, legislation theory provides two valuable insights into the legislative process. First, the types of industries whose contracts possess the indicia of a quasi-fiduciary relationship also seem to be the types of business possessing the cohesiveness to lobby effectively. The overlap indicates that fairly cohesive industries with well-defined economic interests might frequently possess the ability (a) to breach opportunistically and (b) to pressure the legislature for favorable market regulation. In other words, the ascription of quasi-fiduciary characteristics to a particular industry is merely another way of saying that it possesses oligopolistic tendencies.[216] The overlap suggests that opportunistic breach is a form of anti-competitive behavior and that its deterrence might be justified on economic as well as normative grounds.[217]

214. First Nat'l Bank v. Twombly, 213 Mont. 66, 73, 689 P.2d 1226, 1230 (1984) (holding punitive bad faith damages available where bank improperly offset debtor's checking funds against promissory note).

215. *See, e.g.* Lachenmeir v. First Bank Sys., Inc., 246 Mont. 26, 33, 803 P.2d 614, 618 (1990) (dismissing debtor's bad faith claim against bank who foreclosed on loan where debtor failed (1) to prove breach of *Story*'s honesty-in-fact standard and (2) to meet the *Story* special relationship test).

216. Thus, if opportunistic breach is construed as one form of market failure, the legislature's bad faith tort reform taken on behalf of industries in the position to breach opportunistically is one more illustration of an elected body's anti-competitive tendency to protect the interests of powerful industrial lobbies. *See* POSNER, *supra* note 4, § 19.3, at 525.

217. *See* Chutorian, *supra* note 13, at 394 (arguing that bad faith tort damages represent an economically sound remedy in the insurance context). Nonetheless, the *Nicholson* ruling exemplifies the economic incentive for plaintiffs to abuse a ruling that allows tortious contract damages. In other words, while opportunistic breach might be anti-competitive, the inefficiencies of any regulatory solution may be great-

Second, the legislature's statutory solution to the bad faith tort's existence seems at odds with any rational judicial or economic basis for its actions. Within the context of the competing needs of the insurer/insured and the employer/employee, a strong argument could be made that the legislature's bad faith bans favor the needs of the industrial lobby at the expense of employees and insureds. Such a result is impossible to justify on the basis of traditional jurisprudence, with its normative values of fairness to all and careful scrutiny of measures adversely affecting weaker parties. From an economic perspective as well, the legislature's deeds are inexplicable. Putting aside the question of whether the bad faith tort is a necessary deterrent for employers and insurers, the earlier discussion of commercial cases illustrated that the bad faith tort is most inappropriate for arms-length contracts negotiated between commercial parties.[218] For the legislature to allow the bad faith tort's existence to continue in the commercial realm and not in contracts where the quasi-fiduciary nature of the relationship provides a normative, if not economic, basis for the tort is irrational.[219] In short, whether viewed from a jurisprudential or an economic perspective, the legislature's actions banning bad faith exemplify its lobby-driven agenda; and, thus, its inability to fashion equitable and efficient statutes.

If the legislature is institutionally flawed in its ability to deliver fundamentally fair market regulation, the focus on a branch of government capable of fulfilling this role shifts back to the judiciary. Yet, the legislative histories of UTPAI and WEDA, and the *Story* opinion all include evidence that the compliance costs of the court's bad faith tort—whether intended or not—brought about significant political opposition, and subsequent legislative action to curb those costs. Thus, the court's actions can be considered the initiating event for the entire political and economic upheaval. On the other hand, the *Story* court returned the bad faith tort to its proper role as a quasi-fiduciary exception to limited *Hadley* damages. Thus, if one considers *Story* to represent the best compromise of contract and tort for bad faith claims, the judiciary deserves credit for adopting that solution from California common law. The *Story* decision exemplifies the court's ability to balance its normative

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218. *See supra* notes 138-42 and accompanying text.

219. The assumption is that the normative goal of preventing opportunistic breach legitimates the judiciary's use of market-distorting economic disincentives to breach. *See* POSNER, *supra* note 4, § 19.1, at 519.

goals and to structure its rulings to efficiently accomplish them, suggesting that the judicial branch is capable of shaping contract law to fairly and flexibly govern the economic activities of contract parties.

The unfortunate aspect of the bad faith tort's fall is that the legislative bans block the full effect of the *Story* special relationship and prevent the court from reshaping common law in those areas as new situations develop. Yet, the positive role of the legislature cannot be overlooked. The *Story* court pointed to those bans as legislative disapproval of the common law bad faith tort and took that disapproval as a sign that the common law needed midstream corrections. Thus, the legislature's disapproval—a political manifestation of the court's adverse impact on powerful businesses—and the legislature's ability to articulate that disapproval—with statutes preempting court authority—may serve as important factors in discouraging courts from economically irrational rulings. In light of these factors, the legislature provides an important, but not always proportionate or direct, counterweight to economically costly rulings, and a necessary check on judicial activism.

VI. THE SIGNIFICANCE OF *STORY*

In the course of examining *Story*'s impact on bad faith law in Montana, this Note explored the rise and the fall of the bad faith claim as a tort. It started with the spread of the bad faith tort to commercial contracts under *Nicholson* showing how the *Nicholson* court took the final step of allowing the bad faith tort to sound in any contract claim. Next, it discussed the special relationship test which the *Story* court imposed on bad faith claims to foreclose tort damages in most contract suits, especially suits between commercial plaintiffs. This Note showed that the dearth of successful bad faith claims in post-*Story* case law substantiates the assertion that the *Story* court intended to foreclose plaintiff's use of the bad faith tort. Later sections treated parallel legislative acts showing that UTPAI and WDEA prevent most bad faith tort claims that might meet the *Story* special relationship test. In conjunction with these statutes, it is clear that *Story* ends the reign of Montana's bad faith tort.

Although *Story* draws to a close Montana's short unification of contract and tort, it does not represent a triumph in Montana's contract law, but only a water mark in its ebb and flow. As the theoretical component of this Note revealed, the underlying battle over how to compensate breaches of contract

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continues. The economic incentives for plaintiff litigators to expand contract damages beyond the value of the bargain remain unchanged. As exemplified by Story's second trial award in which he won $850,000 on pure contract claims, litigators will exploit other legal avenues to pursue large recoveries.

Moreover, the tug-of-war between parties before the court is not the only source of tension in the shaping of the law. The court's shared jurisdiction with the legislature also produces regulatory competition. Thus, the statutory bans on bad faith not only reshaped Montana's contract law, but hampered the court's ability to implement its own normative goals. The discussion of regulation theory and the legislative history of those bans illustrates that the legislature's lobby-driven process is ill-equipped to adjudicate economic disputes fairly. However, this Note also made clear that the economic impact of decisions by the Montana Supreme Court produced the political backlash that foreclosed further judicial action through statutory preemption. Therefore, the most significant conclusion is that courts are better able than the legislature to adjudicate economic disputes fairly, but that in order to fulfill properly its duties, the court must consider the economic ramifications of its decisions on the public.[220]

This Note should also have illustrated that *Story* has not solved the underlying problems with *Hadley* damages, i.e., opportunistic breach and undercompensation, which drove the creation of the bad faith tort. Therefore, social forces pushing for greater compensation for contract breach, aided by the economic incentive of plaintiff litigators, will probably reemerge at some point. Furthermore, if insurers and employers take advantage of the statutory bans on the bad faith tort to oppress their contractual counterparts, either the courts will recognize new actions to address the resulting grievances, or public pressure may drive the legislature to rescind its bans. It is impossible to predict the future except to suggest that contract law will remain in a state of flux. The guidelines to shaping economically rational rulings afforded here will hopefully aid in creating laws that efficiently and narrowly accomplish the court's judicial goals.

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220. Admittedly, just and economically efficient rulings may still run afoul of vested business interests that will push for protective and biased legislation.

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