Legal Opinion Letter

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ACTIVIST STATE HIGH COURT HAS NO FAITH IN CONTRACTS

by
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Most citizens would be dismayed to learn that the implied covenant of good faith, a concept designed principally to fill gaps in the language of a contract, is being used by courts to nullify clearly-worded terms crafted by the parties. This was the result in *Sons of Thunder, Inc. v. Borden, Inc.*, 148 N.J. 396 (1997), a recent decision by the Supreme Court of New Jersey. The case illustrates how courts sometimes misuse vague, elastic concepts in the law to reach a particular result in a given case.

Recognizing that an expansive view of the covenant of good faith could upset the balance struck by the parties in a contract's negotiated terms and conditions, wise jurists hold that the implied covenant does not "trump" contract terms. Thus, where the parties have spoken on an issue in the language of the contract, these courts have held that the implied covenant cannot alter the outcome. *See Kham & Nate's Shoe No. 2 v. First Bank of Whiting*, 908 F.2d 1351, 1357 (7th Cir. 1990).

Sons of Thunder shows that a less disciplined approach to the covenant leads to result-oriented decision-making and erodes the law of contracts itself. The facts in *Sons of Thunder* are somewhat involved, but important to an understanding of the Court's excesses in the case. Borden and Sons of Thunder, Inc. (Thunder), a corporation formed by a fisherman named Donald DeMusz, signed a one page agreement calling for Thunder to supply Borden with a quantity of clams each week at the market price. The term was "for a period of one (1) year" after which it could be renewed for "up to five years." Either party had the right to cancel upon written notice pursuant to the following language: "Either party may cancel this contract by giving prior notice of said cancellation in writing Ninety (90) days prior to the effective cancellation date." A second DeMusz corporation, Sea Work, Inc., was party to a separate contract with Borden, and that contract also had a provision authorizing cancellation on notice. DeMusz, with Borden's knowledge, had taken on substantial debt and had cross-collateralized loans to both of his corporations. Unknown to Borden, however, the plant manager of Borden's seafood facility was a one-third owner of both Thunder and Sea Work.

Thunder began to supply Borden in April 1986. Borden bought slightly less than the contractual minimums some weeks and at times paid a bit less than market. Several months into the contract, Borden learned that its plant manager was a one-third investor in Thunder and Sea Work. The Borden manager was promptly fired. About five months later, Borden terminated Thunder's contract and the contract between Borden and Sea Work. Borden claimed at trial the manager's conflict of interest played a role in both contract terminations, though Borden's cancellation letters gave no reason for Borden's action; the decision to cancel was prompted by Borden's internal determination that the project in which Borden and Sea Work (the second DeMusz corporation) were involved was turning out poorly for Borden. Having decided to cancel the Sea Work contract, Borden canceled the contract with Thunder as well. Thunder alone sued for breach; financial pressures after the cancellation had forced

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DeMusz to liquidate his interest in Sea Work. Thunder claimed that there existed an understanding between the parties that Borden would use the 90-day cancellation provision in the contract only if Thunder's vessel proved unable to meet Borden's supply requirements in the first year of the contract. Thunder also asserted that the language did not qualify as an "express" and "unequivocal" right to cancel because it did not say that the cancellation could be "without cause."

Thunder's damages claims were in three parts. Thunder sought $326,000 in damages through the date of cancellation due to Borden's failure to buy the contractual minimum at the market price. In addition, Thunder sought $1,500,000 in lost profits for the four-year period after the cancellation date, asserting that the cancellation was void and that the contract should have been allowed to run five full years. A third category was for diminution in the value of the vessel.

The trial court rejected each of Borden's motions seeking to cut off damages as a matter of law at the end of the 90-day notice period specified in its cancellation letter. At trial, the jury gave Thunder the $326,000 it sought for the period prior to Borden's cancellation, finding that Borden's failure to buy the contract minimum at the market price was a breach. The jury also answered "no" to an interrogatory asking whether Borden breached "by terminating the contract by its letter of May 8, 1987," a reference to Borden's cancellation notice. Over Borden's repeated objections, the trial court also asked the jury whether Borden breached the implied covenant of good faith and fair dealing "in terminating the contract by its letter of May 8, 1987." To this query, the jury answered "Yes" and awarded another $412,000. Borden paid the $326,292 judgment and appealed the $412,000 covenant of good faith award, stating that it could not be reconciled with the jury's determination that Borden's cancellation letter was not a breach of contract. New Jersey's Appellate Division agreed, reversing the $412,000 award. 285 N.J. Super. 27 (App. Div. 1995). The court held that the right to cancel was express in the contract and could not be nullified by reliance upon the implied covenant of good faith.

The opinion is a monument to result-oriented jurisprudence. To overcome the conflict between the jury's finding that Borden had the right to cancel the contract and yet breached the covenant of good faith by exercising that right, the Court rewrote the verdict form. The Court divined that the jury really meant Borden had breached the implied covenant of good faith "in *performing*, not terminating the contract," even though, the Court acknowledged, "framing the issue this way does not seem to follow the wording of [the verdict]." 148 N.J. at 416 (emphasis in original).

Having re-cast the jury's verdict to answer a question not posed, the Court then determined that evidence of Borden's bad faith in "performing" the contract included misdeeds by Borden toward Sea Work (which never sued Borden) and Borden's failure to "buy[] the required amount of clams from the Sons of Thunder." *Id*. at 424. The Court failed to mention, however, that the jury gave Thunder 100% percent of what it had sought for Borden's under-purchases — the $326,000 award — and that Borden paid that judgment promptly after its entry. The Court never explained how it could justify awarding Thunder $412,000 in additional damages over and above those damages attributable to "the contractual period" determined by the jury. Punitive damages were neither claimed in the suit nor available under New Jersey law, yet the Supreme Court's decision gave Thunder 225% of its actual damages for the contract period — a punitive award by any measure.

The decision thus places New Jersey among those few jurisdictions which do not restrict the implied covenant to resolving issues not adequately addressed by the parties' language. As the outcome in *Sons of Thunder* makes clear, an undisciplined approach to the implied covenant can create liability for contract parties entirely "independent" from "the express terms of the contract." 148 N.J. at 423. *Sons of Thunder* thus shows the dangers of amorphous concepts such as the duty of good faith in the hands of result-oriented jurists.

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