

GOOD FAITH AND FAIR DEALING IN CONTRACTS

In Illinois, every contract is subject to an implied covenant known as a *covenant of good faith and fair dealing*. An *implied covenant* is a provision that is automatically deemed to be part of a contract although it is not specifically mentioned in the contract.

The good faith covenant is implied in any contract that gives a party broad discretion to perform or not perform, or to require the other party to perform or refrain from performing. Under the good faith covenant, parties must exercise their discretion reasonably and with a proper motive, and not arbitrarily, capriciously, or in a manner inconsistent with the parties' reasonable expectations. For example, if your contract give you the discretion to reject the other party's work product, your right to reject the work is probably subject to the good faith covenant. In that case, your rejection of the other party's work product should not be unreasonable.

Previously, a party's breach of the good faith covenant has only enabled the other party to sue for breach of contract. Generally, unless otherwise provided by the contract, the damages available for a breach of contract are limited to those that could have been reasonably anticipated by the breaching party. For example, a customer's breach of a contract with its vendor might cause the vendor to become bankrupt due to the poor state of the vendor's financial affairs. If this consequence was not anticipated by the customer, the vendor's damages for breach of contract should be limited to its profit from the contract and should not include the potentially much larger damages for the loss of its entire business.

A recent Illinois appellate case has expanded the damages that may now be available for a breach of the good faith covenant. Now, a party's breach of the good faith covenant may enable the other party to bring a lawsuit under a branch of the law known as *torts*. Torts is the legal term for misconduct other than a breach of contract. Unlike contract cases, the damages available in tort cases are not limited to those that were reasonably anticipated by the breaching party. Instead, damages in tort cases may be recovered for all losses that the injured party incurs as a consequence of the other party's misconduct.

The difference between damages for breach of contract and for a tort can be explained by returning to our previous example. Let us make the following two assumptions: (1) Contrary to the good faith covenant, a customer arbitrarily refuses to accept a vendor's performance and withholds payment. (2) The vendor's financial affairs are shaky, and as a consequence of the withheld payment the vendor becomes bankrupt. Under the new Illinois

case, the vendor may now be able to sue the customer for the potentially much larger damages incurred due to the loss of the vendor's entire business, rather than for the vendor's smaller lost profit, even if the vendor's bankruptcy was not reasonably anticipated by the customer.

This new case is not necessarily binding everywhere in Illinois. Illinois has five appellate courts, and they do not always agree with each other. In other words, although the decision of the appellate court in this new case will probably be given great consideration by the other four appellate courts, it is not necessarily binding on them. Also, this new decision could be reversed by the Illinois Supreme Court. Nevertheless, until this new expansion of the law more fully evolves, you should now be more careful than ever in exercising the discretion granted to you in your contracts. In the meantime, one way around this new court decision might be to insert a provision into your contracts that allows you to exercise your discretion at your sole and subjective satisfaction. Of course, this broad grant of discretion may or may not be acceptable to your business partners.