

THE SUPREME COURT OF ARKANSAS REFUSED TO IDENTIFY A  
SEPARATE CAUSE OF ACTION FOR BREACH OF AN IMPLIED  
COVENANT OF GOOD FAITH AND FAIR DEALING.

In *Arkansas Research Medical Testing, LLC v. Osborne*,<sup>1</sup> the Supreme Court of Arkansas provided that because it has never recognized failing to act in good faith as a cause of action, it would not make an exception for the present case. Thus, the court rejected the argument on appeal, which followed that not acting in good faith should be viewed as a cause of action.<sup>2</sup>

The appellees, William Jennings B. Osborne and Marie E. Osborne (the “Osbornes”), owned Arkansas Research Medical Testing Center, Inc. (“ARMT”), which mainly focused on conducting clinical drug trials for pharmaceutical companies.<sup>3</sup> In June 2004, the Osbornes sold ARMT through an asset purchase and sale agreement to Arch Sub, LLC, a subsidiary of Stephens Capital Partners (“SCP”), and shortly thereafter, SCP reorganized the acquisition as ARMT.<sup>4</sup>

The purchase agreement provided that Mr. Osborne would remain employed by ARMT as a consultant, and that ARMT would compensate him \$500,000 over the course of five years.<sup>5</sup> This agreement also included an earn-out provision, which explained that if ARMT achieved specific minimum profit goals, then it would pay the Osbornes an extra \$3,000,000 a year from 2004 through 2006.<sup>6</sup> Additionally, the Osbornes agreed to a noncompete clause in the contract, and for their agreement, ARMT promised to compensate the Osbornes an additional \$100,000 per year for a five year period.<sup>7</sup>

In 2004, AMRT fulfilled its promise in the earn-out provision, thus, it compensated the Osbornes \$3,000,000.<sup>8</sup> However, because ARMT did not achieve its specific minimum profit goal, which was a yearly gross revenue of \$7,500,000, in 2005 or in 2006, ARMT declined to pay the Osbornes.<sup>9</sup> Pursuant to ARMT refusing to pay, on October 10, 2008, the Osbornes filed suit against ARMT, Arch Sub, LLC, SCP, and Stephens Holding Compa-

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1. 2011 Ark. 158, 2011 WL 1423993.

2. *Id.* at 5–6, 2011 WL 1423993, at \*3.

3. *Id.* at 2, 2011 WL 1423993, at \*1.

4. *Id.* at 2, 2011 WL 1423993, at \*1 (noting that SCP completely owned Arch Sub, LLC).

5. *Id.* at 2, 2011 WL 1423993, at \*1.

6. *Id.*, 2011 WL 1423993, at \*1.

7. *Osborne*, 2011 Ark. 128 at 2, 2011 WL 1423993, at \*1.

8. *Id.* at 2, 2011 WL 1423993, at \*1

9. *Id.* at 2-3, 2011 WL 1423993, at \*1.

ny.<sup>10</sup> In the complaint, the Osbornes alleged “breach of the covenant of good faith and fair dealing, breach of fiduciary duty, breach of contract, breach of third-party-beneficiary agreement, interference with contract, constructive fraud, and promissory estoppel.”<sup>11</sup> This case went to a jury trial after the judge denied the motion for partial summary judgment on the allegations of implied covenant and contract.<sup>12</sup>

At trial, ARMT motioned for a directed verdict after both the Osbornes and ARMT presented their cases, and the judge denied this motion in regards to the following counts: breach of the covenant of good faith and fair dealing, breach of contract, breach of a third-party-beneficiary agreement, and constructive fraud.<sup>13</sup> After it deliberated, the jury came back with a favorable verdict for the Osbornes, in which it found that ARMT breached the implied covenant of good faith and fair dealing in 2005 and in 2006, thus, the jury awarded \$2,000,000 and \$1,000,000 respectively.<sup>14</sup> The jury did not find, however, that there was a breach of contract, breach of a third-party-beneficiary agreement, or constructive fraud.<sup>15</sup>

Upon the jury verdict, ARMT motioned for judgment notwithstanding the verdict, in which it contended that “Arkansas has not recognized a separate cause of action for breach of an implied covenant and that there was no evidence of bad faith to prevent the earn-out payments.”<sup>16</sup> After the judge denied this motion, ARMT appealed this case to the Supreme Court of Arkansas, in which it specifically argued four points: “(1) the evidence was insufficient to support a verdict for breach of the implied covenant of good faith and fair dealing”; (2) “the implied covenant of good faith and fair dealing does not provide a separate cause of action for bad faith”; (3) “the verdict should be dismissed because the first count of the Osbornes’ complaint sounded in tort”; and (4) “the circuit court erred in ruling that the Osbornes could introduce their reliance upon alleged oral misrepresentations contrary to the purchase agreement after its execution.”<sup>17</sup>

In addressing ARMT’s appeal, the court found it necessary to initially answer whether in Arkansas a breach of the implied covenant of good faith and fair dealing is a separate cause of action from an ordinary breach of contract.<sup>18</sup> In holding that it is not a separate cause of action, the court used its

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10. *Id.* at 3, 2011 WL 1423993, at \*1.

11. *Id.*, 2011 WL 1423993, at \*1.

12. *Id.*, 2011 WL 1423993, at \*1.

13. *Osborne*, 2011 Ark. 158 at 3, 2011 WL 1423993, at \*1.

14. *Id.*, 2011 WL 1423993, at \*1.

15. *Id.*, 2011 WL 1423993, at \*1.

16. *Id.*, 2011 WL 1423993, at \*2.

17. *Id.* at 1-2, 2011 WL 1423993, at \*1.

18. *Osborne*, 2011 Ark. 158 at 3-4, 2011 WL 1423993, at \*2.

opinion in *Country Corner Food & Drug, Inc. v. First State Bank*,<sup>19</sup> to explain “[t]he fact that every contract imposes an obligation to act in good faith does not create a cause of action for a violation of that obligation, and ... this court has never recognized a cause of action for failure to act in good faith.”<sup>20</sup>

Additionally, the court provided a more recent case, *Preston v. Stoops*,<sup>21</sup> which reaffirmed its holding in *First State Bank*.<sup>22</sup> However, it also explained that it did not address whether this issue could be claimed under contract law because the plaintiff in *Preston* had pled under tort law.<sup>23</sup> When the Arkansas Court of Appeals addressed this action under contract law in *West Memphis Adolescent Residential, LLC v. Compton*,<sup>24</sup> it relied on the Supreme Court’s holding in *Preston*, and it found “that Arkansas law does not recognize a separate cause of action for a breach of contractual duties of good faith and fair dealing and only recognizes a separate cause of action in tort against insurance companies for bad faith.”<sup>25</sup>

After reviewing its prior holdings in factually similar cases that addressed the same separate cause of action issue, the Supreme Court of Arkansas found that the Osbornes did not put forth a persuasive argument as to why it “should recognize a separate cause of action for breach of the implied covenant of good faith and fair dealing separate from a breach-of-contract claim.”<sup>26</sup> Because the court narrowly analyzes any claim pertaining to the tort of bad faith, whose root is the concept of the duty of good faith and fair dealing implied in a contract, in order for the Osbornes to convince the court that it should recognize a separate cause of action, they needed to present a strong enough policy argument for the recognition in contract law that was equivalent to the policy argument regarding the court’s recognition of the tort of bad faith.<sup>27</sup> The court recognizes the tort of bad faith only in situations where an insurer is “actively engaged in dishonest, malicious, or oppressive conduct in order to avoid its liability.”<sup>28</sup> However, the Osbornes’ argument simply amounted to furthering the idea that “a breach of the im-

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19. 332 Ark. 645, 655, 966 S.W.2d 894, 899 (1998).

20. *Osborne*, 2011 Ark. 158 at 4, 2011 WL 1423993, at \*2 (quoting *First State Bank*, 332 Ark. at 656, 966 S.W.2d at 899).

21. 373 Ark. 591, 594, 285 S.W.3d 606, 609–10 (2008).

22. *Osborne*, 2011 Ark. 158, at 4, 2011 WL 1423993, at \*2.

23. *Id.*, 2011 WL 1423993, at \*2 (citing *Preston*, 373 Ark. at 594, 285 S.W.3d at 609).

24. 2010 Ark. App. 450, \_\_\_ S.W.3d \_\_\_.

25. *Osborne*, 2011 Ark. 158 at 5, 2011 WL 1423993, at \*2 (citing *Compton*, 2010 Ark. App. 450, at 9, \_\_\_ S.W.3d at \_\_\_).

26. *Id.*, 2011 WL 1423993, at \*2.

27. *Id.* at 6, 2011 WL 1423993, at \*2.

28. *Osborne*, 2011 Ark. 158 at 6, 2011 WL 1423993, at \*3 (citing *Findley v. Time Insurance Co.*, 264 Ark. 647, 648, 573 S.W.2d 908, 908 (1978)).

plied covenant of good faith and fair dealing remains nothing more than evidence of a possible breach of a contract between parties.”<sup>29</sup>

The court focused on the issue of whether a breach of the implied covenant of good faith and fair dealing was a separate cause of action from just an ordinary breach of contract and did not address the other arguments on appeal. The outcome of addressing this single issue impacted the entirety of the case, from the potency of the Osbornes arguments to the amount of damages awarded by the jury. Thus, if a party in a law suit alleges that a breach of the implied covenant of good faith and fair dealing occurred, it must have such a compelling argument for recognizing this particular claim in the first place. Because Arkansas case law is clear on this issue now, it will take an extremely persuasive argument to not only reach the Supreme Court of Arkansas, but also to have the court overturn its consistent holding that a breach of the implied covenant of good faith and fair dealing is a separate cause of action from an ordinary breach of contract.

*\* Andrew Ritchie*

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29. *Osborne*, 2011 Ark. 158 at 6, 2011 WL 1423993, at \*3.