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"Bad Faith Breach": A New and Growing Concern for Financial Institutions

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I. INTRODUCTION

A majority of courts have determined that all contracts impose on the parties to the contract an implied covenant of good faith and fair dealing in their actions with each other.[1] This implied covenant prohibits a contracting party from injuring another party's right to receive the benefits of the agreement.[2] Breach of this implied covenant usually cre-

* Throughout the Special Project, this piece is cited as Special Project Note, *"Bad Faith Breach"*.

1. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 404 app. (1980) (citing cases in jurisdictions that have developed this rule). For a discussion of implied covenants of good faith and fair dealing, see Recent Development, *Implied Covenants of Good Faith and Fair Dealing: Loose Cannons of Liability for Financial Institutions?*, 40 VAND. L. REV. 1197 (1987).

2. *See* Kirke La Shelle Co. v. Paul Armstrong Co., 263 N.Y. 79, 87, 188 N.E. 163, 167 (1933), *noted in* Burton, *supra* note 1, at 400 app.; *see also* Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 577, 510 P.2d 1032, 1040, 108 Cal. Rptr. 480, 484 (1973).

ates a cause of action based on contract rights.[3] Moreover, California courts maintain that breach of the implied covenant of good faith and fair dealing creates a tort action as well. The California courts initially limited these tort actions to claims against insurance companies.[4] Other states have followed California in allowing tort recovery for breach of the implied covenant of good faith and fair dealing in insurance contracts.[5] The imposition of tort liability in contract suits has allowed courts to award the injured party all damages proximately caused by breach of the contract, as well as punitive damages.[6]

Recently, California courts expanded bad faith breach outside of the insurance context and into the commercial arena.[7] Financial institutions have been significantly affected by this expansion.[8] Since the in-

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3. *See* RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981) [hereinafter RESTATEMENT OF CONTRACTS] (stating that "every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement"); *see also* Masonite Corp. v. Pacific Gas & Elec. Co., 65 Cal. App. 3d 1, 9, 135 Cal. Rptr. 170, 175 (1976).

4. *See, e.g.*, Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 620 P.2d 141, 169 Cal. Rptr. 691 (1979), *cert. denied*, 445 U.S. 912 (1980) (holding that Mutual of Omaha's failure to properly investigate insured's claim by having its own physician examine insured and by failing to consult with insured's own physician and surgeon amounted to a breach of the implied covenant of good faith and fair dealing contained in the disability policy); *Gruenberg*, 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (holding tbat Aetna's refusal to compensate insured without cause for loss covered by the insurance policy could give rise to a tort action for breach of the implied covenant of good faith and fair dealing); Crisci v. Security Ins. Co., 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967) (holding that an insurance company breaches the implied covenant of good faith and fair dealing when it refuses to accept a reasonable settlement, thereby depriving the insured of the policy's benefits); Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 328 P.2d 198 (1958) (holding that the implied covenant of good faitb and fair dealing imposes an unexpressed duty on an insurance company to accept a reasonable settlement with a third party).

5. *See* Kornblum, *Recent Cases Interpreting the Implied Covenant of Good Faith and Fair Dealing*, 30 DEF. L.J. 411, 431 n.50 (1981). The other state courts that have followed California in allowing tort recovery for breach of the implied covenant of good faith and fair dealing are Arizona, Connecticut, Illinois, Iowa, Kansas, Missouri, Montana, Nevada, New Jersey, New Mexico, North Dakota, Ohio, Oklahoma, Tennessee, and Wisconsin. *Id.* Several federal district courts with diversity jurisdiction have interpreted state law as imposing the implied covenant of good faith and fair dealing on parties to an insurance contract. These courts include the federal district courts in Vermont, South Carolina, and Florida. *Id.*

Breach of the implied covenant of good faith and fair dealing has been referred to under a variety of labels. These labels include the "insurer's mistaken judgment," the "new tort of outrage," the "tort of bad faith," "tortious interference with a protected property interest," and "bad faith breach." This Note will refer to the tortious breach of the implied covenant of good faith and fair dealing as "bad faith breach."

6. *See* RESTATEMENT (SECOND) OF TORTS § 917 (1977) [hereinafter RESTATEMENT OF TORTS] (stating that a person who "harms the person or property of another is subject to liability for the consequences of the harm"). These damages include compensation for emotional distress, *id.* § 905(b), and compensation for punitive damages if the defendant's conduct is "outrageous" because of "evil motive" or "reckless indifference to the rights of others," *id.* § 908(2).

7. *See, e.g.*, Seaman's Direct Buying Serv., Inc. v. Standard Oil Co., 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984); *see also infra* notes 71-85 and accompanying text.

8. The imposition of bad faith breach on financial institutions has caused them to become much more cautious in their dealings with clients. A financial institution may have to place its

troduction of bad faith breach into the banking industry, borrowers are suing lenders with increasing frequency.[9] These borrowers frequently prevail on the merits and obtain large judgments against the financial institutions.[10]

This Note, in Part II, examines the good faith doctrine and in Parts II and III traces the development of bad faith breach into the commercial realm. Special emphasis is placed on the introduction of bad faith breach into the banking area. Part III also reviews a case recently reversed by the California Court of Appeals because of the court's determination that the borrower's bad faith breach cause of action against the financial institution was factually unsupported. Finally, in Part IV, this Note examines the possibility of a financial institution using Uniform Commercial Code (U.C.C.) sections 2-609 and 2-610 during times of insecurity to demand payment from its client without imposing liability on itself.

II. History of the Implied Covenant of Good Faith and Fair Dealing

Traditionally, lender liability claims against financial institutions were governed by the Bankruptcy Code,[11] federal securities laws,[12] tax

client's needs in front of its own, thereby subjecting itself to economic loss in order to avoid a suit by its client for bad faith breach. Moreover, the judgments against financial institutions for bad faith breach have been extremely large, and an increasing number of states are imposing this tort action on financial institutions.

9. *See generally* American Bar Association, Emerging Theories of Lender Liability (H. Chaitman ed. 1985); Granoff, *Emerging Theories of Lender Liability: Flawed Applications of Old Concepts*, 104 Banking L.J. 492 (1987).

10. *See, e.g.*, K.M.C. Co. v. Irving Trust Co., 757 F.2d 752 (6th Cir. 1985) (affirming jury award of $7.5 million); State Nat'l Bank v. Farah Mfg. Co., 678 S.W.2d 661 (Tex. Ct. App. 1984) (affirming jury award of $18.5 million).

11. 11 U.S.C. § 510(c)(1) (1982) (providing that "under principles of equitable subordination, [a court may] subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim"). Bankruptcy Code § 547(b) allows a court to require a financial institution to return property received in a preferential transfer. *Id.* § 547(b).

12. *See* 15 U.S.C. §§ 77(o), 78t(a) (1982). A court may hold a bank liable as being a "controlling person" under the Securities Act of 1933 § 15, *id.* § 77(o), and the Securities Exchange Act of 1934 § 20(a), *id.* § 78t(a). Section 15 of the Securities Act of 1933 states that:

> Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under sections 11 or 12 of this title, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person bad no knowledge of or reasonable ground to believe in the existence of the facts by reason of whicb the liability of the controlled person is alleged to exist.

Id. § 77(o). Section 20(a) of the Securities Exchange Act of 1934 declares:

> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled

and wage laws,[13] and the Racketeer Influenced Corrupt Organizations Act (RICO).[14] In addition, potential common-law theories that could be asserted included fraud,[15] duress,[16] breach of fiduciary duty,[17] and in-

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> person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

Id. § 78t(a).

13. *See* I.R.C. § 3505(a) (1982). A financial institution who is not an employer but who finances the payroll of its debtor can be liable under the Internal Revenue Code (I.R.C.) for failing to collect and remit wage withholding taxes. Section 3505(a) of the I.R.C. declares:

> [I]f a lender . . . who is not an employer . . . pays wages directly to such an employee or group of employees . . . such lender . . . shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) required to be deducted and withheld from such wages by such employer.

Id.

14. 18 U.S.C. §§ 1961-1968 (1982). A financial institution may be liable if it engages in activities prohibited by the Racketeer Influenced and Corrupt Organizations Act. *Id.* Section 1962(a) declares:

> It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt in which such person has participated as a principal . . . to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce.

Id. § 1962(a).

15. *See* RESTATEMENT OF TORTS, *supra* note 6, § 525. A person who fraudulently makes a misrepresentation of fact for the purpose of inducing another person to act is liable for injuries caused to the relying person. *Id.* The California Supreme Court held a financial institution liable for fraud in Sanchez-Corea v. Bank of Am., 38 Cal. 3d 892, 701 P.2d 826, 215 Cal. Rptr. 679 (1985). In *Sanchez-Corea*, the bank represented that it would finance the debtor in return for an assignment of all the debtor's accounts receivable. *Id.* at 909, 701 P.2d at 838, 215 Cal. Rptr. at 691. At the time of this representation, Bank of America had determined that it would not finance the debtor. *Id.* Bank of America, after the accounts receivable assignment, denied the debtor's long-term loan application. *Id.* The jury awarded the debtor $1 million in punitive damages and the California Supreme Court affirmed. *Id.* at 910, 701 P.2d at 839, 215 Cal. Rptr. at 692; *see also Farah*, 678 S.W.2d 661 (jury verdict of $18.5 million, based in part on damages for fraud, was affirmed by the court of appeals with a remittitur of $300,105); *cf.* Stirling v. Chemical Bank, 382 F. Supp. 1146 (S.D.N.Y. 1974), *aff'd*, 516 F.2d 1396 (2d Cir. 1975) (shareholder's suit alleging fraud in connection with purchase and sale of securities dismissed for failure to state a claim on which relief could be granted). For further discussion, see Special Project Note, *Lender Liability, supra*, at notes 152-60 and accompanying text.

16. *See* 13 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1602 (3d ed. 1970). Duress occurs when one person unlawfully threatens another person, causing that other person to do something he otherwise would not do. *Id.* For cases holding a financial institution liable under duress, see Spillers v. Five Points Guaranty Bank, 335 So. 2d 851, 852 (Fla. Dist. Ct. App. 1976) (holding a lender may be liable for duress if it threatens to enforce legal rights that are nonexistent); and *Farah*, 678 S.W.2d 661 (jury verdict of $18.5 million based in part on damages for duress). *See also* Special Project Note, *Lender Liability, supra*, at notes 161-71 and accompanying text.

17. *See, e.g.*, First Bank of WaKeeney v. Moden, 235 Kan. 260, 262, 681 P.2d 11, 13 (1984). Banks have been held to the standards of a fiduciary in many instances. In determining whether a fiduciary relationship exists, courts look for:

> [T]he acting of one person for another; the having and the exercising of influence over one person by another; the reposing of confidence by one person in another; the dominance of one

terference.[18] More recently, however, courts have held lenders liable under the breach of the implied covenant of good faith and fair dealing theory.[19]

Original contract theory allowed a party either to perform its contractual obligation or to pay compensatory damages.[20] If the damaged

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> person by another; the inequality of the parties; and the dependence of one person upon another. In addition, courts have considered weakness of age, mental strength, business intelligence, knowledge of the facts involved or other conditions giving to one an advantage over the other.

Id. Many courts have held a lender liable for hreaching its fiduciary duties. *See, e.g.*, Stanghellini Ranch, Inc. v. Bank of Am., No. 35448, No. 3 Civ. C003244 (Cal. App. Dep't Super. Ct. 1987) (holding Bank of America liable to plaintiffs for fraud, breach of fiduciary duty, and intentional infliction of emotional distress because it seized almost one million dollars from plaintiffs' passbook accounts and began foreclosure proceedings on their farm and homes after it persuaded plaintiffs to expand their business by signing personal guarantees for loans); Hooper v. Barnett Bank, 474 So. 2d 1253 (Fla. Dist. Ct. App. 1985) (holding that under certain circumstances, a financial institution bas a fiduciary duty to disclose the financial condition of its customers); First Nat'l Bank v. Brown, 181 N.W.2d 178 (Iowa 1970) (holding that First National Bank's withholding of facts to plaintiff when transacting a loan to buy property which would have caused plaintiff not to buy the property was a breach of First National Bank's fiduciary duty that amounted to fraud); Smith v. Saginaw Sav. & Loan Ass'n, 94 Mich. App. 263, 288 N.W.2d 613 (1979) (holding Saginaw Savings & Loan liable for breach of its fiduciary obligation when it abused its relationship with plaintiff by maintaining that a builder was reliable when it knew the builder was having financial difficulties, by assuring that funds from plaintiff's loan would be available for construction, and by asserting that it would not give the builder any funds from the loan unless work was done by the builder, when the opposite proved to be true); *see also* Special Project Note, *Lender Liability, supra*, at notes 63-134 and accompanying text.

18. *See* RESTATEMENT OF TORTS, *supra* note 6, § 766. Interference occurs when one party improperly and intentionally interferes with the performance of a contract by causing one of the contracting parties not to perform under the contract. *Id.* For cases holding a financial institution liable for interference, see Melamed v. Lake County Nat'l Bank, 727 F.2d 1399 (6th Cir. 1984) (in a suit by the trustee in a bankruptcy case, the court held the financial institution liable for interfering with debtor's business because it replaced the debtor's accountant with one selected by the bank; it retained final approval over all payments made by the debtor; and it forced the debtor's president to take a fifty percent pay cut); and *Farah*, 678 S.W.2d 661 (jury verdict of $18.5 million based in part on damages for interference); *see also* Special Project Note, *Lender Liability, supra*, at notes 172-81 and accompanying text.

19. *See* Sokolsky, *Of Good Faith and Fair Dealing: A Tort is Expanded to the Banks*, Nat'l L.J., Oct. 24, 1988, at 22. Some factors courts have used in determining whether a financial institution has breached the implied covenant of good faith and fair dealing are as follows:

> The degree of dependence and trust that the borrower has upon the bank; [t]he existence of a relationship of trust and confidence between a bank and the borrower; [w]hether the bank stands to benefit by virtue of the borrower's default; [whether] the bank is the only avenue of financing upon which the borrower may rely, or [w]hether it is highly unlikely that the borrower would get credit elsewhere by virtue of the lender's handling of the loans; [whether] there is a consistent and uninterrupted course of dealing between the parties over an extended period of time; [w]hether the borrower anticipated and relied upon receiving a specific line of credit; . . . (with regard to loan acceleration), whether a reasonable person would have greatly accelerated the debt under the circumstances; whether the borrower acted in good faith; [and m]ost important, whether the borrower was given adequate time to seek alternative financing.

Id.

20. *See* RESTATEMENT OF CONTRACTS, *supra* note 3, §§ 344-385 (remedies); *see also id.* intro-

party could not be adequately remedied with compensatory damages, a court could award specific performance.[21] Courts were not concerned with the motive behind the breach.[22] In addition, punitive damages were not allowed because the purpose of compensation was not to punish the breaching party, but rather to put the damaged party in as good a position as he would have been if the contract had been performed.[23]

A. *The Uniform Commercial Code and the Implied Covenant of Good Faith and Fair Dealing*

Original contract theories have been modified by the judicial imposition of an implied covenant of good faith and fair dealing into every contract.[24] This implied covenant prohibits parties to the contract from doing anything that would deprive the other party of the benefits of the bargain.[25] U.C.C. section 1-203[26] states that "[e]very contract or duty within this Act imposes an obligation of good faith in its performance or enforcement."[27] U.C.C. section 1-201(19)[28] defines good faith as "honesty in fact in the conduct or transaction concerned."[29] Article 2 expands a merchant's obligation of good faith to include not only honesty in fact, but also "the observance of reasonable commercial standards of fair dealing in the trade."[30] Additionally, U.C.C. section 1-102(3)[31] will not allow parties to waive the good faith requirement, but

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ductory note, at 100. The *Restatement* indicates that a party may find himself at an economic advantage to breach the contract "if he will still have a net gain after he has fully compensated the injured party for the resulting loss." *Id.*

21. *See id.*; G. GILMORE, THE DEATH OF CONTRACT 14-15 (1974).

22. *See* RESTATEMENT OF CONTRACTS, *supra* note 3, §§ 344-385 (remedies); *see also id.* introductory note, at 100 (stating that " 'willful breaches' " have not been distinguished from other breaches).

23. *See* RESTATEMENT OF CONTRACTS, *supra* note 3, § 355 comment a (stating that "[t]he purpose of awarding contract damages is to compensate the injured party . . . [f]or this reason, courts in contract cases do not award damages to punish the party in breach or to serve as an example to others").

24. *See generally* Burton, *supra* note 1; Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666 (1963); Summers, *The General Duty of Good Faith—Its Recognition and Conceptualization*, 67 CORNELL L. REV. 810 (1982). Recent Development, *supra* note 1, at 1202.

25. Burton, *supra* note 1, at 379-80.

26. U.C.C. § 1-203 (1987).

27. *Id.*

28. *Id.* § 1-201(19).

29. *Id.*

30. *Id.* § 2-103(1)(b). A merchant is defined as "a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction." *Id.* § 2-104(1). However, many courts apply only the U.C.C. § 1-201(19) general definition of good faith to financial institutions instead of the more stringent definition of U.C.C. § 2-103(1)(b). *See, e.g.*, Van Bibber v. Norris, 419 N.E.2d 115, 122 (Ind. 1981) (concluding that financial institution is not subject to the "merchant" definition of good faith).

31. U.C.C. § 1-102(3) (1987).

will allow them to determine reasonable standards by which good faith will be measured.[32] Finally, section 205 of the *Restatement (Second) of Contracts*[33] "imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."[34]

Commentators differ in their interpretation of these good faith requirements.[35] Professor Farnsworth distinguishes good faith on the basis of good faith purchase and good faith performance.[36] Good faith purchase is measured subjectively because it describes a state of mind, similar to notice.[37] In contrast, good faith performance does not involve a state of mind. Rather, good faith performance is measured objectively through community standards of "decency, fairness, or reasonableness."[38]

Professor Summers does not identify criteria that courts should use in deciding whether an individual acted in good faith.[39] Rather, he feels good faith can be defined as being the opposite of what a court determines a party has done in bad faith.[40] In other words, Summers suggests that good faith must be measured by a purely objective standard.[41]

Unlike Farnsworth or Summers, Professor Burton uses a cost perspective analysis in his definition of good faith.[42] In his analysis, a party acts in bad faith when he uses discretion to "recapture opportunities

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32. *Id.* Additionally, U.C.C. § 1-208 addresses "insecurity clauses," and allows "at will" acceleration of payment or performance only if the party in good faith believes himself insecure. *Id.* § 1-208.

33. RESTATEMENT OF CONTRACTS, *supra* note 3, § 205.

34. *Id.*

35. For a discussion of the differing approaches of commentators, see Recent Development, *supra* note 1, at 1202.

36. Farnsworth, *supra* note 24, at 667-71.

37. *Id.* at 668. Professor Farnsworth's example of good faith purchase clearly illustrates his definition: "Whether the purchaser of goods takes good title from a seller whose own title is voidable because of fraud depends, under the [U.C.C.], on whether he purchased in good faith." *Id.*

38. *Id.* at 668, 672.

39. Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195, 201 (1968).

40. *Id.* at 200. Professor Summers' example of his theory is illustrative:

> [A] judge may say: "A public authority must act in good faith in letting bids." And from the facts or language of the opinion it may appear that the judge is, in effect, saying: "The defendant acted in bad faith because he lets bids only as a pretense to conceal his purpose to award the contract to a favored bidder." It can then he said that "acting in good faith" here simply means: letting bids without a preconceived design to award the contract to a favored bidder.

Id. at 200-01.

41. *Id.* at 204-05.

42. Burton, *supra* note 1, at 378. Professor Burton notes that a party enters into a contract "when it believes that no greater benefit can be derived by expending elsewhere the resources required for the contract performance." *Id.* at 377. However, events occurring after formation of the contract may prove this to be false. *Id.*

forgone upon entering the contract."[43] Thus, a party breaches a contract in bad faith when he uses his discretion and decides not to perform the contract—an act well beyond the scope of the risks assumed by the party claiming the breach.[44]

Because the good faith standard is so broad and subject to varying definitions, courts, like commentators, often have disagreed on its application to specific fact patterns.[45] Courts initially used the implied covenant of good faith and fair dealing to supply missing terms to a contract.[46] In this way, courts were able to protect a party in an inferior bargaining position.[47] Later, courts used the implied covenant of good faith and fair dealing to imply a reasonableness standard to express contract terms that violated the court's view of an equitable arrangement.[48] This development suggested that courts increasingly were concerned with the reasons for a contract breach.[49] In light of this change in focus, courts began to order large judgments against parties who had breached contracts.[50]

The courts' increasing concern with the underlying causes of contract breach gave rise to an action in tort for breach of the implied covenant of good faith and fair dealing, or "bad faith breach."[51] Similar to the analysis in contract actions, courts focused on whether the breaching party's actions injured the other party's right to receive the benefits of the agreement.[52] Courts determined that this obligation to

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43. *Id.* at 378. Professor Burton uses an example of a corn buyer who fails to perform a contract for future delivery because the market price for corn has fallen subsequent to contract formation. *Id.* at 377. The buyer may choose to "recapture the opportunity of buying on the spot market or on a changed futures market" and thereby breach the contract. *Id.* Obviously, breach of this contract would be to the buyer's economic advantage. His recapture of foregone opportunities, however, would necessarily hurt the seller. This is true in every breach of contract. *Id.* at 387.

44. *Id.* at 386.

45. *See generally* Burton, *supra* note 1; Farnsworth, *supra* note 24; Summers, *supra* note 39.

46. *See, e.g.*, Wood v. Lucy, Lady Duff-Gordon, 222 N.Y. 88, 118 N.E. 214, 164 N.Y.S. 576 (1917) (interjecting into an exclusive sales contract the implied promise that seller was to use reasonable efforts to make a profit).

47. *See, e.g.*, Bak-A-Lum Corp. of Am. v. Alcoa Bldg. Prods., 69 N.J. 123, 351 A.2d 349 (1976) (exclusive distributorship only terminable after a reasonable period of time and on reasonable notice).

48. *See, e.g.*, Sylvan Crest Sand & Gravel Co. v. United States, 150 F.2d 642 (2d Cir. 1945) (interjecting good faith into the contract term allowing the United States to cancel its requirements contract at any time; the court determined that "any time" must be a reasonable time).

49. *See, e.g.*, Art Hill Ford, Inc. v. Callender, 423 N.E.2d 601, 602 (Ind. 1981) (holding that if "it can be shown that the public interest will be served by the deterrent effect of punitive damages," a court should award them "whenever the elements of fraud, malice, gross negligence or oppression mingle").

50. *Id.*

51. *See* discussion *supra* note 5.

52. *See* Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 818-19, 620 P.2d 141, 145, 169 Cal. Rptr. 691, 695 (1979), *cert. denied*, 445 U.S. 912 (1980).

act in good faith in discharging contractual responsibilities did not arise out of the terms of the contract, but rather was imposed on the contracting parties by law.[53]

By allowing tort recovery for breach of the implied covenant of good faith and fair dealing, courts have been able to award greater damages than those allowable under traditional contract law.[54] This expanded recovery includes damages for all proximately caused injuries, including injuries arising from emotional distress,[55] as well as punitive damages.[56] Moreover, courts are grafting ethical standards onto contract law. Instead of being neutral towards breach of contract, courts now are concerned with the reason for the breach. In addition, courts are attempting to deter unethical conduct by imposing large judgments against the breaching party.

B. Bad Faith in Insurance Contracts

Bad faith breach first was recognized in actions against insurance companies.[57] In *Comunale v. Traders & General Insurance Co.*[58] the California Supreme Court applied the implied covenant of good faith and fair dealing and imposed an unexpressed duty on Traders to accept a reasonable settlement with a third party.[59] Currently, an insurer can be held liable for bad faith breach if it fails to give at least as much consideration to the insured's interests as it does to its own interest when evaluating a settlement offer.[60]

The rationale for applying the bad faith breach doctrine to insurance contracts centered on the special nature of insurance contracts. Courts recognized that insurance contracts differed significantly from ordinary commercial contracts.[61] One notable difference was the reason

53. *See id.* at 818, 620 P.2d at 145, 169 Cal. Rptr. at 695.

54. *See* RESTATEMENT OF TORTS, *supra* note 6, § 908(2).

55. *Id.* § 905(b); *see also* Goldberg, *Emotional Distress Damages and Breach of Contract: A New Approach*, 20 U.C. DAVIS L. REV. 57, 61-67, 98-103 (1986).

56. *See supra* note 6 and accompanying text.

57. For a discussion of the extension of the tort of bad faith breach to insurance and other contracts, see generally Recent Development, *supra* note 1, at 1209-15.

58. 50 Cal. 2d 654, 328 P.2d 198 (1958).

59. *Id.* at 659-60, 328 P.2d at 201; *see also* Crisci v. Security Ins. Co., 66 Cal. 2d 425, 430, 426 P.2d 173, 176-77, 58 Cal. Rptr. 13, 16-17 (1967).

60. *See, e.g., Egan*, 24 Cal. 3d at 818, 620 P.2d at 145, 169 Cal. Rptr. at 695. The *Egan* court held that Mutual of Omaha's failure to properly investigate insured's claim by having its own physician examine insured and by failing to consult with insured's own physician and surgeon amounted to a breach of the implied covenant of good faith and fair dealing contained in the disability policy. The court also held that the "governing standard" imposed on an insurer is "whether a prudent insurer would have accepted the settlement offer if it alone were to be liable for the entire judgment." *Id.*

61. *See id.*; *see also infra* notes 62-64 and accompanying text.

an insured enters into the insurance contract. Rather than striving for a "commercial advantage," an insured seeks to obtain peace of mind and security from the insurance contract.[62] Additionally, courts noted the inequality of bargaining power between the insurer and insured, and declared insurance agreements to be adhesion contracts.[63] Furthermore, courts determined that the insurer's service was "quasi-public in nature" and that insurers "h[e]ld themselves out as fiduciaries."[64] By imposing on insurers the additional liability allowed under the bad faith breach doctrine,[65] courts can force insurers, acting as fiduciaries, to use greater care in transactions with insureds.

C. *Bad Faith Breach in Employment Contracts*

California courts initially refused to expand bad faith breach into the commercial realm.[66] In *Tameny v. Atlantic Richfield Co.*,[67] however, the California Supreme Court declared that breach of the implied covenant of good faith and fair dealing in employment contracts could be based in tort as well as in contract law.[68] Other California courts also

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62. *See Egan*, 24 Cal. 3d at 819, 620 P.2d at 145, 169 Cal. Rptr. at 695.

63. *See id.* at 820, 620 P.2d at 146, 169 Cal. Rptr. at 696.

64. *Id.*

65. An insurer's bad faith breach of contract can result in damages for all injuries proximately caused by the breach, including damages for emotional distress, Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 579-80, 510 P.2d 1032, 1040-42, 108 Cal. Rptr. 480, 488-90 (1973), and attorney fees, Brandt v. Superior Court, 37 Cal. 3d 813, 817, 693 P.2d 796, 798, 210 Cal. Rptr. 211, 213 (1985). If the insurer acts with malice, oppression, or fraud, a court may award punitive damages. *Egan*, 24 Cal. 3d at 819, 620 P.2d at 146, 169 Cal. Rptr. at 696.

66. *See* Glendale Fed. Sav. & Loan Ass'n v. Marina View Heights Dev. Co., 66 Cal. App. 3d 101, 135 Cal. Rptr. 802 (1977). The *Glendale* court, while upholding an award of punitive damages based on promissory fraud, declared that "[w]hile a breach of the implied covenant of good faith and fair dealing may give rise to a cause of action sounding in tort in the insurance field, . . . we are not aware of any appellate court case, and none has been cited, extending that principle to other contractual relationships." *Id.* at 135 n.8, 135 Cal. Rptr. at 822 n.8 (citations omitted).

In Sawyer v. Bank of America, 83 Cal. App. 3d 135, 145 Cal. Rptr. 623 (1978), the defendant bank refused to pay the plaintiff for fire damage to his truck. The financial institution had failed to maintain insurance on the plaintiff's truck which was in violation of the terms of an oral agreement. Although the plaintiff claimed that the financial institution's actions caused him emotional distress, the California Court of Appeals, First District, held that the financial institution was not liable for a bad faith breach action extraneous to the contract:

> [I]t is not a tort for a contractual obligor to dispute his liability under the contract. Rather, the tort of breaching an implied covenant of good faith and fair dealing consists [of] bad faith action, extraneous to the contract, with the motive intentionally to frustrate the obligee's enjoyment of contract rights.

Id. at 139, 145 Cal. Rptr. at 625.

67. 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980). The California Supreme Court in Foley v. Interactive Data Corp., 47 Cal. 3d 654, 765 P.2d 373, 254 Cal. Rptr. 211 (1988), recently disapproved of allowing a tort cause of action for breach of the implied covenant of good faith and fair dealing in employment contracts unless the employee has been discharged by the employer because of his unwillingness to participate in unlawful conduct.

68. *Id.* The plaintiff alleged that the defendant committed a bad faith breach of his employ-

have applied the bad faith breach doctrine to certain employment contracts.[69] Yet, other courts found a tort cause of action based on implied-in-fact promises.[70] Thus, before the landmark case of *Seaman's Direct Buying Service, Inc. v. Standard Oil Co.*,[71] bad faith breach was limited to insurance contracts and to certain employment contracts.

D. Extension of Bad Faith Breach to Financial Institutions

In *Seaman's* Standard Oil allegedly refused to recognize the sales contract it had with Seaman's. Standard's obligation under the contract was to supply oil to Seaman's. Standard also allegedly tried to interfere with Seaman's attempts to obtain authorization from the government so that Seaman's could receive the supply of oil that it needed from Standard.[72]

In 1971 Seaman's sought to lease space in a new marina in Eureka, California, in order to operate a marine fuel distributorship.[73] Because Eureka demanded written evidence of a binding oil supply contract before it would lease to Seaman's, Seaman's negotiated with Standard in order to obtain a supply agreement.[74] In 1972, after agreeing on all major issues, Seaman's presented a letter to Eureka as evidence of a

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ment contract by wrongfully discharging him from his job of 15 years because of his refusal to participate in the company's illegal plan to fix gasoline prices. *Id.* at 169, 610 P.2d at 1330-31, 164 Cal. Rptr. at 849. The court determined this to be a cause of action under California's wrongful discharge doctrine. *Id.* at 179, 610 P.2d at 1336-37, 164 Cal. Rptr. at 846. Since this complaint fell within this doctrine, the court did not have to determine whether a cause of action for bad faith breach applied to employment contracts. *Id.* at 179 n.12, 610 P.2d at 1337 n.12, 164 Cal. Rptr. at 846 n.12. However, the court stated that generally, a breach of the implied covenant of good faith and fair dealing in employment contracts sounds in tort and in contract:

> [W]e believe it is unnecessary to determine whether a tort recovery would additionally be available . . . on the theory that Arco's discharge constituted a breach of the implied-at-law covenant of good faith and fair dealing inherent in every contract. We do note in this regard, however, that authorities in other jurisdictions have on occasion found an employer's discharge of an at-will employee violative of the employer's "good faith and fair dealing" obligations, . . . and past California cases have held that a breach of this implied-at-law covenant sounds in tort as well as contract.

Id. (citations omitted).

69. *See, e.g.*, Cleary v. American Airlines, 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980) (holding that defendant's termination of an oral employment contract after eighteen years of satisfactory performance without legal cause breached the implied-at-law covenant of good faith and fair dealing).

70. *See, e.g.*, Pugh v. See's Candies Inc., 116 Cal. App. 3d 311, 171 Cal. Rptr. 917 (1981) (holding that employer discharging employee after 32 years of service violated the implied promise that it would not act arbitrarily in dealing with the employee).

71. 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984); *see* Recent Development, *supra* note 1, at 1212-13.

72. *Id.* at 761-62, 686 P.2d at 1161-62, 206 Cal. Rptr. at 357-58.

73. *Id.* at 759, 686 P.2d at 1160, 206 Cal. Rptr. at 356.

74. *Id.* at 759-60, 686 P.2d at 1160, 206 Cal. Rptr. at 356.

binding contract. Consequently, the city granted the lease.[75]

One year later the Arab oil embargo was implemented and Standard informed Seaman's that because of the new federal fuel allocation program Standard would not supply Seaman's with oil pursuant to the prior contract between the parties.[76] In response to Seaman's numerous requests and appeals, the Federal Energy Office told Seaman's that it would issue a supply order only if Seaman's could establish that it had a valid supply contract with Standard.[77] When asked to stipulate the existence of the contract, Standard refused, knowing that Seaman's could not afford a trial to prove the existence of the contract.[78] Because Seaman's no longer had an oil supply contract, it was forced out of business.[79] Seaman's then brought suit against Standard,[80] alleging that Standard tortiously breached the implied covenant of good faith and fair dealing.[81] The jury held in favor of Seaman's.[82]

On appeal, the California Supreme Court determined that an implied-at-law duty of good faith and fair dealing might interfere with freedom to contract and, thus, refused to extend the application of bad faith breach to commercial contracts.[83] The court recognized the "special relationship" involved in insurance contracts, including elements of public interest, adhesion, and fiduciary responsibility, and determined that only in these types of relationships, along with certain employment relationships, could a court apply the bad faith breach doctrine.[84] The majority, however, did create a separate tort of bad faith denial of a contract.[85]

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75. *Id.* at 760, 686 P.2d at 1161, 206 Cal. Rptr. at 357.

76. *Id.* at 760-61, 686 P.2d at 1161, 206 Cal. Rptr. at 357.

77. *Id.* at 761, 686 P.2d at 1162, 206 Cal. Rptr. at 358.

78. *Id.* at 761-62, 686 P.2d at 1162, 206 Cal. Rptr. at 358.

79. *Id.*

80. *Id.* at 762, 686 P.2d at 1162, 206 Cal. Rptr. at 358.

81. *Id.* The court did not elaborate on Seaman's theory under which it was alleging bad faith breach because it held Standard liable for bad faith breach of contract under its own theory. *Id.* at 768-69, 686 P.2d at 1166-67, 206 Cal. Rptr. at 362-63; *see also infra* note 85 and accompanying text.

82. *Seaman's*, 36 Cal. 3d at 762, 686 P.2d at 1162, 206 Cal. Rptr. at 358.

83. *Id.* at 769, 686 P.2d at 1166-67, 206 Cal. Rptr. at 362-66.

84. *Id.* at 768-69 & n.6, 686 P.2d at 1166 & n.6, 206 Cal. Rptr. at 362 & n.6.

85. *Id.* at 769-70, 686 P.2d at 1166-67, 206 Cal. Rptr. at 362-63. The court determined that "a party may incur tort remedies when, in addition to breaching the contract, it seeks to shield itself from liability by denying, in bad faith and without probable cause, that the contract exists." *Id.* at 769, 686 P.2d at 1167, 206 Cal. Rptr. at 363. The court remanded the case for a new trial because the jury was not instructed that Standard must have denied the existence of the contract in bad faith in order to be liable to Seaman's for tortious breach of the contract. *Id.* at 744, 686 P.2d at 1170, 206 Cal. Rptr. at 366.

For a thorough discussion of *Seaman's*, see Comment, Seaman's Direct Buying Service, Inc. v. Standard Oil Co.: *Tortious Breach of the Covenant of Good Faith and Fair Dealing in a Noninsurance Commercial Contract Case*, 71 IOWA L. REV. 893 (1986); and Comment, *Sailing the Un-*

A "*Seaman's*" cause of action can arise in lender liability litigation. For example, in *999 v. C.I.T. Corp.*,[86] 999, the borrower, sought to obtain a loan from C.I.T. 999 gave C.I.T. a deposit of 25,000 dollars in accordance with a handwritten letter containing the terms of the "proposed financing."[87] The letter did not mention any prepayment penalty. Several weeks later, however, C.I.T. informed 999 that it had added a 25,000 dollar per month prepayment penalty.[88] 999 refused to accept the new term and sought alternative financing. 999, however, was unable to obtain alternative financing before it incurred a loss on one of its investments.[89] The Ninth Circuit held C.I.T. liable on contract principles, but declared that a *Seaman's* cause of action could apply in this context.[90]

The California Court of Appeals applied the *Seaman's* cause of action in *Commercial Cotton Co. v. United California Bank*.[91] The court held that United California Bank had breached the implied covenant of good faith and fair dealing by asserting a defense that it knew to be without merit in an effort to avoid bearing the loss resulting from its own negligence.[92] The jury awarded the plaintiff 124,000 dollars in damages, including damages for emotional distress and negligent payment, as well as punitive damages for breach of the implied covenant of good faith and fair dealing.[93]

The California Supreme Court, on appeal, affirmed the judgments for negligent payment and breach of the covenant of good faith and fair

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charted Seas of Bad Faith: Seaman's Direct Buying Service, Inc. v. Standard Oil Co., 69 MINN. L. REV. 1161 (1985).

86. 776 F.2d 866 (9th Cir. 1985). Although the company 999 was in serious financial trouble, the transaction gave 999 an opportunity to operate a "captive buyer" that would manufacture products from raw materials processed hy another 999 subsidiary. *Id.* at 868. Because the manufacturing company was nearly insolvent, however, its creditors demanded that 999 guaranty the company's debts in return for the creditors promise to continue supplying the company with necessary operating materials. *Id.*

87. *Id.* at 868. The $25,000 was apparently prepayment for certain costs and expenses.

88. *Id.*

89. *Id.*

90. *Id.* at 870. Several recent cases have rejected bad faith breach as it applies to financial institutions. *See, e.g.*, Betterton v. First Interstate Bank, 800 F.2d 732 (8th Cir. 1986) (holding that since Arizona courts had not extended bad faith breach from insurance contracts to employment contracts, the tort should not be extended to lending contracts; thus, a borrower is limited to contractual remedies only); Rigby Corp. v. Boatmen's Bank & Trust Co., 713 S.W.2d 517 (Mo. Ct. App. 1986) (holding that good faith obligations are contractual and do not give rise to a cause of action sounding in tort).

91. 163 Cal. App. 3d 511, 209 Cal. Rptr. 551 (1985); *see* Recent Development, *supra* note 1, at 1219-20.

92. *Id.* at 514, 209 Cal. Rptr. at 553. The client brought suit after the bank negligently paid two checks containing unauthorized siguatures and then refused to recredit the account. *Id.*

93. *Id.* at 513-14, 209 Cal. Rptr. at 552.

dealing, but reversed the judgment for infliction of emotional distress.[94] In its analysis, the court declared that breach of the covenant of good faith and fair dealing could be applied outside of insurance contracts. The court also noted that *Seaman's* did not preclude the application of this doctrine to ordinary commercial contracts.[95] The court justified its position of allowing United California Bank to be held liable for breach of the implied covenant of good faith and fair dealing by noting the similarities between the contract of an insurance company and its insured and that of a financial institution and its client.[96] The court determined that at least a quasi-fiduciary relationship exists between the financial institution and its client.[97] Thus, the court declared that the financial institution's assertion of a nonmeritorious defense constituted a bad faith breach.

After *Commercial Cotton*, it appeared that the California courts only would allow recovery for bad faith breach by a financial institution if a "special relationship" existed between the two parties, similar to the relationship found to exist between an insurer and its insured.

III. Further Extension of Bad Faith Breach into Commercial Contracts: No Special Relationship Needed

A. K.M.C. Co. v. Irving Trust Co.

In *K.M.C. Co. v. Irving Trust Co.*[98] the Sixth Circuit held that a financial institution's acceleration of its client's indebtedness constituted a breach of the implied covenant of good faith and fair dealing. K.M.C. operated its business on a 3.5 million dollar line of credit from Irving Trust.[99] All advances to K.M.C. were on a demand basis, but

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94. *Id.* at 516-17, 209 Cal. Rptr. at 554-55. The court stated that emotional distress arising from breach of the covenant of good faith and fair dealing must be "severe, i.e., substantial or enduring as distinguished from trivial or transitory." *Id.* at 517, 209 Cal. Rptr. at 555. The court determined the plaintiff's emotional distress was short-lived and therefore not severe enough to rise to a cause of action. *Id.*

95. *Id.* at 516, 209 Cal. Rptr. at 554 (stating that the California Supreme Court found it unnecessary to determine how far the *Seaman's* doctrine should extend to ordinary commercial contracts, if at all).

96. *Id.* The court noted that a client depends on the financial institution's honesty and expertise to protect his funds. *Id.* A financial institution stands in a superior bargaining position in relation to its client. *Id.* The government regulates financial institutions as heavily as it does the insurance industry; and a financial institution, like the insurance industry, provides a vital service affected with public interest. *Id.*

97. *Id.*

98. 757 F.2d 752 (6th Cir. 1985); *see also* Recent Development, *supra* note 1, at 1217-18; Special Project Note, *Lender Liability, supra*, at notes 208-21 and accompanying text; Special Project Note, *Written Agreements, infra*, at note 104 and accompanying text.

99. *Id.* at 754. K.M.C. secured its line of credit with its accounts receivable and inventory, which K.M.C. deposited into a "blocked account" at Irving Trust. Id. at 759. A "blocked account" is a lender-controlled account that holds accounts receivable receipts derived from the borrower's

Irving Trust had no contractual obligation to advance any funds.[100]

On March 1, 1982, without notice, Irving Trust refused to advance K.M.C. 800,000 dollars even though the advance would have left K.M.C. well within the 3.5 million dollar credit limit,[101] and despite the fact that Irving Trust was secured to the full amount of the anticipated 800,000 dollar advance request.[102] Irving Trust's refusal to make the advance forced K.M.C. out of business.[103]

K.M.C. brought an action against Irving Trust asserting that its refusal, without prior notice, to make the requested advance was a breach of its duty of good faith, implied into the loan agreement.[104] The jury awarded K.M.C. 7.5 million dollars, which was affirmed on appeal.[105] The court rejected Irving Trust's contention that the client was required to demonstrate dishonesty on the financial institution's part. Rather, the court held that if a financial institution abused its discretion in exercising the demand provision, this fact alone was sufficient to establish a breach of the duty of good faith.[106] The court also noted that good faith required Irving Trust to give notice to K.M.C. before termination of the line of credit in order to allow K.M.C. to obtain alternative financing.[107] In reaching this conclusion, the court analogized the

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operations. The borrower's customers mail their payments directly to the lender, and the lender then deposits the receipts into the account. As K.M.C.'s receivables were collected, Irving Trust advanced it additional funds up to the credit limit. *Id.*

100. *Id.* Essentially, the arrangement between K.M.C. and Irving Trust was a pattern of Irving Trust covering of K.M.C.'s overdrafts. The court noted that if K.M.C. could not obtain alternative financing, and if Irving Trust refused to advance K.M.C. funds, this would leave K.M.C. without capital until it could pay off some amount of the line of credit it owed Irving Trust. *Id.* Moreover, the court determined that companies similar to K.M.C. (a medium-sized company in the wholesale grocery business) could not operate without outside financing. *Id.* Thus, this type of financing left K.M.C. "entirely at the whim or mercy of Irving, absent an obligation of good faith performance." *Id.*

101. *Id.* at 762.

102. *Id.* at 762-63.

103. *Id.* at 754. K.M.C.'s checks bounced as a result of Irving Trust's refusal to advance the funds it needed. *See* Hilfinger, K.M.C. Co. v. Irving Trust Co.: *Discretionary Financing and the Implied Duty of Good Faith*, 81 Nw. U.L. Rev. 539, 542 (1987) (citing Plaintiff's Complaint at 4-6, K.M.C. Co. v. Irving Trust Co., 757 F.2d 752 (6th Cir. 1985) (No. CIV-3-82-365)). Moreover, K.M.C. was unable to obtain alternative financing. *Id.* These factors led to K.M.C.'s bankruptcy. *Id.*

104. *K.M.C. Co.*, 757 F.2d at 754.

105. *Id.* at 755, 766.

106. *Id.* at 760-61. Irving Trust stated that in order to determine whether it acted in good faith, a court should use a subjective test and determine whether it believed there were valid reasons for refusing to advance funds to K.M.C. *Id.* at 760. The Sixth Circuit, however, opted to measure Irving Trust's behavior by objective standards—that is, it looked to see "whether a reasonable loan officer in the same situation would have refused to advance funds to K.M.C. without notice as [was done] on March 1, 1982." *Id.* at 761. The court determined that Irving Trust acted unreasonably and thus breached the implied covenant of good faith and fair dealing. *Id.*

107. *Id.* at 763.

case to U.C.C. section 2-309, which requires reasonable notification to the other party before terminating a contract.[108]

Contrary to the California Supreme Court's holding in *Commercial Cotton*, the Sixth Circuit in *K.M.C. Co.* imposed on the financial institution the duty to act in good faith and to deal fairly in its transactions with its client even in the absence of a "special relationship."

B. Other Cases

1. Conduct Relating to Checking Accounts

In several cases, courts have held that a financial institution's actions with regard to its client's checking accounts had breached the duty of good faith and fair dealing.[109] In these situations, the financial institutions initiated actions on their clients' checking accounts that created overdraft situations, without first notifying the client.

For example, in *First National Bank v. Twombly*,[110] the Montana Supreme Court held First National Bank liable for accelerating its clients' indebtedness. In *Twombly*, the clients signed a promissory note calling for a lump sum payment in August 1979.[111] The clients entered into a one year lease with the option to buy the restaurant after the lease's expiration.[112] The lease expired in July 1979, however, and the Twomblys were faced with the probability of unemployment since they were not exercising their option to buy the restaurant.[113] Because of the possibility of unemployment, the Twomblys became concerned about repaying the note, which was due in one month.[114] Consequently, the clients entered into a new agreement with First National Bank's loan officer which converted the lump sum payment arrangement into an in-

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108. *Id.* at 759 (citing U.C.C. § 2-309 (1987)). The court noted that comment 8 to U.C.C. § 2-309 states that " '[t]he application of principles of good faith and sound commercial practice normally call for such notification of the termination of a going contract relationship as will give the other party reasonable time to seek a substitute arrangement.' " *Id.* (quoting U.C.C. § 2-309 comment 8 (1987)).

109. *See, e.g.*, Tribby v. Northwestern Bank, 217 Mont. 196, 704 P.2d 409 (1985) (holding that Northwestern Bank's cancellation of a provision allowing its client to write checks in excess of the balance in his account, without notice, and in retaliation against the client because of an action brought by him to enforce the terms of an account agreement, amounted to a breach of the implied covenant of good faith and fair dealing); First Nat'l Bank v. Twombly, 213 Mont. 66, 689 P.2d 1226 (1984) (holding that First National Bank's creation of an overdraft situation in its clients' account constituted a breach of the implied covenant of good faith and fair dealing); *see also* Recent Development, *supra* note 1, at 1220-22.

110. 213 Mont. 66, 689 P.2d 1226 (1984).

111. *Id.* at 68, 689 P.2d at 1228.

112. *Id.*

113. *Id.* The Twomblys did not exercise their option to buy the restaurant because of failed negotiations with the owner. *Id.* Thus, the Twomblys faced the probability of unemployment in July 1979 when the restaurant's lease terminated.

114. *Id.*

stallment plan.[115] Before the transaction was completed, however, the loan officer was called out of town.[116] He told the Twomblys that they could continue the transaction with First National Bank's vice president, and that he would inform the vice president concerning the current status of the agreement.[117]

When the Twomblys contacted the vice president, he claimed that he knew nothing about the transaction.[118] Moreover, he refused to convert the lump sum payment plan into an installment loan arrangement because the Twomblys currently were unemployed.[119] The vice president also determined the loan to be in jeopardy, and accelerated its due date.[120] Finally, he offset the amount of the loan against the amount in the Twomblys' checking account, but failed to notify them of his action.[121] As a result of First National Bank's acceleration of the loan and its offset action, several of the Twomblys' checks were returned for insufficient funds.[122]

Citing U.C.C. sections 1-203 and 1-208 as applicable in this situation, the court stated that when the duty to exercise good faith is imposed by law rather than by the contract itself, breach of that duty is tortious.[123] The court declared that the Twomblys could recover punitive damages if First National Bank's conduct was in reckless disregard of the Twomblys' rights.[124] The court also noted that a jury could have found that First National Bank acted in a sufficiently culpable manner to justify the imposition of punitive damages.[125]

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115. *Id.*

116. *Id.*

117. *Id.*

118. *Id.*

119. *Id.*

120. *Id.* at 70, 689 P.2d at 1229. The only reason the vice president gave in support of his insecurity was a phone conversation he had with Mr. Twombly who stated he would not be able to repay the promissory note in August. *Id.* at 70, 689 P.2d at 1228-29. The court also noted that the vice president did not try to find out whether the Twomblys were planning to leave the community or to establish any other facts to support his finding of insecurity. *Id.* at 71, 689 P.2d at 1229.

121. *Id.* at 70, 689 P.2d at 1229.

122. *Id.* at 71, 689 P.2d at 1229.

123. *Id.* at 73, 689 P.2d at 1230. Section 1-203 of the U.C.C. imposes on the parties to a contract the obligation of good faith in its performance and enforcement. U.C.C. § 1-203 (1987); *see also supra* notes 26-30 and accompanying text. Section 1-208 of the U.C.C. states that a party may "accelerate payment or performance . . . 'at will' or 'when he deems himself insecure' " only if the party "in good faith believes that the prospect of payment or performance is impaired." U.C.C. § 1-208 (1987).

124. *Twombly*, 213 Mont. at 71, 689 P.2d at 1229.

125. *Id.* The court noted that under state statutory law, a party could recover punitive damages if malice, oppression, or fraud were shown. The court defined malice to be:

> [w]hen a person knows or has reason to know of facts which create a high degree of risk of harm to the substantial interests of another, and either deliberately proceeds to act in conscious disregard of or indifference to that risk, or recklessly proceeds in unreasonable disre-

Similarly, in *Tribby v. Northwestern Bank*[126] the court held that Northwestern Bank had violated the covenant of good faith and fair dealing when, without notice to the client, it cancelled a provision in its client's checking account that would cover overdrafts.[127] Northwestern Bank allegedly took this action in retaliation against the client for bringing an action to enforce the terms of an account agreement.[128] The court cited *Twombly* in support of its decision to hold Northwestern Bank liable for punitive damages because of its tortious breach of the covenant of good faith and fair dealing.[129]

2. Conduct Relating to Loan Processing

In *Jacques v. First National Bank*[130] the Maryland Supreme Court found that First National Bank had committed a bad faith breach of contract by failing to use due care in processing a loan application. First National Bank agreed to make a loan of 41,400 dollars at 11.875 percent interest even though the Jacques' had applied for a 112,000 dollar loan.[131] When the Jacques' discovered that First National Bank only was committed for 41,400 dollars, they applied with another financial institution and received a commitment for 110,000 dollars, but at 13.875

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gard of or indifference to that risk . . . .

Id. at 73, 689 P.2d at 1230 (quoting Owens v. Parker Drilling Co., 207 Mont. 446, 451, 676 P.2d 162, 164 (1984)). The court remanded the case for a new trial on punitive damages only, since the trial court refused to submit the issue of punitive damages to the jury. *Id.* at 71, 689 P.2d at 1229.

126. 217 Mont. 196, 704 P.2d 409 (1985).

127. *Id.* at 212, 704 P.2d at 419.

128. *Id.* at 201, 704 P.2d at 412.

129. *Id.* at 211-12, 704 P.2d at 419. The court expressly stated that it was not holding that every contract or statutorily imposed obligation, alone, carries an implied covenant of good faith and fair dealing which, if breached, would allow for recovery in tort. *Id.* at 212, 704 P.2d at 419. The court noted that in this case, however, the circumstances were similar to those in *Twombly* so as to justify an instruction to the jury to consider recovery in tort, and more specifically, punitive damages. *Id.* at 211-12, 704 P.2d at 419. The court said that the financial institution's conduct, like the financial institution's conduct in *Twombly*, might "support a finding of reckless disregard for Tribby's rights." *Id.* at 212, 704 P.2d at 419. Moreover, it noted that "the bank stands in the position of superior bargaining power to its customer that was noted in *Twombly*; and the evidence might support a finding that the bank breached an obligation to Tribby." *Id.*

For cases holding that a bank's actions resulting in an overdraft situation of a client's checking account did not breach the covenant of good faith and fair dealing, see Luxonomy Cars, Inc. v. Citibank 65 A.D.2d 549, 408 N.Y.S.2d 951 (App. Div. 1978) (holding that Citibank's acceleration of its loan to Luxonomy without notice and its use of Luxonomy's checking account balance to cover the loan did not amount to a breach of the implied covenant of good faith and fair dealing, even though Citibank's action caused several of Luxonomy's checks to bounce); and Happy Cattle Feeders, Inc., v. First Nat'l Bank, 618 S.W.2d 424 (Tex. Civ. App. 1981) (holding that First National Bank's acceptance of a check from its [the bank's] client that created an overdraft situation on another client's account, and its subsequent refusal to honor two of Happy Cattle Feeders' checks drawn from the same account did not breach the implied covenant of good faith and fair dealing).

130. 307 Md. 527, 515 A.2d 756 (1986).

131. *Id.* at 529-30, 515 A.2d at 757.

percent interest.[132] Instead of accepting the loan with the higher interest rate, the Jacques' accepted First National Bank's 41,400 dollar loan and made up the difference with loans from relatives and a 50,000 dollar short-term loan from First National Bank at an annual interest rate of fifteen percent.[133] Consequently, the Jacques sued First National Bank on claims of malicious interference with contract, gross negligence, and negligence.[134]

As a condition for finding bad faith breach, the court looked for contractual privity between First National Bank and the loan applicant.[135] The court found that a contractual relationship arose when First National Bank agreed to process the loan in consideration for the payment of an appraisal and credit report fee, and when it further agreed to give the Jacques a guaranteed interest rate if the loan was processed, approved, and closed within ninety days of the date of the application.[136]

The court noted that the negligent breach of a contract in the absence of an independent duty or obligation imposed by law is insufficient to support a tort action.[137] The court determined, however, that a duty separate from those obligations arising from the contract exists between parties with contractual privity,[138] especially when the contract is formed with a professional possessing a particular skill[139] or with a business affected with a public interest.[140] Thus, First National Bank's failure to use due care in processing the loan application was a bad faith breach.

Similarly, the court in *High v. McLean Financial Corp.*[141] held that a "tort duty" existed when McLean Financial failed to advise a loan applicant that a third-party lender would be reviewing the loan applica-

132. *Id.* at 530, 515 A.2d at 757. The interest rates had increased since the applicant's initial loan application with First National.

133. *Id.*

134. *Id.* at 531-32, 515 A.2d at 757-58. The trial court found for the Jacques on the negligence claim and awarded them $10,000 consequential damages, but found for First National Bank on the claims of malicious interference with contract and gross negligence. *Id.* at 532, 515 A.2d at 758. On appeal, the Maryland Court of Special Appeals reversed, holding that First National Bank "had no duty to use due care in evaluating the Jacques' application for a loan." *Id.* The Maryland Court of Appeals granted certiorari to determine whether First National Bank indeed owed a duty to Jacques to evaluate a loan application with due care. *Id.* at 532, 515 A.2d at 758.

135. *Id.* at 534-35, 515 A.2d at 759-60.

136. *Id.* at 537-38, 515 A.2d at 761.

137. *Id.* at 534, 515 A.2d at 759 (construing Heckrotte v. Riddle, 224 Md. 591, 595, 168 A.2d 879, 882 (1961)).

138. *Id.* at 534, 515 A.2d at 759 (citing Slacum v. Eastern Shore Trust Co., 163 Md. 350, 352-53, 163 A. 119, 120 (1932)).

139. *Id.* at 541, 515 A.2d at 763.

140. *Id.* at 542, 515 A.2d at 763.

141. 659 F. Supp. 1561 (D.D.C. 1987).

tion to decide whether or not to grant the loan. The court determined that when McLean Financial accepted the processing fee and loan application, it "implicitly agreed to process the loan application."[142] The court ascertained that McLean Financial's implied promise to process the loan application also contained an implied promise to process the application with reasonable care.[143] The court, like the court in *Jacques*, noted that McLean Financial was a business affected with a public interest, and, therefore, it must process the applications that its clients have paid it to process.[144]

The Delaware District Court in *Hill v. Equitable Bank, N.A.*[145] followed the analysis of the court in *Jacques*. In *Hill* the court held the bank liable for bad faith breach due to the negligent misrepresentations that it made to a potential client, Hill.[146] As a result of those misrepresentations, Hill suffered an economic loss. As in *Jacques*, the court looked for a contract between the two parties. The court determined that a contract had been formed when Equitable Bank offered to provide Hill with investment advice and financing in exchange for Hill's establishment of a banking relationship with Equitable.[147] Because the court found that a contractual relationship existed, it determined that Equitable Bank was required to "exercise due care in communicating facts to plaintiffs."[148] Thus, Equitable Bank was liable for bad faith breach because of its misrepresentations to Hill.

3. Emotional Distress

In addition to allowing recovery for punitive damages against financial institutions, courts now allow plaintiffs to receive damages for emotional distress. A classic example is *Young v. Bank of America*.[149] In that case, the plaintiff, Young, received damages for emotional distress in addition to treble damages for Bank of America's wrongful actions. Young allowed a friend, Wooden, to use her credit card,[150] but Wooden failed to return it.[151] Young then contacted Bank of America to report

142. *Id.* at 1570.
143. *Id.*
144. *Id.*
145. 655 F. Supp. 631 (D. Del. 1987), *aff'd*, 851 F.2d 691 (3d Cir. 1988), *cert. denied*, 57 U.S.L.W. 3452 (U.S. Jan. 10, 1989).
146. *Id.* The financial institution failed to supply Hill with all the information it had regarding certain limited partnerships that Hill was considering investing in, and ultimately did invest in.
147. *Id.* at 650. Hill deposited a large amount of money with Equitable, and borrowed funds as well.
148. *Id.* at 651.
149. 141 Cal. App. 3d 108, 190 Cal. Rptr. 122 (1983).
150. *Id.* at 111, 190 Cal. Rptr. at 124.
151. *Id.* at 111-12, 190 Cal. Rptr. at 124.

that her credit card had been stolen and to cancel it immediately.[152] Approximately three months later, Bank of America recovered the credit card, but, in the interim period, over 2000 dollars had been charged on it.[153] Bank of America refused to adjust Young's balance and billed her for the charges on her card.[154]

In awarding treble damages and damages for emotional distress, the court relied on several factors. First, the financial institution persistently sought collection of the charges from Young.[155] Second, it refused to correct the charges even though it knew that Young's credit card had been stolen.[156] The financial institution also reported negative credit information to a credit reporting service, which had adverse consequences on Young.[157] Finally, Young's application for another credit card was denied because of her bad credit report.[158] The court held that the distress Young suffered from Bank of America's actions was "substantial and of the requisite severity" to recover damages for emotional distress.[159]

4. A Factually Unsupported Claim

The California Court of Appeals in *Kruse v. Bank of America*[160] recently overturned a judgment against Bank of America awarded by the jury in *Jewell v. Bank of America*.[161] The Court of Appeals determined that the plaintiffs' claims were unsupported by the evidence. In *Jewell* the jury awarded the plaintiff-borrower more than thirty-nine million dollars.[162] In that case the widow of James O'Connell had inherited his apple processing company, the O'Connell Company. The O'Connell Company's apples were supplied by a broker named Jewell.

Three years later, in 1974, Bank of America suddenly denied the O'Connell Company's request for a capital improvement loan.[163] Subsequently, the bank also refused to provide the O'Connell Company with its customary annual line of credit.[164]

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152. *Id.* at 112, 190 Cal. Rptr. at 124.
153. *Id.*
154. *Id.*
155. *Id.* at 115, 190 Cal. Rptr. at 127.
156. *Id.*
157. *Id.*
158. *Id.*
159. *Id.*
160. 202 Cal. App. 3d 38, 248 Cal. Rptr. 217 (1988), *cert. denied sub nom.* Duck v. Bank of Am., 57 U.S.L.W. 3486 (U.S. Jan. 24, 1989).
161. No. 112439 (Cal. App. Dep't Super. Ct. 1985), *rev'd sub nom.* Kruse v. Bank of Am., 202 Cal. App 3d 38, 248 Cal. Rptr. 217 (1988).
162. *Id.* This award was later reduced to $22 million. *Id.*
163. *Kruse*, 202 Cal. App. 3d at 45, 248 Cal. Rptr. at 220.
164. *Id.* Bank of America provided a line of credit to the O'Connell Company to fund the

Between 1975 and 1980, Jewell loaned over 2.7 million dollars to the O'Connell Company.[165] Jewell, in turn, was indebted heavily to Bank of America, after taking out many short-term loans to assist the O'Connells and his own financially troubled company.[166] Jewell, however, believed that Bank of America would combine the loans into a single long-term loan with a favorable payment schedule because Sullivan, the bank officer, told him that "something would be 'worked out' at the end of the year."[167] But Jewell also knew that Sullivan lacked authority to approve the consolidated loan arrangement.[168]

In 1980 Bunch, the new branch manager, determined that Jewell owed too much money.[169] Subsequently, in September 1980, Bunch informed Jewell that Bank of America would not lend him any more money.[170] Consequently, the O'Connell Company was forced to liquidate its properties in order to obtain funds to pay off the outstanding bank loans that Jewell had taken out for its benefit.[171]

When O'Connell's widow filed a fraud action against Jewell and Bank of America, Jewell and his wife cross-claimed against Bank of America claiming fraud and bad faith denial of the existence of a contract.[172] The California Court of Appeals reversed the trial court's finding of fraud by Bank of America because Jewell had failed to prove the essential element of justifiable reliance.[173] The court found that in 1978 and 1979, the Jewells had borrowed over one million dollars in short-term bank loans, assuming that the bank ultimately would consolidate the loans into one long-term loan.[174] The court, however, determined that Jewell could not justifiably rely on this assumption because Jewell's request for long-term financing previously had been denied in 1978.[175] In addition, Jewell knew that Sullivan lacked authority to approve of a loan of this magnitude.[176] Thus, the court concluded that

company's business operations.

165. *Id.* at 50, 248 Cal. Rptr. at 223.

166. *Id.*

167. *Id.* at 48, 248 Cal. Rptr. at 222.

168. *Id.* at 49, 248 Cal. Rptr. at 222.

169. *Id.* at 50, 248 Cal. Rptr. at 223.

170. *Id.*

171. *Id.* at 50, 248 Cal. Rptr. at 224.

172. *Id.* The court stated that essentially, Jewell's complaint was that "the Bank wrongfully induced [the Jewells] to borrow heavily in order to finance the O'Connell Company; that once the Jewells were hopelessly overextended, the Bank reneged on its promise to provide long-term financing to the O'Connell Company which would have enabled it to repay the Jewells." *Id.* at 52, 248 Cal. Rptr. at 225.

173. *Id.* at 54, 248 Cal. Rptr. at 226.

174. *Id.*

175. *Id.* at 55, 248 Cal. Rptr. at 226.

176. *Id.*; *see also supra* notes 167-68 and accompanying text.

Jewell should not have relied on Sullivan's statement made in 1979 that things would be "worked out."[177]

The court also held that Jewell's theory of bad faith denial of a contract based on Bank of America's failure to supply Jewell with long-term financing was wholly unsupported by the record.[178] The court determined that, at best, the long-term loan was open to negotiation, and that the parties had not formed a contract.[179] Citing *Seaman's*, the court noted that a tort claim arises when a party breaches a contract and denies, in bad faith, that the contract exists. An inherent condition to this tort claim is the existence and breach of an enforceable contract.[180] Similarly, the court determined that a tort cause of action could arise when a party asserts an invalid defense to a breach of contract claim.[181] In any event, however, there must be a valid contract. The court dismissed Jewell's cross-appeals because no contract existed between Jewell and Bank of America.[182]

IV. Using Article 2 of the U.C.C. as a Good Faith Method for Demanding Assurances When Insecure

In a recent case, *K.M.C. Co.*,[183] the court used Article 2 of the U.C.C. by analogy to imply good faith action with regard to discontinuing a line of credit. By analogy, a financial institution could use U.C.C. sections 2-609 and 2-610 when insecure, for example, about loan repayment or a client's solvency.[184] If the U.C.C. guidelines are followed, a

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177. *Kruse*, 202 Cal. App. 3d at 55, 248 Cal. Rptr. at 226-27.

178. *Id.* at 57, 248 Cal. Rptr. at 228.

179. *Id.* at 59, 248 Cal. Rptr. at 229-30. The court noted that Jewell was told that Sullivan was attempting to obtain his superior's approval for the loan. *Id.* at 59, 248 Cal. Rptr. at 229. Moreover, the court determined that there was no manifestation of assent to contract by Bank of America, and, therefore, no agreement was found. *Id.*

180. *Id.* at 57, 248 Cal. Rptr. at 228; *see also supra* notes 72-85 and accompanying text.

181. *Kruse*, 202 Cal. App. 3d at 58, 248 Cal. Rptr. at 228.

182. *Id.* at 68, 248 Cal. Rptr. at 235. The court also determined that the widow, Mrs. Kruse, had failed to establish that Bank of America was responsible for the bankruptcy of the O'Connell Company. *Id.*

183. *See supra* notes 98-108 and accompanying text.

184. Section 2-609(1) of the U.C.C. states that "[w]hen reasonable grounds for insecurity arise with respect to performance of either party the other in writing may demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance for which he has not already received the agreed return." U.C.C. § 2-609(1) (1987). Section 2-609(2) of the U.C.C. states that "the reasonableness of grounds for insecurity and the adequacy of any assurance offered shall be determined according to commercial standards." *Id.* § 2-609(2). Section 2-609(4) of the U.C.C. states that if thirty days pass after a party makes a written demand for assurance and no assurance has been received, the contract is repudiated. *Id.* § 2-609(4). Section 2-610 of the U.C.C. states that if a party repudiates the contract:

> the loss of which will substantially impair the value of the contract to the other, the aggrieved party may
>
> (a) for a commercially reasonable time await performance

court may not question the financial institution's good faith conduct in accelerating a loan, demanding payment, or discontinuing a line of credit.

For example, if a financial institution fears that a client, because of future insolvency, will become unable to repay a loan, under U.C.C. section 2-609(1), the financial institution could demand assurances for adequate performance.[185] Reasonable grounds could exist if, for example, a financial institution fears that a loan will not be repaid because of a client's impending insolvency.[186] In determining what constitutes a reasonable time for receiving assurances, U.C.C. section 2-609(4) states that any assurance received within thirty days is reasonable.[187] Section 2-609(2) of the U.C.C. declares that the adequacy of assurance is "determined according to commercial standards."[188] If the financial institution does not receive assurance within thirty days, or, in the alternative, receives assurance within thirty days but that assurance is not adequate according to commercial standards, the contract is repudiated.[189]

Contract repudiation and its remedies are covered under U.C.C. section 2-610. Under that section, an aggrieved party only may determine the contract to be in repudiation if the lack of performance would "substantially impair the value of the contract to the [aggrieved party]."[190] Arguably, a party's inability to repay a loan because of impending insolvency would "substantially impair" the financial institution's value of the contract. Thus, by analogy, a financial institution could either await performance for a commercially reasonable time[191] or resort to any remedy available for breach.[192]

If a financial institution utilized these measures before accelerating a loan, demanding payment, or discontinuing a line of credit, a court may find it difficult to determine that the financial institution acted in bad faith.

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by the repudiating party; or

(b) resort to any remedy for breach . . . and

(c) in either case suspend his own performance.

Id. § 2-610.

185. *Id.* § 2-609(1); *see supra* note 184 (quoting U.C.C. § 2-609(1) (1987)).

186. *See, e.g.*, Rigby Corp. v Boatmen's Bank & Trust Co., 713 S.W.2d 517 (Mo. Ct. App. 1986) (holding that Boatmen's Bank & Trust acted reasonably when it called Rigby's loan due and when it applied deposits it already had against the loan when it found that Rigby was insolvent).

187. U.C.C. § 2-609(4) (1987); *see supra* note 184 (quoting U.C.C. § 2-609(4) (1987)).

188. U.C.C. § 2-609(2) (1987); *see supra* note 184 (quoting U.C.C. § 2-609(2) (1987)).

189. *See* U.C.C. § 2-609 comment 5 (1987).

190. U.C.C. § 2-610 (1987); *see supra* note 184 (quoting U.C.C. § 2-610 (1987)).

191. U.C.C. § 2-610(a) (1987); *see supra* note 184 (quoting U.C.C. § 2-610 (1987)).

192. U.C.C. § 2-610(b) (1987); *see supra* note 184 (quoting U.C.C. § 2-610 (1987)).

V. Conclusion

Lender liability is a developing area of law. The U.C.C. duties of good faith have helped to expand the field of lender liability. Since the introduction of bad faith breach into banking is relatively new, its scope has not been defined clearly. Courts have been inconsistent in their application of bad faith breach against financial institutions.[193] While several courts expressly acknowledge this cause of action, other courts do not recognize bad faith breach. In addition, some courts only will allow a cause of action for bad faith breach if the elements of the "special relationship" typically found in insurance contracts are present in the banking relationship.[194] Regardless, financial institutions can be sure that plaintiffs will continue to try new ways to include a tort action against them when suing for breach of contract. With this in mind, a

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193. Since lender liability cases are very fact specific, it is difficult to make any generalizations about what sort of conduct could lead a financial institution into trouble. One must be aware, however, that the recent trend for courts is to find liability under breach of the implied covenant of good faith and fair dealing where once there would have been none. With this in mind, listed below are several do's and don't's that a financial institution should hear in mind:

1. Give a client reasonable advance notice before accelerating a loan or discontinuing a line of credit so the client has an opportunity to find alternative financing. *See, e.g., K.M.C. Co.*, 757 F.2d 752; *see also supra* notes 98-108 and accompanying text.

2. Give a client adequate written notice before taking any discretionary action against the client's accounts. *See, e.g., Twombly*, 213 Mont. 66, 689 P.2d 1226; *see also supra* notes 110-25 and accompanying text.

3. Make sure the client knows the financial institution's intentions of whether it plans on stopping or continuing a line of credit. *See, e.g., K.M.C. Co.*, 757 F.2d 752; *see also supra* notes 98-108 and accompanying text.

4. Never use as a defense to an impending breach of contract that a contract does not exist unless the financial institution is certain that this defense has merit. Additionally, and more generally, a financial institution should never justify its actious with a defense it knows lacks merit in order to induce the client not to litigate his claim. *See, e.g., Seaman's*, 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354; *see also supra* notes 72-85 and accompanying text. For further support, see *Commercial Cotton*, 163 Cal. App. 3d 511, 209 Cal. Rptr. 551, and *supra* notes 91-97 and accompanying text.

5. A financial institution should not threaten the client with default in order to induce the client to follow its advice. *See, e.g.*, State Nat'l Bank v. Farah Mfg. Co., 678 S.W.2d 661 (Tex. Ct. App. 1984) (holding State National Bank liable for fraud in threatening to call Farah's loan if it made a company managing change that State National Bank did not like).

6. Realize tbat a client expects the financial institution wbo accepts his loan application to process it. If another financial institution will do the processing and will determine whether or not to grant the loan, the client should be told. *See, e.g.*, High v. McLean Fin. Corp., 659 F. Supp 1561 (D.D.C. 1987); *see also supra* notes 141-44 and accompanying text.

7. Wben offering a client investment advice, do not make misrepresentations to a client or withhold information tbat the financial institution knows will affect a client's decision. *See, e.g., Hill*, 655 F. Supp. 631; *see also supra* notes 145-48 and accompanying text.

8. Act promptly on a client's request to cancel his credit card. *See, e.g., Young*, 141 Cal. App. 3d 108, 190 Cal. Rptr. 122; *see also supra* notes 149-59 and accompanying text.

194. *See, e.g., Seaman's*, 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354; *see also supra* notes 71-85 and accompanying text. For further support, see *Commercial Cotton*, 163 Cal. App. 3d 155, 209 Cal. Rptr. 551, and *supra* notes 91-97 and accompanying text.

financial institution must conduct itself carefully in dealing with its clients or risk the imposition of a large judgment against it.

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