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Article

Good Faith and Fair Dealing as an Underenforced Legal Norm

Paul MacMahon†

INTRODUCTION

Most contract litigation requires courts to give meaning to contracts using doctrines of interpretation and implied terms. The most ambitious of these doctrines is the implied covenant of good faith and fair dealing. According to the Restatement (Second) of Contracts (Restatement), “[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement,” and the duty of good faith and fair dealing is well established in most American jurisdictions. Though few doubt its significance, the duty’s meaning is notoriously unclear. Good faith is “an intangible and abstract quality with no technical meaning”; its fellow

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2. See Steven J. Burton & Eric G. Andersen, The World of a Contract, 75 IOWA L. REV. 861, 869 (1990) (noting that the implied duty of good faith and fair dealing is “standard common law doctrine’). Texas is a rare exception to the general consensus in favor of a general common-law duty of good faith and fair dealing. There, “the duty of good faith and fair dealing has only been applied to protect parties who have a special relationship based on trust or unequal bargaining power.” Natividad v. Alexis, Inc., 875 S.W.2d 695, 697 (Tex. 1994); see also Mark Gergen, A Cautionary Tale About Contractual Good Faith in Texas, 72 TEX. L. REV. 1235, 1237 (1994) (criticizing the Texas Supreme Court’s limited application of good faith).
3. Robert S. Summers, Good Faith Revisited, 46 SAN DIEGO L. REV. 723, 726 (2009) (“I believe there is no obligation in all of the U.C.C. and in general contract law of more overall importance than the general obligation of good faith.”).
traveler, “fair dealing,” is no more precise. Determining the scope of such “nebulous” standards has caused courts “intractable difficulty.” Exasperation with the case law on good faith and fair dealing is commonplace among contracts scholars, who have confessedly had “very little success in agreeing on standards that might give a court guidance.”

This Article aims to make sense of good faith and fair dealing by showing that it is an underenforced legal norm. Let me explain. Much of the difficulty with good faith and fair dealing involves a mismatch between, on one hand, what legislatures and judges say and, on the other hand, what judges do. At first glance, the doctrine seems to demand that parties adhere to lofty standards of contractual conduct: the Restatement states that the duty involves “faithfulness to an agreed common purpose and consistency with the justified expectations of the other party.” The Uniform Commercial Code’s (U.C.C.; the Code) general definition of good faith encompasses both “honesty in fact and the observance of reasonable commercial standards of fair dealing.” The duty, one court recently said, is breached when a party “exercises discretion authorized in a contract in an unreasonable way.” These ways of expressing the duty seem to give judges and juries a powerful role in pronouncing on the appropriateness of the parties’ post-formation conduct, regardless of whether the contract’s text explicitly forbids the defendant’s action.

But in the real world of litigation, the application of good faith and fair dealing has generally fallen short of these demanding ideals. The case law is replete with judges expressing the need for caution, and courts have devised various restrictive doctrinal tests that make it difficult to establish a

5. The term did not even merit a definition in the sixth edition of BLACK’S LAW DICTIONARY.
9. U.C.C. § 1-201(20) (2014) (emphasis added). The definition of good faith under the Code has evolved over the years, as explained in Part I.A. infra.
breach of the duty.\textsuperscript{12} When evaluating the defendant’s performance, courts sometimes use deferential standards of review,\textsuperscript{13} akin to corporate law’s business judgment rule. In addition, courts often require plaintiffs to establish a bad motive, trickery,\textsuperscript{14} or some other form of particularly egregious conduct by the defendant.\textsuperscript{15} Another way that courts make it difficult to invoke the duty is to place challenging evidentiary burdens upon those claiming breaches.\textsuperscript{16} Further, in some contexts, particularly suits challenging terminations of employment, many courts effectively refuse to apply the doctrine of good faith and fair dealing.\textsuperscript{17} And some judges are hostile to any doctrine that allows the implication of terms beyond the contract’s express text.\textsuperscript{18}

In response to this clear divergence between the rhetoric of good faith and the reality of judicial enforcement, scholars have articulated two main ways of closing the gap. Advocates of literalism in the interpretation and construction of contracts contend that courts should “level down” the rhetoric of good faith to match the reality of their enforcement practices.\textsuperscript{19} Some go so far as to say that American courts should abandon their decades-long experiment with the doctrine of good faith perfor-

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\item \textsuperscript{13} \textit{E.g.}, Svela v. Union Oil Co. of Cal., 807 F.2d 1494, 1501 (9th Cir. 1987) (refusing to engage in “judicial second-guessing of the economic decisions of franchisors”).
\item \textsuperscript{14} \textit{E.g.}, Mkt. St. Assocs. v. Frey, 941 F.2d 588, 596 (7th Cir. 1991) (Posner, J.).
\item \textsuperscript{15} \textit{E.g.}, Unishippers Global Logistics, LLC v. DHL Express (USA), Inc., 526 F. App’x 899, 910 (10th Cir. 2013) (finding that the freight service company’s conduct in terminating a long-term services agreement “[did] not rise to the level of action so egregious as to constitute a breach of good faith” under Utah law).
\item \textsuperscript{16} \textit{E.g.}, Am-Pro Protective Agency, Inc. v. United States, 281 F.3d 1234, 1238–39, 1241 (Fed. Cir. 2002) (finding that plaintiffs suing the federal government for breach of the implied covenant must provide clear and convincing evidence of bad faith).
\item \textsuperscript{17} \textit{E.g.}, Morris v. Coleman Co., 738 P.2d 841, 851 (Kan. 1987) (“[T]he principle of law stated in Restatement (Second) of Contracts § 205 . . . is overly broad and should not be applicable to employment-at-will contracts.”).
\item \textsuperscript{18} \textit{E.g.}, Kham & Nate’s Shoes No. 2, Inc. v. First Bank of Whiting, 908 F.2d 1351, 1357 (7th Cir. 1990) (Easterbrook, J.) (“[P]rinciples of good faith . . . do not block use of terms that actually appear in the contract.”).
\item \textsuperscript{19} \textit{E.g.}, Original Great Am. Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd., 970 F.2d 273, 280 (7th Cir. 1992) (Posner, J.) (“There is no blanket duty of good faith . . . . Contract law does not require parties to behave altruistically toward each other.”).
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Supporters of a more extensive judicial role take the opposite approach. In the face of weak enforcement practices, they contend that courts should “level up” those practices to bring them into line with expansive conceptions of fairness.  

Contending that the duty can usefully be understood as an underenforced legal norm, this Article offers a way to reconcile rhetoric and judicial enforcement in good faith and fair dealing. The duty is valid as a legal norm to the fullest extent, requiring parties to treat each other reasonably when exercising contractual discretion. But the rules of decision applied by the courts when adjudicating disputes over good faith and fair dealing involve only partial enforcement of the norm’s demands. Judicial decision rules draw their inspiration from the duty of good faith and fair dealing, but courts, due to their limited competence, do not attempt to exhaust the duty’s content. Underenforcement is particularly likely to make sense where other mechanisms for checking unreasonable contractual conduct—especially self-help and reputational sanctions—are available and likely to be effective. Though courts may have overreacted to the difficulties of adjudicating breaches of good faith and fair dealing, I contend that some degree of underenforcement of the norm is sensible.

Contrary to the assumption common to the leveling-up and leveling-down strategies, 22 then, I contend that legal obligation in the law of contracts can exist in a particular instance even though the legal system will not attach a sanction to some instances of its breach. To explain how this can be so, I adopt Meir Dan-Cohen’s distinction between conduct rules and decision rules. 23 Like any other legal rule, the law of good faith and fair dealing can be understood both as a rule of conduct directed at


22. For an explicit statement of this generally held assumption, see Gregory Klass, Three Pictures of Contract: Duty, Power, and Compound Rule, 83 N.Y.U. L. REV. 1726, 1728, 1780 n.167, 1783 (2008) (assuming, for the sake of argument, that “a contractual obligation might exist without any sanction attached to breach,” but claiming “that is not the contract law we have”).

the parties (a conduct rule) and as a set of rules directed at courts tasked with enforcing the norm (decision rules).\textsuperscript{24} Though we generally expect conduct rules and decision rules to align, my suggested way forward allows them to diverge in the good faith and fair dealing context: the conduct rule extends to behavior not covered by the decision rules.

Though mostly absent from private law scholarship,\textsuperscript{25} the notion of underenforced legal norms is established in other areas of the law. The idea is particularly well known in constitutional law, where scholars have long argued that it is justifiable for gaps to open up between the meaning of the Constitution and the doctrines the courts devise for its enforcement.\textsuperscript{26} Justiciability doctrines like the political question doctrine provide the most obvious instances of the courts holding their fire.\textsuperscript{27} More subtly, the doctrines the courts have devised for adjudicating equal protection cases—particularly the rule of rational basis review that governs ordinary cases—fall short of full enforcement.\textsuperscript{28} Courts refrain from full enforcement of constitutional norms because of the special limitations and pitfalls of judicial action.\textsuperscript{29} Similar ideas are at work in a recent vein of corporate law scholarship. In that field, scholars have noted a disparity between standards of conduct and standards of review in the law of directors’ and officers’ duties.\textsuperscript{30} Without making the link with constitutional law, one writer has recently argued that directors’ and officers’ duties are underenforced and that partial underenforcement is a justifiable response to the institutional limitations of courts and judicial sanctions.\textsuperscript{31}

\textsuperscript{24} Id.
\textsuperscript{27} See id. at 1280.
\textsuperscript{28} See infra Part II.A.2 for an examination of this form of underenforcement.
In the same way that a constitutional norm or a rule of corporate law can be valid and binding on government actors or corporate office-holders even though the courts will not always award a remedy for its violation, the norm of good faith and fair dealing binds parties even though they face no risk of legal sanction for certain kinds of breach. The insight that good faith and fair dealing is an underenforced legal norm provides both an explanation for the current state of the doctrine and the beginnings of a suggested way forward. In brief, we should abandon the search for a single, crisp definition of good faith and fair dealing that courts can apply in every case. Instead, we should be moving toward a series of sub-doctrines applicable to different contexts. Because the relative effectiveness of courts and non-judicial sanctions varies greatly in different contexts, we should not be surprised that the courts have been more receptive to good faith claims in some areas than in others. This kind of doctrinal elaboration would not provide a replacement for the norm of good faith and fair dealing, any more than “tiers of scrutiny” in constitutional law replace the constitutional norm of equal protection. Rather, we should be seeking a set of judicially manageable standards inspired by the norm of good faith and fair dealing in the performance of contracts.

The Article proceeds as follows. In Part I, I explain the development of the good faith and fair dealing norm in American contract law, emphasizing the gap between the rhetoric of good faith and fair dealing and the reality of judicial practice. In Part II, I explain the notion of underenforced norms in constitutional law, focusing particularly on the example of the Fourteenth Amendment’s Equal Protection Clause. I also canvass the literature on the divergence between standards of conduct and standards of review in corporate law. Armed with insights from constitutional and corporate law, I return in Part III to good faith and fair dealing in contracts. The parallels between these contexts are, I claim, illuminating in several ways. I explore the reasons why courts or legislators would deliberately choose to announce a broad norm of good faith and fair dealing while eschewing full judicial enforcement. In Part IV, I examine the normative implications of the insight, making a series

33. See Part III.B infra (describing how the availability of alternative sanctions makes up for the underenforcement of the norm).
34. Stock contracts and franchise statutes are two examples of areas where courts accept arguments about good faith to differing degrees. See Part IV.A. infra.
of doctrinal proposals.

I. GOOD FAITH AND FAIR DEALING: RHETORIC AND REALITY

The duty of good faith and fair dealing is a tool that helps courts discern the meaning of, or to fill gaps in, contracts that the parties have already concluded. Contracts are notoriously incomplete. Lacking infinite foresight and endless time to clarify their potential future entitlements and responsibilities, contracting parties do not provide specifically for every contingency that might arise during the course of performance. By accident or by design, then, contracts give parties discretion in the ways that they perform and enforce their mutual obligations. In turn, this discretion creates a risk that it will be exercised in a purely self-interested or opportunistic way. But the courts are not powerless to police exercises of post-contractual discretion. Various interpretive or gap-filling doctrines allow the courts to imply terms restraining some kinds of

35. I sidestep the debate over whether good faith and fair dealing is, on one hand, a doctrine of interpretation, or, on the other hand, an invitation for judges to fill gaps in incomplete contracts how they see fit. My arguments are intended to be compatible with both views. For a recent defense of the view that good faith and fair dealing holds the parties to the correct interpretation of their own agreement, see Daniel Markovits, Good Faith As Contract’s Core Value, in PHILOSOPHICAL FOUNDATIONS OF CONTRACT LAW 272 (Gregory Klass et al. eds., 2014). For the gap-filling view, see, for example, Koehrer v. Superior Court, 226 Cal. Rptr. 820, 828 (Ct. App. 1986) (“[T]he obligations stemming from the implied covenant of good faith and fair dealing are imposed by law as normative values of society.”); see also Summers, supra note 3, at 226 (“[Good faith] can fill significant gaps in contracts.”).

36. American courts do not apply the duty to the precontractual phase, though they will generally enforce an express precontractual agreement to negotiate in good faith. See, e.g., SIGA Techs., Inc. v. PharmAthene, Inc., 67 A.3d 330, 333–34 (Del. 2013) (reaffirming that an explicit agreement to negotiate in good faith is enforceable under Delaware law). In some jurisdictions, courts are willing to find implied agreements to negotiate in good faith once the parties have agreed on major terms but have left other terms open. See Teachers Ins. & Annuity Ass’n v. Tribune Co., 670 F. Supp. 491, 507–08 (S.D.N.Y. 1987) (regarding New York law); see also Alan Schwartz & Robert E. Scott, Precontractual Liability and Preliminary Agreements, 129 HARV. L. REV. 661, 664 n.7 (2007) (“[T]hirteen states, sixteen federal district courts, and seven federal circuits [follow the Tribune approach].”). Even in the absence of an express or implied agreement to negotiate in good faith, American courts sometimes police bad faith conduct using other doctrines, including promissory estoppel. See, e.g., Hoffman v. Red Owl Stores, 133 N.W.2d 267, 273–75 (Wis. 1965).

37. See, e.g., Robert E. Scott, A Theory of Self-Enforcing Indefinite Agreements, 103 COLUM. L. REV. 1641, 1641 (2003) (“All contracts are incomplete. There are infinite states of the world and the capacities of contracting parties to condition their future performance on each possible state are finite.”).
self-interested behavior, even if the parties have not explicitly written such constraints into their contracts. Perhaps the most important of these doctrines is the implied duty of good faith and fair dealing.

Below, I chart the divergence between the expansive terms in which most legislatures and courts have defined the duty of good faith and fair dealing (Section A) and the limited extent to which courts have actually enforced the duty (Section B), a divergence that has already been noted by other scholars. I then explain two common strategies for closing the gap between the rhetoric of good faith performance and its actual enforcement: what I call the the “leveling-down” strategy, and the less popular “leveling-up” strategy (Section C).

A. THE DEFINITIONAL TRIUMPH OF COMMERCIAL REASONABLENESS

For centuries, the common law generally took a cautious approach to the idea of good faith in contracts, despite Lord Mansfield’s claim in the 1760s that good faith is the basis of all contracts and dealings.38 Until the twentieth century, the notion of good faith appeared most prominently in the common law in disputes over title to property and negotiable instruments, where it continues to play a crucial role in the doctrine of good faith purchase.39 In these cases, good faith was, and is, essentially a state of mind—innocence, or lack of notice.40 Because courts generally refrained from assessing the reasonableness or diligence of a purchaser’s inquiries, good faith was sometimes known as the rule of the “pure heart and the empty head.”41 The distinct notion of good faith as a source of duties to one’s contractual counterparty was limited in the nineteenth century to fiduciary relations and to certain insurance contracts.42

New York appears to have been the first American jurisdiction to embrace good faith performance as a general doc-

39. See E. Allan Farnsworth, Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code, 30 U. Chi. L. REV. 666, 668–69 (1963) (distinguishing “good faith purchase” and “good faith performance” under the U.C.C., and noting that the U.C.C.’s recognition of good faith performance revived a largely forgotten principle from Roman law).
40. See id. at 668.
In the 1933 case of *Kirk La Shelle Co. v. Paul Armstrong Co.*, the defendants settled a copyright lawsuit with the plaintiff by agreeing to pay the plaintiff half of the receipts from the revival of a play. The agreement gave the plaintiff approval rights over all arrangements, except the motion picture rights. At the time of the agreement, all motion pictures were silent. After the advent of talking motion pictures, the defendants sold all the motion picture rights without seeking the plaintiff's approval. This course of action was seemingly permitted by the words of the agreement, but the New York Court of Appeals nevertheless ruled that it was a breach of contract. The court stated that the defendants had "assumed a fiduciary relationship which had its origin in the contract." In fact, the court stressed that there was nothing special about this particular contract; rather,

in every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing.\footnote{45}

Over the next twenty-five years, several other jurisdictions adopted a general duty of good faith and fair dealing, in terms broadly similar to New York’s.\footnote{47}

The adoption of the U.C.C. provided a major leap forward for good faith in American contract law. The U.C.C. itself

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\footnote{43. By contrast, civil law countries allowed good faith a more general role. For example, section 242 of the German Civil Code, which came into force in 1900, provides that a person subject to an obligation under the Code is obligated to perform in such a manner as good faith *(Treu und Glauben)* requires, taking into account general practice. *BÜRGERLICHES GESETZBUCH [BGB] [CIVIL CODE]*, Jan. 1, 1900, as amended Jan. 1, 1992, translated by Simon L. Goren (1994), at xii, §242 at 41. The German courts have used the idea of good faith for a variety of creative purposes, including imposing precontractual liability, protecting third parties, and, most famously, revising price terms in the wake of the hyperinflation crisis of the 1920s. For an overview, see Werner F. Ehke & Bettina M. Steinhauer, *The Doctrine of Good Faith in German Contract Law*, in GOOD FAITH AND FAULT IN CONTRACT LAW 171 (Jack Beatson & Daniel Friedmann eds., 1995); see also JOHN P. DAWSON, THE ORACLES OF THE LAW 461–79 (1968).

44. 188 N.E. 163 (N.Y. 1933).

45. *Id.* at 166.

46. *Id.* at 167 (emphasis added). For a similar, earlier statement, see Brassil v. Maryland Cas. Co., 104 N.E. 622, 624 (N.Y. 1914).

provides that “[e]very contract or duty within [the Code] imposes an obligation of good faith in its performance or enforcement.”48 In addition to the general requirement, the Code requires parties to observe a good faith standard in more than fifty specific provisions.49 Karl Llewellyn, the Chief Reporter and principal architect of the U.C.C., was primarily responsible for the Code’s adoption of a general obligation of good faith.50 The obligation of good faith was a crucial part of Llewellyn’s more general project of reforming the classical law of contract to bring it into line with the norms generally accepted by businesspeople, with the aim of ensuring that commercial law would be flexible enough to keep pace with changes in commercial practice.51

Llewellyn also proposed his own definition of good faith under the Code. Before the Code, the idea of “good faith” was mostly used as a precondition for a purchaser wishing to assert good title to an item of property despite the seller’s lack of authority to do so. Debates over how to define the term in that area of law had long focused on whether good faith depended solely on the relevant party’s actual state of mind (a “subjective” standard) or turned instead on whether the party had complied with standards of reasonable behavior (an “objective” standard). In keeping with Llewellyn’s expansive vision for commercial law, his initial proposed definition of good faith in the Code was broad, encompassing both “honesty in fact in the conduct or transaction concerned” and “observance by a person of the reasonable commercial standards of any business or trade in which he is engaged.”52 But, at least initially, Llewellyn did not

50. Llewellyn drew both on existing American precedents and on German law. See James Whitman, Commercial Law and the American Volk: A Note on Llewellyn’s German Sources for the Uniform Commercial Code, 97 Yale L.J. 156, 157–58, 162–63, 166–67 (1987) (noting the affinity between Llewellyn’s vision of commercial law and the views of some nineteenth-century German legal scholars). Compare supra note 47 (listing some earlier American good faith cases), with supra note 43 (discussing good faith in German law).
51. In addition to the good faith provisions, Llewellyn was also behind the Code’s adoption of a lax parol evidence rule and also the Code’s directions to courts to consider usages of trade, courses of performance, and courses of dealing in contract adjudication. See David G. Epstein et al., Fifty: Shades of Grey—Uncertainty About Extrinsic Evidence and Parol Evidence After All These UCC Years, 45 Ariz. St. L. J. 925, 937–39 (2013).
52. U.C.C. § 1-201(18) (May 1940 Draft).
entirely get his way when it came to the definition of good faith. His inclusion of a reasonableness requirement in the draft Code drew criticism from some practicing lawyers involved in the U.C.C. project, who objected to the legalization of commercial morality, and voiced fears that customers would be encouraged to bring unjustified suits for supposed failures to comply with reasonable standards of behavior. The ABA Section of Corporation, Banking, and Business Law thus urged a narrower definition of good faith, limited to honesty in fact and “the absence of trickery, deceit or improper purpose.”

The U.C.C.’s drafters adopted a compromise. They agreed that the Code’s overarching obligation of good faith in the performance and enforcement of commercial obligations should be restricted to “honesty in fact.” But in Article 2, which governs sales of goods, the drafters applied Llewellyn’s broader view of good faith to cases where the party performing or enforcing an obligation was a merchant, requiring merchants to observe “reasonable commercial standards of fair dealing.” This compromise was ultimately incorporated into the first version of the Code’s Official Text, approved in 1962. And even the seemingly narrower term “honesty in fact” was subject to broad readings by the Code’s proponents. Commending the Code to New York’s legislators, Edwin Patterson contended that “honesty in fact” encompassed requirements of “generosity” and “co-operation,” and that it would mitigate the effects of “hard luck” in commerce.

In this form, good faith became a major part of commercial law in the jurisdictions adopting the U.C.C.—all of the states and the District of Columbia —and the idea soon spread far

53. Walter D. Malcolm et al., Report of Committee on the Proposed Commercial Code, 6 BUS. LAW. 119, 127 (1951) (“Why should the Code draftsmen tell us to be good? Businessmen, or at least most of them, carry on business ethically and did so long before the Code was ever conceived. The Code should not try to prescribe morals.” (internal quotation marks omitted)).
54. Id. at 128.
55. U.C.C. § 1-201(19) (1962).
56. Id. § 2-103(1)(b).
57. See id. §§ 1-201(19), 2-103(1)(b).
beyond the Code. Robert Summers’s 1968 article on good faith was an important step along the way to the widespread adoption of a general obligation in American contract law.\textsuperscript{60} Using an idea borrowed from the philosophy of language,\textsuperscript{61} Summers claimed that good faith was an “excluder”—it served to exclude a wide range of heterogeneous forms of bad faith.\textsuperscript{62} Summers’s own nonexhaustive list of categories of bad faith performance included: (1) evasion of the spirit of the deal, (2) lack of diligence and slacking off, (3) willfully rendering only substantial performance, (4) abuse of a power to specify terms, (5) abuse of a power to determine compliance, and (6) interference with or failure to cooperate in the other party’s performance. In Summers’s view, the U.C.C.’s general definition as “honesty in fact” was plainly too narrow, for there are several categories of non-dishonest bad faith.\textsuperscript{63}

In turn, Summers’s conception of good faith influenced Robert Braucher, who drafted section 205 of the Restatement.\textsuperscript{64} That provision states that “[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.”\textsuperscript{65} By using both of the U.C.C.’s terms—“good faith” and “fair dealing”—the Restatement made clear that the duty extended beyond an honesty requirement. According to the comments to section 205, in the particular context of contract performance and enforcement, good faith “emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party.”\textsuperscript{66} Adopting the “excluder” analysis, the comments continue by saying that good faith “excludes a variety of types of conduct characterized as involving ‘bad faith’ because they violate community standards of decency, fairness or reasonableness.”\textsuperscript{67} Again echoing Sum-

\begin{itemize}
  \item \textsuperscript{60} See generally Summers, supra note 49.
  \item \textsuperscript{62} Summers, supra note 49, at 201.
  \item \textsuperscript{63} See id. at 204.
  \item \textsuperscript{64} See Robert S. Summers, The General Duty of Good Faith and Fair Dealing—Its Recognition and Conceptualization, 67 Cornell L. Rev. 810, 810 (1982) (“Professor Braucher acknowledged that an article I wrote . . . substantially influenced the recognition and conceptualization of good faith in section 205.”).
  \item \textsuperscript{65} Restatement (Second) of Contracts § 205 (1981).
  \item \textsuperscript{66} Id. § 205 cmt. a.
  \item \textsuperscript{67} Id.
mers, the comments state that “[a] complete catalogue of types of bad faith is impossible,” and recite Summers’s list of types of bad faith conduct as illustrations.68

The vast majority of American jurisdictions have adopted the duty as a matter of general contract law; many have explicitly endorsed the Restatement approach.69 State and federal statutes governing particular classes of contracts contain similar requirements.70 Moreover, over time, various amendments to the U.C.C. extended the “objective” standard of commercial reasonableness to various contexts beyond Article 2.71 Eventually, the Code’s definition of good faith flipped, so that commercial reasonableness now constitutes the general rule. Since 2003, the Official Text of the U.C.C. now essentially reinstates Llewellyn’s definition of good faith, defining the term as “honesty in fact and the observance of reasonable commercial standards of fair dealing.”72 Though some states continue to limit the general definition of good faith in their version of U.C.C. to “honesty in fact,” most jurisdictions now adopt the broader view as a general matter.73

For the most part, then, the American law of good faith provides that those performing and enforcing contractual obligations must observe standards of “fair dealing” or “commercial reasonableness.” As envisaged by influential contracts scholars like Llewellyn and Summers, the good faith duty requires substantial deference to the other party’s interests, beyond what the terms of the formal document demand. Courts have used a variety of formulations to reflect the understanding that good

68. Id. § 205 cmt. d.
70. See, e.g., 15 U.S.C. § 1222 (2012) (providing automobile franchisee with a cause of action against an automobile manufacturer who fails to “act in good faith in performing or complying with any of the terms or provisions of the franchise”); Id. § 2802(b)(3)(D) (franchisor terminating franchise arrangement for reason other than franchisee misconduct must do so “in good faith and the normal course of business”).
71. For example, Article 2A of the U.C.C., which governs leases of goods, applied the broader standard to merchants from its inception. See U.C.C. § 2A-103(4) (2014).
72. U.C.C. § 1-201(20) (2014). The Code continues to exempt Article 5, which governs letters of credit, from the commercial reasonableness standard. Id.
73. See 6 CORBIN ON CONTRACTS § 26.8 n.6 (2014), available at LexisNexis CORBIN (noting that as of August 1, 2010, thirty-nine states had adopted the revised Article 1 of the U.C.C.; twenty-eight of those adopt the broader general definition of good faith).
faith and fair dealing involves the incorporation into law of “contractual morality,”
opening up the potential for extensive judicial superintendence of contractual discretion. As scholars
in a long tradition of work on the relational aspects of contract have shown, the morality of contracting—as perceived by the
participants—pervasively demands cooperation, flexibility, and some degree of accommodation of the other party’s legitimate
interests. Along similar lines, many courts have cited the Summers-Restatement reference to community standards of decency,
fairness, and reasonableness as an interpretation of the meaning of good faith and fair dealing. Others say that the
duty prevents parties from frustrating the purpose of the contract. Some courts have spoken of a “duty of cooperation.”
Still other courts say that the duty prevents a party from upsetting the other party’s justified, reasonable, or legitimate
expectations. Such expectations may arise from informal norms and implicit understandings between the parties, not just from
the formal contractual documents. Enthusiasts for expansive views of the duty have endorsed it as a demand for acts of altruism
toward one’s contractual partner, and as a requirement that one exercise one’s formal entitlements in a spirit of solidarity with the other party. Along similar lines, skeptics of broad conceptions of good faith have worried that the doctrine

74. Summers used this phrase in his 1968 article. Summers, supra note 49, at 195, 214.
75. Roughly speaking, relational contract theory explores the implications of the insight that contracts are embedded within a broader set of relations between the parties, an idea that has been a source of inspiration both for law-and-economics scholarship and for sociological scholarship on contracts. For an excellent recent overview of relational contract scholarship of both kinds, see Robert E. Scott, The Promise and Peril of Relational Contract Theory, in REVISITING THE CONTRACTS SCHOLARSHIP OF STEWART MACAULAY 105 (Jean Braucher et al. eds., 2013).
77. E.g., Carma Developers (Cal.), Inc. v. Marathon Dev. Cal., Inc., 826 P.2d 710, 728 (Cal. 1992).
78. E.g., Beidel v. Sideline Software, Inc., 811 N.W.2d 856, 864 (Wis. 2013); In re Estate of Chayka, 176 N.W.2d 561, 564 n.7 (Wis. 1970).
79. E.g., Beraha v. Baxter Health Care Corp., 956 F.2d 1436, 1444 (7th Cir. 1992) (reasonable expectations); Carma Developers, 826 P.2d at 728 (legitimate expectations).
81. Duncan Kennedy, Form and Substance in Private Law Adjudication, 89 HARV. L. REV. 1685, 1721 (1976) (in its most altruistic form, good faith could include a “duty to absorb some loss in order to avoid a larger loss to one’s contractual partner”).
82. ROBERTO MANGABEIRA UNGER, LAW IN MODERN SOCIETY 210 (1976).
requires judicial enforcement of the Golden Rule or of Kant’s Categorical Imperative;83 that it enshrines “commercial Good Samaritanism”;84 or even that the good faith and fair dealing duty imposes a regime of “commercial palimony.”85

The duty of good faith and fair dealing has been invoked in several thousand cases, often successfully. And the duty has sometimes served as the basis for strikingly liberal impositions of liability. For example, in K.M.C. Co. v. Irving Trust Co.,86 the Sixth Circuit invigorated the field of “lender liability” by applying the duty to a bank’s decision to refuse further advances to a borrower in financial difficulties. Without giving any notice, the lender dishonored checks drawn by the borrower, and the borrower’s business soon collapsed.87 Though the text of the parties’ loan agreement seemed to place no limits on the lender’s discretion to grant or deny a request for further credit, the borrower provided expert testimony stating that a reasonable lender would at least have given notice of the denial so as to give the borrower time to find alternative sources of financing.88

Having been instructed to impose liability if it found the lender had acted unreasonably when it exercised its discretion to deny further credit, the jury found a violation of the implied covenant of good faith and fair dealing, and awarded the borrower damages of $7.5 million.89 The Sixth Circuit upheld the verdict.90 The court stressed that the borrower was at the lender’s mercy, and that the parties had a long-term banking relationship.91

83. White, supra note 7, at 690–91.
84. See Gillette, supra note 6, at 635; see also Melvin A. Eisenberg, The Duty To Rescue in Contract Law, 71 FORDHAM L. REV. 647, 666–70 (2002) (contending, more enthusiastically than Gillette, that some instances of the duty of good faith performance exemplify a duty to rescue one’s contractual counterparty).
86. 757 F.2d 752 (6th Cir. 1985).
87. Id. at 754.
88. Id. at 759.
89. Id. at 755, 760.
90. Id. at 766.
91. As Steven Burton points out, the K.M.C. decision is an illustration of relational contract law (to which Burton himself is hostile). Steven J. Burton, Good Faith in Articles 1 and 2 of the U.C.C.: The Practice View, 35 WM. & MARY L. REV. 1533, 1554 (1994).
B. THE LIMITED ENFORCEMENT OF GOOD FAITH AND FAIR DEALING

Despite the expansive implications of a duty to engage in commercially reasonable behavior, judicial enforcement practices have usually fallen short of what Llewellyn seemed to intend. It is admittedly difficult to provide a comprehensive account of the case law on good faith performance, because there is no generally accepted doctrinal framework, and many decisions rely on judicial or jury intuition to distinguish between good faith and bad faith performance. Still, a large number of scholars reviewing the case law agree that the reality of enforcement has failed to match good faith’s definitional rhetoric.92 Courts often quickly undercut their own sweeping invocations of commercial reasonableness with statements that the task of implying terms based on the duty is a “cautious enterprise,”93 or that courts should not be “overly ambitious” when applying the duty.94 In addition, courts have developed myriad doctrinal tests to limit the duty’s enforcement. As I explain below, courts often assess defendants’ conduct under deferential standards of review; they sometimes require plaintiffs to establish improper motive or near-dishonest conduct; they impose heightened burdens of proof on plaintiffs; and they sometimes allow pro-defendant norms to trump good faith and fair dealing.

1. Deferential Standards of Review

One way that courts restrict the effectiveness of good faith and fair dealing is by providing that the reasonableness of a defendant’s contractual performance should be reviewed under a deferential standard. Rather than decide for themselves what counts as bad faith or unreasonable behavior, courts explicitly allow the defendant some degree of latitude. For example, many courts state that, to ground a claim based on a defendant’s exercise of discretion, the plaintiff must establish that the decision was “arbitrary” or “capricious.”95

92. For accounts stressing the divergence between the rhetoric and reality of enforcement in good faith and fair dealing cases, see Dubroff, supra note 20; Gillette, supra note 6; Hou, supra note 21; Imwinkelried, supra note 12.
In some cases, courts have applied standards of review closely equivalent to corporate law’s business judgment rule. In corporate law, the business judgment rule involves the presumption that the Board of Directors acted independently, with due care, in good faith, and in the honest belief that its actions were in the stockholders’ best interests. The rule shields directors and officers from liability for failure to take due care where the challenged decision can be attributed to any rational business purpose; effectively, the rule limits liability to extreme cases. A similar approach emerges from a review of franchise litigation under various statutory and common-law good faith duties. Though one court in California has found a contractual provision unconscionable on the ground that it superimposed the business judgment rule on the duty of good faith and fair dealing, many franchise cases have actually applied something very like the business judgment rule when reviewing franchisor discretion, even without a contractual provision to that effect.

Courts also constrain the good faith and fair dealing standard by superimposing doctrinal requirements in specified contexts to restrict the scope of a reasonableness test. The Supreme Court of Nevada’s decision in Davis v. Nevada National Bank, a lender liability case, provides an example. The defendant bank granted the plaintiffs a loan to finance the construction of their new home. Rather than simply advancing the money to the plaintiff, the bank reserved the power to disburse the funds to the builder. As construction progressed, the plaintiffs noticed serious structural defects in the foundation, and implored the bank to stop doling out their cash to the builder. Yet the bank continued to make advances, squander-
ing the plaintiffs’ money on a fundamentally defective house. The bank’s conduct was certainly commercially unreasonable, but that alone was not enough to ground a claim. While accepting that the bank was under a duty of care, the court took pains to reject the idea of a general legally enforceable duty on the bank’s part to exercise care in the disbursement of the loan. It crafted more restrictive conditions for the duty to be applied by the jury, stating that “it would be unjust to permit a lender, with impunity, to simply disregard a borrower’s complaint of substantial construction deficiencies affecting the structural integrity of a project.” A genuine attempt to impose a full-blooded standard of commercial reasonableness would not stop there.

2. Requiring Proof of Bad Motive or Borderline Duplicity

As we have seen, at the level of definitional rhetoric, the covenant of good faith and fair dealing can be breached by objectively unreasonable conduct, regardless of the actor’s motive or mental state. But courts have nevertheless developed doctrinal tests that focus the inquiry on the defendant’s state of mind. Even where courts purport to apply an “objective” standard, they often require the plaintiff to establish an improper motive or borderline dishonesty. In this way, courts fall short of what a true attempt to enforce a norm of commercial reasonableness would involve.

Again, franchise cases provide examples of this process. Courts adjudicating challenges by franchisees to the discretionary decisions of franchisors often impose a requirement of improper motive. In Wilson v. Amerada Hess Corp., for example, a gas station franchisee complained that the franchisor had exercised its discretion to raise prices so drastically that it

104. Id.
105. Id. at 505.
106. Id.
107. Id.; see also id. at 506.
108. E.g., Carma Developers (Cal.), Inc. v. Marathon Dev. Cal., Inc., 826 P.2d 710, 727 (Cal. 1992) (“Dishonesty presupposes subjective immorality; the covenant of good faith can be breached for objectively unreasonable conduct . . . .”).
109. Sometimes statutory definitions of bad faith make clear that a defendant will be liable only for specified forms of wrongdoing. For example, the Automobile Dealer’s Day in Court Act limits actionable conduct to “coercion, intimidation, or threats of coercion or intimidation from the other party.” 15 U.S.C. § 1221(e); see also, e.g., Paccar Inc. v. Elliot Wilson Capitol Trucks LLC, 905 F. Supp. 2d 675, 685 (D. Md. 2012).
drove the franchisee out of business. The court ruled that the franchisee would only be entitled to damages under the duty of good faith and fair dealing if it could show that the franchisor had acted from a “bad motive.” The court remanded the case for further discovery on the issue of whether the franchisor had acted with the intention of putting the franchisee out of business—an allegation the court admitted would be “difficult to prove.”

Sometimes, courts demand proof of something very close to dishonesty when applying the supposedly “objective” standard of good faith and fair dealing. One particularly well-known example is Judge Posner’s opinion in Market Street Associates v. Frey. The case involved a real estate sale and leaseback transaction, originally entered into for financing purposes between a retail tenant and a landlord in 1968. The lease entitled the tenant to ask the landlord to finance repairs to the property. The contract also stated that, if negotiations over financing the requested improvements failed, the tenant could repurchase the property at a price determined by a formula. Almost twenty years later, a new tenant requested financing to build a new store. At this time, the contract’s price formula evidently offered the tenant a knock-down price for the property. The landlord rejected the financing request out of hand, having forgotten the extreme consequences of a failure of negotiations. Seeking to avoid the automatic sale provision, the landlord invoked the duty of good faith and fair dealing.

Judge Posner applied a narrow conception of the duty’s requirements. He accepted that it would be inconsistent with good faith to “take deliberate advantage of an oversight by your contract partner concerning his rights under the contract.” The dispositive question, on Judge Posner’s view, was “simply whether [the tenant] tried to trick [the landlord] and succeeded

111. Id. at 1130–31.
112. Id. at 1131.
115. Id.
116. Id.
117. Id.
118. Id.
119. Id.
120. Id. at 591–93.
121. Id. at 594.
in doing so.” As Todd Rakoff has shown, Judge Posner’s opinion does not explain convincingly why his “anti-trickery” reading of good faith and fair dealing is preferable to the District Court’s finding that the duty simply required the tenant to notify the landlord of the contract’s terms as a precondition for seeking to invoke them. But Judge Posner’s view is in keeping with a series of other judicial opinions—including his own—stating that good faith and fair dealing does not necessarily entail the judicial enforcement of commercial reasonableness, even though legislatures and courts often express the norm in those terms.

3. Imposing Heightened Evidentiary Burdens

Another way that courts discourage resort to the duty of good faith and fair dealing is by erecting evidentiary hurdles in front of plaintiffs who seek to invoke it. The most explicit example comes from government contract litigation. The federal common law of government contracting recognizes the implied duty of good faith and fair dealing. But where a private contractor claims a breach, courts apply a strong presumption that government officials acted in good faith. That presumption can be overcome only if the plaintiff provides “well-nigh irrefragable proof,” or, in more modern language, “clear and convincing evidence,” of bad faith. The application of this heavy presumption of good faith to the implied covenant of good faith and fair dealing appears to be the product of historical confusion. Nevertheless, it seems to have survived a recent judicial

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122. Id. at 596. On remand, the District Court conducted a bench trial, and ruled that there was a breach of the duty of good faith even under Judge Posner’s restrictive standard. Mkt. St. Assocs. Ltd. P’ship v. Frey, 817 F. Supp. 784, 788 (E.D. Wis. 1993), aff’d 21 F.3d 782 (7th Cir. 1994).


124. E.g., Original Great Am. Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd., 970 F.2d 273, 280 (7th Cir. 1992) (stating that reasonableness is not the test for good faith).

125. See, e.g., Centex Corp. v. United States, 395 F.3d 1283, 1304 (Fed. Cir. 2005).


129. See Stuart B. Nibley & Jade Totman, Let the Government Contract:
attempt to confine it to cases where "a government official is accused of fraud or quasi-criminal wrongdoing in the exercise of his official duties," and continues to apply to ordinary breaches of the implied covenant by the federal government.

A heightened evidentiary burden makes it particularly difficult to establish a breach of good faith when it is combined, as it often appears to be, with a requirement of proof of improper motive. Plaintiffs do sometimes prevail in government contracting suits based on the implied covenant. In one recent case, the judge made a finding of bad faith, having reviewed internal communications among officials and concluded the plaintiff had proved, by clear and convincing evidence, that a number of Army officials had engaged in a "prolonged campaign to harm" the plaintiff. But a plaintiff will generally need to engage in extensive and costly discovery to find the necessary degree of proof, and, as a result, many government contractors presumably decide not to file suit at all.

4. Giving Precedence to Other Legal Norms

The duty of good faith and fair dealing is supposedly implied in every contract, giving rise to the potential for conflict with other implied contract law norms. In particular, the good faith norm conflicts with the general American rule of at-will employment, under which employment under an indefinite contract of employment can be terminated for any reason, or for no reason at all. The dominant trend is to subordinate the doctrine of good faith and fair dealing in the field of employment terminations.

It once appeared that the new contract law duty would take precedence over the at-will norm. In a series of decisions in the 1970s and 1980s, several courts applied the Summers-
Restatement logic to employment terminations as an exception to the rule of at-will employment. The Massachusetts Supreme Judicial Court explicitly linked the emerging norm against bad faith termination of an at-will employment contract to the Restatement’s provision on good faith and fair dealing. The jury had held for the plaintiff based on a theory of bad faith termination, in a case where the employer had fired a salesman for the purpose of depriving him of bonuses to which he was about to become entitled. The court upheld the verdict even though the literal words of the contract gave the employer the power to terminate the contract without cause at any time.

But the tide has turned against the application of the good faith norm to terminations of indefinite employment arrangements. Faced with a conflict of norms, the majority of states simply award victory to the at-will norm; they do not permit the implied covenant to operate. Courts rejecting the duty in the employment setting claim that the implied covenant is just too vague (a somewhat unconvincing contention, given that the covenant applies to every other contract), or find that it is simply incoherent to have a rule of at-will employment while simultaneously restricting that doctrine with a duty of good faith and fair dealing. In the at-will employment setting, then, even proof of bad-faith motive will generally not ground a claim for breach of contract. Even the states that originally recognized the application of the duty of good faith and fair dealing in this field have “circumscribed the covenant’s impact in what amount to expressions of judicial remorse.” The Supreme Court of California, for example, now says that, notwithstanding the covenant of good faith and fair dealing, an at-will employer “may act peremptorily, arbitrarily, or inconsistently, without providing specific protections such as prior warning,

136. Fortune, 364 N.E.2d at 1257.
137. Id. at 1253.
138. Id. at 1258.
140. See Brockmeyer v. Dun & Bradstreet, 335 N.W.2d 834, 838 (Wis. 1983) (describing the concept of bad faith as amorphous).
141. See Sabetay v. Sterling Drug, Inc. 506 N.E.2d 919, 922 (N.Y. 1987) (explaining that implying a duty of good faith and fair dealing that restricts an employer’s right to terminate at will would be inconsistent).
142. Brudney, supra note 139, at 774.
fair procedures, objective evaluation, or preferential reassignment.”

C. PROPOSALS TO CLOSE THE GAP BETWEEN RHETORIC AND REALITY

Scholars seeking to make sense of this area of contract law have assumed that courts must bring the rhetoric of good faith into line with the reality of enforcement—or vice versa. Among those skeptical of broad judicial pronouncements, doubts about full-blooded enforcement of good faith and fair dealing find an intellectual foundation in the “neoformalist” trend in contracts scholarship. The duty of good faith and fair dealing was a product of the realist and contextualist reaction to classical formalism, so it is no surprise that it has come under fire from neoformalists both on the bench and in academia. Robert Scott, for example, contends that the cost of having courts discern commercial reasonableness exceeds any benefits it could bring to the parties. Lisa Bernstein, another critic of the U.C.C.’s strategy of incorporating commercial reasonableness, concludes that the idea of good faith plays only a very minor role in private arbitration systems chosen by commercial parties to adjudicate their own disputes.

The most obvious implication of these arguments is that courts should “level down” the rhetoric of good faith to reflect the limited reality of enforcement. In their strongest form, lev-

145. See Robert E. Scott, A Theory of Self-Enforcing Indefinite Agreements, 103 COLUM. L. REV. 1641, 1688 (2003) (arguing that “an attempt to enforce deliberately incomplete contracts by adopting a broad standard of reasonableness or good faith is socially inefficient”).
146. See Lisa Bernstein, Merchant Law in a Merchant Court: Rethinking the Code’s Search for Immanent Business Norms, 144 U. PA. L. REV. 1765, 1775–76 (1996) [hereinafter Bernstein, Merchant Law] (stating that arbitrators for the National Grain and Feed Association never rely on a general duty of good faith, though conceding that the term “good faith” is used in some arbitration decisions); Lisa Bernstein, Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions, 99 MICH. L. REV. 1724, 1734 (2001) (claiming that “notions of good faith and fairness do not appear to affect case outcomes” under private arbitration in the cotton industry). Bernstein admits that notions of good faith and substantive fairness “may . . . influence the outcome of arbitration cases in ways that cannot be detected by reading opinions.” Bernstein, Merchant Law, supra, at 1776 n.37.
eling-down accounts argue that courts and legislatures should abandon the good faith and fair dealing norm. A slightly less direct way to level down the duty is to pay lip service to it, but to tie the contours of the duty to the literal words of the contract’s text. A basic starting point for the duty of good faith and fair dealing is that the contract’s written words do not provide an exhaustive guide to the contract’s terms. Yet Judge Easterbrook’s opinion in *Kham & Nate’s Shoes No. 2, Inc. v. First Bank of Whiting* states another view of good faith and fair dealing’s meaning. The case concerned an attempt to subordinate a lender’s claim in bankruptcy for inequitable conduct, based on conduct broadly similar to the conduct at issue in the Sixth Circuit’s *K.M.C.* decision discussed above.

Judge Easterbrook took the opportunity to disagree with *K.M.C.*, stating that “[u]nless pacts are enforced according to their terms, the institution of contract, with all the advantages private negotiation and agreement brings, is jeopardized.” Accordingly, he continued, parties must be allowed to enforce the terms of their agreement “to the letter, even to the great discomfort of their trading partners, without being mulcted for lack of ‘good faith.’” For Judge Easterbrook, the borrower had no hope of establishing bad faith, because the text of the contract afforded a discretion to the lender without explicitly limiting that discretion. Good faith, he said, cannot “block

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147. See Dubroff, supra note 20 (concluding that fair contracts should “be enforced without the uncertainties that would be created by enabling a party disadvantaged by enforcement of the deal to claim bad faith as a defense”); Victor Goldberg, *Discretion in Long-Term Open Quantity Contracts: Reining in Good Faith*, 35 U.C. DAVIS L. REV. 319 (2002) (contending that courts are ill-equipped to police exercises of discretion in long-term contracts); Mark Snyderman, Comment, *What’s So Good About Good Faith? The Good Faith Performance Obligation in Commercial Lending*, 55 U. CHI. L. REV. 1335, 1338 (1988) (arguing that imposing an obligation of good faith in the commercial lending context “upset[s] the reasonable expectations of the parties and significantly limit[s] the flexibility available to lenders and borrowers in furtherance of commercial transactions”).

148. See Dennis M. Patterson, *A Fable from the Seventh Circuit: Frank Easterbrook on Good Faith*, 76 IOWA L. REV. 503, 523 (1991) (explaining that under the U.C.C. “[t]he concept of agreement is not limited to the terms of the parties’ writing: it includes a variety of elements, all of which must be synthesized” (footnote omitted)).

149. *Kham & Nate’s Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1357 (7th Cir. 1990).

150. See supra text accompanying notes 86–91.

151. *Kham*, 908 F.2d at 1357.

152. *Id*.

153. See id. (“Debtor and Bank signed a contract expressly allowing the Bank to cease making further advances. . . . The Bank exercised its contractu-
As Judge Antonin Scalia once explained, the upshot of a strongly textualist approach would be “virtually to read the doctrine of good faith . . . out of existence.” Though the textualist approach to good faith has not completely swept the board, it has had some effect on judicial decisions. In particular cases, the contract’s express language is said to preclude the plaintiff’s attempt to invoke the good faith and fair dealing norm. Even in jurisdictions that often give effect to the duty of good faith, strongly textualist statements appear spasmodically. Courts sometimes say that “[t]he implied covenant of good faith and fair dealing is limited to assuring compliance with the express terms of the contract, and cannot be extended to create obligations not contemplated by the contract.” In a recent case decided under Pennsylvania law, a federal district court judge even refused to give any effect to an express covenant of good faith and fair dealing, requiring the plaintiff to establish a breach of some other express term.

al privilege after loaning Debtor $75,000; it made a clean break and did not demand improved terms. It had the right to do this for any reason satisfactory to itself.

154. Id.
156. For example, in July 2013, the Supreme Court of Wisconsin decided Beidel v. Sideline Software, Inc., 842 N.W.2d 240 (Wis. 2013). The majority decision permitted a claim based on the covenant to proceed, despite an absence of explicit textual warrant for the claimed duty. Id. at 257. The majority disapproved of approaches to interpretation that follow “the letter but not the spirit of an agreement.” Id. at 250. The dissent, with approving citations to Judge Easterbrook, complained that majority was overriding the contract’s express text. Id. at 262–64 (Gableman, J., dissenting).
157. See In re Facebook PPC Adver. Litig., 709 F. Supp. 2d 762, 770 (N.D. Cal. 2010) (finding that an express term of contract placing risk of improper actions by a third party on one of the contracting parties precluded a good faith and fair dealing claim seeking to reallocate that risk); Imwinkelried, supra note 12, at 11–12; Michael P. Van Alstine, Of Textualism, Party Autonomy, and Good Faith, 40 WM. & MARY L. REV. 1223, 1223–24 (1999).
158. See Facebook, 709 F. Supp. 2d at 770.
159. See, e.g., Super Valu Stores, Inc. v. D-Mart Food Stores, Inc., 431 N.W.2d 721, 726 (Wis. Ct. App. 1988) (“[W]here, as here, a contracting party complains of acts of the other party which are specifically authorized in their agreement, we do not see how there can be any breach of the covenant of good faith.”).
Though subsequent courts applying the implied duty of good faith and fair dealing have explicitly rejected the court’s error,\(^1\) the fact that a federal judge could make such a mistake is a strong indication of the doctrine’s vulnerability to textualist claims.

Relatedly, many courts recite the claim that the duty of good faith and fair dealing provides no “independent” or “separate” cause of action.\(^2\) Sometimes, courts use this language to make the relatively uncontroversial point that a breach of the covenant of good faith and fair dealing generally provides a claim for breach of contract, not a tort claim.\(^3\) Similarly, courts have also used the same idea at the pleading stage to clarify that a suit based on good faith and fair dealing is a species of claim for breach of contract, not an alternative cause of action.\(^4\) But for many courts, the “no independent cause of action” line—like the textualist approach—has become a piece of boilerplate doctrine, to be deployed when rejecting claims that do not find judicial favor.

An alternative reaction to the disparity between rhetoric and reality in good faith is to hold the rhetoric constant, while advocating an increase in enforcement activity to match that rhetoric. In commercial cases, this “leveling-up” strategy is exemplified by Richard Speidel’s argument that courts should seek out and enforce implicit relational norms under the doctrine of good faith performance, using the doctrine to lend judicial force to requirements that parties cooperate, share risks,


\(^3\) See, e.g., Bellemare v. Wachovia Mortg. Corp., 894 A.2d 335, 345–46 (Conn. App. Ct. 2006) (stating that a “claim brought pursuant to a contract, alleging a breach of the implied covenant of good faith and fair dealing, sounds in contract” and was therefore subject to the statute of limitations for breach of contract claims); Littlejohn v. Parrish, 839 N.E.2d 49, 54 (Ohio Ct. App. 2005) (noting the “prevailing view” that “the good-faith-and-fair-dealing requirement is part of the contract—not a separate tort claim”).

\(^4\) See, e.g., ICD Holdings S.A. v. Frankel, 976 F. Supp. 234, 243–44 (S.D.N.Y. 1997) (stating that when conduct that allegedly violates the implied covenant of good faith and fair dealing is also the predicate for breach of an express contract provision, the breach of good faith claim will be dismissed as redundant).
and act in ways that preserve the parties’ relationship. Another “leveling-up” argument is to be found in Emily Houh’s contention that courts should ramp up their enforcement practices to bring them into line with an expansive vision of societal equality. Houh argues that the duty of good faith and fair dealing should be used to provide remedies to victims of unconscious gender and racial subordination in the contracting process, even where remedies under civil rights statutes are unavailable in such cases. Yet another version of the “leveling-up” strategy is Chunlin Leonhard’s argument that courts should use the good faith and fair dealing doctrine to combat a business culture of everyone for themselves. Leonhard contends that courts adjudicating claims under the doctrine should impose liability where a reasonable person would find the conduct unacceptable, and that courts should have the power to impose tort damages in the event of a breach of this negligence standard.

II. UNDERENFORCED LEGAL NORMS

Though in one sense their positions are diametrically opposed, advocates of the leveling-down and leveling-up strategies share a common assumption. Both sides assume that the scope of the good faith and fair dealing norm is, or should be, coextensive with judicial enforcement of that norm. In this way, partisans on both sides are characteristic of contracts scholars more generally; the idea that a legal norm can be valid beyond the boundaries of judicial enforcement is unfamiliar in contracts scholarship. But the idea has a respectable intellectual provenance in other legal fields, and finds support in writings on general jurisprudence. So, in this Part, I begin the process of defending my claim that good faith and fair dealing is an

166. See Speidel, supra note 21, at 796–77.
167. See Houh, supra note 21.
168. Id. at 1029.
170. Id. at 635–36. Leonhard also advocates the extension of good faith and fair dealing to the pre-contractual phase. Id.
171. See, e.g., Klass, supra note 22 (explaining that contract theorists view contract law as either conferring a power or imposing a duty). One possible exception to this generalization is an article by Emily Sherwin on remedies for breach of contract, which uses a somewhat similar idea to bridge the gap between the rhetoric of remedies for breach of contract and the reality of judicial enforcement. Emily L. Sherwin, Law and Equity in Contract Enforcement, 50 Md. L. REV. 253, 300–14 (1991) (the disparity between rights and remedies in contract law gives rise to “acoustic separation”).
underenforced legal norm by reaching outside the law of contracts.

The best-known discussion of divergences between legal norms and the rules for their enforcement in the American legal literature is probably Meir Dan-Cohen’s article on criminal law. Dan-Cohen shows that we can understand legal rules as being addressed to two audiences: rules addressed to the general public, and rules addressed to legal officials in their capacity as legal officials. A law against theft, as Bentham long ago pointed out, can be understood as saying both “[l]et no man steal” and “[l]et the judge cause whoever is convicted of stealing to be hanged.” In Dan-Cohen’s terminology, the former is a “conduct rule” for citizens to follow; the latter is a “decision rule” for courts to apply. Typically, conduct rules and decision rules correspond in criminal law, in that courts follow a decision rule requiring them to impose sanctions in the event of any breach of a given conduct rule.

But, Dan-Cohen shows, it is logically possible for gaps to open up between conduct rules and decision rules. So, in the hypothetical example on which Dan-Cohen focuses, criminal law might contain a conduct rule that intentional killing is forbidden, even in circumstances of necessity. Simultaneously, however, the law might contain a decision rule that shields a necessitous killer from conviction. In addition to exposing the logical possibility of divergence between conduct rules and decision rules, Dan-Cohen’s article explores the legitimacy of hiding such divergences from the general populace. But the distinction between conduct rules and decision rules is not itself premised on deception; divergences between conduct rules and decision rules might be openly acknowledged and communicated to citizens. Though Dan-Cohen does not use the term “underenforcement,” his necessity-as-a-defense-to-murder example is an illustration of an underenforced conduct rule: the law defines as murder, and forbids, killing in necessitous circumstances, but no legal sanctions will attach to the violation

172. See Dan-Cohen, supra note 23.
173. Id. at 627.
175. Dan-Cohen, supra note 23.
176. See id. at 637–39 (presenting the hypothetical necessity example).
177. See id.
178. Id. at 665–77.
of the rule where the judge or jury finds that the defendant acted out of necessity.

A. UNDERENFORCED NORMS IN CONSTITUTIONAL LAW

Though the conduct rule-decision rule distinction has been deployed fruitfully in criminal law, constitutional law is the site of the most elaborate scholarly work—so much so that there is an accepted genre of scholarship adopting a “constitutional decision rules” model. Scholars adopting this model draw a distinction between, on the one hand, what the Constitution requires or authorizes (i.e., conduct rules, referred to in the literature as “constitutional meaning” or “constitutional operative propositions”) and, on the other hand, judicial doctrines whose function is to implement those conduct rules (i.e., decision rules, or “implementing doctrines”). For the most part, the text of the Constitution leaves the task of devising decision rules to the courts. Most constitutional adjudication does not involve interpretation of the constitutional text, so much as the development of “a substructure of substantive, procedural, and remedial rules drawing their inspiration and authority from, but not required by, various constitutional provisions.” On this view, constitutional law doctrine implements, but does not always track, the norms set forth in the Constitution itself. Working in this vein, Richard Fallon has defended the “permissible disparity thesis”—the claim that “a [justifiable] gap frequently exists between constitutional meaning and judicially enforced doctrine.” Where constitutional conduct rules extend to a broader degree of circumstances than those reached by the corresponding decision rule, the effect is an underenforced constitutional norm.


180. For an extensive review, see Mitchell N. Berman, Constitutional Decision Rules, 90 VA. L. REV. 1 (2004).

181. For reasons mostly specific to constitutional law, Mitchell Berman prefers the term “constitutional operative propositions” to “conduct rules.” Id. at 58–59 n.192. I will stick with “conduct rules” to preserve symmetry with the rest of the paper.

182. Id. at 57–58.


185. Outside the United States, one can find even clearer examples of unenforced constitutional duties. For example, the Irish Constitution requires
1. Underenforcement and Political Questions

Let’s begin with the clearest example of judicial underenforcement of legal norms in American constitutional law, the political question doctrine.186 When a plaintiff brings an action seeking relief on the basis that the defendant’s action violated the Constitution, or that a legislative enactment under which the defendant acted is unconstitutional, the defendant may respond in several ways. Most straightforwardly, the defendant can join the issue on the merits, and rebut the claim of unconstitutionality. But, alternatively, the defendant can respond that the claim should be dismissed because it raises a nonjusticiable political question. When a court dismisses a constitutional claim on the ground that it raises a nonjusticiable political question, the court does not say that the defendant has not violated the plaintiff’s constitutional rights. Rather, the court simply declines to decide the issue.187 At least sometimes, then, courts must be rejecting valid constitutional claims.

In political question cases, the reasons for declining to enforce the Constitution to its fullest extent stem from the institutional features of courts. The Supreme Court’s decision in Vieth v. Jubilirer188 is a particularly clear illustration of the point. The plaintiffs complained that the defendants had engaged in partisan gerrymandering in drawing electoral districts, and claimed that the defendants’ conduct violated the Constitution. Writing for the plurality in Vieth, Justice Scalia assumed, for the sake of argument, that “an excessive injection of politics [into the redistricting process] is unlawful” under the Equal Protection Clause.189 He maintained nonetheless that the federal courts should not even try to adjudicate partisan gerrymandering claims. Legislatures, he said, can pass laws that are “inconsistent, illogical, and ad hoc,” but, “law pronounced by the courts must be principled, rational, and based upon reasoned distinctions.”190 Accordingly, courts must develop “judi-

the legislature to apply “directive principles of social policy,” including socioeconomic rights, while explicitly providing that these principles “shall not be cognisable by any Court under any of the provisions of this Constitution.” Ir. CONST., 1937, art. 45. Conversely, courts sometimes engage in “overenforcement,” by adopting prophylactic rules to protect constitutional rights. See Fallon, supra note 26, at 1303–06.
186. See Sager, supra note 32, at 1224–25; see also Fallon, supra note 26, 1280–97.
189. Id. at 293 (emphasis omitted).
190. Id. at 278.
cially discernible and manageable standards” for adjudicating claims. Justice Scalia reviewed various proposed doctrinal tests for partisan gerrymandering claims, and found that none provided sufficient guidance to courts to save them from confusion and arbitrariness. Sometimes, and, for the majority of the Supreme Court, *Vieth* was one of those times, “the judicial department has no business entertaining the claim of unlawfulness—because the question is entrusted to one of the political branches or involves no judicially enforceable rights.”

Leaving aside the particular claim of nonjusticiability in *Vieth*, the case shows that the absence of judicially manageable standards sometimes leads to a gap between the constitutional conduct rule (in this case, the norm of equal protection) and the decision rules applied by courts. In at least some instances, constitutional underenforcement may well be justified, for precisely the kinds of institutional reasons the Supreme Court has offered in support of it. Broadly speaking, these reasons stem from concerns about the court’s limited expertise and its own lack of direct democratic legitimacy. In addition to a desire for judicially manageable standards, the Supreme Court has given the following reasons that may support a finding that a case raises a nonjusticiable political question: “a textually demonstrable constitutional commitment of the issue to a coordinate political branch”; “the impossibility of a court’s undertaking independent resolution without expressing lack of the respect due coordinate branches of government”; “an unusual need for unquestioning adherence to a political decision already made”; “or the potentiality of embarrassment from multifarious pronouncements by various departments on one question.” None of these institutional reasons affects the validity of a constitutional norm invoked by a plaintiff. Rather, each of these reasons bears on the suitability of the judiciary determining whether or not the government actor has violated that norm.

It is often meaningful to say that an action is unconstitutional, even if no court will ever rule on the issue. Government officials should follow the Constitution whether or not their acts can be challenged in court. For example, many recent actions by executive officials engaged in counterterrorism efforts will probably never be challenged in a court of law because of the political question doctrine, standing doctrines, and executive immunity doctrines (another significant source of judicial

191. *Id.*
192. *Id.* at 277.
underenforcement). But a claim of unconstitutionality has significant resonance in the court of public opinion, and at least some officials consider themselves bound in conscience to act within the Constitution’s limits. For these reasons, officials take great pains to convince themselves and others—often implausibly—that their actions are compliant with the Constitution and other binding sources of law, even where there is no prospect of judicially imposed sanctions.194

2. Subtler Examples of Underenforcement: Doctrinal Tests

The examples in the previous section provide relatively obvious examples of constitutional conduct rules extending beyond the boundaries of judicial decision rules. But constitutional law doctrine contains many subtler, less openly acknowledged, forms of underenforcement. In constitutional adjudication, interpretation of the Constitution’s text is pervasively supplemented by doctrinal tests devised by the Supreme Court. These doctrinal tests supply precisely the kinds of judicially manageable standards identified in the political question jurisprudence as a precondition of enforcement by the courts. Yet the very same standards often entail partial underenforcement of the conduct rules they implement.

The most obvious kinds of doctrinal test that give rise to underenforcement are those explicitly mandating deference to other governmental institutions. For example, in due process challenges to disciplinary actions by prison authorities, courts will reject the claim so long as “some evidence” supports the disciplinary action.195 This doctrinal test means that, so long as the record contains some indication of justifiability, a prisoner who is innocent of the alleged misconduct, and whose punishment was motivated by malice, has no judicially cognizable due process claim.196 Similarly, courts adopt a principle of judicial deference to military regulations on the ground that judges are often ill-equipped to second-guess military decisions.197 Where courts defer to a legislative or executive actor’s determination in the course of assessing the constitutionality of its action,

196. See Fallon, supra note 26 at 1299–300.
courts must, at least sometimes, be leaving actual constitutional violations unremedied.

The example on which I will focus is perhaps the grandest constitutional norm: the Equal Protection Clause. While equal protection claims are sometimes completely excluded from a given field under the political question doctrine, they are more often subjected to more understated forms of underenforcement. The Clause provides simply that “no state shall . . . deny to any person within its jurisdiction the equal protection of the laws.” But equal protection litigation does not proceed simply by laying the government action side by side with the text of the Clause and checking for consistency. First, the Clause itself requires interpretation to discern its meaning. The Supreme Court has said that the Clause is “a direction that all persons similarly situated should be treated alike.” The Clause may mean that a state may only treat persons differently when it is fair to do so, or that the government may not classify individuals in ways not reasonably designed to promote a legitimate state interest, or that the government may not engage in discrimination that shows a lack of equal concern and respect for a particular group. No interpretation commands universal assent, and plausible interpretations of the Equal Protection Clause tend to be both highly demanding and vague.

For these reasons, the Supreme Court has developed decision rules for equal protection cases. In the courts, advocacy is generally structured around that judicially created doctrinal framework. The Supreme Court’s main doctrinal tool in equal protection cases involves sorting measures into three different boxes: those deserving strict scrutiny, those deserving intermediate scrutiny, and those subject only to rational basis review. Racial classifications are subject to strict scrutiny, whereby the government is under a burden to establish that the action is narrowly tailored to a compelling government interest.

200. U.S. CONST. amend. XIV.
202. E.g., Sager, supra note 32, at 1215.
203. See Berman, supra note 180, at 9.
205. See, e.g., Parents Involved in Cmty. Sch. v. Seattle Sch. Dist. No. 1,
sifications based on gender are subject to an intermediate form
of scrutiny, under which the government must show a substan-
tial relationship to an important government interest. But
heightened scrutiny of either kind is exceptional; most govern-
ment actions are subject only to rational basis review. Under
rational basis review, government action is presumed to be con-
stitutional, and the party challenging the action will prevail only
if she establishes that it bears no rational relationship to any
legitimate governmental objective.

These tiers of review cannot seriously be defended as form-
ing part of the meaning of the Equal Protection Clause. Rather,
they are constitutional decision rules, justifiable (if at all)
only by reference to the Supreme Court’s perception of its institu-
tional competence and, relatedly, to the perceived need to de-er to legislative will for reasons of legitimacy. Starting with
the assumption that racial classifications are especially unlik-
ely to be justified, the court applies strict scrutiny in such cases
so that it can “smoke out’ illegitimate uses of race by assuring
that [government] is pursuing a goal important enough to war-
rant use of a highly suspect tool.” The rational basis test,
conversely, is a “salutary principle of judicial decision,” among
the “self-imposed restraints intended to protect [the Supreme
Court] and the state against irresponsible exercise of [the Su-
preme Court’s] unappealable power.” All statutes discrini-
mate among people, but the fairness of such classifications is
best left primarily to the political process.

206. See United States v. Virginia, 518 U.S. 515, 533 (1996) (the justifica-
tion for a gender-based classification must be “exceedingly persuasive”); id. at
559 (Rehnquist, C.J., concurring) (“[A] gender-based classification must bear a
close and substantial relationship to important governmental objectives.” (in-
ternal quotation marks omitted)).
207. See, e.g., Armour v. City of Indianapolis, 132 S. Ct. 2073, 2079–80
(2012).
208. See Fallon, supra note 26, at 1297–98 (“None of these tests tracks the
language of the Equal Protection Clause, nor has the Supreme Court attempt-
ed to link them to the original historical understanding.”); Berman, supra note
180, at 82 (noting that it is “hard to imagine that the strict scrutiny test con-
stitutes any part of the original meaning of the Equal Protection Clause”).
equal protection cases is “a limitation stemming, not from the Fourteenth
Amendment itself, but from the nature of judicial review”).
211. See Plyler v. Doe, 457 U.S. 202, 216 (1982); cf. JOHN HART ELY,
DEMOCRACY AND DISTRUST: A THEORY OF JUDICIAL REVIEW 105 (1980)
(“[R]ights like [those in the First Amendment], whether or not they are explicit-
ly mentioned, must nonetheless be protected, strenuously so, because they
cases subject only to rational basis review, the constitutional norm of equal protection—whatever it means—is substantially underenforced in the courts. 212

Another important feature of equal protection litigation is its focus on governmental purpose or motive. 213 Sometimes, the Supreme Court’s focus on the government actor’s motive favors plaintiffs. Even in cases formally governed by rational basis review, the Supreme Court has sometimes struck down measures because they were motivated by animus toward an unpopular group. This form of review began in United States Department of Agriculture v. Moreno, 214 a challenge to Congress’s decision to deny food stamps to individuals who lived in households with other unmarried adults to whom they were not related. Though a rational basis could surely be found for Congress’s action, the Supreme Court concluded that the measure was aimed at discriminating against hippies, and, on that basis, found a violation of the Equal Protection Clause. 215 Subsequent decisions have held unconstitutional measures motivated by animus toward undocumented children, 216 people with mental disabilities, 217 and gay people. 218

More often, however, the Supreme Court’s focus on motive redounds to the government’s benefit. To invoke heightened scrutiny, the judicially enforced version of the Equal Protection Clause requires the plaintiff challenging a facially neutral measure to establish that an official decisionmaker was motivated by a discriminatory purpose. 219 In suits brought pursuant to the Fourteenth Amendment, a disparate impact, no matter how disproportionate, foreseeable, and unfair, will not suffice to sustain the suit (though it may provide evidence of the required discriminatory purpose). The Equal Protection Clause itself says nothing about motive; states can treat people unfairly without acting with a discriminatory motive. If the Supreme

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212. See Ross, supra note 199, at 315 (“Through sparing use of heightened scrutiny and extensive application of the deferential rational basis test, the Court has adopted a policy of underenforcing equal protection issues.”).
213. On purpose tests in constitutional law more generally, see Fallon, supra note 183, at 71–73, 90–94.
215. Id. at 534–38.
Court’s requirement of purpose is to be justified, then, it must be supported by pragmatic reasons. In Washington v. Davis, Justice White offered just such a reason. He claimed that a rule requiring a compelling justification for legislative measures that have a racially disparate impact would be “far reaching” and would call into question a whole range of tax, welfare, public service, and licensing statutes.\footnote{Id. at 248.} Here, as elsewhere in constitutional law, a purpose test provides a minimal protection against unconstitutional conduct, but its reach falls short of total enforcement.\footnote{See Richard H. Fallon, Jr., Jurisdiction-Stripping Reconsidered, 96 VA. L. REV. 1043, 1081 (2010) (“When important constitutional values are at stake, and it is difficult for the Supreme Court to agree on an alternative test of constitutional validity to protect those values, purpose tests provide a minimal protection against abuses of governmental power.”).} The Court left Congress to decide whether and when judges should engage in strict scrutiny of measures having a racially disparate impact.

Indeed, the Constitution explicitly confers on Congress a power to create decision rules for equal protection cases,\footnote{See U.S. CONST. amend. XIV, § 5 (“The Congress shall have the power to enforce, by appropriate legislation, the provisions of this article.”).} illustrating the proposition that constitutional law is not just what the judges say it is. With its distinct institutional capacities and sources of legitimacy, Congress is—at least sometimes\footnote{In a long line of cases beginning in the mid-1990s, the Supreme Court has jealously guarded its prerogative to determine the scope of constitutional rights, and has struck down several congressional attempts to expand access to judicial remedies under the Equal Protection Clause and other elements of the Reconstruction Amendments. See, e.g., Shelby Cty. v. Holder, 133 S. Ct. 2612, 2629–31 (2013) (invalidating the Voting Rights Act’s requirement that changes to state voting laws undergo federal “preclearance” review to ensure that such changes are not racially discriminatory); Bd. of Trs. of Univ. of Ala. v. Garrett, 531 U.S. 356, 365 (2001); City of Boerne v. Flores, 521 U.S. 507, 536 (1997). But even on the Court’s view of the scope of the enforcement power, Congress has some power to design appropriate decision rules for courts.}—able to supply remedies where the Court has declined to act. Moreover, regardless of judicially or congressionally mandated enforcement, the equal protection norm is valid as a conduct rule binding other government actors. Legislators and other government officials remain independently bound to comply with equal protection, and should not limit their constitutional calculations to asking if judicial doctrine would spell victory in litigation.

To be clear, I do not seek to defend the particular forms of underenforcement chosen by the Supreme Court. But, for the purposes of illuminating the law of contracts by analogy, I
adopt the following aspects of the constitutional law literature: the analytical distinction between conduct rules and decision rules; the descriptive claim that the Supreme Court has often chosen the path of underenforcement in constitutional cases; and the relatively weak normative claim that perfect judicial enforcement of demanding, open-ended constitutional norms, even if attainable, is undesirable.

B. UNDERENFORCEMENT IN CORPORATE LAW

A similar phenomenon is at work in corporate law. Though it appears that no one has explicitly made the link with the constitutional law literature, a body of scholarship shows that the law of directors' and officers' duties also consists of partially underenforced legal norms. About twenty years ago, Melvin Eisenberg pointed to a gap between what courts say directors and officers must do (“standards of conduct”) and the doctrines that courts apply when enforcing these duties (“standards of review”).

Eisenberg contended that “the standards of review in corporate law pervasively diverge from the standards of conduct.” The idea has even been incorporated into the ABA’s Model Business Corporation Act.

Directors and officers, for example, are subject to a duty of care in the management of the corporation. When explaining the duty of care, courts say that a director or officer must take the care that an ordinarily prudent person would reasonably be expected to take in the circumstances. This standard, as Eisenberg says, is “fairly demanding.” Nevertheless, directors and officers will often escape legal liability for many breaches of the duty of care. That is because, when they come to court, claims for breach of the duty of care are frequently adjudicated under deferential standards such as the business judgment rule.

To surmount the business judgment rule, it is not enough to show that the defendant’s decision or action was unreasonable; the plaintiff must show that the defendant is guilty of subjective bad faith, or that the decision was irrational.

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224. See generally Eisenberg, supra note 30.
225. Id. at 438.
227. See 1 PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01(a) cmt. to § 4.01(a), para. 1 (1994).
228. Eisenberg, supra note 30, at 440.
229. Some claims for breach of the duty of care are adjudicated not under the business judgment rule but under some other limited decision rule, such as a gross negligence test. See id. at 447–49.
230. See id. at 439–43.
is much easier for directors and officers to escape liability under rationality review than it would be under reasonableness review. The business judgment rule “preserves a minimum and necessary degree of director and officer accountability,” but it is “considerably less demanding than the relevant standard of conduct, which is based on reasonableness.”

Similarly, according to judicial statements of corporate law’s duty of loyalty, directors and officers must act fairly in matters involving their self-interest. The standard of conduct requires both that the terms of the transaction into which the corporation enters must be fair, and also that those terms were the result of a fair process. Where a disinterested Board of Directors has not approved the transaction in question, the judicial standard of review hews quite closely to the standard of conduct. But where a disinterested Board has approved the transaction, courts apply less searching standards of review, asking only, for example, whether disinterested directors could reasonably have believed that the transaction was fair. Eisenberg explains that this standard of review accommodates, on the one hand, “the need to make self-interested transactions reviewable for fairness,” and, on the other hand, “the value of institutional autonomy and the desirability of providing self-interested directors and officers with an incentive to seek early approval from disinterested directors.”

As constitutional law scholars have done, Eisenberg explicitly links his contrast between standards of conduct and standards of review in corporate law to Dan-Cohen’s conduct rule-decision rule distinction. Like Dan-Cohen, Eisenberg rejects the reductionist claim that the law consists solely of decision rules. He affirms the independent significance of standards of conduct in corporate law as messages to directors and officers about how they ought to discharge their functions. In a recent

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231. Id. at 443 (emphasis omitted).
232. Interestingly, Eisenberg concludes that corporate law’s narrow duty of good faith is not an underenforced norm. Id. at 449. It appears that, even as a standard of conduct, the duty of good faith in corporate law requires knowingly wrongful conduct. Id. To put the point another way, corporate law’s duty of good faith is not a duty of good faith and fair dealing.
233. See id. at 450.
234. See id. at 453–54.
235. Id. at 454.
236. See supra text accompanying note 172.
article building on Eisenberg’s insights, Julian Velasco follows Eisenberg in noting that, as a result of the divergence between standards of conduct and standards of review, corporate law’s standards of conduct are only “imperfectly enforced,” or, using the very same word as constitutional law scholars, “underenforced.”

Standards of review are sensibly more lenient than standards of conduct, so as to leave directors and officers some room for maneuver, and to leave courts some room for error. Velasco is particularly concerned to characterize corporate law’s standards of conduct as genuine duties, against claims that, to the extent they go beyond judicial standards of review, corporate law’s standards of conduct are merely aspirational. For Velasco, as for Eisenberg, it still makes sense to speak of a legal duty in the absence of a sanction. Corporate law’s functions include providing guidance for those directors who wish to obey the law, regardless of whether they will face liability for violating their duties.

The structure of this claim is similar to the constitutional decision rules scholars’ understanding of equal protection doctrine. Indeed, scholars of corporate law might fruitfully pursue the analogy between the underenforcement of directors’ and officers’ duties and underenforced constitutional norms. I will note just a couple of significant parallels. As in constitutional law, the existence of some alternative enforcement mechanism for inducing compliance with the conduct rule helps to build a case for the wisdom of underenforcement by courts. In corporate law, the relevant alternative mechanisms are provided mainly by corporate governance structures. Corporate officers are accountable to the Board of Directors; the Board, in turn, is mainly accountable to shareholders through means other than litigation. In the event of conduct that falls short of reasonable care or fairness in the conduct of self-interested transactions, shareholders can seek a more active role in corporate decision making (the mechanism of “voice”) or sell their stock (the mechanism of “exit”).

These governance mechanisms will generally be more effective than litigation, and at lower cost.

238. Velasco, supra note 31, at 524, 580.

239. See id. at 525, 550–51.

But, of course, corporate governance mechanisms are far from perfect, and corporate law does not completely forswear judicial enforcement of directors’ duties. Its standards of review may perhaps be too deferential, but the courts are not entirely toothless. At the very least, courts maintain a useful role in identifying, and applying legal sanctions to, the worst breaches of the duties of care and loyalty. In addition, the debate over whether the unenforced portions of corporate law duties are “merely aspirational” is paralleled by a debate in constitutional law over whether some of the Constitution’s most demanding norms should be viewed as partly aspirational.241

III. GOOD FAITH AND FAIR DEALING AS AN UNDERENFORCED LEGAL NORM

In this Part, I pursue the analogy between the constitutional law of equal protection, corporate law’s duties of care and loyalty, and the contracts norm of good faith and fair dealing. By this stage, certain elements of the analogy should be fairly obvious. All of these norms are stated at a high level of generality, and all are subject to contestation about their very meaning and their proper application to the facts of individual cases. As a result, many commentators and judges have voiced doubts about the institutional capacity of courts to handle such broad norms. Crucially, in all three areas, the courts have declined to enforce these norms to their fullest extent. Moreover, underenforcement may be justified in each case because of the availability of alternative institutions for giving effect to the norm. In the law of equal protection, the most common alternative mechanism for defining and enforcing a norm is the political process.242 In corporate law, shareholder activism and markets provide other ways of inducing compliance with legal duties.243 In contracts, as I will explain below, the most obvious alternative mechanisms to give effect to good faith and fair dealing are self-help measures and reputational sanctions. But, as in constitutional and corporate law, the existence of alternative mechanisms has not meant that courts simply refrain from giving any effect to the norm of good faith and fair dealing. In all three areas, the courts have attempted

241. Richard Fallon suggests that some constitutional rights should be viewed as partly aspirational from the point of view of any actor. See Fallon, supra note 26, at 1324–27. But see Roosevelt, supra note 204, at 197 (expressing discomfort with this aspect of Fallon’s argument).
243. See Part II.B.
to devise judicially manageable standards, and, moreover, have often reached for doctrinal solutions focusing on the defendant’s motivations.

A. GOOD FAITH AND FAIR DEALING: THE CONDUCT RULE

I propose that we take the rhetoric of good faith and fair dealing seriously—as a statement of the conduct rule that binds the parties to a contract. To that extent, the law of most states adopts Llewellyn’s vision of a legal norm requiring commercial reasonableness; in the words of the Restatement, good faith and fair dealing demands compliance with “community standards of decency, fairness or reasonableness.” As a conduct norm, good faith and fair dealing is analogous to the norm of equal protection—it is an abstract principle of fairness in contract performance and enforcement. Just as the equal protection norm prevents government actors from classifying people unfairly, so the basic conduct norm of good faith and fair dealing prohibits unreasonable exercises of contractual discretion.

Reasonableness in contract performance frequently extends beyond what the contract’s written terms seem to permit or require. Moreover, reasonableness demands more of contracting parties than avoiding spiteful behavior and borderline dishonesty. In the words of a business person interviewed by Stewart Macaulay for his famed study of contractual behavior: “[y]ou don’t read legalistic contract clauses at each other if you ever want to do business. One doesn’t run to lawyers if he wants to stay in business because one must behave decently.” Reasonableness in contractual conduct very often requires the parties to share losses and benefits unforeseen at the time of the initial contract. Particularly in contracts of longer duration, the parties are bound by social norms of reasonableness to adjust the terms of exchange to meet with new circumstances.

244. RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. a (1981).

245. Conceivably, good faith and fair dealing really stands for two norms: a norm of honesty and a norm of reasonableness. See Thomas A. Diamond & Howard Foss, Proposed Standards for Evaluating When the Covenant of Good Faith and Fair Dealing Has Been Violated: A Framework for Resolving the Mystery, 47 HASTINGS L.J. 585, 600–01 (1996). At a higher level of abstraction, however, the honesty norm might be folded into the reasonableness norm: reasonableness requires honesty.


Ian Macneil’s work on relational contract theory similarly identifies norms of contractual solidarity, reciprocity, cooperation, and flexibility in the performance of contracts. While Macneil’s work is associated with an *ex post* perspective, broadly similar understandings of what reasonableness in contractual behavior involves have been derived from an *ex ante* perspective. Robert Scott, for example, defends a general norm of mutual cooperation in relational contracts, contending that rationally self-interested actors seek to share risks by agreeing, explicitly or implicitly, to cooperate with their contractual counterparties when new contingencies arise.

The conduct rule of good faith and fair dealing in contract performance is certainly open-ended. It is, however, a mistake to leap from the truism that good faith and fair dealing is vague to the claim that it “has no general meaning or meanings of its own.” As the editors of *Corbin on Contracts* explain, “[g]ood faith is a vague and shifting concept, but so is justice. That a concept cannot be formalized into a tight matrix does not make it wrong.” For more specific guidance as to what counts as reasonable behavior in a particular class of cases, we might look to the particular social norms actually prevailing in a given industry. These prevailing norms provide significant, though non-conclusive, evidence of what counts as good faith and fair dealing. The task of discerning the demands of reasonableness in particular circumstances is admittedly a chal-

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250. Summers, *supra* note 49, at 196. *But see* Patterson, *supra* note 61 (criticizing Summers’s “excluder” analysis on the ground that it “fails to separate the need for clarification of a fuzzy concept from concepts that are totally parasitic on other notions”).


252. For a powerful attack on the idea that one can discern the content of good faith performance from prevailing practices, *see generally* Alan D. Miller & Ronen Perry, *Good Faith Performance*, 98 IOWA L. REV. 689 (2013). Courts do not seem to have leaned heavily on specific trade usages when adjudicating good faith cases.

lenging one for an outsider to undertake.

B. UNDERENFORCEMENT, THE LIMITATIONS OF COURTS, AND ALTERNATIVE MEANS OF ENFORCEMENT

The courts have spared themselves the task of articulating a fully specified account of good faith and fair dealing. As the discussion in Part I.B makes clear, the courts do not even try to enforce the norm of good faith and fair dealing to its conceptual limits—whatever the norm’s precise meaning may be. Judicial practice makes clear that good faith and fair dealing “is not an enforceable legal duty” to behave in accordance with commercial decency toward one’s contractual counterparty. 254 Many scholars have seen this divergence between rhetoric and reality as a simple form of hypocrisy. But with analogous examples from constitutional and corporate law in mind, it should be easier to see now that pro-defendant judicial decisions do not necessarily mean that good faith and fair dealing is not valid as a conduct rule to its fullest extent.

Just as courts lack the necessary legitimacy and expertise to discern the precise metes and bounds of equal protection and of duties in corporate law, so do they labor under analogous limitations when it comes to discerning fair exercises of contractual discretion. As neoformalist contracts scholars have stressed, it is both challenging and expensive for courts to figure out what counts as fair behavior between contracting parties. 255 The point is not that the courts are completely unable to give content to vague standards. Indeed, the idea of good faith and fair dealing is no more uncertain than many of the legal standards that judges and juries are required to apply. The tort of negligence, for example, often requires courts to determine what a reasonable person would have done in the circumstances, and eliminates or reduces a damage award when the plaintiff’s own unreasonable conduct contributed to her injury. 256

The question, rather, is one of relative competence. As in the constitutional law of equal protection, where most claims of classificatory unfairness are left by the courts to the political branches, it is the existence of alternative, often superior ways

255. See, e.g., Scott, supra note 145 (contending that the costs of having courts discern commercial reasonableness exceed any benefits it could bring to parties).
of dealing with unreasonable exercises of contractual discretion that makes underenforcement of the good faith norm a plausible strategy. Unreasonable behavior by contracting parties is usually checked by self-help by the victim, who may refuse to deal with the other party in future, and by reputational sanctions.\textsuperscript{257} Compared with these mechanisms, litigation is both expensive and in more severe danger of error.\textsuperscript{258} Litigation requires lawyers and judges. These outsiders require payment for their time, and they must also contend with informational deficits about the parties’ relationship before they can participate usefully in adjudication of the dispute.\textsuperscript{259}

On the other hand, when self-help and reputational sanctions break down—as they sometimes do when the parties’ relationship is at an end—litigation may come into its own in the limited class of cases where courts are fairly sure they can identify a misuse of contractual discretion. The underenforcement thesis thus fits with Eric Posner’s claim—meant to apply more generally to contract law—that “a court, with its superior sanctions but inferior information, could do an adequate job of identifying extreme cases of opportunism but not minor cases of opportunism.”\textsuperscript{260}

Along these lines, one court has summed up its limited ambitions when developing good faith doctrine: “Without attempting to give positive content to the phrase ‘good faith,’ it is possible to set forth operational standards by which good faith can be distinguished from bad faith within a particular context.”\textsuperscript{261} Much of the material in Part I.B of this Article can fruitfully be understood in this way. Thus, a decision rule that requires plaintiffs to prove that the defendant acted from an improper motive does not exhaust the full scope of the requirement of good faith and fair dealing. But courts might sensibly choose a decision rule that limits liability to cases where the plaintiff can establish such an improper motive.\textsuperscript{262} Or


\textsuperscript{258} See id. at 426–27.

\textsuperscript{259} See id. at 427.

\textsuperscript{260} ERIC A. POSNER, LAW AND SOCIAL NORMS 63 (2000).


\textsuperscript{262} See Henry E. Smith, \textit{The Equitable Dimension of Contract}, 45 Suffolk U. L. Rev. 897, 907 (2012) (“[C]ourts should not aid one who is enforcing a promise out of spite . . . . Where someone is enforcing a right out of motivation to harm someone else, it is likely that something other than serving contractual purposes or welfare maximization is going on.”).
courts might choose to review the reasonableness of the defendant’s decision under a deferential standard of review, reserving liability for truly arbitrary or unreasoned decisions. Again, they might impose a heightened burden of proof on plaintiffs to ease the burden on the courts and to channel the parties toward self-help and reputational sanctions. In crafting decision rules for good faith and fair dealing cases, courts have done all of these things and more.\(^{263}\)

Though my claim that good faith and fair dealing is an underenforced legal norm is novel, it does not come entirely out of the blue. Clayton Gillette, whose article was among the earliest to identify the disparity between the rhetoric of good faith and its enforcement, hints at something like the underenforcement thesis when he says that, though “enforcement of an expansive notion of good faith appears to present overwhelming difficulties,”\(^{264}\) a more expansive good faith obligation might have a “precatory use.”\(^{265}\) But, by way of contrast to my views, Gillette characterizes compliance with a more expansive vision of good faith as “a supererogatory act” rather than as a matter of duty.\(^{266}\) Moreover, Gillette adopts the assumption that legal duty depends for its existence on remedial enforcement by the courts,\(^{267}\) seemingly leaving no conceptual space for the enforcement gap between legal conduct rules and judicial decision rules. Again, somewhat similar ideas can also be found in the neoformalist scholarship of Robert Scott, who argues that the parties to relational contracts operate under two “sets of rules”: a literalistic set of rules for legal enforcement, and “a more flexible set of rules for social enforcement.”\(^{268}\) I agree with Scott that two sets of rules are at play. Scott, however, characterizes the more flexible set of rules as “extralegal norms.”\(^{269}\) My interpretation of good faith and fair dealing as an underenforced legal norm allows for the possibility of legally recognized relational norms, even if judges refrain from full enforcement of those norms.

C. Why Engage in Deliberate Underenforcement?

Admittedly, it would be a fool’s errand to try to establish

\(^{263}\) See Part I.B.1–3.
\(^{264}\) Gillette, supra note 6, at 665.
\(^{265}\) Id. at 664.
\(^{266}\) Id.
\(^{267}\) Id. at 620–23.
\(^{268}\) Scott, supra note 249, at 615.
\(^{269}\) Id.
that good faith and fair dealing is at present an underenforced legal norm in every jurisdiction in the United States; the case law is much too varied to admit only of a single interpretation. I offer one possible way of understanding judicial practice, but it is not the only conceivable way of doing so. Why should we choose this understanding of the doctrine as a basis for its future development, as I suggest in Part IV? Why, indeed, should legislatures or courts ever announce norms that they do not intend to be fully enforced? After all, in this context, and in others, there are some strong reasons against deliberately setting up a system of underenforcement. For one thing, disparities between conduct rules and decision rules can be misleading, or at least mentally taxing—it is difficult enough to keep one set of rules straight, without having to understand two. In corporate law, for example, some commentators have contended that divergences between conduct rules and enforcement rules are confusing, and have called for an alignment between standards of conduct and standards of review.270

One deflationary way to think about underenforcement is to see it as a regrettable glitch in the lawmaking process: the result of a disagreement between different sources of lawmaking authority. In constitutional law, for example, one might say that underenforcement results from a judicial desire to depart from what the Constitution itself provides. If the judges could go back and rewrite the Constitution to make its conduct rules less demanding (i.e., level them down), they would. But judges cannot amend the Constitution—they are stuck with it. Underenforcement, on this view, is just the next best thing to leveling down. One could tell a similar story about good faith under the U.C.C. Having been handed what they consider an overexpansive understanding of the parties’ conduct rules but being unable to rewrite the Code themselves—this story might go—judges have effectively amended the good faith provision by engaging in underenforcement.

The story, however, must be different at least when a given field is governed purely by common law. In common-law fields, courts generally could align their conduct rules and decision rules if they wished. If courts are unconstrained by another source of binding authority (constitutional or statutory), why

270. See, e.g., Gregory Scott Crespi, Standards of Conduct and Standards of Review in Corporate Law: The Need for Closer Alignment, 82 NEB. L. REV. 671, 673 (2004) (“Regardless of the particular criterion used, a single, clearly articulated standard is preferable to the current conflation of legal standards with moral exhortations.”).
would they want to say they are adopting a norm, yet leave it partially unenforced? The general doctrine of good faith and fair dealing thus provides a particularly pure testing ground for ideas about the justifiability of underenforcement. In turn, if a case can be made for deliberate underenforcement in the absence of split authority, that case may also apply to cases where authority is in fact divided.

One possible line of reasoning for deliberately choosing the path of underenforcement in good faith and fair dealing might be based on Dan-Cohen’s idea of acoustic separation. According to Dan-Cohen, a legal system might sometimes be justified in announcing its (more demanding) conduct rules to the public, while obscuring its (less demanding) decision rules from public view.271 By engaging in selective transmission of its norms, the law can gain maximal compliance with its directives, while sometimes avoiding the negative consequences of punishment.272 Selective transmission relies for its effectiveness on some degree of deception; for some critics, that is enough reason to reject it outright.273 And whatever its merits in criminal law, where Dan-Cohen suggested it might be justified, selective transmission seems a particularly dubious proposition in private law.274 One extra difficulty with engaging in this form of deception in private law is that private law relations are bilateral. It is one thing to mislead the subject of a criminal law duty into thinking she will face sanctions, only to show mercy in the event of an actual violation. But it is quite another thing to mislead the beneficiary of a duty into believing she has an enforceable claim, only to pull the rug out from underneath her after she suffers a breach. Moreover, in many private law areas, selective transmission is difficult to achieve. In corporate law, for example, it is surely impossible to hide decision rules from directors and officers.275 Worse still, because corporate insiders are especially likely to know what really happens when disputes get to court, the attempt to engage in selective transmission of legal norms may create an added source of share-

271. See Dan-Cohen, supra note 23, at 630.
272. See id. at 667–77.
275. See Velasco, supra note 31, at 541–44 (rejecting acoustic separation in corporate law context on normative and descriptive grounds).
holder ignorance for insiders to exploit. Similarly, selective transmission is unlikely to be effective in good faith and fair dealing cases. If anything, uncommunicated divergences between conduct rules and decision rules in good faith and fair dealing are likely to provide an unfair advantage to repeat players—franchisors, for example—whose discretion the good faith and fair dealing norm is aimed at constraining.

So when courts design and apply decision rules that diverge from conduct rules, at least in the field of good faith and fair dealing, they should generally do so openly. But candor in underenforcement does not necessarily mean that the unenforced portions of conduct rules will be ineffective. To view the effect of law solely in terms of its enforcement is to miss a great deal. The law affects people’s behavior by providing them with standards of behavior for use in their practical reasoning. People obey legal standards in part because they are the law. In addition, people follow legal standards in part because they fear they will suffer reputational sanctions when others learn that they have broken the law. Neither of these mechanisms for affecting behavior is vitiated by the absence of a perfectly corresponding decision rule. Moreover, private law’s guidance function is best achieved through relatively simple, easy-to-understand rules. Though open-ended, the courts’ general statements about the duty of good faith and fair dealing are much easier to digest than the patchwork of decision rules they have developed for adjudication.

Having gloried in private law’s guidance function for the last couple of paragraphs, I should inject an appropriate note of skepticism about it in the specific case of good faith and fair dealing. In truth, it is far from clear how much the unenforced portion of the duty might make a direct difference to the behavior of actual contracting parties. Empirical studies suggest that even the enforceable parts of contract law play only a minor

277. See John C.P. Goldberg, Introduction: Pragmatism and Private Law, 125 HARV. L. REV. 1640, 1656 (2012) (“[T]he law’s authority resides as much in its ability to articulate recognizable norms of conduct as in the state’s enforcement power.”).
279. See id. at 885.
280. See Charny, supra note 257, at 393.
281. See Eisenberg, supra note 30, at 464–65.
role in commercial dealings, giving special reason to doubt the idea that, to the extent they are unenforced, judicial and legislative exhortations to act fairly have a great deal of effect. As I have suggested, the underenforced portion of the good faith and fair dealing norm is enforced by nonjudicial sanctions. But the requirement that one treat one’s contractual counterparty reasonably would be a social norm even without the law’s intervention. The law’s symbolic support for the social norm may make a marginal difference—but is that marginal difference enough to justify the potential confusion caused by an enforcement gap?

Perhaps not. But, in the case of good faith and fair dealing and elsewhere, there is an additional reason to announce a broad, partly underenforced conduct rule: to influence judicial behavior. This may appear a paradoxical thought. Conduct rules, after all, are directed at citizens; decision rules are directed at courts. But, when formulating decision rules, judges are supposed to take much of their inspiration from the conduct rule they seek to implement. The duty of good faith and fair dealing sets a baseline of reasonable behavior, even if it only finds partial expression in judicial decision rules. It reminds judges that contracting is not supposed to be a game of poker, and that their role—though constrained by pragmatic limitations—is to support healthier norms than those envisaged by a literal approach to contractual behavior. In turn, a broad conduct rule can be used to put parties on notice that they risk liability if they act in an opportunistic or excessively self-regarding manner.

Courts should thus not be too concerned about occasionally expanding decision rules to bring them closer to the conduct rule’s demands, even with retroactive effect on the defendant before the court. Such a policy would help induce defendants at least to think twice before aiming to place their conduct in the gap between the law’s conduct rules and its

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283. Dan-Cohen, supra note 23, at 630.
284. See id. at 628–29.
286. See Henry E. Smith, An Economic Analysis of Law Versus Equity 15–30 (Mar. 10, 2010) (unpublished manuscript) (on file with Harvard University), available at http://isites.harvard.edu/fs/docs/icb.topic619738.files/Paper_08_03-22_Smith.pdf. Smith contends that preventing opportunism is a unifying function for equitable doctrines. Id. at 3. Though the doctrine of good faith and fair dealing grew up after the fusion of law and equity, it has strong equitable overtones. See id. at 35.
D. AN OBJECTION: THE MORAL IMPLICATIONS OF DIVERGENCES

At this point, scholars versed in recent debates over contract law’s moral foundations may sense a potential roadblock. The idea of underenforced legal norms in contract law might be thought vulnerable to the arguments in Seana Shiffrin’s intricate and thought-provoking critique of the law of contract as it currently stands. While Shiffrin rejects the simple idea that the law should aim to enforce interpersonal morality as such, she makes the plausible claim that the law should be compatible with the conditions necessary for moral agency to flourish. From this perspective, Shiffrin contends that divergences between promissory morality and the law of contract—particularly the weakness of remedies available for breach of contract—may contribute to a culture of wrongful promise-breaking. While Shiffrin does not mention the doctrine of good faith and fair dealing, we might surmise that its underenforcement would draw her ire. As a matter of promissory morality, the arguments for a robust norm of good faith and fair dealing seem firm. To the extent that the underenforcement thesis suggests permissible caution about the legalization of that norm, the law seems to diverge from promissory morality.

Contra Shiffrin, however, the best way to support and maintain good moral character in contractual situations may often be to allow divergences to open up between promissory morality and the law of contract, or at least between promissory morality and the law of contract.

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289. See id. at 709.

290. Id. at 740–49.

291. Indeed, one of Shiffrin’s critics, Steven Feldman, cites the existence of the doctrine of good faith and fair dealing as part of his argument against the existence of a divergence between contract law and promissory morality. Steven W. Feldman, Autonomy and Accountability in the Law of Contracts: A Response to Professor Shiffrin, 58 DRAKE L. REV. 177, 194–96 (2009). Feldman claims that good faith and fair dealing is a “wide-ranging code of moral conduct that spans the full spectrum of formation, performance, and enforcement.” Id. at 196. Feldman’s descriptive claim is not terribly far off being an accurate depiction of the rhetoric of good faith and fair dealing, but—as Part 1.B shows—it does not match the reality of enforcement.
ry morality and judicial decision rules in the law of contract. If courts were to attempt to occupy the full moral field, they might do more harm than good. Again, the analogy to constitutional law helps to make the point more vivid. There, the underenforcement thesis helps to make clear that an action can violate the Constitution even though no court will provide a remedy for the violation, allowing space for legislators and citizens to make their own constitutional judgments. James Bradley Thayer famously relied on the value of such independent judgments when arguing that courts should apply a “clear error” test when reviewing the constitutionality of legislation. Thayer contended that, if the courts seek to occupy the field, the political branches of government will tend to abdicate their own responsibility for interpreting the Constitution, leading to unfortunate setbacks to constitutional values. Similarly, a body of judicial enforcement practices that tried to enforce promissory morality would risk “crowding out” the operation of trust and social norms by means of excessive juridification. The courts’ inevitably clumsy attempts to enforce the morality of good faith in full might backfire on moral as well as economic grounds, hindering people’s ability to develop valuable relationships of interpersonal trust.

But Shiffrin’s underlying premises, particularly when combined with Thayer’s argument, do reinforce my earlier conclusion that courts should be open and clear that their decisions to impose liability for good faith and fair dealing do not occupy the full field. Candor in underenforcement should go some of the way to addressing Shiffrin’s concerns, for it helps to avoid the implication that a decision to reject the plaintiff’s claim for institutional reasons necessarily entails approval of the defendant’s conduct. Hence, when dismissing claims, courts should

292. See supra Part II.A.
294. See id. at 155–56.
296. For intricate discussion of some analogous issues in contract law, see Dori Kimel, FROM PROMISE TO CONTRACT: TOWARDS A LIBERAL THEORY OF CONTRACT 7–87 (2003); Aditi Bagchi, Separating Contract and Promise, 38 FLA. ST. U. L. REV. 709, 715–32, 739–45 (2011). For a more economic rendering of similar ideas, see, for example, Charny, supra note 257, at 428–29, 441–44.
297. I say “some of the way” because even if courts try to make clear that they are engaging in underenforcement, observers might draw the wrong im-
be cautious about stating that a particular party’s conduct was in good faith and complied with reasonable standards of fair dealing. In closer cases, courts should take pains to say instead that the plaintiff failed to establish the requirements of decision rules.

To some extent, judicial opinions already do something similar. Take, as an example, the First Circuit’s decision in a recent case, Young v. Wells Fargo Bank, N.A. The court was asked by a mortgage debtor to apply the Massachusetts law of good faith and fair dealing to a creditor’s conduct. The court rejected the claim because the complaint failed to satisfy the doctrinal rubric laid down by Massachusetts courts: it did not establish that the bank had acted with an improper purpose. Nevertheless, the First Circuit’s opinion stated that the bank’s “dilatory and careless conduct [was] troubling,” found it “problematic” that the bank had refused to give the debtor clear answers about the parties’ relative legal obligations until she hired a lawyer, and noted that the complaint painted a picture of an “unthinking and sloppy” institution. None of these remarks was strictly necessary for the court’s decision to dismiss the good faith and fair dealing claim. But they do help to make clear that the enforcement of good faith falls short of what the conduct rule requires.

IV. IMPLICATIONS

The underenforcement thesis both illuminates existing judicial practice and points the way to a more intelligible and defensible body of good faith and fair dealing doctrine. While I do not offer a full elaboration of how the doctrine should look, I explore four ways that viewing good faith and fair dealing as an underenforced norm would be helpful to courts and scholars seeking to develop the law.

pression from the court’s decision to reject a claim of good faith and fair dealing. For a stimulating discussion of some analogous problems in the law, see generally Bert I. Huang, Shallow Signals, 126 HARV. L. REV. 2227, 2229 (2013) (“Whenever the law quietly permits some actors to act in a way that is usually forbidden, copycat misconduct may be erroneously inspired by the false appearance that ‘others are doing it too.’”).

298. 717 F.3d 224 (1st Cir. 2013).
299. Id. at 228, 237–38.
300. Id. at 239.
301. Id. at 238–39.
302. Id. at 239.
A. LEVELS OF SCRUTINY IN GOOD FAITH AND FAIR DEALING

Perhaps the most useful analogy between equal protection and good faith is that the degree of underenforcement of these norms rightly varies with context. There is no a priori reason why the choice of decision rule should be made at the wholesale level. In different contexts, the relative strengths of judicial enforcement and alternative mechanisms for inducing compliance with good faith and fair dealing will wax and wane. A single doctrinal test has the merit of simplicity, but a one-size-fits-all approach is unlikely to be optimal. And existing doctrine shows some signs of contextual differentiation, though it is difficult to discern consistent patterns.

As a matter of current practice, many exercises of contractual discretion get fairly light scrutiny under the doctrine of good faith and fair dealing, akin to rational basis review in constitutional law.\(^\text{303}\) Usually, if a defendant so much as offers a legitimate reason for her decision, she will escape liability.\(^\text{304}\) And in many cases, a deferential approach to exercises of contractual discretion may make sense. For example, the courts of Delaware have been especially reluctant to use good faith and fair dealing to augment the text of preferred stock contracts.\(^\text{305}\) Such contracts are typically the result of negotiations by sophisticated and well-advised parties. In this kind of case, at least, the courts may rightly feel more comfortable with the notion that the parties should be responsible for identifying constraints on contractual discretion ex ante, rather than relying on costly and difficult ex post determinations of fair dealing by courts.\(^\text{306}\) As in constitutional law, the availability of an—admittedly imperfect—institutional alternative helps to justify judicial deference.

This line of thought suggests two questions for scholars of good faith and fair dealing: first, what classes of cases are ripe

\(^{303}\) See supra note 207 and accompanying text.

\(^{304}\) On the other hand, if the defendant offers no reason at all for her exercise of discretion, she may well find herself liable. See Empire Gas Corp. v. Am. Bakeries Co., 840 F.2d 1333, 1340 (7th Cir. 1988).

\(^{305}\) See D. Gordon Smith, Independent Legal Significance, Good Faith, and the Interpretation of Venture Capital Contracts, 40 WILLAMETTE L. REV. 825, 851–52 (2004) (“While no one seriously advocates a strict application of the ‘plain meaning’ approach to contract interpretation in all cases, the Delaware courts have adhered fairly consistently to such a standard in cases involving the interpretation of preferred stock terms.”).

\(^{306}\) But see id. at 850–51 (suggesting that greater judicial intervention may be justified even in this kind of case because contracts are inevitably incomplete no matter how sophisticated the parties).
for heightened scrutiny, in the way that race and gender-based classifications are singled out for special treatment among equal protection claims? And, second, what sort of heightened scrutiny should courts give to claims singled out in this way? Again, existing judicial practice offers some hints; sometimes courts in good faith cases apply doctrinal tests with real teeth. For example, in construing some state-law franchise statutes, courts apply a pro-plaintiff test in which the burden falls on the franchisor to explain and justify a termination decision.307 The structural inequalities that characterize many franchise relationships may well justify a more searching judicial role because alternative mechanisms for controlling franchisor discretion are less likely to be effective than in cases involving two roughly equal commercial parties. Another class of claims that might deserve—and may even be getting—heightened scrutiny are claims against subprime consumer mortgage creditors.308 On the other hand, the near-total absence of scrutiny for employment terminations is difficult to understand in these terms.309 If anything, such decisions seem particularly worthy of heightened scrutiny.

These varying forms of treatment rarely receive official acknowledgement in judicial doctrine. In the interests of clarity and consistency, courts would likely benefit from borrowing the idea of differing levels of scrutiny from constitutional law and applying it explicitly to good faith and fair dealing claims. To be sure, the claim that the norm is underenforced provides only a framework for analysis rather than a full set of answers. But focusing attention on the right questions, and moving towards a manageable and accessible body of doctrine, would be major steps forward.

B. TOTAL EXCLUSION OF GOOD FAITH V. LIMITED DECISION RULE

The idea of good faith and fair dealing as an underenforced legal norm can also help to illuminate the choice between, on

307. See Am. Mart Corp. v. Joseph E. Seagram & Sons, 824 F.2d 733, 734 (9th Cir. 1987). This test certainly falls short of the constitutional law test for strict scrutiny; I have found no court requiring a defendant in a good faith case to establish a compelling interest for her exercise of discretion.


309. See supra text accompanying notes 140–43.
one hand, refusing to enforce good faith entirely and, on the other hand, giving some limited effect to the norm via a decision rule. Courts often face an analogous question in constitutional law: faced with institutional reasons counseling against judicial enforcement of a particular norm in a given context, should they decline to operate in that field entirely (pursuant to the political question doctrine)? Or should they design a test that gives some effect to the constitutional norm? Richard Fallon argues convincingly that the burden of persuasion should fall on those who advocate complete judicial abstention as opposed to the development of some sort of manageable standard.310

Certainly, total exclusion of the implied norm of good faith and fair dealing might well be justified in the right circumstances. The law of interstate compacts provides a potential illustration, at an interesting intersection between public law and private law. Agreements between and among the States must be approved by Congress,311 and disputes arising from them come before the Supreme Court under its original jurisdiction.312 The Court treats interstate compacts as contracts, and generally interprets them in line with general principles of contract interpretation.313 Nevertheless, in 2010, the Supreme Court ruled that states are not subject to implied duties of good faith and fair dealing in the performance of an interstate compact.314 The court ruled that North Carolina’s explicitly stated power to withdraw from a compact could not be subjected to review for its fairness in the way that a private party’s exercise of discretion might.315 In explaining this decision for the Court, Justice Scalia stressed institutional factors: federalism and separation-of-powers concerns counseled against a rule that would permit the Supreme Court to supplement the express terms to which political branches of state and federal governments have agreed.316 Moreover, the

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310. See Fallon, supra note 26, at 1306–09 (“Viewed along a spectrum, a determination of nonjusticiability due to the absence of judicially manageable standards is simply the limiting case of a decision to underenforce constitutional norms.”).
311. U.S. CONST. art. I, § 10, cl. 3.
313. See, e.g., Tarrant Reg’l Water Dist. v. Herrmann, 133 S. Ct. 2120, 2130 (2013) (“Interstate compacts are construed as contracts under the principles of contract law.”).
315. Id. at 352.
316. Id.
context in which interstate compacts are drafted and ratified suggests that these compacts are more likely than ordinary contracts to be considered complete at the time of drafting.\footnote{317. As Justice Scalia noted, the drafters of several interstate compacts for the disposal of radioactive waste have explicitly chosen to incorporate duties of good faith into those agreements. \textit{Id.} at 353 (citing Omnibus Low-Level Radioactive Waste Interstate Compact Consent Act, Pub. L. No. 99-240, \S\S\ 222, 224, 225, 99 Stat. 1859, 1865, 1886, 1897 (1986) (referring to the Central Interstate Low-Level Radioactive Waste Compact, the Central Midwest Interstate Low-Level Radioactive Waste Compact, and the Midwest Interstate Low-Level Radioactive Waste Management Compact)).}

But in other areas, such as at-will employment, some courts seem to have moved too soon to the conclusion that good faith and fair dealing has \textit{no} role to play.\footnote{318. See \textit{supra} Part I.B.4; \textit{supra} note 17.} More generally, when one considers the wide range of potential decision rules from which courts can choose in implementing the good faith and fair dealing norm, the neoformalist critique of the general duty of good faith seems to be an overreaction. While Bernstein, Scott, and others may have been right to criticize Llewellyn's attempts to incorporate commercial morality in its entirety into commercial law, the neoformalist critique has considerably less bite on a doctrine of good faith that is underenforced via the operation of constrained, judicially manageable standards.\footnote{319. Stewart Macaulay makes a similar point when responding to Bernstein's work. \textit{Stewart Macaulay, Relational Contracts Floating on a Sea of Custom? Thoughts About the Ideas of Ian Macneil and Lisa Bernstein,} 94 NW. U. L. REV. 775, 787–88 (2000). If, as Bernstein suggests, there are often reasons to doubt the existence of trade usages, why isn't it sufficient to meet this concern to craft a decision rule whereby the party seeking to rely on a trade usage bears the burden of establishing it?}

C. SHOULD THE DUTY OF GOOD FAITH AND FAIR DEALING BE EXCLUDABLE?

Distinguishing between good faith and fair dealing as a conduct rule and good faith as a set of judicial decision rules also sheds some light on a doctrinal conundrum: should parties be able to contract out of the norm of good faith and fair dealing? Existing law suggests that the obligation of good faith is not just a default rule, but an immutable rule.\footnote{320. See Ian Ayres \& Robert Gertner, \textit{Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules,} 99 YALE L.J. 87, 87 (1989) (noting that "under the Uniform Commercial Code \ldots the duty to act in good faith is an immutable part of any contract").} The general duty of good faith under the U.C.C. cannot be disclaimed by
Admittedly, the Code quickly qualifies the immutability of good faith, noting that parties can define the standards for judging good faith, so long as their chosen standards are not “manifestly unreasonable.” Similarly, though there is little case law on whether parties can contract around the general common-law duty of good faith and fair dealing, some courts have said that attempts to do so will be ineffective. In the words of the New York Court of Appeals, “[n]o covenant of immunity can be drawn that will protect a person who acts in bad faith, because . . . the courts will not enforce it.”

Supporting the immutability of good faith, some writers have claimed that it must be either self-contradictory or fraudulent to enter into a contract while denying one’s obligation to perform in good faith. But these arguments become substantially less powerful when one allows for the possibility of a divergence between conduct rules and decision rules. It need not be self-contradictory or fraudulent for a party to wish to exclude judicial enforcement of good faith and fair dealing. Commercial parties, in particular, might rationally and fairly decide that the risk of error and litigation costs that would accompany legal enforceability are not worth the benefits that judicial enforcement would bring. Thus, there seems to be little reason for a complete ban on excluding a good-faith-based judicial decision rule by means of an explicit contractual provision. In this respect, the U.C.C.’s rule that the duty of good faith is partially immutable is somewhat difficult to justify. On the other hand, for familiar reasons, the courts should often be suspicious of attempts to exclude the duty of good faith and fair dealing by clickwrap and other standard-form consumer contracts, and should limit the duty’s displacement to genuine cases of agreed exclusion.

D. ARBITRATION DECISIONS ON GOOD FAITH AND FAIR DEALING

In constitutional law, the underenforcement literature suggests that political actors lacking the institutional limitations of courts should take a more expansive view of constitu-

321. U.C.C. § 1-302(b) (2013).
322. Id.
325. Markovits, supra note 35, at 284.
326. See BURTON & ANDERSEN, supra note 323, at 74.
tional rights and duties.\textsuperscript{327} Applying this insight to contract law, comparative institutional considerations suggest that arbitrators are in a position to impose more demanding duties of good faith and fair dealing. More than courts, which tend to be staffed by generalist judges and juries who lack expertise, arbitrators are often in a better position to identify unreasonable contractual behavior, and at a lower cost.\textsuperscript{328} Other things being equal, the case for gaps between conduct rules and decision rules is lessened, and such gaps should be smaller.

Though the available evidence is equivocal,\textsuperscript{329} the application of the good faith norm in collective bargaining does seem to provide one example of arbitrators giving fuller effect to the good faith norm than their judicial counterparts. As we have seen, the majority of American states refuse to apply the implied covenant of good faith and fair dealing to employment termination cases.\textsuperscript{330} But labor arbitrators adjudicating collective bargaining disputes have been willing to give serious force to the covenant.\textsuperscript{331} The covenant is well established as a matter of arbitral jurisprudence, and has, for example, been applied to disputes over employers’ decisions to sub-contract work in arguable violation of the spirit of a labor agreement.\textsuperscript{332} In the absence of a contrary contractual provision, management must demonstrate that its decision to sub-contract—and thus to avoid the collective bargaining agreement’s employment provisions—was “made in good faith and [is] objectively reasonable.”\textsuperscript{333} In labor arbitration, the covenant of good faith and fair dealing “serves as the basis for the proposition that management discretion must be exercised reasonably.”\textsuperscript{334} The degree of underenforcement is further reduced by decisions that place

\begin{itemize}
  \item \textsuperscript{327} See supra Parts II.A.1–2.
  \item \textsuperscript{328} See Steven Shavell, \textit{Alternative Dispute Resolution: An Economic Analysis}, 24 J. LEGAL STUD. 1, 5–6 (1995) (reasoning that arbitrators may be in a better position than courts to detect substandard contractual performance).
  \item \textsuperscript{329} As against the example in the text, Lisa Bernstein contends that some industry-specific private arbitration bodies apply a “formalistic” approach, seemingly hostile to enforcement of a good faith norm. \textit{See supra} note 146.
  \item \textsuperscript{330} \textit{See supra} Part I.B.4.
  \item \textsuperscript{331} Brudney, \textit{supra} note 139, at 806–07.
  \item \textsuperscript{332} \textit{Id.} at 807.
  \item \textsuperscript{333} \textit{See In re Libbey Glass}, Inc., 116 Lab. Arb. Rep. (BNA) 182, 186–87 (2000) (Ruben, Arb.) (finding no violation of the covenant as a result of an employer’s decision to sub-contract because of cost considerations).
\end{itemize}
the burden of satisfying this doctrinal test on the management.335

Perhaps this greater arbitral willingness to enforce the
covenant of good faith against employers is just a result of the
dynamics of labor negotiations, but my analysis suggests other
reasons why it might make sense. Labor arbitrators have a
greater degree of expertise in the subject of labor disputes, and
are presumably less prone to the kinds of errors made by gen-
eralist courts, which are more likely to fail to understand the
parties’ employment relationship. Moreover, these consider-
tations have obvious implications for judicial review of arbitra-
tion decisions. Of course, courts already have general reasons
to defer to the decisions of arbitrators—but those reasons are
particularly strong in the good faith and fair dealing field.

CONCLUSION

My purpose in this Article has been to establish that good
faith and fair dealing can helpfully be understood as an
underenforced legal norm. But the status of underenforced le-
gal norms is—to use a word from the constitutional law liter-
ature—a larger metadoctrinal issue.336 The phenomenon of
underenforcement appears to exist elsewhere in private law.
Most fundamentally, the idea of an enforcement gap between
legal duties and available sanctions helps to make sense of how
the courts talk about remedies in contracts, torts, and property
cases. In particular, the notion of underenforced legal norms
provides a line of response to Holmes’s aphorism that there is
no duty at common law to keep one’s contracts—only a duty to
pay damages.337 Once we have abandoned the assumption that
being vulnerable to judicial sanction is the essence of legal du-
ty, we can see why courts speak of legal duties to keep con-
tracts even where specific performance is not available, and of
rights to exclude others from property even where a court will
not award an injunction.

It is no coincidence that constitutional law scholarship
helps the analysis.338 For various reasons, similar metadoctrinal

336. See Berman, supra note 180, at 4.
337. O. W. Holmes, The Path of the Law, 10 HARV. L. REV. 457, 462 (1897).
338. In the last few years, the trend has mostly been in the opposite dire-
c tion; scholars have more often drawn ideas from private law into debates
about public law. See, e.g., Daryl J. Levinson, Rights Essentialism and Rem-
questions have received more attention from scholars in constitutional law in recent years than have analogous questions in private law. For some time, much interesting and original work in private law eschewed the internal perspective on doctrine, preferring to assess contracts, torts, property, and so on through the lenses of other disciplines, especially economics. Without jettisoning the enormous insights to be gained from interdisciplinary scholarship, I suggest that private law would benefit—and is benefiting—from a metadoctrinal turn of its own. By juxtaposing problems of doctrinal design from constitutional law and private law, we can shed light on questions of comparative institutional analysis that cut across legal domains.340
