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### Employee Innocence and the Privileges of Power: Reappraisal of Implied Contract Rights

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# EMPLOYEE INNOCENCE AND THE PRIVILEGES OF POWER: REAPPRAISAL OF IMPLIED CONTRACT RIGHTS

Murray Tabb\*

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## I. INTRODUCTION

### A. *Background*

Over fifty years ago Justice Cardozo wrote, “Liberty of contract is not an absolute concept. It is relative to many conditions of time and place and

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circumstance. The constitution has not ordained that the forms of business shall be cast in imperishable moulds."<sup>1</sup> The limits of contractual freedom in the non-union workplace have been challenged in favor of a policy of protecting at-will employees from abusive discharge. In response, employers have defended their actions by relying upon the common law rule of employment at-will which, as formulated in the United States,<sup>2</sup> provides that an employer

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1. *Hartford Accident Co. v. Nelson Co.*, 291 U.S. 352, 360-61 (1934).

2. The English common law, as articulated by Blackstone, presumed that an employment for indefinite term was a hiring for one year:

If the hiring be general, without any particular time limited, the law construes it to be a hiring for a year; upon a principle of natural equity, that the servant shall serve, and the master maintain him, throughout all the revolutions of the respective seasons, as well when there is work to be done, as when there is not, but the contract may be made for any larger or smaller term.

W. BLACKSTONE, COMMENTARIES \* 425. This presumption could be rebutted, however, by showing that the contracting parties considered a custom of trade with a shorter duration. See C. SMITH, TREATISE ON THE LAW OF MASTER AND SERVANT 53 (1852); Feinman, *The Development of the Employment At Will Rule*, 20 AM. J. LEGIS. HIST. 118, 119-20 (1976); Murg & Sharman, *Employment at Will: Do the Exceptions Overwhelm the Rule?*, 23 B.C.L. REV. 329, 332 (1982). Although originally formulated to protect seasonal agricultural workers and domestic workers, the English rule was gradually extended to include all classes of servants. See C. SMITH, *supra*, at 51-57.

The initial American interpretation of the employment at will rule generally mirrored the English law principles of mutual interest and responsibilities of master and servant, but later developments in the mid-nineteenth century industrial revolution reflected the use of laissez-faire economics and concomitant reliance on formalistic interpretation of contracts. See *Pugh v. See's Candies, Inc.*, 116 Cal. App. 3d 311, 319, 171 Cal. Rptr. 917, 921 (1981); Feinman, *supra*, at 122-25; Note, *Protecting at Will Employees Against Wrongful Discharge: The Duty to Terminate Only in Good Faith*, 93 HARV. L. REV. 1816, 1824 (1980); see also P. SELZNICK, LAW, SOCIETY AND INDUSTRIAL JUSTICE 123 (1969) (18th century law of master and servant viewed the master-servant relationships as status based where custom and public policy shaped the framework of mutual rights and obligations of the parties, rather than being contractually defined by the will of the parties).

Some early American courts looked to the period of payment as determinative of the term of employment. E.g., *Moline Lumber Co. v. Harrison*, 128 Ark. 260, 194 S.W. 25 (1917); *Pinckney v. Talmage*, 32 S.C. 364, 10 S.E. 1083 (1890). Other courts assigned to the jury the role of ascertaining the intent of the parties. *Wagenseller v. Scottsdale Memorial Hosp.*, 147 Ariz. 370, —, 710 P.2d 1025, 1030-31 (1985); *Magnan v. Anaconda Indus.*, 193 Conn. 558, 563, 479 A.2d 781, 784 (1984); see also *Graves v. Lyon Bros. & Co.*, 110 Mich. 670, 68 N.W. 985 (1896); *Chamberlain v. Detroit Stove Works*, 103 Mich. 124, 61 N.W. 532 (1894). In *Darlington v. General Elec.*, 350 Pa. Super. 183, 504 A.2d 306 (1986), the court stated:

The at-will presumption flourished in the laissez-faire climate of the latter part of the last century. The philosophy of "freedom of contract," of which the at-will presumption was a manifestation, served to fuel the furnace of the free enterprise system. Because commerce was king, laws were tailored to facilitate business and courts were very much disinclined to impede the natural workings of the free enterprise system. Thus laws were developed

has absolute power to discharge an employee for "good cause, for no cause, or even cause morally wrong."<sup>3</sup> Sensitive to the potential for unfair hardship

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whereby courts largely left business decisions to businessmen.

*Id.* at \_\_\_\_, 504 A.2d at 309.

Resolution of the American position on at-will employment crystallized in the classic treatise by Horace Wood in 1877, where he stated:

With us the rule is inflexible, that a general or indefinite hiring is prima facie a hiring at will, and if the servant seeks to make it out a yearly hiring, the burden is upon him to establish it by proof. A hiring at so much a day, week, month, or year, no time being specified, is an indefinite hiring, and no presumption attaches that it was for a day even, but only at the rate fixed for whatever time the party may serve. It is competent for either party to show what the mutual understanding of the parties was in reference to the matter; but unless their understanding was mutual that the service was to extend for a certain fixed and definite period, it is an indefinite hiring and is determinable at the will of either party. . . .

H. WOOD, A TREATISE ON THE LAW OF MASTER AND SERVANT § 134, at 272 (1877). Wood's reliance on certain cases which supported his formulation of the rule has been largely discredited as being misplaced. See *Toussaint v. Blue Cross & Blue Shield*, 408 Mich. 579, 602 & nn.13-14, 292 N.W.2d 880, 886-87 & nn.13-14 (1980); Note, *Protecting Employees at Will Against Wrongful Discharge: The Public Policy Exception*, 96 HARV. L. REV. 1931, 1933 (1983); Note, *Implied Contract Rights to Job Security*, 26 STAN. L. REV. 335, 341-45 (1974).

The New York Court of Appeals adopted Wood's rule in 1895 in *Martin v. New York Life Ins. Co.*, 148 N.Y. 117, 118, 42 N.E. 416, 417 (1895), and it gained widespread acceptance as the prevailing American doctrine. 1 C. LABATT, COMMENTARIES ON THE LAW OF MASTER AND SERVANT § 159 (2d ed. 1913); 1 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 39, at 61-64 (1921).

3. *Payne v. Western & Atl. R.R.*, 81 Tenn. 507, 519-20 (1884), *overruled on other grounds*, *Hutton v. Watters*, 132 Tenn. 527, 179 S.W. 134 (1915). In *Payne*, the court stated:

All may dismiss their employees at will, be they many or few, for good cause, for no cause or even for cause morally wrong, without being thereby guilty of legal wrong. . . . The sufficient and conclusive answer to the many plausible arguments to the contrary, portraying the evil to workmen and to others from the exercise of such authority by the great and strong, is: They have the right to discharge their employees. The law cannot compel them to employ workmen, nor to keep them employed. If they break contracts with workmen they are answerable only to them; if in the act of discharging them, they break no contract, then no one can sue for loss suffered thereby. Trade is free; so is employment. The law leaves employer and employee to make their own contracts; and these, when made, it will enforce; beyond this it does not go. Either the employer or employee may terminate the relation at will, and the law will not interfere, except for contract broke.

This secures to all civil and industrial liberty.

*Id.*; see also *Wagenseller v. Scottsdale Memorial Hosp.*, 147 Ariz. 370, \_\_\_\_, 710 P.2d 1025, 1030-31 (1985); *Magnan v. Anaconda Indus.*, 193 Conn. 558, 563, 479 A.2d 781, 784 (1984); *Woolley v. Hoffmann-La Roche, Inc.*, 99 N.J. 284, \_\_\_\_, 491 A.2d 1257, 1260 (1985); *Darlington v. General Elec.*, 350 Pa. Super. 183, \_\_\_\_, 504 A.2d 306, 309 (1986); *Thompson v. St. Regis Paper Co.*, 102 Wash. 2d 219, 227-28, 685 P.2d 1081, 1084 (1984); *Mobil Coal Producing, Inc. v. Parks*, 704 P.2d 702, 704

upon employees through strict adherence to the at-will rule, courts have created three limitations on the discretion of employers to fire at-will employees: (1) through recognizing a tort cause of action where an employer's conduct contravenes an important public policy,<sup>4</sup> (2) by finding a breach of implied-in-fact contract terms of an employment commitment for a specific duration or for discharge only upon "good cause," typically based upon assurances of job security contained in company handbooks or manuals,<sup>5</sup> and (3) by finding a breach of an implied-in-law contractual covenant of good faith and fair dealing that the employer shall not act in a manner which deprives the employee of the fruits of the employment agreement.<sup>6</sup>

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(Wyo. 1985); 9 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1017, at 129-30 (3d ed. 1967).

4. See, e.g., *Novosel v. Nationwide Ins. Co.*, 721 F.2d 894 (3d Cir. 1983); *Wagenseller v. Scottsdale Memorial Hosp.*, 147 Ariz. 370, 710 P.2d 1025 (1985); *Petermann v. International Bhd. of Teamsters*, 174 Cal. App. 2d 184, 344 P.2d 25 (1959); *Sheets v. Teddy's Frosted Foods, Inc.*, 179 Conn. 471, 427 A.2d 385 (1980); *Parnar v. Americana Hotels, Inc.*, 65 Haw. 370, 652 P.2d 625 (1982); *Frampton v. Central Indiana Gas Co.*, 260 Ind. 249, 297 N.E.2d 425 (1973); *Trombetta v. Detroit, Toledo & Ironton Rail Co.*, 81 Mich. App. 489, 265 N.W.2d 385 (1978); *Boyle v. Vista Eyewear, Inc.*, 700 S.W.2d 859 (Mo. Ct. App. 1985) (noted at 52 Mo. L. REV. 677 (1987)); *Nees v. Hocks*, 272 Or. 210, 536 P.2d 512 (1975); *Thompson v. St. Regis Paper Co.*, 102 Wash. 2d 219, 685 P.2d 1081 (1984); *Harless v. First Nat'l Bank*, 162 W. Va. 116, 246 S.E.2d 270 (1978).

5. See *Ellis v. El Paso Natural Gas Co.*, 754 F.2d 884 (10th Cir. 1985) (applying New Mexico law); *Rupinsky v. Miller Brewing Co.*, 627 F. Supp. 1181 (W.D. Pa. 1986) (applying North Carolina law); *Kistler v. Life Care Centers of America, Inc.*, 620 F. Supp. 1268 (D. Kan. 1985); *Ring v. R.J. Reynolds Indus.*, 597 F. Supp. 1277 (N.D. Ill. 1984); *Eales v. Tanana Valley Medical-Surgical Group, Inc.*, 663 P.2d 958 (Alaska 1983); *Leikvold v. Valley View Community Hosp.*, 141 Ariz. 544, 688 P.2d 170 (1984); see also *Pugh v. See's Candies, Inc.*, 116 Cal. App. 3d 311, 171 Cal. Rptr. 917 (1981); *Shah v. American Synthetic Rubber Corp.*, 655 S.W.2d 489 (Ky. 1983); *Buchanan v. Martin Marietta Corp.*, 494 A.2d 677 (Me. 1985); *Toussaint v. Blue Cross & Blue Shield*, 408 Mich. 579, 292 N.W.2d 880 (1980); *Pine River State Bank v. Mettelle*, 333 N.W.2d 622 (Minn. 1983); *Weiner v. McGraw-Hill, Inc.*, 57 N.Y.2d 458, 443 N.E.2d 441, 457 N.Y.S.2d 193 (1982); *Mera v. Dispatch Printing Co.*, 19 Ohio St. 3d 100, 483 N.E.2d 150 (1985); *Clanton v. Cain-Sloan Co.*, 677 S.W.2d 441 (Tenn. 1984); *Parker v. United Airlines, Inc.*, 32 Wash. App. 722, 649 P.2d 181 (1982).

6. See *Savage v. Holiday Inn Corp.*, 603 F. Supp. 311 (D. Nev. 1985); *Wynn v. Boeing Military Airplane Co.*, 595 F. Supp. 727 (D. Kan. 1984); *Cleary v. American Airlines*, 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980); *Magnan v. Anaconda Indus.*, 193 Conn. 558, 479 A.2d 781 (1984); *Fortune v. National Cash Register Co.*, 373 Mass. 96, 364 N.E.2d 1251 (1977); *Gates v. Life of Montana Ins. Co.*, 638 P.2d 1063 (Mont. 1982); *Monge v. Beebe Rubber Co.*, 114 N.H. 130, 316 A.2d 549 (1974); *Thompson v. St. Regis Paper Co.*, 102 Wash. 2d 219, 685 P.2d 1081 (1984). See generally 3 A. CORBIN, CONTRACTS § 541, at 97 (1960); 5 S. WILLISTON, THE LAW OF CONTRACTS § 670, at 159 (3d ed. 1961); *Diamond, The Tort of Bad Faith Breach of Contract: When, If At All, Should It Be Extended Beyond Insurance Transactions?*, 64 MARQ. L. REV. 425 (1981); *Lopatka, The Emerging Law of Wrongful*

The inequality of bargaining power between the employer and employee motivated the growth of labor unions and collective bargaining agreements, which typically imposed requirements that dismissals be only for "just cause."<sup>7</sup> The changing attitude toward employee rights was similarly demonstrated by the Supreme Court's deference to "freedom of contract" in *Adair v. United States*<sup>8</sup> and *Coppage v. Kansas*.<sup>9</sup> However, just several decades later the court

*Discharge — A Quadrennial Assessment Of The Labor Law Issue Of The 80's*, 40 BUS. LAW 1 (1984); Murg & Scharman, *Employment at Will: Do The Exceptions Overwhelm The Rule?*, 23 B.C.L. REV. 329 (1982); Note, *Implied Contract Rights To Job Security*, 26 STAN. L. REV. 335 (1974); RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981); Note, *Protecting At Will Employees Against Wrongful Discharge: The Duty To Terminate Only In Good Faith*, 93 HARV. L. REV. 1816 (1980).

7. *Pugh v. See's Candies, Inc.*, 116 Cal. App. 3d 311, 320, 171 Cal. Rptr. 917, 926 (1981). See generally Peck, *Unjust Discharges from Employment: A Necessary Change in the Law*, 40 OHIO ST. L.J. 1 (1979).

8. 208 U.S. 161 (1908). In *Adair*, the Court held unconstitutional a federal statute which imposed criminal liability upon common carriers engaged in interstate commerce for unjustly discriminating against their employees because of memberships in labor organizations. *Id.* at 180. Justice Harlan, writing for a divided Court, stated:

While . . . the right of liberty and property guaranteed by the Constitution against deprivation without due process of law is subject to such reasonable restraints as the common good or the general welfare may require, it is not within the functions of government — at least, in the absence of contract between the parties — to compel any person in the course of his business and against his will, to accept or retain the personal services of another, or to compel any person against his will, to perform personal services for another. The right of a person to sell his labor upon such terms as he deems proper is, in its essence, the same as the right of the purchaser of labor to prescribe the conditions upon which he will accept such labor from the person offering to sell it. So the right of the employee to quit the service of the employer, for whatever reason, is the same as the right of the employer, for whatever reason, to dispense with the services of such employee. . . . In all such particulars the employer and the employee have equality of right, and any legislation that disturbs that equality is an arbitrary interference with the liberty of contract which no government can legally justify in a free land.

*Id.* at 174-75.

9. 236 U.S. 1 (1915). In *Coppage*, the Court struck down a Kansas statute similar to that involved in *Adair*, which forbade contracts that required employees, as a condition of employment, to agree not to join a union. *Id.* at 26. The Court rejected the argument that inequality of bargaining power between employer and employee should dictate modification of the freedom of contract ideology, stating:

[N]o doubt, wherever the right of private property exists, there must and will be inequalities of fortune; and thus it naturally happens that parties negotiating about a contract are not equally unhampered by circumstances. This applies to all contracts, and not merely to that between employer and employee. . . .

[I]t is from the nature of things impossible to uphold freedom of contract and the right of private property without at the same time recognizing as legitimate those inequalities of fortune that are the necessary result of the

recognized that the disparity in negotiating strength between employers and employees necessitated modification of formalistic contractual interpretation and the need for labor organizations:

“[Labor unions] were organized out of the necessities of the situation; that a single employee was helpless in dealing with an employer; that he was dependent ordinarily on his daily wage for the maintenance of himself and family; that if the employer refused to pay him the wages he thought fair, he was nevertheless unable to leave the employ and resist arbitrary and unfair treatment; that union was essential to give laborers opportunity to deal on an equality with their employer.<sup>10</sup>

Congressional efforts to safeguard employees from abusive or discriminatory firings resulted in an outpouring of legislation preventing discharge on the basis of race,<sup>11</sup> sex,<sup>12</sup> age,<sup>13</sup> physical handicap,<sup>14</sup> and engaging in union activity.<sup>15</sup>

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exercise of those rights.

*Id.* at 17.

10. *NLRB v. Jones & Laughlin Steel Corp.*, 301 U.S. 1, 33 (1937). The Court upheld the constitutionality of the National Labor Relations Act of 1935 provisions safe-guarding the right of employees to self-organize and to select representatives for collective bargaining. *Id.* at 33-34. Also, in *West Coast Hotel Co. v. Parrish*, 300 U.S. 379 (1937), the Court upheld a Washington minimum wage law for women as not violative of constitutional due process.

The Constitution does not speak of freedom of contract. It speaks of liberty and prohibits the deprivation of liberty without due process of law. In prohibiting that deprivation, the Constitution does not recognize an absolute and uncontrollable liberty. Liberty in each of its phases has its history and connotation. But the liberty safe-guarded is liberty in a social organization which requires the protection of law against the evils which menace the health, safety, morals, and welfare of the people. . . . This essential limitation of liberty in general governs freedom of contract in particular. . . .

*Parrish*, 300 U.S. at 391-93.

11. Civil Rights Act of 1964, 42 U.S.C. § 2000e-2(a)(1) (1976).

12. *Id.*

13. Age Discrimination in Employment Act of 1967, 29 U.S.C.A. § 623(a)(1) (West 1985).

14. Rehabilitation Act of 1973, 29 U.S.C.A. § 794 (West Supp. 1987).

15. National Labor Relations Act of 1935, 29 U.S.C. § 158(a)(3) (1976). Also, the Consumer Credit Protection Act prohibits discharge of employees whose wages are garnished for indebtedness, 15 U.S.C.A. § 1674(a) (West 1982); the Bankruptcy Code prohibits discriminatory treatment for filing for bankruptcy relief, 11 U.S.C.A. § 525 (West Supp. 1987); and a number of federal environmental statutes contain whistleblower protection provisions, e.g., Clean Air Act Amendments of 1977 § 312(a), 42 U.S.C.A. § 7622(a) (West 1983); Comprehensive Environmental Response, Compensation and Liability Act of 1980, 42 U.S.C.A. § 9610 (West 1983); Resource Conservation Recovery Act, 42 U.S.C.A. § 6971 (West 1983); Toxic Substances Control Act, 15 U.S.C.A. § 2622 (West 1985); Water Pollution Control Act, 33 U.S.C.A. § 1367 (West 1985); see also *Elrod v. Burns*, 427 U.S. 347 (1976); *Perry v. Sinderman*, 408 U.S. 593 (1972); Civil Service Reform Act of 1978, 5 U.S.C.A. § 7503 (West

Despite the shift in sentiment toward heightened protection of job security for union and public sector employees, the historical policy which favored unfettered managerial discretion over the workplace, reflective of the laissez-faire attitude in the industrial revolution, still persists. The modifications of the at-will rule reflect a needed reformation in the balance of rights for workers who individually lack the bargaining power to contract for greater job security and are not otherwise protected by collective bargaining agreements. However, the judicially created exceptions to the common law at-will doctrine have been inconsistently applied and the standards for analysis often muddled.

The thrust of this Article is twofold: to evaluate the policy considerations and the substantive foundations underlying implied-in-fact contract rights and the implied-in-law covenant and to provide a principled framework for future analysis which will accommodate the respective interests of management and employees. Although the utility of at-will contracts is accepted, it is proposed that employers not be permitted to eviscerate employee rights through "disclaimers," and that the covenant of good faith and fair dealing should be construed to give employees remedial protection against bad faith discharges.

### B. *Implied Rights of Job Security: A Contextual Overview*

Consider the hypothetical situation where two at-will employees work for the same company. Employee A files a proper claim for workers' compensation benefits and employee B files a health insurance claim under the employer's group policy. The employer subsequently discharges both employees in retaliation for filing the legitimate claims. At least one jurisdiction recognizes different rights and remedies for these two similarly situated employees.<sup>16</sup> Employee A may pursue a tort cause of action against the employer for contravening the important public policy, embodied in the workers' compensation statutory scheme, that workers should be entitled to receive com-

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1980); Employment Retirement Income Security Act of 1974, 29 U.S.C.A. § 1140 (West 1985); Occupational Health and Safety Act of 1970, 29 U.S.C.A. § 660(c) (West 1985); CONN. GEN. STAT. ANN. §§ 31-51m (West Supp. 1983); ME. REV. STAT. ANN. tit. 26, §§ 831-839 (West Supp. 1983); MICH. COMP. LAWS ANN. §§ 15.361-15.369 (West 1981 & Supp. 1983); Chaturvedi, *Legal Protection Available to Federal Employees Against Wrongful Dismissal*, 63 NW. U.L. REV. 287 (1968); Lowy, *Constitutional Limitations on the Dismissal of Public Employees*, 43 BROOKLYN L. REV. 1 (1976); Peck, *Unjust Discharges From Employment: A Necessary Change in the Law*, 40 OHIO ST. L.J. 1 (1979).

16. *Compare Price v. Carmack Datsun, Inc.*, 109 Ill. 2d 65, 485 N.E.2d 359 (1985) (no public policy violation where employee was discharged for filing health insurance claim) with *Kelsay v. Motorola, Inc.*, 74 Ill. 2d 172, 384 N.E.2d 353 (1979) (employer contravened public policy for terminating at-will employee in retaliation for filing workmen's compensation claim).



compensation for their job-related injuries.<sup>17</sup> In contrast, employee B may not possess a tort claim because statutes governing the insurance industry are aimed at the operations of insurance companies, and therefore would not serve as the basis for an implied right of action for an employee against an employer.<sup>18</sup> Moreover, in some jurisdictions, employee B may not be entitled to maintain a contract action for breach of the covenant of good faith and fair dealing because a strict interpretation of the at-will rule holds that the employee may be fired even for "bad cause."

Tolerating such disparate and abusive treatment of at-will employees, who lack the job security protections embodied in collective bargaining agreements or in statutes governing public sector employees, is insupportable both in policy and in analysis. The at-will rule should be reformed to continue to permit discharges of employees for either good cause or no cause, but limited by an implied-in-law covenant of good faith and fair dealing which would prevent "bad cause" firings. The proposed standard does not embrace the extreme position which would jettison the at-will contract in favor of a "just cause" requirement for dismissal,<sup>19</sup> nor the opposite extreme which would

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17. *Kelsey v. Motorola, Inc.*, 74 Ill. 2d 172, 384 N.E.2d 353 (1979). The court stated:

We are not convinced that an employer's otherwise absolute power to terminate an employee at will should prevail when that power is exercised to prevent the employee from asserting his statutory rights under the Workmen's Compensation Act. As we have noted, the legislature enacted the Workmen's Compensation Law as a comprehensive scheme to provide for efficient and expeditious remedies for injured employees. This scheme would be seriously undermined if employers were permitted to abuse their power to terminate by threatening to discharge employees for seeking compensation under the Act. We cannot ignore the fact that when faced with such a dilemma many employees, whose common law rights have been supplanted by the Act, would choose to retain their jobs, and thus, in effect, would be left without a remedy either common law or statutory. This result, which effectively relieves the employer of the responsibility expressly placed upon him by the legislature, is untenable and is contrary to the public policy as expressed in the Workmen's Compensation Act. We cannot believe that the legislature, even in the absence of an explicit proscription against retaliatory discharge, intended such a result.

*Id.* at 181-82, 384 N.E.2d at 357; *see Smith v. Piezo Technology & Professional Adm'rs*, 427 So. 2d 182 (Fla. 1983); *Frampton v. Central Indiana Gas Co.*, 260 Ind. 249, 297 N.E.2d 425 (1973); *Firestone Textile Co. v. Meadows*, 666 S.W.2d 730 (Ky. 1984); *Ducote v. Jones Constr. Co.*, 471 So. 2d 704 (La. 1985); *Hanson v. Harrah's*, 100 Nev. 60, 675 P.2d 394 (1984); *Ruiz v. Miller Curtain Co.*, 702 S.W.2d 183 (Tex. 1985). *Contra Self v. Bennett*, 474 So. 2d 673 (Ala. 1985); *see also Johnson v. Hussmann Corp.*, 610 F. Supp. 757 (E.D. Mo. 1985) (state law claim for retaliatory discharge for pursuing workers' compensation claim preempted by federal labor law).

18. *Price v. Carmack Datsun, Inc.*, 109 Ill. 2d 65, 69, 485 N.E.2d 359, 361 (1985).

19. *See Peck, Unjust Discharges from Employment: A Necessary Change in*

resist inroads or limitations on an employer's freedom to fire employees.<sup>20</sup> This change in the law would strike an important balance in employment relationships because it would avoid the pitfalls of judicially rewriting contracts so as to become equivalent to collective bargaining agreements, yet it would protect the legitimate expectations of at-will employees not to be treated in bad faith. The covenant of good faith and fair dealing should be implied by courts in all employment contracts as a matter of policy, and therefore should be non-waivable by employees and non-disclaimable by employers.

The policy against bad faith termination should be viewed as embodying both tort and contract duties and remedial principles. Although employer conduct may in certain circumstances give rise to both contract and tort causes of action, the two theories, as discussed in Part III of this Article, are not co-extensive but have different policy underpinnings, substantive requirements, and remedial consequences. The tort cause of action for violations of public policy should be narrowly focused to provide redress against employer conduct which offends expressions of societal norms, typically embodied in statutory or constitutional law, but for which the statute does not provide a remedy for the disenfranchised employee. In contrast, the implied contractual covenant of good faith and fair dealing should be concerned principally with the relations of the employer and employee *inter se*.

In addition to tort duties, the definition of what constitutes a "bad faith" discharge necessarily encompasses the protection of the basic contract interests of expectancy, reliance and restitution. Bad faith in the employment contract is chameleon-like in that it takes on meaning depending upon the nature of the performance being rendered or to be rendered by the employee *qua* employee.

For example, assume that an employee makes a large sale of computer equipment for which her employer is obligated to pay her a commission. Promptly after entry of the order, the employee is fired so that the employer can avoid payment of the commission. Led by Massachusetts, courts have recognized that the covenant of good faith should prevent the unjust enrichment of the employer in these circumstances and have required payment of the commission based upon the employee's restitutionary interest. Although the restitution cases are the clearest to identify, they do not complete the definition of a bad faith discharge.

The implied contractual covenant of good faith and fair dealing must also protect the at-will employee's expectancy and reliance interests. The

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*the Law*, 40 OHIO ST. L.J. 1, 4 (1979); Note, *Protecting At Will Employees Against Wrongful Discharge: The Duty to Terminate Only in Good Faith*, 93 HARV. L. REV. 1816, 1940 (1980); Note, *Employment At Will: Just Cause Protection Through Mandatory Arbitration*, 62 WASH. L. REV. 151, 163-66 (1987).

20. See *Gordon v. Matthew Bender & Co.*, 562 F. Supp. 1286 (N.D. Ill. 1983).

immediate objection to this view, as voiced by some courts, is that an at-will employee has no expectation of continued employment and therefore the reasons for discharge are irrelevant.<sup>21</sup> Certainly an at-will employee does not have a legitimate expectation of being discharged only for "good cause" as do public sector employees or those protected by a collective bargaining agreement. Moreover, an at-will employee cannot properly assert an expectation for lifetime or permanent employment. It should be considered reasonable to hold that all employees have a legitimate expectation, which deserves legal recognition and protection, of not being discharged for "bad cause."

Further support for recognition of an expectation interest of at-will employees not to be discharged in bad faith may be borrowed by analogy from the large body of case law defining bad faith in the insurance context. In that regard, the "special relationship" between insurer and insured provides that a breach of the implied covenant of good faith and fair dealing has occurred when the reasonable expectations of an insured are not satisfied.

At this juncture a word of caution is in order. A handful of courts, principally in California, incorrectly have muddled the analysis of the expectancy interest involved in the implied-in-law good faith covenant with implied-in-fact contract provisions concerning job security.<sup>22</sup> This Article, in Part III. B., discusses why the two implied contract limitations on the employment at-will rule are mutually exclusive. Also, Part II. reviews recent developments which have limited the at-will doctrine through implied-in-fact contract rights, as well as the principal defenses marshalled by employers against attempts to curtail their broad prerogative to discharge at-will employees.

Consider again the earlier hypothetical about employees A and B who were fired in retaliation for filing a workers' compensation claim and a health insurance claim, respectively. Add the variable that the employer had distributed to all employees a policy manual which set forth internal grievance and termination procedures and yet disclaimed any promise that the employee's status was other than at-will. Some courts have held that similar promises by an employer of continued employment or to follow certain procedures contained in handbooks or manuals are unenforceable because the employee has not provided any independent consideration<sup>23</sup> for the promise or because the provision lacks mutuality of obligation.<sup>24</sup> Several reasons exist for elimination of these defenses to implied-in-fact contract rights for employees. A disclaimer that announced company procedures to be non-

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21. See, e.g., *id.*

22. See *infra* Part III. B. of text.

23. E.g., *Jones v. East Center for Community Mental Health*, 19 Ohio App. 3d 19, 23, 482 N.E.2d 969, 973 (1984).

24. See generally *Pitcher v. United Oil & Gas Syndicate*, 174 La. 66, 69, 139 So. 760, 761 (1932); *Rape v. Mobile & O.R.R.*, 136 Miss. 38, 100 So. 585 (1924).

binding on the employer should be viewed as inconsistent with the notion that the employer may expect compliance with their terms by employees. As discussed in Part II. D., the very term "disclaimer" is inartful in the at-will employment context because it connotes the idea that otherwise existing substantive rights are unenforceable. In the at-will employment contract setting, the disclaimer actually only limits which terms should be considered implied-in-fact into the contract. The employer should not have it both ways—mandate that an employee's failure to follow procedures is a bar to any recovery yet simultaneously claim that an employer's own failure to follow its promised procedures is irrelevant because of the disclaimer.

## II. IMPLIED-IN-FACT CONTRACT RIGHTS

### A. Background

An increasing number of courts, perhaps anxious to circumscribe the harsh operation of the at-will rule, have implied contract terms regarding job security or fair treatment in disciplinary procedures from oral assurances by employers or have extracted such terms from statements made in employee policy manuals or personnel handbooks.<sup>25</sup> Since employment contracts often are "informal, with brevity in working and much uncertainty in meaning,"<sup>26</sup> this methodology of implied-in-fact contract provisions has been a Pandora's box in at-will employment contracts.

The at-will employee by definition has no legally protectable contract right either to continued employment or to being discharged only for "good cause."<sup>27</sup> Rather, the employment relationship may be severed at any time by either party, with or without cause.<sup>28</sup> In contrast, employment contracts with a specified duration or collective bargaining agreements typically provide heightened job security by restricting the grounds for discharge to good cause or just cause.<sup>29</sup>

The willingness of courts to find implied-in-fact contractual promises of job security reflects a needed equitable adjustment of the relative bargaining powers of employer and employee, enhancing the protections afforded employees in the private sector who are not covered by collective bargaining

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25. *E.g.*, *Toussaint v. Blue Cross & Blue Shield*, 408 Mich. 579, 598, 292 N.W.2d 880, 885 (1980); *Pine River State Bank v. Mettille*, 333 N.W.2d 622, 626 (Minn. 1983).

26. 3 A. CORBIN, *CONTRACTS* § 684 (1960).

27. *Thompson v. St. Regis Paper Co.*, 102 Wash. 2d 219, 223, 685 P.2d 1081, 1084 (1984).

28. *Ryan v. J.C. Penney Co.*, 627 F.2d 836 (7th Cir. 1980).

29. *See Pugh v. See's Candies, Inc.*, 116 Cal. App. 3d 311, 320, 171 Cal. Rptr. 917, 921 (1980).

agreements. Inherent in making such determinations is the accommodation and balancing of the respective interests of employer and employee in bringing fairness to the workplace.<sup>30</sup> The balancing process, then, considers the interests involved in freedom of contract and stability in labor relations together with the dependency on job security for an employee's livelihood.<sup>31</sup> Moreover, some courts properly have recognized that if employers receive the benefits of better employee relations through, for example, the dissemination of policy manuals which provide assurances of job security, a substantial injustice would result if the employer treated the promises as illusory.<sup>32</sup> Courts have increasingly recognized that the presumption that an employment contract for indefinite duration was intended to be terminable at-will, like any other presumption, may be rebutted by contrary evidence.<sup>33</sup> Even *Martin v. New York Life Insurance Co.*,<sup>34</sup> which adopted Wood's at-will formulation in 1895, only accorded it the status of a rebuttable presumption.<sup>35</sup> Therefore,

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30. In *Woolley v. Hoffmann-La Roche, Inc.*, 99 N.J. 284, 491 A.2d 1257 (1985), the court stated:

In recognizing a cause of action to provide a remedy for employees who are wrongfully discharged, we must balance the interests of the employee, the employer, and the public. Employees have an interest in knowing they will not be discharged for exercising their legal rights. Employers have an interest in knowing that they can run their businesses as they see fit as long as their conduct is consistent with public policy. The public has an interest in employment stability and in discouraging frivolous lawsuits by dissatisfied employees.

*Woolley*, 99 N.J. at \_\_\_\_, 491 A.2d at 1261 (quoting *Pierce v. Ortho Pharmaceutical Corp.*, 84 N.J. 58, 71, 417 A.2d 505, 511 (1980)).

31. *Woolley v. Hoffmann-La Roche, Inc.*, 99 N.J. 284, \_\_\_\_, 491 A.2d 1257, 1261, 1266 (1985).

32. In *Toussaint v. Blue Cross & Blue Shield*, 408 Mich. 579, 292 N.W.2d 880 (1980), the court stated:

While an employer need not establish personnel policies or practices, where an employer chooses to establish such policies and practices and makes them known to its employees, the employment relationship is presumably enhanced. The employer secures an orderly, cooperative and loyal work force, and the employee the peace of mind associated with job security and the conviction that he will be treated fairly.

*Id.* at 613, 292 N.W.2d at 892.

33. See, e.g., *McNulty v. Borden, Inc.*, 474 F. Supp. 1111, 1119 (E.D. Pa. 1979); *Leikvold v. Valley View Community Hosp.*, 141 Ariz. 544, \_\_\_\_, 688 P.2d 170, 172-73 (1984); *Pugh v. See's Candies, Inc.*, 116 Cal. App. 3d 311, 324, 171 Cal. Rptr. 917, 930 (1981); *Weiner v. McGraw-Hill, Inc.*, 57 N.Y.2d 458, 466-67, 443 N.E.2d 441, 446, 457 N.Y.S.2d 193, 198 (1982); see also *Wagenseller v. Scottsdale Memorial Hosp.*, 147 Ariz. 370, \_\_\_\_, 710 P.2d 1025, 1036, 1038 (1985) (the right of discharge without cause as an implied contractual term in employment at-will relationship, merely reiterates the English common law one year presumption); RESTATEMENT (SECOND) OF AGENCY § 442 comment a (1986).

34. 148 N.Y. 117, 42 N.E. 416 (1895).

35. *Id.* at 121, 42 N.E. at 417.

the general rule which provides that an employment contract of indefinite duration is terminable at-will should be characterized as a rule of construction rather than as a substantive limit on contract formation.<sup>36</sup>

### B. *The Objections: Mutuality and Consideration*

Several difficult and controversial issues are involved in whether handbook provisions relating to job security, i.e., that an employee would be discharged only for "good cause," are contractually binding and enforceable. Employers have presented a number of objections to any modification of the at-will relationship through implied-in-fact contract terms extracted from policy manuals or personnel handbooks. The principal employer defense is that the at-will contract is not modified in instances where the employee has failed to provide "independent consideration," other than the services already agreed upon, in exchange for implied-in-fact promises of job security.<sup>37</sup> Secondly, employees have contended that such implied-in-fact terms are not contractually binding based upon the doctrine of mutuality of obligation.<sup>38</sup>

#### 1. Independent Consideration

The most troublesome issue with respect to the enforceability of job security provisions in an at-will employment relationship has two facets: whether an employee must supply some consideration other than his continued work for his employer, and, if so, what satisfies that independent consideration requirement. Some courts have held that policy manual provisions regarding job security should be treated like individual long-term employment

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36. See *Toussaint v. Blue Cross & Blue Shield*, 408 Mich. 579, 598, 292 N.W.2d 880, 885 (1980); *Woolley v. Hoffman La-Roche, Inc.*, 99 N.J. 284, \_\_\_\_\_, 491 A.2d 1257, 1263 (1985). The court in *Pine River State Bank v. Mettelle*, 333 N.W.2d 622 (Minn. 1983) stated:

It should not be necessary for an employee to prove a contract is of "permanent" employment or for a specified term in order to avoid summary dismissal if the parties have agreed otherwise. There is no reason why the at-will presumption needs to be construed as a limit on the parties' freedom to contract. If the parties choose to provide in their employment contract of an indefinite duration for provisions of job security, they should be able to do so.

*Id.* at 628; see also *Leikvold v. Valley View Community Hosp.*, 141 Ariz. 544, \_\_\_\_\_, 688 P.2d 170, 173 (1984); *Eklund v. Vincent Brass & Aluminum Co.*, 351 N.W.2d 371, 376 (Minn. Ct. App. 1984).

37. See *Gordon v. Matthew Bender & Co.*, 526 F. Supp. 1286 (N.D. Ill. 1983); *Gates v. Life of Montana Ins. Co.*, 638 P.2d 1063 (Mont. 1982); *Roberts v. Atlantic Richfield Co.*, 88 Wash. 2d 887, 568 P.2d 764 (1977).

38. See *Johnson v. National Beef Packing Co.*, 220 Kan. 52, 551 P.2d 779 (1976); *Campbell v. Eli Lilly & Co.*, 413 N.E.2d 1054 (Ind. Ct. App. 1980).

contracts which, to be contractually enforceable, must be supported by consideration other than the services to be performed by the employee.<sup>39</sup> In that regard, one court explained:

The additional consideration rule usually does not offer relief from the at-will presumption to the typical, lower echelon employee who brings nothing beyond his skills to the employment. Nor does it offer relief to the typical white collar professional such as appellant. However, we do not believe the rule to be inherently "unfair" any more than other facets of the law of contracts which, generally, does not realter the economic positions from which parties bargain. All manner of contracts are formed between parties of unequal bargaining strength. The law of contracts has traditionally acted as umpire to contractual disputes—that is, it does not reassign the players to even-out the teams, but insures that the game is played fairly, regardless of the disparity of bargaining power.<sup>40</sup>

An increasing number of courts, though, have enforced job security provisions without requiring additional consideration,<sup>41</sup> based upon the Restatement (Second) of Contracts section 80 Comment a<sup>42</sup> that a single performance may furnish consideration for multiple promises, and upon the general contract principle that courts should not inquire into the adequacy of consid-

39. *E.g.*, *Ryan v. J.C. Penney Co.*, 627 F.2d 836, 838 (7th Cir. 1980) (applying Indiana law); *Gordon v. Matthew Bender & Co.*, 526 F. Supp. 1286, 1295 (N.D. Ill. 1983); *Gates v. Life of Montana Ins. Co.*, 638 P.2d 1063, 1066 (Mont. 1982).

40. *Darlington v. General Elec.*, 350 Pa. Super. 183, —, 504 A.2d 306, 315 (1986). In *Weiner v. McGraw-Hill, Inc.*, 57 N.Y.2d 458, 443 N.E.2d 441, 457 N.Y.S.2d 193 (1982), the court stated that "the detriment suffered or the thing promised need be of no benefit to the one who agreed to it." *Id.* at 464, 443 N.E.2d at 445, 457 N.Y.S.2d at 197. However, in *Roberts v. Atlantic Richfield Co.*, 88 Wash. 2d 887, 894-95, 568 P.2d 764, 769 (1977), the court took a very restrictive approach and stated that the consideration must involve a detriment to the employee and a benefit to the employer.

41. *E.g.*, *Pugh v. See's Candies, Inc.*, 116 Cal. App. 3d 311, 325, 171 Cal. Rptr. 917, 924 (1980); *Pine River State Bank v. Mettill*, 333 N.W.2d 622, 629 (Minn. 1983); *Southwest Gas Corp. v. Ahmad*, 99 Nev. 594, 595, 668 P.2d 261, 261 (1983); *Woolley v. Hoffman-La Roche, Inc.*, 99 N.J. 284, —, 491 A.2d 1257, 1267 (1985); *Weiner v. McGraw-Hill, Inc.*, 57 N.Y.2d 458, 465, 443 N.E.2d 441, 445, 457 N.Y.S.2d 193, 197 (1982); *Helle v. Landmark, Inc.*, 15 Ohio App. 3d 1, 11, 472 N.E.2d 765, 775 (1984).

42. According to Comment a:

Since consideration is not required to be adequate in value (See § 79), two or more promises may be binding even though made for the price of one. A single performance or return promise may thus furnish consideration for any number of promises. But if the performance or return promise would not be consideration for a single promise, it is not consideration for that promise as part of a set of promises, or for the other promises in the set.

RESTATEMENT (SECOND) OF CONTRACTS § 80 comment a (1981).

eration.<sup>43</sup> Therefore, the fact that an employee stays on the job should be interpreted as providing sufficient consideration to support several promises by the employer. In *Pugh v. See's Candies, Inc.*,<sup>44</sup> a leading California state court decision which addressed implied contract rights for at-will employees, the court speculated that the most likely explanation for the independent consideration requirement was that it served an evidentiary function.<sup>45</sup> Accordingly, the additional consideration requirement should be viewed as a rule of construction rather than a substantive limitation on contract formation.<sup>46</sup> As one court explained:

The term "consideration" is not used here as it is in the usual contractual context to signify a *validation* device. The term is used, rather, more as an *interpretation* device. When "sufficient additional consideration" is present, courts infer that the parties *intended* that the contract will not be terminable at-will. This inference may be nothing more than a legal fiction because it is possible that in a given case, the parties never truly contemplated how long the employment would last even though additional consideration is present.<sup>47</sup>

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43. RESTATEMENT (SECOND) OF CONTRACTS § 79 (1979); *see* *Stauter v. Walnut Grove Prods.*, 188 N.W.2d 305, 311 (Iowa 1971); *Toussaint v. Blue Cross & Blue Shield*, 408 Mich. 579, 600, 292 N.W.2d 880, 885 (1980). One scholar has stated:

If an executed consideration is given by the promisee, a promise of employment on stated terms is not rendered unenforceable by the fact that the employment is to continue permanently, or for an indefinite period or as long as the employee wishes to stay. The employee is not bound; but the employer is bound. There is no mutuality of obligation; but there was other sufficient consideration.

1A. A. CORBIN, CONTRACTS § 152, at 14 n.11.15 (1963).

44. 116 Cal. App. 3d 311, 171 Cal. Rptr. 917 (1980).

45. The court stated that "it is more probable that the parties intended a continuing relationship, with limitations upon the employer's dismissal authority, when the employee has provided some benefit to the employer, or suffers some detriment, beyond the usual rendition of service." *Id.* at 326, 171 Cal. Rptr. at 925.

46. *See* *Leikvold v. Valley View Community Hosp.*, 141 Ariz. 544, \_\_\_\_\_, 688 P.2d 170, 172 (1984) (en banc); *Pugh v. See's Candies, Inc.*, 116 Cal. App. 3d 311, 326, 171 Cal. Rptr. 917, 925 (1980); *Toussaint v. Blue Cross & Blue Shield*, 408 Mich. 579, 600, 292 N.W.2d 880, 885 (1980); *Pine River State Bank v. Mettelle*, 333 N.W.2d 622, 629 (Minn. 1983); *Weiner v. McGraw-Hill, Inc.*, 57 N.Y.2d 458, 466-67, 443 N.E.2d 441, 446, 457 N.Y.S.2d 193, 198 (1982); RESTATEMENT (SECOND) OF AGENCY § 442 (1971).

47. *Darlington v. General Elec.*, 350 Pa. Super. 183, \_\_\_\_\_, 504 A.2d 306, 314 (1986) (emphasis in original). The court further explained:

Even so, the at-will presumption would be overcome. On the other hand, if the parties specifically agreed that the employment would be *at-will*, even though additional consideration were present, we would expect a court to construe the contract according to the parties' stated intention and hold it to be at-will. Thus, we start with the usual at-will presumption which, let us say, has not been overcome by evidence of a contract for a term or for a reasonable length of time. Then, if sufficient additional consideration is



For those courts that still require independent consideration to render an employer's promise of job security binding, however, a complex derivative issue has been determining the nature of the conduct by an employee which may be characterized as "additional" consideration. The services for which the employee was hired obviously constitute the initial consideration for contract formation.

It is a highly artificial and dubious analysis, however, to distinguish between the consideration necessary for formation of an employment contract and "additional" consideration, apart from the services to be performed, as a requirement for an employment contract which may not be terminable at-will. This problematic dichotomy requires courts to engage in fine line-drawing as to whether or not, for example, longevity of service,<sup>48</sup> foregoing other employment opportunities,<sup>49</sup> or relocating to take the new position<sup>50</sup> would satisfy the additional consideration test. As a result, the court decisions will continue to reach inconsistent and unpredictable results. Therefore, the better approach would be to eliminate the independent consideration requirement as a basis for a "just cause" standard for discharge, and to limit its application to a rule of construction to ascertain the intentions of the parties concerning job security.

## 2. Mutuality of Obligation

In addition to the issue regarding the independent consideration requirement, courts have disagreed as to whether job security provisions in employee

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present, the law presumes this to be sufficient to rebut the at-will presumption. Such a contract could not be rightfully terminated at-will but would continue for a reasonable length of time. 56 C.J.S. *Master and Servant* § 31. However, the presumption created by the additional consideration rule could itself be rebutted by evidence that the parties specifically contracted for employment at-will.

*Id.* at —, 504 A.2d at 314 (emphasis in original).

48. See *Roberts v. Atlantic Richfield Co.*, 88 Wash. 2d 887, 895, 568 P.2d 764, 769 (1977) (en banc). *Contra Pugh v. See's Candies, Inc.*, 116 Cal. App. 3d 311, 327, 171 Cal. Rptr. 917, 925 (1981); see also *Perry v. Sindermann*, 408 U.S. 593, 601-03 (1972).

49. See *Roberts v. Atlantic Richfield Co.*, 88 Wash. 2d 887, 895-96, 568 P.2d 764, 769 (1977) (en banc). *Contra McNulty v. Borden, Inc.*, 474 F. Supp. 1111, 1119 (E.D. Pa. 1979); *Eklund v. Vincent Brass & Aluminum Co.*, 351 N.W.2d 371, 377 (Minn. Ct. App. 1984); *Weiner v. McGraw-Hill, Inc.*, 57 N.Y.2d 458, 465, 443 N.E.2d 441, 445, 457 N.Y.S.2d 193, 197 (1982); see also *Helle v. Landmark, Inc.*, 15 Ohio App. 3d 1, 10-11, 472 N.E.2d 765, 775 (1984) (whether employee actually considered other opportunities for employment was irrelevant).

50. See *Foley v. Community Oil Co.*, 64 F.R.D. 561, 563 (D.N.H. 1974); *Murphree v. Alabama Farm Bureau Ins. Co.*, 449 So. 2d 1218, 1221 (Ala. 1984). *Contra Griffith v. Sollay Found. Drilling, Inc.*, 373 So. 2d 979, 982 (La. Ct. App. 1979).

manuals should be unenforceable on grounds of lacking "mutuality of obligation." The doctrine of mutuality of obligation in essence provides that neither party to a contract will be bound unless both parties are bound.<sup>51</sup> A steadily dwindling number of courts which have followed the mutuality theory have held that in an employment contract for an indefinite term, the at-will employee has made no binding promise to continue working; therefore, the employer correspondingly has unfettered discretion to terminate the employment relationship.<sup>52</sup>

Mutuality of obligation, however, has been expressly rejected by the Restatement (Second) of Contracts,<sup>53</sup> and should not be considered as an essential element to a binding contract.<sup>54</sup> In *Cleary v. American Airlines, Inc.*,<sup>55</sup> for example, the court attempted to circumscribe the mutuality of obligation underpinnings to the at-will rule in California by reasoning:

The absolute power conferred by Labor Code section 2922 on an employer to discharge the at-will employee without cause is founded on the contractual concept of mutuality of obligation. The reasoning is that, since an employee may terminate the employment relationship when he wishes to do so, the employer is entitled to terminate the relationship at his pleasure. However, when viewed in the context of present-day economic reality and the joint, reasonable expectations of employers and their employees, the "freedom" bestowed by the rule of law on the employee may indeed be fictional. As the case law interpreting Labor Code section 2922 demonstrates, the rule applied in its purest form easily leads to harsh results for the employee.<sup>56</sup>

Rather than evaluating the enforceability of the employment contract in terms of mutuality, the better reasoned view should be to inquire whether or not consideration is present when the at-will employment contract is formed.<sup>57</sup>

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51. *Pine River State Bank v. Mettille*, 333 N.W.2d 622, 629 (Minn. 1983); *Helle v. Landmark, Inc.*, 15 Ohio App. 3d 1, 12, 472 N.E.2d 765, 776 (1984).

52. See *Campbell v. Eli Libby & Co.*, 413 N.E.2d 1054, 1062 (Ind. Ct. App. 1980); *Hanson v. Central Show Printing Co.*, 256 Iowa 1221, 1228, 130 N.W.2d 654, 658 (1964).

53. Section 79 of the Restatement rejects mutuality of obligation by providing: "If the requirement of consideration is met, there is no additional requirement of a) a gain, advantage, or benefit to the promisor or a loss, disadvantage, or detriment to the promisee; or b) equivalence in the values exchanged; or c) 'mutuality of obligation.'" RESTATEMENT (SECOND) OF CONTRACTS § 79 (1981).

54. *Pine River State Bank v. Mettille*, 333 N.W.2d 622, 629 (Minn. 1983); *Weiner v. McGraw-Hill, Inc.*, 57 N.Y.2d 458, 465, 443 N.E.2d 441, 445, 457 N.Y.S.2d 193, 197 (1982).

55. 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980).

56. *Id.* at 448-49, 168 Cal. Rptr. at 725.

57. 1 A. CORBIN, CONTRACTS § 152, at 4-6, 14-16 (1960) states: Mutuality of obligation should be used solely to express the idea that each party is under a legal duty to the other; each has made a promise and each

Moreover, some courts have recognized that mutuality of obligation should apply, if at all, to an analysis of bilateral contracts where reciprocal promises are exchanged, and that the mutuality limitation does not make sense in the employment relationship involving a unilateral contract formulation.<sup>58</sup>

### C. *Unilateral Contract Analysis*

The most logical and internally consistent methodology for determining what particular promises of job security by an employer modify the em-

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is an obligor. . . . In order to save the supposed requirement of "mutuality," it is sometimes declared that it means nothing more than that there must be a sufficient consideration. Even though one of the parties has made no promise and is bound by no duty, the contract has sufficient mutuality if he has given an executed consideration. . . . Courts now often say correctly that it is consideration that is necessary, not mutuality of obligation. . . . There are, indeed, cases holding otherwise, in the belief that "both parties must be bound or neither one is bound," that for a valid contract there must be "mutuality of obligation" (or something called "mutuality"), and that if a contract is terminable "at will" by one party it is necessarily terminable "at will" by the other party also. These decisions can be found in considerable number; but the decisions to the contrary are far better considered, both in justice and in theory. This is not the first or only case in which juristic opinion has been confused and conflicting and in which substantial uniformity must be reached by trial and error.

*Id.*; see *Ryan v. J.C. Penney Co.*, 627 F.2d 836, 838 (7th Cir. 1980); *Eales v. Tanana Valley Medical-Surgical Group, Inc.*, 663 P.2d 958, 959 (Alaska 1983); *Toussaint v. Blue Cross & Blue Shield*, 408 Mich. 579, 600, 292 N.W.2d 880, 885 (1980); *Eklund v. Vincent Brass & Aluminum Co.*, 351 N.W.2d 371, 375 (Minn. Ct. App. 1984); *Helle v. Landmark, Inc.*, 15 Ohio App. 3d 1, 12, 472 N.E.2d 765, 776 (1984); see also *Pine River State Bank v. Mettelle*, 333 N.W.2d 622, 629 (Minn. 1983) (mutuality of obligation characterized as "simply a species of the forbidden inquiry into the adequacy of consideration").

58. *E.g.*, *Eales v. Tanana Valley Medical-Surgical Group, Inc.*, 663 P.2d 958, 958 (Alaska 1983); *Weiner v. McGraw-Hill, Inc.*, 57 N.Y.2d 458, 465, 443 N.E.2d 441, 445, 457 N.Y.S.2d 193, 197 (1982); *Helle v. Landmark, Inc.*, 15 Ohio App. 3d 1, 12, 472 N.E.2d 765, 776 (1984). The *Eales* court, quoting Corbin, stated:

[I]f the employer made a promise, either express or implied, not only to pay for the service but also that the employment should continue for a period of time that is either definite or capable of being determined, that employment is not terminable by him "at will" after the employee has begun or rendered some of the requested service or has given any other consideration (or has acted in reliance on the promise in such manner as to make applicable the rule in Restatement, Contracts, § 90). This is true even though the employee has made no return promise and has retained the power and legal privilege of terminating the employment "at will." The employer's promise is supported by the service that has been begun or rendered or by the other executed consideration or action in reliance. There is a valid unilateral contract; there is an obligation although there is no "mutuality of obligation."

*Eales*, 663 P.2d at 960 (quoting 1A A. CORBIN, CONTRACTS § 152, at 14 (1963)).

ployment at-will relationship is to characterize such promises as a unilateral contract formed through the traditional requisites of offer, acceptance and consideration.<sup>59</sup> Whether any particular promise of employment on certain terms may properly be characterized as an offer should be determined by the objective manifestations of the parties rather than by an employee's subjective understanding as to employment.<sup>60</sup> An employer's general statements of policy would not meet the contractual requirements for an offer.<sup>61</sup> An employee accepts the offer and supplies the necessary consideration by continuing to stay on the job after the employer has made the promises.<sup>62</sup> This approach follows the Restatement of Contracts section 80 comment a,<sup>63</sup> that a single performance may furnish consideration for multiple promises.<sup>64</sup>

The language contained in a particular employee handbook and the employer's course of conduct and representations regarding it should constitute the principal evidence relevant to whether the employment at-will relationship has been modified by the handbook provisions becoming implied-in-fact enforceable contractual promises.<sup>65</sup> Courts have considered a wide variety of factors to ascertain the terms of an implied employment contract, including the intent and expectations of the parties,<sup>66</sup> business cus-

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59. See *Pine River State Bank v. Mettille*, 333 N.W.2d 622, 626 (Minn. 1983); *Brookshaw v. South St. Paul Feed, Inc.*, 381 N.W.2d 33, 36 (Minn. Ct. App. 1986); *Woolley v. Hoffman-La Roche, Inc.*, 99 N.J. 284, —, 491 A.2d 1257, 1267 (1985); *Helle v. Landmark, Inc.*, 15 Ohio App. 3d 1, 8, 472 N.E.2d 765, 773 (1984); *Thompson v. St. Regis Paper Co.*, 102 Wash. 2d 219, 228-29, 685 P.2d 1081, 1087 (1984) (en banc).

60. See, e.g., *Allegrì v. Providence-St. Margaret Health Center*, 9 Kan. App. 2d 659, —, 684 P.2d 1031, 1036 (1984); *Sepanske v. Bendix Corp.*, 147 Mich. App. 819, 827, 384 N.W.2d 54, 58 (1985); *Pine River State Bank v. Mettille*, 333 N.W.2d 622, 626 (Minn. 1983); *Thompson v. St. Regis Paper Co.*, 102 Wash. 2d 219, 224, 685 P.2d 1081, 1085 (1984); *Roberts v. Atlantic Richfield Co.*, 88 Wash. 2d 887, 894, 568 P.2d 764, 769 (1977) (en banc); *Parker v. United Airlines, Inc.*, 32 Wash. App. 722, 725, 649 P.2d 181, 183 (1982); see also *Helle v. Landmark, Inc.*, 15 Ohio App. 3d 1, 8-9, 472 N.E.2d 765, 773-74 (1984) (court followed RESTATEMENT (SECOND) OF CONTRACTS § 4 (1979) in holding that oral representations of severance pay made by the employer's agents constituted promissory representations or offers sufficient to bind the employer).

61. *Pine River State Bank v. Mettille*, 333 N.W.2d 622, 626 (Minn. 1983); *Helle v. Landmark, Inc.*, 15 Ohio App. 3d 1, 9, 472 N.E.2d 765, 773 (1984).

62. *Pine River*, 333 N.W.2d at 627; *Helle*, 15 Ohio App. 3d at 11, 472 N.E.2d at 775.

63. See *supra* note 42.

64. See *Pine River*, 333 N.W.2d at 627; *Helle*, 15 Ohio App. 3d at 11, 472 N.E.2d at 775.

65. *Leikvold v. Valley View Community Hosp.*, 141 Ariz. 544, —, 688 P.2d 170, 174 (1984).

66. *Roberts v. Atlantic Richfield Co.*, 88 Wash. 2d 887, 894, 568 P.2d 764, 769 (1977); see also *Wiskotoni v. Michigan National Bank-West*, 716 F.2d 378, 386 (6th Cir. 1983); *Wagenseller v. Scottsdale Memorial Hosp.*, 147 Ariz. 370, —, 710

tom and usage,<sup>67</sup> the nature of the employment,<sup>68</sup> assurances of continued employment by the employer,<sup>69</sup> longevity of service,<sup>70</sup> satisfactory performance evaluations received by the employee,<sup>71</sup> and whether the employee has left another job in alleged reliance upon job security assurances given by the new employer.<sup>72</sup>

Courts have split on whether an employee must prove his reliance on company policies and procedures in order to have them incorporated into his employment contract. Reliance should be presumed equally for all employees in order to prevent the fortuity of discovery of terms in an employee handbook from becoming controlling. Also, the employee would be placed in an evidentiary dilemma of proving his reliance on the assurances of job security.

For example, in *Corbin v. Sinclair Marketing, Inc.*,<sup>73</sup> the court stated that employee handbooks or policy manuals containing specific procedures

P.2d 1025, 1037 (1985); *Toussaint v. Blue Cross & Blue Shield*, 408 Mich. 579, 599, 292 N.W.2d 880, 885 (1980); *Arie v. Intertherm, Inc.*, 648 S.W.2d 142, 153-54 (Mo. Ct. App. 1983); *Forrester v. Parker*, 93 N.M. 781, 782, 606 P.2d 191, 192 (1980); *Woolley v. Hoffman-La Roche, Inc.*, 99 N.J. 284, \_\_\_, 491 A.2d 1257, 1264-65 (1985); *Helle v. Landmark, Inc.*, 15 Ohio App. 3d 1, 7-9, 472 N.E.2d 765, 772-73 (1984); *Parker v. United Airlines, Inc.*, 32 Wash. App. 722, 725, 649 P.2d 181, 183 (1982); *Mobil Coal Producing, Inc. v. Parks*, 704 P.2d 702, 707 (Wyo. 1985). *But see Muller v. Stromberg Carlson Corp.*, 427 So. 2d 266, 268 (Fla. Dist. Ct. App. 1983) (expectations held insufficient to create a binding term of employment).

67. *Wiskotoni v. Michigan National Bank-West*, 716 F.2d 378, 386 (6th Cir. 1983); *Pugh v. See's Candies, Inc.*, 116 Cal. App. 3d 311, 327, 171 Cal. Rptr. 917, 926 (1981); *Eklund v. Vincent Brass & Aluminum Co.*, 351 N.W.2d 371, 376 (Minn. Ct. App. 1984); *Roberts v. Atlantic Richfield Co.*, 88 Wash. 2d 887, 894, 568 P.2d 764, 769 (1977); *Parker v. United Airlines, Inc.*, 32 Wash. App. 722, 725, 649 P.2d 181, 183 (1982).

68. *Roberts v. Atlantic Richfield Co.*, 88 Wash. 2d 887, 894, 568 P.2d 764, 769 (1977); *Parker v. United Airlines, Inc.*, 32 Wash. App. 722, 725, 649 P.2d 181, 183 (1982).

69. *Pugh v. See's Candies, Inc.*, 116 Cal. App. 3d 311, 327, 171 Cal. Rptr. 917, 933 (1981); *Toussaint v. Blue Cross & Blue Shield*, 408 Mich. 579, 613, 292 N.W.2d 880, 892 (1980); *Rowe v. Noren Pattern & Foundry Co.*, 91 Mich. App. 254, 259-60, 283 N.W.2d 713, 716-17 (1979); *Weiner v. McGraw-Hill, Inc.*, 57 N.Y.2d 458, 465, 443 N.E.2d 441, 445, 457 N.Y.S.2d 193, 197 (1982).

70. *Pugh v. See's Candies, Inc.*, 116 Cal. App. 3d 311, 328, 171 Cal. Rptr. 917, 926 (1981); *Cleary v. American Airlines, Inc.*, 111 Cal. App. 3d 443, 456, 168 Cal. Rptr. 722, 729 (1980); *Allegri v. Providence-St. Margaret Health Center*, 9 Kan. App. 2d 659, \_\_\_, 684 P.2d 1031, 1036 (1984).

71. *Kistler v. Life Care Centers of America, Inc.*, 620 F. Supp. 1268, 1270 (D. Kan. 1985); *Allegri v. Providence-St. Margaret Health Center*, 9 Kan. App. 2d 659, \_\_\_, 684 P.2d 1031, 1036 (1984). *Contra Gordon v. Matthew Bender & Co.*, 562 F. Supp. 1286, 1291 (N.D. Ill. 1983).

72. *Allegri v. Providence-St. Margaret Health Center*, 9 Kan. App. 2d 659, \_\_\_, 684 P.2d 1031, 1036 (1984); *Rowe v. Noren Pattern & Foundry Co.*, 91 Mich. App. 254, 263, 283 N.W.2d 713, 718 (1979).

73. 684 P.2d 265 (Colo. Ct. App. 1984).

for termination of employment would give rise to a contractual duty on the part of the employer to comply with the procedures only if relied upon by the employee and supported by the consideration of continued service.<sup>74</sup> In *Southwest Gas Corp. v. Ahmad*,<sup>75</sup> the court considered evidence that the employee had knowledge of the termination provisions of a handbook as supportive of an inference that the handbook constituted part of their employment contract.<sup>76</sup> Conversely, in *Wagenseller v. Scottsdale Memorial Hospital*,<sup>77</sup> the court stated that an employee's reliance on a personnel manual provision was just one of several factors, including the language of the provision, the employer's course of conduct, and oral representations regarding the policy that were relevant in determining whether the parties intended to modify an employment at-will relationship.<sup>78</sup>

In *Thompson v. St. Regis Paper Co.*,<sup>79</sup> the court held that when an employer issues a policy manual with specific promises of job security and fair treatment, employees may justifiably rely on those representations as enforceable provisions of the employment contract:

It would appear that employers expect, if not demand, that their employees abide by the policies expressed in such manuals. This may create an atmosphere where employees justifiably rely on the expressed policies and, thus, justifiably expect that the employers will do the same. Once an employer announces a specific policy or practice, especially in light of the fact that he expects employees to abide by the same, the employer may not treat its promises as illusory.<sup>80</sup>

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74. *Id.* at 267.

75. 99 Nev. 594, 668 P.2d 261 (1983).

76. *Id.* Also, in *Pine River State Bank v. Mettille*, 333 N.W.2d 622, 627 (Minn. 1983), the court stated that: "In the case of unilateral contracts for employment, where an at-will employee retains employment with knowledge of new or changed conditions, the new or changed conditions may become a contractual obligation."

77. 147 Ariz. 370, 710 P.2d 1025 (1985).

78. *Id.* at —, 710 P.2d at 1038.

79. 102 Wash. 2d 219, 685 P.2d 1081 (1984).

80. *Id.* at 230, 685 P.2d at 1088. The court further stated:

Therefore, we hold that if an employer, for whatever reason, creates an atmosphere of job security and fair treatment with promises of specific treatment in specific situations and an employee is induced thereby to remain on the job and not actively seek other employment, those promises are enforceable components of the employment relationship. We believe that by his or her unilateral objective manifestation of intent, the employer creates an expectation, and thus an obligation of treatment in accord with those written promises. See RESTATEMENT (SECOND) OF CONTRACTS § 2 (1981) (promise is a manifestation of intention to act or refrain from acting in a specified way, so made as to justify a promise in understanding a commitment has been made).

*Id.*

The court in *Thompson* also cited the Michigan Supreme Court in *Toussaint*

Finally, in *Woolley v. Hoffman-La Roche, Inc.*,<sup>81</sup> the court took the position that reliance by an employee on an employer's personnel policies would be presumed in order to protect the rights of all employees.<sup>82</sup> The court explained that presuming reliance would make the personnel policies with respect to job security binding on the employer at the time the manual is distributed. Thus, employees hired before or after dissemination of the policies would equally benefit, irrespective of their reliance on the policies, just as union members benefit from collective-bargaining agreements regardless of their individual degree of reliance on its terms.<sup>83</sup> The treatment of the reliance issue by the court in *Woolley* makes the most sense from a pragmatic standpoint. Reliance should be presumed equally for at-will employees; otherwise, employees will have different levels of job security based upon the same "promises" by an employer.

Just as courts have split over the enforceability of employer policies depending on an employee's reliance, courts also have disagreed as to the timing of when a policy becomes binding and whether it applies to employees retroactively. Several courts have held that policy manuals distributed to employees after they were hired did not constitute a part of the employment contract.<sup>84</sup> These courts have reasoned that the manuals merely reflect a unilateral expression of company policies and procedures, the terms were not bargained for, and no meeting of the minds existed.<sup>85</sup> Moreover, the pro-

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v. *Blue Cross & Blue Shield*, 408 Mich. 579, 613, 292 N.W.2d 880, 894 (1980), for the proposition that an employer distributing a personnel manual to employees creates an expectation of compliance, or an "instinct with an obligation." Thus, some measure of reliance on the policies by employees seems apparently required in order to render the promises enforceable. However, the court in *Toussaint* specifically stated that it was unnecessary for the employee even to demonstrate knowledge of the policies, and ipso facto did not require reliance. *Toussaint*, 408 Mich. at 613, 292 N.W.2d at 892.

81. 99 N.J. 284, 491 A.2d 1257 (1985).

82. *Id.* at 295, 491 A.2d at 1268. The court in *Woolley* stated:

If reliance is not presumed, a strict contractual analysis might protect the rights of some employees and not others. For example, where an employee is not even aware of the existence of the manual, his or her continued work would not ordinarily be thought of as the bargained-for detriment. Similarly, if it is quite clear that those employees who knew of the offer knew that it sought their continued work, but nevertheless continued without the slightest intention of putting forth that action as consideration for the employer's promise, it might not be sufficient to form a contract.

*Id.* at 295 n.10, 491 A.2d at 1268 n.10 (citations omitted).

83. *Id.*

84. See, e.g., *Heideck v. Kent General Hosp.*, 446 A.2d 1095, 1097 (Del. 1982); *Johnson v. National Beef Packing Co.*, 220 Kan. 52, 55, 551 P.2d 779, 782 (1976); *Gates v. Life of Montana Ins. Co.*, 196 Mont. 178, 183, 638 P.2d 1063, 1066 (1982).

85. See *National Beef Packing Co.*, 220 Kan. at 55, 551 P.2d at 782; *Gates*, 196 Mont. at 183, 638 P.2d at 1066.

visions could not amount to a modification of the initial employment contract because the employee supplied no new and independent consideration for its terms.<sup>86</sup>

A better reasoned view is that personnel handbooks issued after employment begins may nevertheless become part of an employment contract.<sup>87</sup> The emphasis in decisions adopting such a view is not the fortuity of whether a policy is distributed before or after a particular employee is hired, but rather that the employer expects all employees to abide by the circulated policies and thus has created an expectation on behalf of employees that the terms are applicable.<sup>88</sup>

The language contained in an employee handbook or manual must be evaluated as to its contractual significance in light of the objective purpose intended by the employer. If the employer intended the provisions to serve merely as guidelines to inform employees of normative conduct, then courts should be disinclined to translate the provisions into enforceable contract rights. On the other hand, if the statements objectively may be viewed as requiring certain employee actions, then the terms begin to sound like contractual promises. Courts may be guided by some of the following factors in making that determination: the specificity of the language, the present or future tense of conduct described, the extent of distribution and attention called to the manual, words which prohibit or mandate actions, and any remedial consequences identified. As an illustration, assume that an employer distributes an employee handbook to all employees as part of the initial acclimation process and stresses that employees are responsible to read, keep possession of, and insert updates into the manual. Further assume that the manual contained a section entitled "Grievance and Termination Procedures" which outlines a six stage procedure for handling complaints or discharges concerning employees. If an employer failed to follow the stated procedures, it would be anomalous to contend that the provisions objectively lacked significance as implied-in-fact contractual terms. Such an approach is supported by the widely accepted proposition that any ambiguity in terms should be construed against the employer as the party who caused the uncertainty.<sup>89</sup>

#### D. *Disclaimers*

A number of courts which have found that implied promises of job security or procedural safeguards contained in an employee manual may be

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86. See *National Beef Packing Co.*, 220 Kan. at 55, 551 P.2d at 782; *Gates*, 196 Mont. at 183, 638 P.2d at 1066.

87. See *Pine River State Bank v. Mettelle*, 333 N.W.2d 622, 627 (Minn. 1985); *Mobil Coal Producing, Inc. v. Parks*, 704 P.2d 702, 704-06 (Wyo. 1985).

88. E.g., *Thompson v. St. Regis Paper Co.*, 102 Wash. 2d 219, 230, 685 P.2d 1081, 1088 (1984).

89. *Cavalier County Memorial Hosp. v. Kartes*, 343 N.W.2d 781, 784 (N.D. 1984).



enforceable against an employer, even when employment is for an indefinite term and would otherwise be at-will, have provided employers an escape hatch through the use of disclaimers.<sup>90</sup> In essence, these courts have held that when an employer does not issue a personnel manual at all, or distributes one with language of limitation, then expectations of performance are not created and employees have no justifiable reason to rely on representations in the manual.<sup>91</sup>

Although the case law interpreting the effectiveness of disclaimers in the implied-in-fact employment contract setting has been fairly minimal, it has spawned a number of troublesome issues. As a threshold matter, a large part of the confusion may stem from the term "disclaimer" itself. The concept of disclaiming something necessarily suggests that certain substantive rights which otherwise would belong to one party are either limited or erased as a result of the disclaimer. The source of those rights could be contractual or statutory, such as may be found in the U.C.C. provisions regarding warranties for the sale of goods.<sup>92</sup> However, in the context of the at-will employment contract, calling such limiting language a disclaimer is a misnomer and inartful because the provision does not modify or extinguish existing rights otherwise possessed by an at-will employee. Rather, the "disclaimer" functions to temper statements concerning such topics as job security or the observance of certain procedures by an employer so that such statements do not become promises implied into the employment contract.

The importance of the distinction between extinguishing existing rights and preventing such rights from arising in the first place is illustrated by the problems resulting from the inexact usage of the term "disclaimer." For instance, the following application problems may arise when an employer attempts to erase a previously enunciated promise through the use of a deftly phrased disclaimer: determining to what extent the disclaimer must be "conspicuous," deciding whether other oral or written representations may negate its effect, ascertaining the extent of a particular employee's reliance on the terms of the promise, and determining whether the disclaimer is valid if it is made after the distribution of a manual containing promises of job security.

The courts which have accepted the effectiveness of disclaimers in implied-in-fact contracts of employment premise their analysis on the idea that

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90. See, e.g., *Leikvold v. Valley View Community Hosp.*, 141 Ariz. 544, \_\_\_\_, 688 P.2d 170, 174 (1984); *Toussaint v. Blue Cross & Blue Shield*, 408 Mich. 579, 618-19, 292 N.W.2d 880, 894-95 (1980); *Woolley v. Hoffman-La Roche, Inc.*, 99 N.J. 284, \_\_\_\_, 491 A.2d 1257, 1271 (1985); *Helle v. Landmark, Inc.*, 15 Ohio App. 3d 1, 10, 472 N.E.2d 765, 774-75 (1984); *Thompson v. St. Regis Paper Co.*, 102 Wash. 2d 219, 230-31, 685 P.2d 1081, 1088 (1984).

91. See *Leikvold v. Valley View Community Hosp.*, 141 Ariz. 544, \_\_\_\_, 688 P.2d 170, 174 (1984).

92. See U.C.C. §§ 2-313 to 2-316.

the at-will employee has no expectation of job security and therefore cannot justifiably rely on the policies and procedures stated.<sup>93</sup> Courts have not articulated a clear standard, however, as to the nature and extent to which employees must demonstrate knowledge of or reliance on the employer's policies. Indeed, a leading Michigan case, *Toussaint v. Blue Cross & Blue Shield*,<sup>94</sup> advanced inconsistent arguments in support of finding an implied-in-fact contract modification. The court reached its result based on the expectation of performance created by the employer's distribution of a handbook containing certain job security provisions, implying some requisite awareness or knowledge of those provisions by employees. On the other hand, the court took the additional position that employer statements of policy can give rise to contractual rights in employees even if the employees know nothing of the policies, or that the employer can change them unilaterally and without notice.<sup>95</sup> If reliance is demanded by a court, then the employee's knowledge of the policies becomes essential and the language, location and conspicuousness of disclaiming statements becomes significant. If reliance is presumed, however, or eliminated altogether as a requisite for contractual analysis, then disclaimers are irrelevant.

Similarly, in *Woolley v. Hoffman-La Roche, Inc.*,<sup>96</sup> the court indicated that if an employer does not want a policy manual to be construed as a binding contract, then it must simply include a statement in the manual that no promises are being made.<sup>97</sup> The court failed to reconcile that position, however, with its statements that reliance by employees was to be presumed under the circumstances.<sup>98</sup>

Several courts have indicated that a disclaimer of promises of job security must be "conspicuous"<sup>99</sup> or in a "very prominent position"<sup>100</sup> without explaining what satisfies that requirement. Section 2-316(2) of the U.C.C., which requires that disclaimers of implied warranties in the sale of goods

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93. See *Leikvold v. Valley View Community Hosp.*, 141 Ariz. 544, \_\_\_\_, 688 P.2d 170, 174 (1984); *Toussaint v. Blue Cross & Blue Shield*, 408 Mich. 579, 619, 292 N.W.2d 880, 894-95 (1980); *Thompson v. St. Regis Paper Co.*, 102 Wash. 2d 219, 230-31, 685 P.2d 1081, 1088 (1984).

94. 408 Mich. 579, 292 N.W.2d 880 (1980).

95. *Id.* at 614-15, 292 N.W.2d at 892.

96. 99 N.J. 284, 491 A.2d 1257 (1985).

97. *Id.* at 298, 491 A.2d at 1271.

98. *Id.* at 293, 491 A.2d at 1268. Indeed, the court acknowledged that, "If reliance is not presumed, a strict contractual analysis might protect the rights of some employees and not others. For example, where an employee is not even aware of the existence of the manual, his or her continued work would not ordinarily be thought of as the bargained-for detriment." *Id.* at \_\_\_\_, 491 A.2d at 1268 n.10.

99. *E.g.*, *Thompson v. St. Regis Paper Co.*, 102 Wash. 2d 219, 230-31, 685 P.2d 1081, 1088 (1984).

100. *E.g.*, *Woolley v. Hoffman-La Roche Inc.*, 99 N.J. 284, \_\_\_\_, 491 A.2d 1257, 1271 (1985).

must be conspicuous,<sup>101</sup> may provide guidance as to the interpretation problems presented by disclaimers in employment manuals. Section 1-201(10) defines "conspicuous" as follows:

A term or clause is conspicuous when it is so written that a reasonable person against whom it is to operate ought to have noticed it. A printed heading in capitals (as: NON-NEGOTIABLE BILL OF LADING) is conspicuous. Language in the body of a form is "conspicuous" if it is in larger or other contrasting type of color. But in a telegram any stated term is "conspicuous." Whether a term or clause is "conspicuous" or not is for decision by the court.

Comment 10 to section 1-201(10) states that the test of "conspicuous" is "whether attention can reasonably be expected to be called to it." This attention-calling litmus test has resulted in varied interpretations by courts, including focusing on the capitalization, typeface, bargaining position of the parties, and location of the disclaimer.<sup>102</sup> It is a *non sequitur*, though, for a court to hold that a contract of employment may be modified by an employer's distribution of a policy manual irrespective of knowledge or reliance by employees, while holding that a disclaimer eviscerating those same promises would be effective if "conspicuous."

In addition to determining whether a particular disclaimer statement in an employee handbook is "conspicuous," a potential problem exists as to the timing of when a disclaimer is distributed to employees. As an illustration, a number of courts have held that a disclaimer of implied warranties is ineffective when made after the parties have entered a bargain for the sale of goods.<sup>103</sup> Therefore, assuming that the employment-at-will contract is modifiable by the distribution of a personnel handbook, then an employer may not limit promises made in the handbook by printing a subsequent disclaimer. Moreover, in *Helle v. Landmark, Inc.*,<sup>104</sup> the court held that an employer's oral representations of severance pay which conflicted with a personnel manual disclaimer regarding deviation from company policies, or which caused the employees to disregard the significance of such policies, negated the effect

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101. Section 2-316(2) of the U.C.C. provides:

Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that "There are no warranties which extend beyond the description on the face hereof."

U.C.C. § 2-316(2) (1976).

102. J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* § 12-5, at 440-44 (2d ed. 1980).

103. See generally *id.* at 445-46.

104. 15 Ohio App. 3d 1, 472 N.E.2d 765 (1984).

of the disclaimer.<sup>105</sup> In order for subsequently distributed disclaimers to modify at-will employment contracts, the employer and employee must satisfy the requisites of contract modification. The requirements are demonstrated by analogy in U.C.C. section 2-209.<sup>106</sup>

### III. GOOD FAITH AND FAIR DEALING

Hamlet: What's the news?

Rosencrantz: None, my lord, but that the world's grown honest.

Hamlet: Then is doomsday near: but your news is not true.

“Hamlet” Act II, Scene 2.

#### A. *The Context: Employer Discretion vs. Employee Protection*

The absolute right of an employer to discharge an at-will employee has been curtailed in some jurisdictions by judicial recognition of an implied covenant of good faith and fair dealing in the employment contract.<sup>107</sup> The

105. *Id.* at 10, 472 N.E.2d at 775.

106. Section 2-209 of the U.C.C. provides:

(1) An agreement modifying a contract within this Article needs no consideration to be binding.

(2) A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by the merchant must be separately signed by the other party.

(3) The requirements of the statute of frauds section of this Article (Section 2-201) must be satisfied if the contract as modified is within its provisions.

(4) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2) or (3) it can operate as a waiver.

(5) A party who has made a waiver affecting an executory portion of the contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.

U.C.C. § 2-209 (1976); *see also* *Helle v. Landmark, Inc.*, 15 Ohio App. 3d 1, 13, 472 N.E.2d 765, 777 (1984). According to Corbin, the employer's offered promise becomes irrevocable by him as soon as the employee has rendered any substantial service in the process of accepting; and this is true in spite of the fact that the employee may be privileged to quit the service at any time.” 1A A. CORBIN, CONTRACTS § 153, at 19-20 (1960).

107. *See, e.g.*, *Mitford v. de Lasala*, 666 P.2d 1000, 1007 (Alaska 1983); *Wagenseller v. Scottsdale Memorial Hosp.*, 147 Ariz. 370, —, 710 P.2d 1025, 1040 (1985); *Cleary v. American Airlines, Inc.*, 111 Cal. App. 3d 443, 453, 168 Cal. Rptr. 722, 727-28 (1980); *Magnan v. Anaconda Indus.*, 193 Conn. 558, 567-69, 479 A.2d 781, 786-87 (1984); *Fortune v. National Cash Register Co.*, 373 Mass. 96, 103-04, 364 N.E.2d 1251, 1256-57 (1977); *Gates v. Life of Montana Ins. Co.*, 196 Mont. 178, 185, 638 P.2d 1063, 1066 (1982).

covenant is implied-in-law through the fiction of quasi-contract,<sup>108</sup> as distinguished from implied-in-fact provisions which may be found in employee handbooks or policy manuals. The obligation is imposed by law, apart from or even contrary to the intentions of the employer and employee, for the purpose of avoiding injustice in a bad faith discharge.<sup>109</sup> The essence of the implied good faith covenant is that neither party must do anything that would injure or destroy the right of the other party to receive the benefits which flow from their agreement or contractual relationship.<sup>110</sup>

At least five divergent approaches to the role of good faith in the employment relationship have developed, with particular catalyzing force in California and Massachusetts. The approaches include (1) finding that the implied good faith and fair dealing covenant is breached if an employer terminates an at-will employee with the wrongful intent of depriving the employee of accrued or vested benefits, such as earned commissions,<sup>111</sup> (2) determining that the good faith covenant is implicated where a discharge runs afoul of public policy,<sup>112</sup> (3) holding that the duration of employment, together with special reliance by the employee, justifies implying the good faith covenant,<sup>113</sup> (4) recognizing that the covenant of good faith is implied in every contract, including employment agreements, (although recognizing that the covenant does not create a duty that the employer terminate the employee only for good cause).<sup>114</sup> The fifth, and most restrictive view, is that courts will not imply a covenant of good faith into the at-will relationship because of an unwillingness to predicate liability upon an inquiry into the amorphous concept of bad faith.<sup>115</sup> In short, although the underlying ra-

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108. *Wagenseller v. Scottsdale Memorial Hosp.*, 147 Ariz. 370, —, 710 P.2d 1025, 1038 (1985); *Fireman's Ins. Co. v. Antol*, 14 Ohio App. 3d 428, 429, 471 N.E.2d 831, 833 (1984).

109. *See Gates v. Life of Montana Ins. Co.*, 196 Mont. 178, —, 638 P.2d 1063, 1067 (1982).

110. *See Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 658, 328 P.2d 198, 200 (1958); *Fortune v. National Cash Register Co.*, 373 Mass. 96, 104, 364 N.E.2d 1251, 1257 (1977); *Hall v. Farmers Ins. Exch.*, 713 P.2d 1027, 1029-30 (Okla. 1985).

111. *E.g.*, *Mitford v. de Lasala*, 666 P.2d 1000, 1007 (Alaska 1983); *Fortune v. National Cash Register Co.*, 373 Mass. 96, 103-04, 364 N.E.2d 1251, 1256-57 (1977); *Hall v. Farmers Ins. Exch.*, 713 P.2d 1027, 1031 (Okla. 1985).

112. *E.g.*, *Wynn v. Boeing Military Airplane Co.*, 595 F. Supp. 727, 729 (D. Kan. 1984); *Cort v. Bristol-Myers Co.*, 385 Mass. 300, 303, 431 N.E.2d 908, 910 (1982); *see also Howard v. Dorr Woolen Co.*, 120 N.H. 295, 414 A.2d 1273 (1980); *Crowell v. Transamerica Delaval Inc.*, 206 N.J. Super. 298, 502 A.2d 573 (1984).

113. *E.g.*, *Cleary v. American Airlines, Inc.*, 111 Cal. App. 3d 443, 454, 168 Cal. Rptr. 722, 729 (1980).

114. *E.g.*, *Wagenseller v. Scottsdale Memorial Hosp.*, 147 Ariz. 370, —, 710 P.2d 1025, 1040 (1985); *Magnan v. Anaconda Indus.*, 193 Conn. 558, 566-67, 479 A.2d 781, 786 (1984).

115. *See Gordon v. Matthew Bender & Co.*, 562 F. Supp. 1286, 1290 (N.D.

tionale of protecting employees from overreaching employers demonstrates sympathy for implied-in-law contract rights, application of the various good faith methodologies to employment contracts has been inconsistent and confusing.

Courts ascribing to the fourth and fifth approaches noted above have declined to imply the covenant of good faith as a limit on managerial discretion over the workplace. These courts have stumbled over two critical distinctions, one semantic and the other substantive. The threshold semantic distinction lies in differentiating between a "good cause" or "just cause" standard for dismissal and the "good faith" standard. The former, highlighted in Professor Summers' criticism of the at-will rule,<sup>116</sup> have well developed substantive and procedural connotations applicable to collective bargaining agreements and statutory rights of public sector employees. The covenant of good faith, in contrast, is implied by law to effectuate the intentions of private contracting parties in the performance of their agreement.<sup>117</sup> The difference has been recognized by at least one court, which stated "Where the employee has secured a promise not to be discharged except for cause, he has contracted for more than the employer's promise to act in good faith or not to be unreasonable."<sup>118</sup>

Although several commentators have urged courts to adopt a "just cause" standard for dismissals of at-will employees,<sup>119</sup> such a radical departure from the common law is unnecessary. Rather than completely discarding the at-will rule as a historical anachronism, the rule should be reformulated to curb discharges made in bad faith.

The substantive distinction concerning the good faith covenant involves characterization of an at-will employee's expectation of job security. Courts which have rejected the good faith covenant as a limitation of managerial discretion have pronounced a two step analysis: the covenant, being implied,

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Ill. 1983); *Muller v. Stromberg Carlson Corp.*, 427 So. 2d 266, 270 (Fla. Dist. Ct. App. 1983); *Parnar v. Americana Hotels, Inc.*, 65 Haw. 370, 377, 652 P.2d 625, 629 (1982); *Thompson v. St. Regis Paper Co.*, 102 Wash. 2d 219, 227, 685 P.2d 1081, 1086 (1984); *Brockmeyer v. Dunn & Bradstreet*, 113 Wis. 2d 561, 573, 335 N.W.2d 834, 840 (1983); *Mobil Coal Producing, Inc. v. Parks*, 704 P.2d 702, 704 (Wyo. 1985).

116. Summers, *Individual Protection Against Unjust Dismissal: Time for a Statute*, 62 VA. L. REV. 481, 499-501 (1976).

117. *Wagenseller v. Scottsdale Memorial Hosp.*, 147 Ariz. 370, —, 710 P.2d 1025, 1040 (1985).

118. *Toussaint v. Blue Cross & Blue Shield*, 408 Mich. 579, 623, 292 N.W.2d 880, 896 (1980).

119. See Peck, *Unjust Discharges from Employment: A Necessary Change in the Law*, 40 OHIO ST. L.J. 1, 4 (1979); Note, *Protecting At Will Employees Against Wrongful Discharge: The Duty to Terminate Only in Good Faith*, 93 HARV. L. REV. 1816, 1840 (1980); Note, *Employment At Will: Just Cause Protection Through Mandatory Arbitration*, 62 WASH. L. REV. 151, 163-66 (1987).

is not be read to contradict existing, bargained-for contractual terms; therefore, because the at-will contract provides for freedom of termination, the good faith covenant cannot abrogate the employer's discretion to fire the employee.<sup>120</sup>

This analysis, however, is critically flawed in two respects. First, the covenant of good faith and fair dealing does not, and logically could not, contradict any term in an employment contract because the function of the covenant is to safeguard existing contractual rights and to act as the source of a remedy if those rights are violated.

Secondly, the courts have too narrowly defined the at-will employee's expectancy interest in the employment contract. Although an at-will employee by definition has no justifiable expectation of either continued employment or application of a "good cause" standard upon discharge,<sup>121</sup> the employee should have a reasonable and protectable expectation not to be unfairly discharged for "bad cause."<sup>122</sup> Where an employer discharges an employee in bad faith the implied contractual covenant of good faith and fair dealing should be breached and the employee deserves compensation for an infringement upon his expectancy interest. If the covenant of good faith is simply a derivative principle which defines and modifies contractual duties<sup>123</sup> yet does not restrict terminations made in bad faith, absent public policy

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120. The court in *Murphy v. American Home Prods. Corp.*, 58 N.Y.2d 293, 304-05, 448 N.E.2d 86, 91, 461 N.Y.S.2d 232, 237 (1983), explained as follows: [T]he implied obligation is in aid and furtherance of other terms of the agreement of the parties. No obligation can be implied, however, which would be inconsistent with other terms of the contractual relationship. Thus, in the case now before us, plaintiff's employment was at will, a relationship in which the law accords the employer an unfettered right to terminate the employment at any time. In the context of such an employment it would be incongruous to say that an inference may be drawn that the employer impliedly agreed to a provision which would be destructive of his right of termination. The parties may by express agreement limit or restrict the employer's right of discharge, but to imply such a limitation from the existence of an unrestricted right would be internally inconsistent. In sum, under New York law as it now stands, absent a constitutionally impermissible purpose, a statutory proscription or an express limitation in the individual contract of employment, an employer's right at any time to terminate an employment at will remains unimpaired.

121. See *Wagenseller v. Scottsdale Memorial Hosp.*, 147 Ariz. 370, \_\_\_, 710 P.2d 1025, 1040 (1985); *Magnan v. Anaconda Indus.*, 193 Conn. 558, 566-67, 479 A.2d 781, 786 (1984); *Murphy v. American Home Prods. Corp.*, 58 N.Y.2d 293, 304-05, 448 N.E.2d 86, 91, 461 N.Y.S.2d 232, 237 (1983); *Thompson v. St. Regis Paper Co.*, 102 Wash. 2d 219, 227, 685 P.2d 1081, 1086 (1984).

122. *Wynn v. Boeing Military Airplane Co.*, 595 F. Supp. 727, 729 (D. Kan. 1984); *Khanna v. Microdata Corp.*, 170 Cal. App. 3d 250, 262, 215 Cal. Rptr. 860, 867 (1985).

123. See *Gordon v. Matthew Bender & Co.*, 562 F. Supp. 1286, 1289 (N.D. Ill. 1983).

violations<sup>124</sup> or an employer receiving a financial windfall as a result of the discharge,<sup>125</sup> then it is a hollow covenant. The good faith covenant must be viewed as more than an ideal or a lofty goal. It is a specific contractual covenant which, if breached, should provide a remedy for the harmed employee.

A principled analysis should recognize an overriding policy against bad faith discharges. Within that policy are both tort and contract duties and their attendant remedies. The tort duty should be narrowly focused to remedy bad faith discharges where the discharge either contravenes an important expression of public policy or the circumstances surrounding the discharge reflect particularly offensive conduct on the part of the employer. The public policy exception to at-will discharges serves as a necessary and important check in the balance of employer-employee relations. Its policy underpinnings, however, are broader than the particular private employment contract involved because it is aimed at curtailing conduct which offends society as a whole.<sup>126</sup>

Secondly, the general policy against bad faith discharges should include potential contractual remedies for employer conduct which breaches the implied covenant of good faith and fair dealing. This covenant should protect the employee's expectancy, reliance, and restitutionary interests in not being deprived of the fruits of the employment contract.

Additional reasons for declining to read the good faith covenant into an at-will contract have been that it would open the floodgates of litigation and overburden courts,<sup>127</sup> that the at-will rule would be eviscerated,<sup>128</sup> and that bad faith is too amorphous.<sup>129</sup> Other reasons articulated have been an unwillingness to impose a judicial substitute for collective bargaining agreements,<sup>130</sup> and, closely allied, that the covenant of good faith would unrea-

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124. See *Magnan v. Anaconda Indus.*, 193 Conn. 558, 572, 479 A.2d 781, 789 (1984).

125. See *Wagenseller v. Scottsdale Memorial Hosp.*, 147 Ariz. 370, \_\_\_\_\_, 710 P.2d 1025, 1040 (1985).

126. See *Parnar v. Americana Hotels, Inc.*, 65 Haw. 370, 378, 652 P.2d 625, 630 (1982).

127. *Muller v. Stromberg Carlson Corp.*, 427 So. 2d 260, 269 (Fla. Dist. Ct. App. 1983); *Parnar v. Americana Hotels, Inc.*, 65 Haw. 370, 377, 652 P.2d 625, 629 (1982).

128. *Gordon v. Matthew Bender & Co.*, 562 F. Supp. 1286, 1290 (N.D. Ill. 1983).

129. *Parnar v. Americana Hotels, Inc.*, 65 Haw. 370, 377, 652 P.2d 625, 629 (1982); *Brockmeyer v. Dunn & Bradstreet*, 113 Wis. 2d 561, 569, 335 N.W.2d 834, 838 (1982).

130. *Thompson v. St. Regis Paper Co.*, 102 Wash. 2d 219, 228, 685 P.2d 1081, 1086 (1984).



sonably restrict employer discretion.<sup>131</sup> Thus, in *Thompson v. St. Regis Paper Company*,<sup>132</sup> the Supreme Court of Washington, with reference to the implied covenant of good faith and fair dealing, stated: "An employer's interest in running his business as he sees fit must be balanced against the interest of the employee in maintaining his employment and this exception does not strike the proper balance."<sup>133</sup> The potential economic ramifications of any perceived curtailment on employer discretion in discharging employees was bluntly expressed in one Tennessee lower court opinion:

[A]ny substantial change in the "employee-at-will" rule should first be microscopically analyzed regarding its effect on the commerce of this state. . . . Tennessee has made enormous strides in recent years in its attraction of new industry of high quality designed to increase the average per capita income of its citizens and thus, better the quality of their lives. The impact on the continuation of such influx of new businesses should be carefully considered before any substantial modification is made in the employee-at-will rule.<sup>134</sup>

Finally, as articulated in *Murphy v. American Home Products Corp.*,<sup>135</sup> some view any significant modification of the traditional at-will rule as properly left to the legislature:

It may well be that in the light of modern economic and social considerations radical changes should be made. As all of us recognize, however, resolution of the critical issues turns on identification and balancing of fundamental components of public policy. Recognition of an implied-in-law obligation of good faith as restricting the employer's right to terminate is as much a part of this matrix as is recognition of the tort action for abusive discharge. We are of the view that this aggregate of rights and obligations should not be approached piecemeal but should be considered in its totality and then resolved by the Legislature.<sup>136</sup>

Although comprehensive legislative action would certainly be desirable, it has not yet happened and it does not realistically appear to be forthcoming. Therefore, because the at-will doctrine was judicially created,<sup>137</sup> courts should be adequately equipped to provide a forum for changing the current inequities in the rule. The at-will rule does serve a useful function in the non-union workplace and should not be entirely discarded in favor of a system tantamount to universalizing collective-bargaining agreements or statutory public

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131. *Thompson v. St. Regis Paper Co.*, 102 Wash. 2d 219, 228, 685 P.2d 1081, 1086 (1984); *Brockmeyer v. Dunn & Bradstreet*, 113 Wis. 2d 561, 569, 335 N.W.2d 834, 838 (1983).

132. 102 Wash. 2d 219, 685 P.2d 1081 (1984).

133. *Id.* at 224, 685 P.2d at 1086.

134. *Whittaker v. Care-More, Inc.*, 621 S.W.2d 395, 396-97 (Tenn. Ct. App. 1981).

135. 58 N.Y.2d 293, 448 N.E.2d 86, 461 N.Y.S.2d 232 (1983).

136. *Id.* at 299 n.2, 448 N.E.2d at 92 n.2, 461 N.Y.S.2d at 238 n.2.

137. *See Parnar v. Americana Hotels, Inc.*, 65 Haw. 370, 652 P.2d 625 (1982).

sector employment rights. Recognition of the implied covenant of good faith and fair dealing, however, would not unduly interfere with normal managerial discretion because only firings made in bad faith would be proscribed. The fear of proliferating lawsuits against employers should go unrealized if courts have a clear framework and guidelines within which to evaluate meritorious claims concerning abusive discharge. Similarly, the proposed modification of the at-will rule should not present a severe economic disincentive to attract new industry when employer liability would be imposed only for bad faith treatment of employees. "Freedom of contract" surely was never intended to serve as a complete defense to overreaching or unfair treatment of the other party.

B. *The California Heritage: Confusion of Implied-in-Fact and Implied-in-Law Rights*

A special approach to the implied covenant of good faith and fair dealing in employment at-will relationships has developed in the California courts, principally during the last decade. Although California has codified the common law at-will rule,<sup>138</sup> courts have riddled the rule with exceptions.<sup>139</sup> Thus, current California law concerning the implied covenant of good faith is represented by several often contradictory trends. Because of the influence California law has had in the area of implied-in-law considerations affecting the at-will employee, it is instructive to review the historical progression and subsequent divergence of California judicial sentiment.

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138. CAL. LAB. CODE § 2922 (Supp. 1986) provides: "An employment, having no specified term, may be terminated at the will of either party on notice to the other. Employment for a specified term means an employment for a period of greater than one month."

139. California law recognizes three distinct exceptions to the employment at-will rule: (1) where the employee is wrongfully discharged for a reason which contravenes public policy, *Tameny v. Atlantic Richfield Co.*, 27 Cal. 3d 167, 172, 610 P.2d 1330, 1332, 164 Cal. Rptr. 839, 841 (1980); (2) the contract contains an implied-in-law covenant of good faith and fair dealing, *Cleary v. American Airlines, Inc.*, 111 Cal. App. 3d 443, 455, 168 Cal. Rptr. 722, 729 (1980); and (3) the employment contract embodies implied-in-fact promises which limit the employer's conduct in terminating an employee, *Pugh v. See's Candies, Inc.*, 116 Cal. App. 3d 311, 329, 171 Cal. Rptr. 917, 927 (1981). In *Koehrer v. Superior Court*, 181 Cal. App. 3d 1155, 1163, 226 Cal. Rptr. 820, 824 (1986), the court observed:

It would be conducive to proper analysis if courts and lawyers used a different nomenclature to denominate these different situations in which liability is imposed after all on different legal theories. Appropriate nomenclature might be "breach of employment contract" for the true breach of contract cases, "tortious discharge" for the public policy cases and "bad faith discharge" for the cases involving breach of the implied covenant of good faith and fair dealing.

An early expression of the role of the good faith covenant appeared in *Nelson v. Abraham*,<sup>140</sup> which involved whether a manager was entitled to an accounting and division of profits pursuant to an oral contract. Although the case did not involve termination of an at-will employee, it is significant in several respects. The California Supreme Court in *Nelson* recognized that every contract contained "an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the rights 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."<sup>141</sup> The court adopted this language from a 1933 New York Court of Appeals decision, *Kirke La Shelle v. Paul Armstrong Co.*,<sup>142</sup> which involved an agreement to share in profits from production of a play. In *Kirke La Shelle* and *Nelson* an important factor which implicated the covenant of good faith was the fiduciary relationship between the parties which originated in the contract itself.<sup>143</sup> This historical basis is significant in that, despite a common beginning, California courts later focused on the good faith covenant as a separate and independent basis of liability<sup>144</sup> while a recent influential New York decision held that the implied obligation modified the parties' agreement but was insufficient to alter the at-will relationship.<sup>145</sup>

A series of California Supreme Court decisions regarding the function of the implied covenant of good faith and fair dealing in insurance contracts also has established an important predicate for applying the covenant in employment relationships. In *Comunale v. Traders & General Insurance Co.*,<sup>146</sup> the court held that the implied covenant of good faith required the defendant insurance company to defend the insured and to accept reasonable settlement terms within the policy limits even though the express terms of the contract did not impose such duties.<sup>147</sup> The duty arose out of respect for and consideration of the interests of the insured. The defendant's wrongful conduct in failing to meet its duty constituted a breach of the implied covenant of good faith<sup>148</sup> which justified imposing liability against the insurance company in excess of the policy coverage.<sup>149</sup>

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140. 29 Cal. 2d 745, 177 P.2d 931 (1947).

141. *Id.* at 751, 177 P.2d at 934 (quoting *Kirke La Shelle Co. v. Paul Armstrong Co.*, 263 N.Y. 79, 87, 188 N.E. 163, 167 (1933)).

142. 263 N.Y. 79, 188 N.E. 163 (1933).

143. *Kirke La Shelle*, 263 N.Y. at 85, 188 N.E. at 166; *Nelson*, 29 Cal. 2d at 750, 177 P.2d at 934.

144. *See* *Cleary v. American Airlines, Inc.*, 111 Cal. App. 3d 443, 453, 168 Cal. Rptr. 722, 728 (1980).

145. *Murphy v. American Home Prods.*, 58 N.Y.2d 293, 448 N.E.2d 86, 461 N.Y.S.2d 232 (1983).

146. 50 Cal. 2d 654, 328 P.2d 198 (1958).

147. *Id.* at 659, 328 P.2d at 201.

148. *Id.*

149. *Id.* at 661, 328 P.2d at 202. Also important in *Comunale* was the idea

In *Gruenberg v. Aetna Insurance Co.*,<sup>150</sup> the California Supreme Court applied the covenant of good faith to find the insurance company liable in contract and in tort for unreasonably withholding payments due under a policy.<sup>151</sup> The court rejected the defendant's argument that the plaintiff's conduct excused performance by the defendant, stating that the duty of good faith, implied by law, was "unconditional and independent of the performance of plaintiff's contractual obligations."<sup>152</sup>

Finally, in *Commercial Union Assurance Companies v. Safeway Stores, Inc.*,<sup>153</sup> the court found that, although the duty of good faith in an insurance policy is a "two-way street," the insured owned no corresponding duty to its excess liability carrier to accept a settlement offer within the policy limits.<sup>154</sup> The court thus focused the good faith inquiry upon the legitimate expectations of the parties based upon the nature of the contractual bargain and determined that the excess carrier could not reasonably have expected the insured to consider the interests of the excess carrier.<sup>155</sup> The *Commercial Union* decision set the stage for the important California trilogy *Tameny v. Atlantic Richfield Co.*,<sup>156</sup> *Cleary v. American Airlines, Inc.*,<sup>157</sup> and *Pugh v.*

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that breach of the implied covenant of good faith and fair dealing may sound in contract or in tort to give the plaintiff freedom of election between contract and tort actions for statute of limitation purposes. *Id.* at 663, 328 P.2d at 203. Similarly, in *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967), the court permitted the plaintiff to recover in tort for mental suffering and losses incurred in a judgment against the insured caused by the insurer's breach of the good faith covenant in wrongfully failing to settle. *Crisci*, 66 Cal. 2d at 433-34, 426 P.2d at 178-79, 58 Cal. Rptr. at 18-19. For a discussion of the remedial ramifications of the characterization of breach of the good faith covenant as contract or tort, see *infra* Section E. of text. The court in *Crisci* expanded the meaning of the implied covenant by rejecting the defendant's argument that bad faith must be equivalent to "dishonesty, fraud and concealment," but rather was implicated when the expectations of the insured were not satisfied. *Crisci*, 66 Cal. 2d at 430, 426 P.2d at 177, 58 Cal. Rptr. at 17.

150. 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973).

151. *Id.* at 575, 510 P.2d at 1038, 108 Cal. Rptr. at 486.

152. *Id.* at 578, 510 P.2d at 1040, 108 Cal. Rptr. at 488. The court further stated:

We conclude, therefore, that the duty of good faith and fair dealing on the part of defendant insurance companies is an absolute one. At the same time, we do not say that the parties cannot define, by the terms of the contract, their respective obligations and duties. We say merely that no matter how those duties are stated, the non-performance by one party of its contractual duties cannot excuse a breach of the duty of good faith and fair dealing by the other party while the contract between them is in effect and not rescinded.

*Id.*

153. 26 Cal. 3d 912, 610 P.2d 1038, 164 Cal. Rptr. 709 (1980).

154. *Id.* at 917-19, 610 P.2d at 1041-42, 164 Cal. Rptr. at 711-13.

155. *Id.* at 919-20, 610 P.2d at 1042, 164 Cal. Rptr. at 713.

156. 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980).

157. 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980).

*See's Candies, Inc.*<sup>158</sup> Each of these three cases addressed the applicability of the good faith covenant in the employment at-will context.

In *Tameny*, the California Supreme Court recognized a cause of action in tort in favor of an employee who was wrongfully discharged for refusing to participate in a scheme to fix retail gasoline prices which would have allegedly violated federal antitrust laws.<sup>159</sup> The court stated that a wrongful discharge action based upon statute or public policy considerations could be brought either in contract or in tort.<sup>160</sup> Apart from its public policy analysis, the court made significant and far-reaching statements with regard to the entire employment at-will doctrine. The court examined the historical basis for the at-will rule but cautioned as follows:

In the last half century the rights of employees have not only been proclaimed by a mass of legislation touching upon almost every aspect of the employer-employee relationship, but the courts have likewise evolved certain additional protections at common law. The courts have been sensitive to the need to protect the individual employee from discriminatory exclusion from the opportunity of employment whether it be by the all-powerful union or employer. This development at common law shows that the employer is not so absolute a sovereign of the job that there are not limits to his prerogative. One such limit at least is the present case. The employer cannot condition employment upon required participation in unlawful conduct by the employee.<sup>161</sup>

More importantly with regard to the implied covenant of good faith and fair dealing, the court relied upon its prior holdings in the insurance context and suggested in dictum that an employer's breach of the covenant would possibly give rise to tort recovery for the discharged employee.<sup>162</sup> *Tameny* marked the

158. 116 Cal. App. 3d 311, 171 Cal. Rptr. 917 (1981).

159. *Tameny*, 27 Cal. 3d at 172, 610 P.2d at 1332, 164 Cal. Rptr. at 841. The court held that:

[A]n employer's authority over its employee does not include the right to demand that the employee commit a criminal act to further its interests, and an employer may not coerce compliance with such unlawful directions by discharging an employee who refuses to follow such an order. An employer engaging in such conduct violates a basic duty imposed by law upon all employers, and thus an employee who has suffered damages as a result of such discharge may maintain a tort action for wrongful discharge against the employer.

*Id.* at 178, 610 P.2d at 1036-37, 164 Cal. Rptr. at 846.

160. *Id.* at 176, 610 P.2d at 1335, 164 Cal. Rptr. at 844.

161. *Id.* at 178, 610 P.2d. at 1336, 164 Cal. Rptr. at 845 (citations omitted).

162. The court stated:

In light of our conclusion that plaintiff's complaint states a cause of action in tort under California's common law wrongful discharge doctrine, we believe it is unnecessary to determine whether a tort recovery would additionally be available under these circumstances on the theory that Arco's discharge constituted a breach of the implied-at-law covenant of good faith

first time in a non-insurance setting that a California court recognized that the implied covenant of good faith imposed limits on an employer's discretion with respect to an at-will employee.

*Tameny* was shortly followed by the landmark decision of *Cleary v. American Airlines, Inc.*,<sup>163</sup> which directly confronted the issue of whether the covenant of good faith and fair dealing could serve as the basis for an independent cause of action for wrongful discharge. The plaintiff employee was discharged after eighteen years of employment, allegedly in retaliation for participation in union activities. The complaint, dismissed upon demurrer, asserted both breach of contract and tort theories for wrongful discharge, and sought compensatory and punitive damages.<sup>164</sup> The court followed the lead of *Tameny* and expressly recognized that the covenant of good faith and fair dealing was "unconditional and independent in nature" and would be implied in all contracts.<sup>165</sup> Thus, the court established a cause of action for a bad faith discharge for breach of the covenant of good faith implicit in employment contracts.<sup>166</sup>

The court in *Cleary* focused on the employee's longevity of service and the employer's policies of providing procedures for solving employee grievances as being of "paramount importance" in operating as an estoppel against a discharge without good cause.<sup>167</sup> The court stated:

Termination of employment without legal cause after such a period of time offends the implied-in-law covenant of good faith and fair dealing contained in all contracts, including employment contracts. As a result of this covenant, a duty arose on the part of the employer . . . to do nothing which would deprive plaintiff, the employee, of the benefits of the employment bargain—benefits described in the complaint as having accrued during plaintiff's 18 years of employment.<sup>168</sup>

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and fair dealing inherent in every contract. We do note in this regard, however, that authorities in other jurisdictions have on occasion found an employer's discharge of an at-will employee violative of the employer's "good faith and fair dealing" obligations, and past California cases have held that a breach of this implied-at-law covenant sounds in tort as well as in contract. Since neither plaintiff nor defendants suggest that the elements of a cause of action for breach of the implied covenant in this context would differ from the elements of an ordinary wrongful discharge action, however, we believe that a separate discussion of the "good faith and fair dealing" covenant in this case is unnecessary.

*Id.* at 179 n.12, 610 P.2d at 1337 n.12, 164 Cal. Rptr. at 846 n.12 (citations omitted).

163. 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980).

164. *Id.* at 446, 168 Cal. Rptr. at 723-24.

165. *Id.* at 453, 168 Cal. Rptr. at 728.

166. *Id.* at 455-56, 168 Cal. Rptr. at 729.

167. *Id.* at 455, 168 Cal. Rptr. at 729.

168. *Id.*

The court did not, however, delve into the plaintiff's cause of action for retaliatory discharge for engaging in union activities, but rather premised its decision squarely on the implied covenant of good faith.<sup>169</sup>

The analysis in *Cleary* reflects an unfortunate mixture of several distinct causes of action for wrongfully discharged at will employees. The *Cleary* court's focus on longevity of satisfactory service presents an immediate obstacle to application. How many years would be sufficient to implicate the good faith covenant? Subsequent California decisions have wrestled with this dilemma, reaching irreconcilable results.<sup>170</sup> Also, are the factors enumerated in *Cleary* exclusive or simply illustrative? Again, California courts have reached diametrically opposite views on this question.<sup>171</sup> Perhaps the most grievous flaw in *Cleary*, though, was the court's reliance upon the employer's policies regarding employee disputes as being relevant to the good faith covenant. Such company policies may, in appropriate circumstances, serve as the basis for showing an implied-in-fact promise to treat an employee in a certain manner,<sup>172</sup> but should not be confused with an implied-in-law analysis.

A similar mixing of the implied-in-fact and implied-in-law contract theories occurred in *Gates v. Life of Montana Insurance Co.*<sup>173</sup> (*Gates I*), a Montana Supreme Court decision. In *Gates* the plaintiff alleged wrongful deprivation of unemployment and retirement benefits because the employer obtained a letter of resignation by duress. The plaintiff claimed, among other theories, both breach of contract and breach of the covenant of good faith and fair dealing.

169. *Id.* at 455-56, 168 Cal. Rptr. at 729-30.

170. See *Crain v. Burroughs Corp.*, 560 F. Supp. 849, 853 (C.D. Cal. 1983) (less than two years employment insufficient); *Foley v. Interactive Data Corp.*, 174 Cal. App. 3d 241, 246, 219 Cal. Rptr. 866, 871, review granted, 712 P.2d 891, 222 Cal. Rptr. 740 (1985) (seven years employment too short for longevity test); *Shapiro v. Wells Fargo Realty Advisors*, 152 Cal. App. 3d 467, 478, 199 Cal. Rptr. 613, 619 (1984) (three and one-half years inadequate); *Pugh v. See's Candies, Inc.*, 116 Cal. App. 3d 311, 328, 171 Cal. Rptr. 917, 926-27 (1981) (thirty-two years would not suffice, in itself, to implicate good faith covenant); cf. *Comerio v. Beatrice Foods Co.*, 600 F. Supp. 765, 769 (E.D. Mo. 1985) (applying California law; three years service inadequate).

171. Courts which have limited their inquiry to the *Cleary* factors include *Comerio v. Beatrice Foods Co.*, 600 F. Supp. 765, 769 (E.D. Mo. 1985) (applying California law); *Crain v. Burroughs Corp.*, 560 F. Supp. 849, 853 (C.D. Cal. 1983); *Foley v. Interactive Data Corp.*, 174 Cal. App. 3d 241, 246, 219 Cal. Rptr. 866, 871, review granted, 712 P.2d 891, 222 Cal. Rptr. 740 (1985); and *Shapiro v. Wells Fargo Realty Advisors*, 152 Cal. App. 3d 467, 478, 199 Cal. Rptr. 613, 619 (1984). On the other hand, several courts have interpreted *Cleary* as only providing instruction, not conclusive factors. See, e.g., *Gray v. Superior Court*, 181 Cal. App. 3d 813, 820-21, 226 Cal. Rptr. 570, 573-74 (1986); *Khanna v. Microdata Corp.*, 170 Cal. App. 3d 250, 262, 215 Cal. Rptr. 860, 867 (1985).

172. E.g., *Toussaint v. Blue Cross & Blue Shield*, 408 Mich. 579, 292 N.W.2d 880 (1980).

173. 196 Mont. 178, 638 P.2d 1063 (1982).

Two years after hiring Gates, the employer distributed a handbook containing certain procedures regarding termination. The court held that, because Gates had not supplied any additional consideration apart from the agreed services, the handbook's notice requirement did not become part of the at-will employment contract and was therefore unenforceable as a contract right.<sup>174</sup>

More significantly, the court, although not expressly relying upon *Cleary*, recognized that the covenant of good faith and fair dealing properly accommodated the respective interests of employers and employees and should be implied in employment contracts.<sup>175</sup> The court then noted that the employer's issuance of employee policies created an expectation of job security, and when not followed "the peace of mind of its employees is shattered and an injustice is done."<sup>176</sup> Accordingly, the court held that the plaintiff's assertion that the employer failed to follow its termination procedures precluded summary judgment and, if proven on remand, would constitute a breach of the covenant of good faith and fair dealing.<sup>177</sup>

The analysis in *Gates I* creates an interesting paradox: employee policies contained in a handbook did not constitute enforceable implied-in-fact promises because they were distributed without consideration after hiring. However, the failure to follow such policies would amount to an "injustice" and a breach of the implied-in-law covenant of good faith. Mixture of the implied-in-fact and implied-in-law contract exceptions to the employment at-will rule as in *Cleary* and *Gates I* presents impracticable standards for application and dilutes the policy underpinnings and evidentiary basis for each theory. The Montana Supreme Court further complicated the remedial picture when it evaluated the award of punitive damages after remand in *Gates II*.<sup>178</sup> The court was faced with a statute which would, in certain circumstances, permit assessment of punitive damages for breach of an obligation "not arising from contract."<sup>179</sup> The court held that since the duty to act in good faith existed apart from and in addition to the contract terms, the statutory prohibition was not applicable.<sup>180</sup> Therefore, the court reasoned, breach of the implied duty of good faith and fair dealing in the employment relationship

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174. *Id.* at 183, 638 P.2d. at 1066.

175. *Id.* at 184-85, 638 P.2d at 1066-67.

176. *Id.* at 184, 638 P.2d at 1067.

177. *Id.*

178. *Gates v. Life of Montana Ins. Co. (Gates II)*, 205 Mont. 304, 668 P.2d 213 (1983).

179. MONT. CODE ANN. § 27-1-221 (1983) provided:

In any action for a breach of an obligation not arising from contract where the defendant has been guilty of oppression, fraud, or malice, actual or presumed, the jury, in addition to the actual damages, may give damages for the sake of example and by way of punishing the defendant.

180. *Gates II*, 205 Mont. at 307, 668 P.2d at 215.



sounded in tort and permitted the jury's award of punitive damages. The *Gates II* analysis represents an interesting display of judicial gymnastics where the court simultaneously advanced the propositions that good faith and fair dealing was an implied-by-law contractual covenant, yet did not "arise from" the contract.<sup>181</sup>

The third significant decision in the California trilogy which has largely shaped the contours of the good faith covenant in employment at-will relationships was *Pugh v. See's Candies, Inc.*<sup>182</sup> The plaintiff employee, Pugh, had a successful 32 year career with the defendant company which was highlighted by numerous promotions and by his ultimately becoming vice-president and a member of the board of directors. When Pugh returned from a vacation he was summoned to the corporate offices expecting to be told of another promotion. Instead, the company president discharged him summarily without explanation. In addition to asserting claims for breach of contract, Pugh alleged that the firing was in retaliation for his opposition to management's pay scale to its labor union and thus constituted a tortious discharge which violated public policy.<sup>183</sup> The company responded by claiming that Pugh's at-will status allowed the termination, irrespective of the cause.

The case principally examined Pugh's assertion that the defendant made certain implied-in-fact promises that it would not deal arbitrarily with its employees. The relevant considerations which the court noted in that regard included the duration of Pugh's employment, his promotions and satisfactory performance evaluations, the lack of complaints about his work, and the employer's express policies concerning employees.<sup>184</sup> The court summarized the operation of these factors as follows:

While oblique language will not, standing alone, be sufficient to establish agreement, it is appropriate to consider the totality of the parties' relationship. Agreement may be "shown by the acts and conduct of the parties,

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181. *Id.* at 306-07, 668 P.2d at 214-15.

182. 116 Cal. App. 3d 311, 171 Cal. Rptr. 917 (1981).

183. *Id.* at 318-19, 171 Cal. Rptr. at 920. Pugh asserted three separate bases to justify the tort action for retaliatory discharge contravening public policy. First, Pugh claimed that the union contract which he refused to support would have violated state and federal antitrust law against restraint of trade. Although the court acknowledged that the contention found "doctrinal support" in *Tameny*, it was rejected for lack of evidentiary basis. *Id.* at 322-23, 171 Cal. Rptr. 922-23. Secondly, Pugh contended that the union wage agreement which he objected to violated the Fair Employment Practices Act (now Fair Employment and Housing Act, CAL. GOV'T CODE §§ 12900-12996. (Supp. 1988)) because it wrongfully discriminated against women. Again, the court held that the claim failed for lack of evidentiary support. *Pugh*, 116 Cal. App. 3d at 323, 171 Cal. Rptr. at 923. Lastly, Pugh claimed that the discharge violated CAL. CORP. CODE § 309(a) (West 1977), but the court held that he had not acted in the requisite capacity of an "inquiring corporate director" within the meaning of the statute. *Pugh*, 116 Cal. App. 3d at 324, 171 Cal. Rptr. at 923-24.

184. *Pugh*, 116 Cal. App. 3d at 329, 171 Cal. Rptr. at 927.

interpreted in the light of the subject matter and of the surrounding circumstances.”<sup>185</sup>

Although the court dealt mainly with public policy and implied-in-fact limitations on employment at-will, it significantly qualified the *Cleary* approach to the implied-in-law covenant of good faith and fair dealing. The court recognized the premise for the implied covenant in *Tameny* and then examined the dual basis for the holding in *Cleary*: longevity of employment and the employer’s express policies of adjudicating employee grievances.<sup>186</sup> With regard to *Cleary*’s duration of employment factor, the *Pugh* court stated:

If “[t]ermination of employment without legal cause [after 18 years of service] offends the implied-in-law covenant of good faith and fair dealing contained in all contracts, including employment contracts,” . . . then *a fortiori* that covenant would provide protection to Pugh, whose employment is nearly twice that duration. Indeed, it seems difficult to defend termination of such a long-time employee arbitrarily, i.e., without some legitimate reason, as compatible with either good faith or fair dealing.

We need not go that far, however. In *Cleary*, the court did not base its holding upon the covenant of good faith and fair dealing alone. Its decision rested also upon the employer’s acceptance of responsibility for refraining from arbitrary conduct, as evidence by its adoption of specific procedures for adjudicating employee grievances. While the court characterized the employer’s conduct as constituting “[recognition of] its responsibility to engage in good faith and fair dealing,” the result is equally explicable in traditional contract terms: the employer’s conduct gave rise to an implied promise that it would not act arbitrarily in dealing with its employees.<sup>187</sup>

Thus, presented with an ideal opportunity to clarify the confusion in *Cleary* over implied-in-fact and implied-in-law limitations on employer discretion to fire at-will employees, the *Pugh* court instead chose to skirt the problem.

The progeny of *Tameny*, *Cleary*, and *Pugh* have not yielded any consistent methodology as to what factors or standards should be applied to the implied covenant of good faith and fair dealing in at-will employment contracts. In *Crosier v. United Parcel Service, Inc.*,<sup>188</sup> an employee with 25 years of service with the defendant employer was allegedly discharged for violating an unwritten company policy prohibiting social relationships between management and non-managerial personnel. The plaintiff-employee claimed that company rules proscribing fraternization with non-management employees were arbitrary and unreasonable, and therefore violated the implied covenant of good faith and fair dealing. The court acknowledged some merit in the

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185. *Id.* (citations omitted).

186. *Id.* at 328-29, 171 Cal. Rptr. at 926-27.

187. *Id.* (citations omitted).

188. 150 Cal. App. 3d 1132, 198 Cal. Rptr. 361 (1983).

plaintiff's assertion of unfairness but also emphasized the interest of an employer in managing its work force:

[T]he court must balance the employer's interest in operating his business efficiently and profitably with the interest of the employee in maintaining his employment and the interest of the public in maintaining a proper balance between the two.<sup>189</sup>

The court, however, rejected the defendant's proposition that the legitimacy of an employer's business reasons for discharging an at-will employee should escape judicial review.<sup>190</sup> The court, relying upon the *Pugh* requirements, held that the plaintiff's assertions of improper employer motives were merely speculative and thus insufficient to satisfy the requisite evidentiary burden.<sup>191</sup>

In the context of assessing the burden of producing evidence and proof, however, the court in *Crosier* stated "the implied in law covenant [of good faith] and implied in fact covenant are similar in that both require just cause for dismissal."<sup>192</sup> Certainly, as discussed in Part II., an employer may make promises of job security which would allow dismissal only for good cause or just cause, and which may be properly implied-in-fact into the employment contract.<sup>193</sup> However, the characterization of the good faith covenant as equivalent to or co-extensive with a just cause standard for dismissal of at-will employees is simply incorrect. The just cause standard, presently applicable in collective bargaining agreements and statutes governing public employees, gives greater job protection to employees.<sup>194</sup> Moreover, the two standards have different functions. Good faith serves as a flexible tool to correct a wide range of possible employer abuses,<sup>195</sup> while "just cause" focuses on whether the employee's conduct justifies the dismissal.<sup>196</sup>

189. *Id.* at 1139, 198 Cal. Rptr. at 366.

190. The court stated:

This rule would parallel the business judgment rule which prevents judicial scrutiny of the acts of corporate directors using honest judgment. We decline to adopt such a rule. An implied in fact or implied in law promise to dismiss an employee only for cause would be illusory if the employer were permitted to be the sole judge and final arbiter of the propriety of the policy giving rise to the discharge. If we were to adopt such a rule, an employer could implement a patently absurd business policy carapaced from judicial inquiry.

*Id.* at 1140, 198 Cal. Rptr. at 366.

191. *Id.* at 1139, 198 Cal. Rptr. at 365.

192. *Id.* at 1138, 198 Cal. Rptr. at 365.

193. See *supra* notes 25-89 and accompanying text.

194. See M. TROTTA, *ARBITRATION OF LABOR-MANAGEMENT DISPUTES* 236-42 (1974); Peck, *Unjust Discharges from Employment: A Necessary Change in the Law*, 40 OHIO ST. L.J. 1, 8 (1979).

195. *Khanna v. Microdata Corp.*, 170 Cal. App. 3d 250, 262-63, 215 Cal. Rptr. 860, 867 (1985).

196. *Toussaint v. Blue Cross & Blue Shield*, 408 Mich. 579, 292 N.W.2d 880 (1980).

A more expansive application of the implied covenant of good faith and fair dealing is found in another recent California appellate court decision, *Khanna v. Microdata Corp.*<sup>197</sup> The employee, Khanna, achieved an outstanding sales record and received commendations from his employer. While still employed, Khanna sued the company to recover the amount of certain disputed commissions. The company subsequently fired him, asserting that the lawsuit was "totally unfounded" and that the employee had exhibited "disloyalty." The employee sued<sup>198</sup> on all three theories of wrongful discharge and the jury returned a general verdict in his favor without specifying which theory of liability it relied upon.<sup>199</sup> The court found that elements regarding each wrongful discharge theory were present but upheld the jury award solely on the company's violation of the implied covenant of good faith and fair dealing.<sup>200</sup>

The most significant aspect of *Khanna* was the court's liberal reading of *Cleary's* treatment of the implied covenant of good faith. The court reviewed the post-*Pugh* trend of limiting *Cleary* to its facts<sup>201</sup> by stating:

We cannot agree . . . that the factors relied on by the court in *Cleary* are the *sine qua non* to establishing a breach of the covenant of good faith and fair dealing implied in every employment contract . . . To the contrary, a breach of the implied covenant of good faith and fair dealing in employment contracts is established whenever the employer engages in "bad faith action extraneous to the contract, combined with the obligor's intent to frustrate the [employee's] enjoyment of contract rights."<sup>202</sup>

The court considered the plaintiff's sales performance, commendations, timing of the discharge, the discharge's effect of preventing the plaintiff from receiving substantial commissions, and the apparent discrepancies in the contract terms regarding commission payments as together providing a substantial basis for the jury's finding of bad faith discharge.<sup>203</sup>

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197. 170 Cal. App. 3d 250, 215 Cal. Rptr. 860 (1985).

198. Khanna dismissed the suit after being discharged in hopes that the company would pay the commission. When the company continued to deny liability, however, Khanna reinstated the suit alleging wrongful discharge, fraud and breach of contract. *Id.* at 254, 215 Cal. Rptr. at 864.

199. *Id.*

200. *Id.* at 260, 215 Cal. Rptr. at 865.

201. See *Comerio v. Beatrice Foods, Co.*, 600 F. Supp. 765 (E.D. Mo. 1985) (applying California law); *Foley v. Interactive Data Corp.*, 174 Cal. App. 3d 175, 219 Cal. Rptr. 866, review granted, 712 P.2d 891, 222 Cal. Rptr. 740 (1985); *Shapiro v. Wells Fargo Realty Advisors*, 152 Cal. App. 3d 467, 199 Cal. Rptr. 613 (1984).

202. *Khanna v. Microdata Corp.*, 170 Cal. App. 3d 250, 263, 215 Cal. Rptr. 860, 867 (1985).

203. *Id.* at 264-65, 215 Cal. Rptr. at 868-69.

In sum, the California courts have recognized both implied-in-fact and implied-in-law limitations on the freedom of employers to discharge at-will employees.<sup>204</sup> The analysis, however, has demonstrated an unfortunate blurring of the two theories, and thus has created inconsistent and misleading precedent. The *Cleary* factors regarding length of employment service and handbook provisions of a "just cause" standard for dismissal<sup>205</sup> properly fit under implied-in-fact contract methodology. In contrast, some of the factors mentioned in *Khanna*, such as whether the discharge effectively deprived the employee of financial benefits to the employer's gain,<sup>206</sup> should be evaluated in light of the implied-in-law covenant of good faith. The covenant of good faith should restrict discharges made for a bad cause, but should not be implicated for discharges made either for good cause or no cause. This approach would properly effectuate the reasonable expectations of employees to be treated equitably, while still preserving managerial discretion over the workplace.

### C. *Massachusetts: The Restitutory Basis*

Massachusetts courts have articulated two separate bases for an employee at-will to state a cause of action for wrongful discharge: (1) where an employer violates public policy by acting with the "predatory" motive to deprive an employee of rightful financial benefits for the purpose of retaining those benefits;<sup>207</sup> or (2) where a discharged employee will lose ascertainable future financial benefits based upon past services,<sup>208</sup> irrespective of evidence of bad motive on the part of the employer.

The first approach to the treatment of the good faith principle in the employment context holds that an employer who discharges an employee because of a wrongful intent to deprive the employee of certain vested benefits breaches the at-will employment contract.<sup>209</sup> This analysis had its genesis in the Massachusetts decision of *Fortune v. National Cash Register Co.*<sup>210</sup>

204. *Tameny v. Atlantic Richfield Co.*, 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980); *Pugh v. See's Candies, Inc.*, 116 Cal. App. 3d 311, 171 Cal. Rptr. 917 (1981); *Cleary v. American Airlines, Inc.*, 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980).

205. *Cleary*, 111 Cal. App. 3d at 455, 168 Cal. Rptr. at 729.

206. *Khanna*, 170 Cal. App. 3d at 263-64, 215 Cal. Rptr. at 868-69.

207. *See Cort v. Bristol-Myers Co.*, 385 Mass. 300, 304, 431 N.E.2d 908, 910 (1982); *Fortune v. National Cash Register Co.*, 373 Mass. 96, 104-05, 364 N.E.2d 1251, 1257 (1977).

208. *See Gram v. Liberty Mut. Ins. Co.*, 384 Mass. 659, 671-72, 429 N.E.2d 21, 29 (1981).

209. *See Mitford v. de Lasala*, 666 P.2d 1000, 1007 (Alaska 1983); *Fortune v. National Cash Register Co.*, 373 Mass. 96, 104, 364 N.E.2d 1251, 1257 (1977); *Hall v. Farmers Ins. Exch.*, 713 P.2d 1027, 1031 (Okla. 1985).

210. 373 Mass. 96, 364 N.E.2d 1251 (1977).

In *Fortune*, the plaintiff salesman was entitled to commissions on orders he obtained for the company, but his written contract of employment allowed termination at will without cause on written notice. The defendant company gave the plaintiff, an employee for twenty-five years, the requisite notice of discharge one business day after the plaintiff had obtained a \$5,000,000 order. The company allowed the plaintiff to work for an additional eighteen month period following receipt of the notice, but in a lesser position which did not allow payment of commissions. However, the employee did receive the commissions to which he was contractually entitled.<sup>211</sup>

The court nevertheless upheld the submission to the jury of the issue regarding the employer's "motive" in terminating the employment.<sup>212</sup> The question of motive, then, was relevant to whether the employer had breached the implied covenant of good faith and fair dealing despite an express contract provision which reserved to the employer the unqualified power to discharge the employee.<sup>213</sup>

The case is anomalous in several respects. First, the court declined to categorize a breach of the implied covenant of good faith as a tort action, but rather limited it to a contractual remedy.<sup>214</sup> The immediate difficulty with couching it solely as a contract remedy was that the employee actually received all the commissions to which he was entitled under the contract. Therefore, the restitutionary principle of preventing the unjust enrichment of an overreaching employer was not involved. The court's recognition of the restitutionary goal of protecting employees from overreaching employer conduct<sup>215</sup> however has unfortunately caused the case to be mischaracterized as having only a restitutionary basis.<sup>216</sup> Professor Epstein, in defending em-

211. *Id.* at 99, 101, 364 N.E.2d at 1254-55.

212. *Id.* at 100, 364 N.E.2d at 1255.

213. *Id.* at 101, 364 N.E.2d at 1256. The court explained:

We do not question the general principles that an employer is entitled to be motivated by and to serve its own legitimate business interests; that an employer must have wide latitude in deciding whom it will employ in the face of uncertainties of the business world; and that an employer needs flexibility in the face of changing circumstances. We recognize the employer's need for a large amount of control over its work force. However, we believe that where, as here, commissions are to be paid for work performed by the employee, the employer's decision to terminate its at will employee should be made in good faith.

*Id.*

214. *Id.* at 102, 364 N.E.2d at 1256.

215. *Id.* at 105, 364 N.E.2d at 1257.

216. In *Mitford v. de Lasala*, 666 P.2d 1000, 1007 (Alaska 1983), the Supreme Court of Alaska relied upon *Fortune* and held that the implied covenant of good faith dealing would prevent the defendant employer from terminating the employee for the purpose of depriving him from receiving future profits otherwise payable according to an employment contract. The court loosely referred to this view as the "prevention doctrine," taken also from its interpretation of the Restatement (Second)

ployment at-will,<sup>217</sup> recognized the fallacy of the restitution theory in *Fortune* and thus concluded that the implied covenant of good faith should yield to freedom of contract.<sup>218</sup> The good faith covenant should be read more broadly than as being synonymous with restitution. Rather, in addition to the interest in receiving restitution, at-will employees have another interest which is also deserving of legal protection, and that is the expectation not to be discharged in bad faith.

In sum, the ill-timed discharge of a faithful long-term employee may be "full of sound and fury"<sup>219</sup> but have no real pecuniary significance to the employer. Further, the *Fortune* court declined to speculate as to whether the covenant of good faith would always be implied in at-will employment contracts.<sup>220</sup> The impact of the case cannot be gainsaid, however, because it did recognize that a breach of the covenant of good faith will result in remedial consequences.<sup>221</sup>

In *Gram v. Liberty Mutual Insurance Co.*,<sup>222</sup> (Gram I) the Massachusetts Supreme Court had an opportunity to address the questions reserved in

of Contracts section 205 (1981) which provides: "Every contract imposes upon each party a duty of good faith and fair dealing in its performance or its enforcement."

In *Hall v. Farmers Ins. Exch.*, 713 P.2d 1027, 1030 (Okla. 1985), an insurance agent successfully maintained a breach of implied covenant of good faith action for termination by the employer by demonstrating a wrongful intent to deprive him of future payments of renewal premiums. Although *Hall* agreed with the analysis in *Fortune*, it also predicated its holding on the Restatement (Second) of Agency section 454 which states:

An agent to whom the principal has made a revocable offer of compensation if he accomplishes a specific result is entitled to the promised amount if the principal, in order to avoid the payment of it revokes the offer and thereafter the result is accomplished as the result of the agent's prior efforts.

RESTATEMENT (SECOND) OF AGENCY § 454 (1958).

217. See Epstein, *In Defense of the Contract at Will*, 51 U. CHI. L. REV. 947 (1984).

218. *Id.* at 982.

219. SHAKESPEARE, *MacBeth*, act V., scene V.

220. The court stated:

In the instant case, we need not pronounce our adherence to so broad a policy nor need we speculate as to whether the good faith requirement is implicit in every contract for employment at will. It is clear, however, that, on the facts before us, a finding is warranted that a breach of the contract occurred. Where the principal seeks to deprive the agent of all compensation by terminating the contractual relationship when the agent is on the brink of successfully completing the sale, the principal has acted in bad faith and the ensuing transaction between the principal and the buyer is to be regarded as having been accomplished by the agent.

*Fortune v. National Cash Register Co.*, 373 Mass. 96, 104-05, 364 N.E.2d 1251, 1257 (1977).

221. *Id.* at 96, 364 N.E.2d at 1256.

222. 384 Mass. 659, 429 N.E.2d 21 (1981).

*Fortune* of whether an obligation to act in good faith was implicit in every at-will employment contract, and whether the absence of good cause in the discharge of an employee was co-extensive with the absence of good faith.<sup>223</sup> In *Gram I* an insurance agent was discharged without cause but the employer had no improper motive behind the discharge. The court rejected the view that the termination of an at-will employee without good cause would alone constitute a violation of the employer's duty of good faith and fair dealing.<sup>224</sup> Rather, a discharge absent good cause would not establish bad faith but would be considered a factor in ascertaining whether fair dealing existed.<sup>225</sup> The significance of *Gram I*, then, was in rejecting job security as the sole basis for justifying recovery in termination of an at-will employee without good cause.<sup>226</sup> The court remanded for a determination of the amount of damages that the employer owed for the employee's past service.<sup>227</sup>

An important aspect of the Massachusetts line of cases is the treatment of damages for breach of the implied covenant of good faith and fair dealing. The courts have focused on restitutionary principles of preventing the unjust enrichment of employers and have therefore characterized the cause of action as sounding in contract rather than in tort,<sup>228</sup> or on a *quantum merit* theory.<sup>229</sup>

223. *See id.* at 664, 429 N.E.2d at 26.

224. *Id.* at 666, 429 N.E.2d at 28. The court recognized that collective bargaining agreements and certain public employment statutes only permit a just cause discharge, but implicitly left it to legislative action to change the balance of employment rights then existing under the common law. *Id.* at 671, 429 N.E.2d at 28. The court also noted that the meaning of good faith in terminating contracts may require something more than the meaning of good faith in section 2-103(1)(b) of the Uniform Commercial Code which requires "honesty in fact in the conduct or transaction concerned." U.C.C. § 2-103(1)(b) (1976).

225. *Gram I*, 384 Mass. at 665, 429 N.E.2d at 27.

226. *Id.* at 677, 429 N.E.2d at 29.

227. The court further explained:

Indeed, inconsistency with the "justified expectations of the other party" and the violation of "community standards of decency, fairness, or reasonableness" may demonstrate the absence of "good faith." Such an objective test of "good faith" is not significantly different from the test of "fair dealing." It eliminates the difficult burden of proving the motivations of the former employer.

The rule we adopt will not have wide implications. The amount of the renewal commissions substantially proves the outer limit of the compensation *Gram* lost for past services. In most other employment arrangements, the "windfall" to an employer and the loss to the former employee derived from an employee's loss of compensation for past service cannot be as clearly identified.

*Id.* at 667 n.10, 429 N.E.2d at 29 n.10 (citations omitted).

228. *E.g.*, *McCone v. New England Tel. & Tel. Co.*, 393 Mass. 231, 234, 471 N.E.2d 47, 50 (1984); *Gram v. Liberty Mut. Ins. Co.*, 384 Mass. 659, 671-72, 429 N.E.2d 21, 29 (1981); *Fortune v. National Cash Register Co.*, 373 Mass. 96, 102, 364 N.E.2d 1251, 1256 (1977).

229. *E.g.*, *Maddaloni v. Western Massachusetts Bus Lines, Inc.*, 386 Mass. 877, 883, 438 N.E.2d 351, 352 (1982).



In that regard, the courts have drawn a distinction between an allowable recovery of damages for the employee's loss of reasonably ascertainable future compensation based upon past services,<sup>230</sup> and disallowing compensation for future services.<sup>231</sup> The effect of this characterization generally is to lessen the amount of damages allowed. For example, in *Maddaloni v. Western Mass. Bus Lines, Inc.*,<sup>232</sup> the plaintiff was employed as a general manager pursuant to a written contract which provided that the employer would pay a commission if the plaintiff procured a special charter from the Interstate Commerce Commission. The plaintiff was instrumental in obtaining the charter, received some commission payments, and was then discharged by the company. The court, following *Fortune*, found that the defendant had terminated plaintiff based on a bad faith attempt to avoid paying the commissions.<sup>233</sup> Accordingly, the plaintiff was entitled to damages in an amount attributable to past services, but not to lost wages and fringe benefits unrelated to past services.<sup>234</sup>

In *Gram v. Liberty Mutual Ins. Co.*, (Gram II)<sup>235</sup> the court further clarified the distinction between damages properly recoverable by an at-will employee for breach of the implied covenant of good faith to prevent a windfall to the employer and compensation for future services.<sup>236</sup> The court vacated the jury's verdict on remand in *Gram I* because the judge improperly submitted to the jury the issue of future career credits instead of limiting it to renewal commissions based on past services.<sup>237</sup> Moreover, questions of how changes in policy coverage might affect future commissions were deemed not includable in the measure of damages.<sup>238</sup>

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230. See *Gram v. Liberty Mut. Ins. Co.*, 384 Mass. 659, 671-72, 429 N.E.2d 21, 29 (1981); *Fortune v. National Cash Register Co.*, 373 Mass. 96, 104-05, 364 N.E.2d 1251, 1257 (1977).

231. See *McCone v. New England Tel. & Tel. Co.*, 393 Mass. 231, 235, 471 N.E.2d 47, 50 (1984); *Gram v. Liberty Mut. Ins. Co.*, 384 Mass. 659, 671-72, 429 N.E.2d 21, 29 (1981).

232. 386 Mass. 877, 438 N.E.2d 351 (1982).

233. *Id.* at 881, 438 N.E.2d at 355.

234. *Id.* at 882, 438 N.E.2d at 356. The court stated:

In *Fortune v. National Cash Register Co.*, and *Gram v. Liberty Mutual Ins. Co.*, we imposed an obligation of good faith and fair dealing to prevent an employer from being unjustly enriched by depriving the employee of money that he had fairly earned and legitimately expected. However, a majority do not believe that an employee should be entitled to benefits which he neither contemplated nor included in his contract.

*Id.* (citations omitted).

235. 391 Mass. 333, 461 N.E.2d 796 (1984).

236. *Id.* at 335, 461 N.E.2d at 798.

237. *Id.*

238. *Id.* at 335-36, 461 N.E.2d at 798-99. The court held:

Although the question is not free from doubt, we conclude that commissions on future endorsements and the consequences of any anticipated future

Similarly, the Massachusetts Supreme Court in *McCone v. New England Telephone and Telegraph Co.*,<sup>239</sup> determined that job evaluations conducted in bad faith, which resulted in demotions or lost salary increases, did not constitute a breach of the implied covenant of good faith.<sup>240</sup> The plaintiffs had received job evaluations which were not based upon their actual performance. Rather, the employer had completed the evaluations in such a way as to satisfy the requirements of a predetermined Bell Curve. The court denied the plaintiffs compensation for potential lost salary raises and corresponding unvested pension benefits because the defendant employer did not, as alleged in *Fortune*, stand to gain any pecuniary windfall from the method of evaluations.<sup>241</sup>

In the same vein, the court in *Jordan v. Duff and Phelps, Inc.*<sup>242</sup> recently characterized the implied covenant of good faith and fair dealing in employment relationships as functioning to prevent either party from taking "opportunistic advantage" of the other:

Employment creates occasions for opportunism. A firm may fire an employee the day before his pension vests, or a salesman the day before a large commission becomes payable. Cases of this sort may present difficult questions about the reasons for the decision (was it opportunism, or was it a decline in the employee's performance?). The difficulties of separating opportunistic conduct from honest differences of opinion about an employee's performance on the job may lead firms and their employees to transact on terms that keep such disputes out of court—which employment at will usually does. But no one . . . doubts that an avowedly opportunistic discharge is a breach of contract, although the employment is at-will.<sup>243</sup>

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inflation should not be included in the measure of Gram's damages. Future policy changes and future premium levels are speculative. We think that Gram's damages should be measured by the amount of annual renewal commissions payable under his compensation agreement in effect at the time of his discharge, recognizing the renewal of coverage but disregarding the effect of endorsements. Attrition in the block of business produced by Gram should be determined for each future year of his anticipated employment, and anticipated future renewal commissions should be adjusted to present value. The calculation of Gram's damages should also reflect the proportion of Gram's time that would have been devoted to servicing renewal policies, but, because we exclude the effects of endorsements in measuring the renewal commissions recoverable, the portion of Gram's time reasonably expected to be devoted to servicing renewals should not include time devoted to handling endorsements.

*Id.* at 336, 461 N.E.2d at 799.

239. 393 Mass. 231, 471 N.E.2d 47 (1984).

240. *Id.* at 234, 471 N.E.2d at 50.

241. *Id.*

242. 815 F.2d 429 (7th Cir. 1987).

243. *Id.* at 438.

Thus, Massachusetts courts have narrowly tailored the good faith covenant to serve as the basis for applying restitutionary principles for at-will employees. If an employer stands to gain a financial advantage as a result of the discharge, the court will find a breach of the good faith covenant and will award damages based upon the employee's vested or accrued benefits. Conversely, where the employer would not be unjustly enriched, as in *McCone*, then the good faith covenant will not protect employees from abusive behavior by an employer. The good faith covenant, though, should not be limited only to restitutionary principles because, as shown in Part III. A., it encompasses protection of the broader justifiable expectancy of employees not to be treated in bad faith.

#### D. *The Interplay of Public Policy and Good Faith*

A number of courts have recognized an exception to the employment at-will rule where an employer may be held liable in tort if the discharge of an employee contravenes some important public policy.<sup>244</sup> An early expression of the public policy theory is found in *Kouff v. Bethlehem Alameda Shipyard*,<sup>245</sup> where the court held that the firing of an employee in retaliation for serving as an election officer justified tort remedies against the employer because a state statute expressly prohibited such discharges.<sup>246</sup> Courts began to expand the public policy limitation to include any discharge which violated a statute, even where the statute was silent with respect to sanctions.<sup>247</sup> More

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244. *E.g.*, *Wiskotoni v. Michigan Nat'l Bank - West*, 716 F.2d 378, 388 (6th Cir. 1983); *Tameny v. Atlantic Richfield Co.*, 27 Cal. 3d 167, 177, 610 P.2d 1330, 1335, 164 Cal. Rptr. 839, 844 (1980); *Sheets v. Teddy's Frosted Foods, Inc.*, 179 Conn. 471, 480, 427 A.2d 385, 387 (1980); *Pierce v. Ortho Pharmaceutical Corp.*, 84 N.J. 58, 65, 417 A.2d 505, 512 (1980); *Harless v. First Nat'l Bank*, 246 S.E.2d 270, 275 (W. Va. 1978). In *Geary v. United States Steel Corp.*, 456 Pa. 171, 319 A.2d 174 (1974), the court explained public policy as the basis for liability in wrongful discharge:

It may be granted that there are areas of an employee's life in which his employer has no legitimate interest. An intrusion into one of these areas by virtue of the employer's power of discharge might plausibly give rise to a cause of action particularly where some recognized facet of public policy is threatened. The notion that substantive due process elevates an employer's privilege of hiring and discharging his employees to an absolute constitutional right has long since been discredited.

*Geary*, 456 Pa. at 184, 319 A.2d at 180.

245. 90 Cal. App. 2d 322, 202 P.2d 1059 (1949).

246. *Id.* at 324, 202 P.2d at 1061.

247. *See, e.g.*, *Nees v. Hocks*, 272 Or. 210, 536 P.2d 512 (1975). In *Nees*, an employer who discharged an employee for absenteeism from work due to serving on jury duty, was held liable for compensatory damages. The *Nees* court stated:

These actions by the people, the legislature and the courts clearly indicate that the jury system and jury duty are regarded as high on the scale of

recently, some courts have redefined the public policy exception by predicating liability on constitutional, statutory and decisional law.<sup>248</sup>

The rationale behind the public policy theory has been expressed as follows:

[U]nchecked employer power, like unchecked employee power, has been seen to present a distinct threat to the public policy carefully considered and adopted by society as a whole. As a result, it is now recognized that a proper balance must be maintained among the employer's interest in operating a business efficiently and profitably, the employee's interest in earning a livelihood, and society's interest in seeing its public policies carried out.<sup>249</sup>

Definitional problems, called the "Achilles heel of the principle,"<sup>250</sup> have accompanied the geometric increase in the use of public policy to circumscribe

American institutions and citizen obligations. If an employer were permitted with impunity to discharge an employee for fulfilling her obligation of jury duty, the jury system would be adversely affected. The will of the community would be thwarted. For these reasons we hold that the defendants are liable for discharging plaintiff because she served on the jury.

*Id.* at 214, 536 P.2d at 516.

248. See, e.g., *Wagenseller v. Scottsdale Memorial Hosp.*, 147 Ariz. 370, 710 P.2d 1025 (1985); *Parnar v. Americana Hotels, Inc.*, 65 Haw. 370, 652 P.2d 625 (1982); *Pierce v. Ortho Pharmaceutical Corp.*, 84 N.J. 58, 417 A.2d 505 (1980); *Thompson v. St. Regis Paper Co.*, 102 Wash. 2d 219, 685 P.2d 1081 (1984). In *Wagenseller*, the court stated:

We do not believe, however, that expressions of public policy are contained only in the statutory and constitutional law, nor do we believe that all statements made in either a statute or the constitution are expressions of public policy. Turning first to the identification of other sources, we note our agreement with the following: "Public policy is usually defined by the political branches of government. Something against public policy is something that the Legislature has forbidden. But the legislature is not the only source of such policy. In common-law jurisdictions the courts too have been sources of law, always subject to legislative correction, and with progressively less freedom as legislation occupies a given field. It is the courts, to give an example, that originated the whole doctrine that certain kinds of businesses — common carriers and innkeepers — must serve the public without discrimination or preference. In this sense, then, courts make law, and they have done so for years."

*Wagenseller*, 147 Ariz. at \_\_\_\_\_, 710 P.2d at 1033-34 (citations omitted). The court further concluded:

Thus, we believe that reliance on prior judicial decisions, as part of the body of applicable common law, is appropriate, although we agree with the Hawaii Supreme Court that "courts should proceed cautiously if called upon to declare public policy absent some prior legislative or judicial expression on the subject." Thus, we will look to the pronouncements of our founders, our legislature, and our courts to discern the public policy of this state.

*Id.* (citations omitted).

249. *Palmateer v. International Harvester Co.*, 85 Ill. 2d 124, 130, 421 N.E.2d 876, 878 (1981).

250. *Id.*

employer conduct. Thus, in the leading case of *Petermann v. International Bhd. of Teamsters*,<sup>251</sup> the court recognized that "[t]he term 'public policy' is inherently not subject to precise definition . . . Public policy is a vague expression. . . ."<sup>252</sup> Similarly, in *Palmateer v. International Harvester Co.*,<sup>253</sup> the court stated:

But what constitutes clearly mandated public policy? There is no precise definition of the term. In general, it can be said that public policy concerns what is right and just and what affects the citizens of the State collectively. It is to be found in the State's constitution and statutes and, when they are silent, in its judicial decisions. Although there is no precise line of demarcation dividing matters that are the subject of public policy from matters purely personal, a survey of cases in other States involving retaliatory discharges shows that a matter must strike at the heart of a citizen's social rights, duties, and responsibilities before the tort will be allowed.<sup>254</sup>

Other courts, perhaps in an attempt to prevent wholesale abandonment of the at-will doctrine, have required a threshold showing of a "clear mandate" of public policy<sup>255</sup> or have restricted the foundation to constitutional or statutory sources.<sup>256</sup>

The factual scenarios giving rise to application of the public policy exception may be broken down into three general categories. The first broad grouping is where an employer discharges an employee in retaliation for the employee's refusal to commit an unlawful act.<sup>257</sup> The nature and character of such acts has been extremely varied, and have included instances where employees refused to commit perjury,<sup>258</sup> violate antitrust laws,<sup>259</sup> practice

251. 174 Cal. App. 2d 184, 344 P.2d 25 (1959).

252. *Id.* at 188, 344 P.2d at 27.

253. 85 Ill. 2d 124, 421 N.E.2d 876 (1981).

254. *Id.* at 130, 421 N.E.2d at 878 (citation omitted).

255. See *Parnar v. Americana Hotels, Inc.*, 65 Haw. 370, 380, 652 P.2d 625, 631 (1982); *Geary v. United States Steel Corp.*, 456 Pa. 171, 184, 319 A.2d 174, 180 (1974); *Thompson v. St. Regis Paper Co.*, 102 Wash. 2d 219, 232-33, 685 P.2d 1081, 1089 (1984).

256. See *Brockmeyer v. Dunn & Bradstreet*, 113 Wis. 2d 561, 577-79, 335 N.W.2d 834, 841 (1983).

257. *E.g.*, *Tameny v. Atlantic Richfield Co.*, 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980); *Petermann v. International Bhd. of Teamsters*, 174 Cal. App. 2d 184, 344 P.2d 25 (1959); *Trombetta v. Detroit, Toledo & Ironton R.R.*, 81 Mich. App. 489, 265 N.W.2d 385 (1978).

258. See, *e.g.*, *Petermann*, 174 Cal. App. 2d 184, 344 P.2d 25. The court in *Petermann* stated:

The commission of perjury is unlawful. It is also a crime to solicit the commission of perjury. The presence of false testimony in any proceeding tends to interfere with the proper administration of public affairs and the administration of justice. It would be obnoxious to the interests of the state and contrary to public policy and sound morality to allow an employer to discharge any employee, whether the employment be for a designated or

certain medical procedures without a license,<sup>260</sup> or violate an indecent exposure statute.<sup>261</sup>

A second basis of liability has been found where the employer discharges an employee for performing public responsibilities such as jury duty<sup>262</sup> or testifying before a grand jury.<sup>263</sup> This category also has embraced instances where an employee was fired for "blowing the whistle"<sup>264</sup> on illegal activities of the employer or co-workers.

Third, courts have imposed protection from traditional at-will discharge for employees who have been terminated in retaliation for exercising a legal right or privilege.<sup>265</sup> Typical examples of proscribed conduct fitting this area

unspecified duration, on the ground that the employee declined to commit perjury, an act specifically enjoined by statute. The threat of criminal prosecution would, in many cases, be a sufficient deterrent upon both the employer and employee, the former from soliciting and the latter from committing perjury. However, in order to more fully effectuate the state's declared policy against perjury, the civil law, too, must deny the employer his generally unlimited right to discharge an employee whose employment is for an unspecified duration, when the reason for the dismissal is the employee's refusal to commit perjury. To hold otherwise would be without reason and contrary to the spirit of the law. The public policy of this state as reflected in the penal code sections referred to above would be seriously impaired if it were to be held that one could be discharged by reason of his refusal to commit perjury. To hold that one's continued employment could be made contingent upon his commission of a felonious act at the instance of this employer would be to encourage criminal conduct upon the part of both the employee and the employer and would serve to contaminate the honest administration of public affairs. This is patently contrary to the public welfare. The law must encourage and not discourage truthful testimony. The public policy of this state requires that every impediment, however remote to the above objective, must be struck down when encountered.

*Id.* at 188-89, 344 P.2d at 27 (citations omitted).

259. *See, e.g.,* McNulty v. Borden, Inc., 474 F. Supp. 1111 (E.D. Pa. 1979); Tameny v. Atlantic Richfield Co., 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980); Parnar v. Americana Hotels, Inc., 65 Haw. 370, 652 P.2d 625 (1982).

260. *See, e.g.,* O'Sullivan v. Mallon, 160 N.J. Super. 416, 390 A.2d 149 (1978).

261. *See, e.g.,* Wagenseller v. Scottsdale Memorial Hosp., 147 Ariz. 370, 710 P.2d 1025 (1985).

262. *E.g.,* Nees v. Hocks, 272 Or. 210, 536 P.2d 512 (1975); Reuther v. Fowler & Williams, Inc., 255 Pa. Super. 28, 386 A.2d 119 (1978).

263. *E.g.,* Wiskotoni v. Michigan Nat'l Bank - West, 716 F.2d 378 (6th Cir. 1978).

264. *See* Tameny v. Atlantic Richfield Co., 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980); Sheets v. Teddy's Frosted Foods, Inc., 179 Conn. 471, 427 A.2d 385 (1980); Geary v. United States Steel Corp., 456 Pa. 171, 319 A.2d 174 (1974); Harless v. First Nat'l Bank, 246 S.E.2d 270 (W. Va. 1978). *See generally* Malin, *Protecting the Whistleblower From Retaliatory Discharge*, 16 MICH. J.L. REF. 277 (1983).

265. *Perks v. Firestone Tire & Rubber Co.*, 611 F.2d 1363 (3d Cir. 1979); *Kelsay v. Motorola, Inc.*, 74 Ill. 2d 172, 384 N.E.2d 353 (1978); *Frampton v. Central Indiana Gas Co.*, 260 Ind. 249, 297 N.E.2d 425 (1973).

would be where an employer discharges an employee for filing a claim under the worker's compensation laws<sup>266</sup> or engaging in union activities,<sup>267</sup> although it has also been more expansively interpreted to protect constitutional guarantees of free speech.<sup>268</sup>

The difficulties of defining public policy and the varied factual situations in which a legally protected policy expression may arise have presented courts with problems of clearly articulating standards to determine liability on a consistent basis. Additionally, some courts have complicated the analysis further by intermingling public policy considerations with the protections afforded by the implied covenant of good faith and fair dealing.<sup>269</sup> The confusion caused by this unfortunate overlay of two distinct bases of liability for wrongful discharge is exacerbated by those courts which have required a showing of a public policy mandate as a preliminary requirement before reaching the merits of liability under the implied good faith covenant.<sup>270</sup>

Two examples where courts have examined the interplay of public policy and good faith are *Cort v. Bristol-Myers Co.*<sup>271</sup> and *Wagenseller v. Scottsdale Memorial Hospital*.<sup>272</sup> In *Cort*, the Massachusetts Supreme Court further narrowed the scope of *Fortune* by holding that an at-will employee discharged without cause did not have a claim for bad faith termination although the employer gave a false reason or pretext for the discharge.<sup>273</sup> *Cort* is distinguishable from prior Massachusetts decisions in that the plaintiff alleged neither wrongful deprivation of earned commissions (as in *Fortune*) nor the loss of reasonably ascertainable future compensation based on prior services (as in *Gram I*). The significance of *Cort*, however, is that the court enunciated as a second basis for potential employer liability that the reason for discharge

266. *Kelsay*, 74 Ill. 2d 172, 384 N.E.2d 353; *Frampton*, 260 Ind. 249, 297 N.E.2d 425.

267. *Krystad v. Lau*, 65 Wash. 2d 827, 400 P.2d 72 (1965).

268. See *Novosel v. Nationwide Ins. Co.*, 721 F.2d 894 (3d Cir. 1983). In *Novosel*, the court stated:

Given that there are no statutory remedies available in the present case and taking into consideration the importance of the political and associational freedoms of the federal and state Constitutions, the absence of a statutory declaration of public policy would appear to be no bar to the existence of a cause of action. Accordingly, a cognizable expression of public policy may be derived in this case from either the First Amendment of the United States Constitution or Article I, Section 7 of the Pennsylvania Constitution.

*Id.* at 899.

269. See *Wynn v. Boeing Military Airplane Co.*, 595 F. Supp. 727 (D. Kan. 1984); *Cort v. Bristol-Myers Co.*, 385 Mass. 300, 431 N.E.2d 908 (1982); *Crowell v. Transamerica Delaware, Inc.*, 206 N.J. Super. 298, 502 A.2d 573 (1984).

270. See *Wagenseller v. Scottsdale Memorial Hosp.*, 147 Ariz. 370, 710 P.2d 1025 (1985); *Magnan v. Anaconda Indus.*, 193 Conn. 558, 479 A.2d 781 (1984).

271. 385 Mass. 300, 431 N.E.2d 908 (1982).

272. 147 Ariz. 370, 710 P.2d 1025 (1985).

273. *Cort*, 385 Mass. at 303, 431 N.E.2d at 911.

contravened some important public policy.<sup>274</sup> The court stated, "The employer's predatory motivation in the *Fortune* case can be classified as a reason contrary to public policy."<sup>275</sup> This language unfortunately mixes public policy analysis with the implied covenant of good faith and fair dealing.<sup>276</sup> The public policy limitation on the right of an employer to terminate an at-will employee should be viewed as an entirely separate basis for liability.

Another instance involving the interplay of public policy theory and the implied covenant of good faith and fair dealing as limitations on the power of employers to discharge at-will employees occurred in *Wagenseller v. Scottsdale Memorial Hospital*.<sup>277</sup> In that case, the plaintiff was employed in a management position as paramedic coordinator by the defendant hospital. The plaintiff had consistently received positive job performance evaluations, but was terminated after the relationship with her supervisor deteriorated following a camping and rafting trip with other hospital personnel. The plaintiff refused to participate in certain activities during the outing which arguably would have violated the state's indecent exposure statute. The Arizona Supreme Court held that the defendant could not fire the plaintiff for a bad cause contrary to the "public policy articulated by constitutional, statutory, or decisional law."<sup>278</sup>

With respect to the plaintiff's claim that the employer's conduct also constituted a breach of the implied covenant of good faith and fair dealing, however, a different result obtained. The court stated that the good faith covenant was implicit in the employment contract but served only to prevent the hospital from reaping a windfall of financial benefits earned by the employee for past services.<sup>279</sup> The court denied any compensation for prospective employment benefits because "the Hospital made no promise of continued employment. To the contrary, [the contract, being at-will,] was, by its nature subject to termination by either party at any time, subject only to the legal prohibition that she could not be fired for reasons which contravene public policy."<sup>280</sup> Finally, stating its concerns that the discretion of an employer in managing the work force should not be unduly restricted and that tenure was inconsistent with employment at-will, the court held that a no cause termination did not violate the implied good faith covenant.<sup>281</sup>

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274. *Id.* at 302, 431 N.E.2d at 910.

275. *Id.*

276. See *Wynn v. Boeing Military Airplane Co.*, 595 F. Supp. 727, 728-29 (D. Kan. 1984); *Howard v. Dorr Woolen Co.*, 120 N.H. 295, 297, 414 A.2d 1273, 1274 (1980); *Crowell v. Transamerica Delaval, Inc.*, 206 N.J. Super. 298, —, 502 A.2d 573, 574-75 (1984).

277. 147 Ariz. 370, 710 P.2d 1025 (1985).

278. *Id.* at 381, 710 P.2d at 1036.

279. *Id.* at 385, 710 P.2d at 1040.

280. *Id.* at 386, 710 P.2d at 1041.

281. *Id.*



The court's analysis is troubling in several respects. Significantly, the court improperly viewed the public policy exception to wrongful discharge as being co-extensive with the implied covenant of good faith and fair dealing. The factual basis which justified application of the public policy exception in tort should also have been sufficient to form the predicate for a separate and independent cause of action sounding in contract for breach of the implied covenant of good faith and fair dealing. This distinction becomes even more important to an aggrieved employee if the tort action for violations of public policy is unavailable either because the necessary public policy expression cannot be found or, on a more pragmatic level, if the shorter tort statute of limitations has already run.<sup>282</sup>

The *Wagenseller* facts provide an excellent illustration of the potential combination of tort and contract theory because the plaintiff had been discharged for a "bad cause" where the termination ran afoul of an Arizona public policy embodied in certain criminal statutes. The bad cause discharge was sufficient to violate public policy, and it certainly should have amounted also to a breach of the implied contractual covenant of good faith. What also makes *Wagenseller* interesting is that the hospital stood to derive no ascertainable pecuniary benefit from discharging the plaintiff. Therefore, the restitutionary component of the good faith covenant was not in issue. The court should have recognized that the discharged employee had a separate contractual expectation not to be fired for a "bad cause" which was distinct both from restitutionary theory and from the public policy exception.

In conclusion, there are several reasons why the public policy and good faith theories of liability should not be viewed as necessarily co-extensive. First, the policy underpinnings with respect to implied contract rights and public policy protections differ—the former focus on the expectations of the parties based upon the contract itself,<sup>283</sup> while the latter serve a broader purpose of ensuring protection of rights shared by the general public irrespective of agreement or status.<sup>284</sup> Secondly, the factual predicate which evidences a bad faith discharge may or may not be co-extensive with that justifying application of the public policy exception. This point is critical because some courts limit the applicability of the public policy exception to certain narrowly defined circumstances,<sup>285</sup> while the covenant of good faith

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282. See *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 328 P.2d 198 (1958); *Eisenberg v. Insurance Co. of North America*, 815 F.2d 1285 (9th Cir. 1987).

283. *Wagenseller*, 147 Ariz. at \_\_\_\_\_, 710 P.2d at 1040.

284. *Parnar v. Americana Hotels, Inc.*, 65 Haw. 370, 377-78, 652 P.2d 625, 631 (1982).

285. See, e.g., *Darlington v. General Elec.*, 350 Pa. Super. 183, \_\_\_\_\_, 504 A.2d 306, 318 (1986). In *Magnan v. Anaconda Indus.*, 193 Conn. 558, 479 A.2d 781 (1984), Associate Justice Parskey, concurring in part and dissenting in part, aptly provided the following illustration of why the covenant of good faith and fair dealing

and fair dealing should be read into all contracts.<sup>286</sup> Finally, the remedial consequences of the two theories may differ substantially. The public policy exception sounds in tort and may permit assessment of both compensatory and punitive damages.<sup>287</sup> Courts are split, however, as to whether a breach of the implied covenant of good faith and fair dealing should carry tort as well as contractual remedies.<sup>288</sup> Moreover the statute of limitations and the propriety of awarding attorney's fees may differ depending upon whether the cause of action is characterized in tort or in contract.<sup>289</sup>

### E. *Breach of the Good Faith Covenant: Contract vs. Tort Theory*

Courts have split over the question whether a breach of the covenant of good faith and fair dealing sounds in contract,<sup>290</sup> tort,<sup>291</sup> or both.<sup>292</sup> For example, in *Fortune v. National Cash Register Co.*,<sup>293</sup> the Massachusetts Supreme Court recognized the efficacy of a tort action to remedy a violation

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should be a separate legal basis for recovery from the public policy exception:

Assume that an employer falsely accuses an employee of theft of the employer's property. Assume further that the employer insists on the employee signing a statement admitting to the theft and upon the employee's refusal terminates the employment. Under these facts the employee should be able to bring an action for wrongful discharge in two counts, one based on a bad faith breach of the implied covenant, the other on a retaliatory discharge in violation of the public policy. If, in such case, the plaintiff can prove that he was discharged on the basis of a false accusation of theft but could not prove that the employer demanded that he sign a false statement then his failure to recover on the second should not preclude recovery on the first count.

*Magnan*, 193 Conn. at 580, 479 A.2d at 792-93.

286. *Cleary v. American Airlines, Inc.*, 111 Cal. App. 3d 443, 453, 168 Cal. Rptr. 722, 727-28 (1980).

287. *Parnar v. Americana Hotels, Inc.*, 65 Haw. 370, 378, 652 P.2d 625, 631 (1982).

288. See *Koehrer v. Superior Court*, 181 Cal. App. 3d 1155, 1171, 226 Cal. Rptr. 820, 828 (1986); *Cleary v. American Airlines, Inc.*, 111 Cal. App. 3d 443, 455-56, 168 Cal. Rptr. 722, 730 (1980); *Gates v. Life of Montana Ins. Co.*, 196 Mont. 178, 185, 638 P.2d 1063, 1067 (1982). Compare *Murray v. Bridgeport Hosp.*, 40 Conn. Supp. 56, \_\_\_\_\_, 480 A.2d 610, 612 (1984); *Fortune v. National Cash Register Co.*, 373 Mass. 96, 102, 364 N.E.2d 1251, 1256 (1977).

289. *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 662, 328 P.2d 198, 203 (1958).

290. *Fortune v. National Cash Register Co.*, 373 Mass. 96, 102, 364 N.E.2d 1251, 1256 (1977).

291. E.g., *K-Mart Corp. v. Ponsock*, 732 P.2d 1364, 1369 (Nev. 1987).

292. E.g., *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 430, 426 P.2d 173, 178, 58 Cal. Rptr. 13, 19 (1967); *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 660, 328 P.2d 198, 203 (1958); *Cubic Corp. v. Marty*, 185 Cal. App. 3d 438, \_\_\_\_\_, 229 Cal. Rptr. 828, 837 (1986).

293. 373 Mass. 96, 364 N.E.2d 1251 (1977).

of public policy, but determined that breach of the implied covenant of good faith and fair dealing would appropriately be remedied by a contract action.<sup>294</sup> In contrast, the Wisconsin Supreme Court in *Brockmeyer v. Dunn & Bradstreet*<sup>295</sup> adopted a restrictive approach by holding that contract rather than tort remedies should be applied in all wrongful discharge cases, including those involving a violation of public policy.<sup>296</sup> Characterization as a tort action rather than breach of contract has certain direct remedial consequences, including the recoverability of attorney's fees,<sup>297</sup> possible assessment of punitive damages,<sup>298</sup> and a shorter statute of limitations.<sup>299</sup>

A breach of the implied covenant of good faith and fair dealing was first treated as giving rise to an action in tort in the insurance context. In *Comunale v. Traders & General Insurance Co.*,<sup>300</sup> the court characterized the covenant as sounding in both contract and tort, giving the plaintiff freedom of election for statute of limitations purposes.<sup>301</sup> Similarly, in *Crisci v. Security Insurance Co.*,<sup>302</sup> the court allowed recovery of damages to compensate an insured for a judgment in a personal injury action and for mental suffering

294. *Id.* at 101, 364 N.E.2d at 1256.

295. 113 Wis. 2d 561, 335 N.W.2d 834 (1983).

296. *Id.* at 574-75, 335 N.W.2d at 841. The court stated:

Whether the cause of action for wrongful discharge should be maintained in tort or contract or both needs to be resolved. Those cases implying a contractual term of good faith dealing sounded in contract. Most, though not all of the public policy exception cases from other states were tort actions. The most significant distinction in our view between the two causes of action in wrongful discharge suits is in the damages that may be recovered. In tort actions, the only limitations are those of "proximate cause" or public policy considerations. Punitive damages are also allowed. In contract actions, damages are limited by the concepts of foreseeability and mitigation. The remedies established by the majority of Wisconsin wrongful discharge statutes are limited to reinstatement and backpay, contractual remedy concepts. We believe that reinstatement and backpay are the most appropriate remedies for public policy exception wrongful discharges since the primary concern in these actions is to make the wronged employee "whole." Therefore, we conclude that a contract action is most appropriate for wrongful discharges. The contract action is essentially predicated on the breach of an implied provision that an employer will not discharge an employee for refusing to perform an act that violates a clear mandate of public policy. Tort actions cannot be maintained.

*Id.*

297. *Sawyer v. Bank of America*, 83 Cal. App. 3d 135, 140, 145 Cal. Rptr. 623, 626 (1978).

298. *K-Mart Corp. v. Ponsock*, 732 P.2d 1364, 1373 (Nev. 1987).

299. *Eisenberg v. Insurance Co. of North America*, 815 F.2d 1285, 1291-92 (9th Cir. 1987); *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 662, 328 P.2d 198, 203 (1958).

300. 50 Cal. 2d 654, 328 P.2d 198 (1958).

301. *Id.* at 663, 328 P.2d at 203.

302. 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

as a result of the insurer's wrongful failure to settle.<sup>303</sup> In *Crisci*, with regard to the availability of the tort action, the court stated:

Fundamental in our jurisprudence is the principle that for every wrong there is a remedy and that an injured party should be compensated for all damage proximately caused by a wrongdoer. Although we recognize exceptions from these fundamental principles, no departure should be sanctioned unless there is a strong necessity therefore.<sup>304</sup>

Central to the imposition of tort remedies for breach of the covenant of good faith and fair dealing was the notion that a "special relationship" existed between the insurer and insured, characterized by a public interest in, and a fiduciary responsibility to protect, the interests of the insured.<sup>305</sup> In *Seaman's Direct Buying Service, Inc., v. Standard Oil Co.*,<sup>306</sup> the Supreme Court of California considered whether the implied covenant of good faith in a non-insurance, commercial context would permit application of tort remedies.<sup>307</sup> The court acknowledged the emphasis on the special relationship between insurer and insured as a key factor in the tort analysis<sup>308</sup> but, with an expression of caution, left open the question of whether it should be applied in other relationships:

When we move from such special relationships to consideration of the tort remedy in the context of the ordinary commercial contract, we move into largely uncharted and potentially dangerous waters. Here, parties of roughly equal bargaining power are free to shape the contours of their agreement and to include provisions for attorney fees and liquidated damages in the event of breach. They may not be permitted to disclaim the covenant of good faith but they are free, within reasonable limits at least, to agree upon the standards by which application of the covenant is to be measured.

In such contracts, it may be difficult to distinguish between breach of the covenant and breach of contract, and there is the risk that interjecting tort remedies will intrude upon the expectations of the parties. This is not to say that tort remedies have no place in such a commercial context, but that it is wise to proceed with caution in determining their scope and application.<sup>309</sup>

The court determined that a contracting party would be subject to tort liability when it breached the contract and attempted "to shield itself from

303. *Id.* at 434, 426 P.2d at 178-79, 58 Cal. Rptr. at 19.

304. *Id.* at 433, 426 P.2d at 178, 58 Cal. Rptr. at 18.

305. *Seaman's Direct Buying Serv. v. Standard Oil Co. of California*, 36 Cal. 3d 752, 768, 686 P.2d 1158, 1166, 206 Cal. Rptr. 354, 362 (1984); *K-Mart Corp. v. Ponsock*, 732 P.2d 1364, 1370-71 (Nev. 1987).

306. 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984).

307. *Id.* at 767, 686 P.2d at 1167, 206 Cal. Rptr. at 363.

308. *Id.* at 768, 686 P.2d at 1166, 206 Cal. Rptr. at 362.

309. *Id.* at 769, 686 P.2d at 1166-67, 206 Cal. Rptr. at 362-63.

liability by denying, in bad faith and without probable cause, that the contract exists."<sup>310</sup>

An issue left unresolved in *Seaman's* was whether other relationships possessed the indicia of a fiduciary character and public interest sufficient to apply tort and contract remedies. Several recent breach of employment contract cases,<sup>311</sup> both in California and elsewhere, have answered in the affirmative. In *K-Mart Corporation v. Ponsock*,<sup>312</sup> for example, the Nevada Supreme Court held that the employer's discharge of the plaintiff in order to deprive him of retirement benefits constituted a tortious breach of the covenant of good faith and fair dealing which justified a jury award of compensatory and punitive damages.<sup>313</sup> The court distinguished situations where an employer would be subject to contractual remedies for its failure to provide requisite notices or other agreed protections versus those instances where the employer acted in bad faith.<sup>314</sup> Thus, breach of the covenant of good faith and fair dealing would justify tort remedies only in situations evidencing a "special relationship" between the parties, such as in insurance, partnership and franchise agreements.<sup>315</sup> The court, limiting its inquiry to the particular relationship between the plaintiff and defendant, determined that sufficient elements of special reliance existed to assess tort liability.<sup>316</sup> The court posited a dual rationale in support of its holding — that contract damages would not make the plaintiff whole<sup>317</sup> and that such egregious con-

310. *Id.* at 769, 686 P.2d at 1167, 206 Cal. Rptr. at 363.

311. *Koehrer v. Superior Court*, 181 Cal. App. 3d 1155, 1171, 226 Cal. Rptr. 820, 829 (1986); *K-Mart Corp. v. Ponsock*, 732 P.2d 1364, 1371 (Nev. 1987).

312. 732 P.2d 1364 (Nev. 1987).

313. *Id.* at 1365. The court determined that certain provisions in an employee handbook issued by K-Mart modified the plaintiff's employment contract, making his status a tenured employee "until retirement" rather than being at-will. *Id.*

314. *Id.* at 1370.

315. *Id.* at 1370-71. The court reasoned:

The bad faith discharge case finds its origins in the so-called covenant of good faith and fair dealing implied in law in every contract. The fact that such a covenant exists by legislative fiat most certainly does not mean that out of every contract can emanate a tort action. Still, oftentimes tortious conduct arises out of or is related to a contractual relationship. A tort, however, requires the presence of a duty created by law, not merely a duty created by contract; and, although a duty of good faith and fair dealing is created by law in all cases, it is only in rare and exceptional cases that the duty is of such a nature as to give rise to tort liability. The kind of breach of duty that brings into play the bad faith tort arises only when there are special relationships between the tort-victim and the tortfeasor as described below.

*Id.* at 1370 (citations omitted).

316. *Id.* at 1372.

317. *Id.* at 1371. The court stated:

One of the underlying rationales for extending tort liability in the described kinds of cases is that ordinary contract damages do not adequately com-

duct on the part of the defendant should be deterred.<sup>318</sup> Accordingly, an award of punitive damages was merited.<sup>319</sup>

*Ponsock* and several recent California lower court cases<sup>320</sup> have interpreted *Seaman's* as drawing a distinction between breaches of an employment contract which give rise only to contractual remedies and situations where tort remedies may exist; the latter being evidenced, for example, by an employer's bad faith motivation of frustrating or depriving the employee of contract rights.<sup>321</sup> Thus, the availability of tort remedies for breach of the good faith covenant thus apparently turns upon whether some "plus factor" is present beyond a breach of contract by the employer. This plus factor may be a retaliatory response to certain employee conduct (which would find protection in the public policy exception) or, on a more mercenary level, may simply be the employer's attempt to gain a pecuniary benefit at the expense of an employee. Inquiries into employer motivations in discharging an employee may fail for lack of evidence if approached too subjectively.

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pensate the victim because they do not require the party in the superior or entrusted position, such as the insurer, the partner, or the franchiser, to account adequately for grievous and perfidious misconduct; and contract damages do not make the aggrieved, weaker, "trusting" party "whole."

*Id.*

318. *Id.* at 1372.

319. *Id.* at 1373. The court stated:

The use of punitive damages in appropriate cases of breach of the duty of good faith and fair dealing expresses society's disapproval of exploitation by a superior power and creates a strong incentive for employers to conform to clearly defined legal duties. Such duties are so explicit and so subject of common understanding as to justify the punitive award.

*Id.*

320. See *Koehrer v. Superior Court*, 181 Cal. App. 3d 1155, 226 Cal. Rptr. 820 (1986); *Khanna v. Microdata Corp.*, 170 Cal. App. 3d 250, 215 Cal. Rptr. 860 (1985).

321. See *Koehrer v. Superior Court*, 181 Cal. App. 3d 1155, 1171, 226 Cal. Rptr. 820, 829 (1986); *Khanna v. Microdata Corp.*, 170 Cal. App. 3d 250, 262-63, 215 Cal. Rptr. 860, 867 (1985); *K-Mart Corp. v. Ponsock*, 732 P.2d 1364, 1370 (Nev. 1987). This dichotomy was stated by the court in *Koehrer* as follows:

In our view the standard developed in *Seaman's* is appropriate to distinguish between the simple breach of an employment contract by discharge of the employee without good cause and a breach of the implied covenant of good faith and fair dealing affording tort remedies. If the employer merely disputes his liability under the contract by asserting in good faith and with probable cause that good cause existed for discharge, the implied covenant is not violated and the employer is not liable in tort. If, however, the existence of good cause for discharge is asserted by the employer without probable cause and in bad faith, that is, without a good faith belief that good cause for discharge in fact exists, the employer has tortiously attempted to deprive the employee of the benefits of the agreement, and an action for breach of the implied covenant of good faith and fair dealing will lie.

*Koehrer*, 181 Cal. App. 3d at 1170-71, 226 Cal. Rptr. at 829 (citation omitted).

Therefore, bad faith should be measured, if possible, by an objective standard.

The divergent viewpoints concerning treatment of a breach of the implied covenant of good faith and fair dealing as sounding in contract or in tort may be harmonized. The tort duty may be manifested in expressions of public policy or in those circumstances where an employer's conduct in discharging the employee is so egregious that it demands deterrence. Otherwise, characterization as a contract action should control.

#### IV. CONCLUSION

The employment at-will doctrine gives the employer the absolute freedom, without risk of incurring liability, to discharge an employee who is not otherwise protected by public law, a collective bargaining agreement, or a private contract. Courts have limited this harsh common law rule by recognizing a tort cause of action to redress employer conduct which contravenes some important public policy, by recognizing that job security rights may be implied-in-fact in the employment contract, and by acknowledging an implied-in-law covenant of good faith and fair dealing that the employer shall not act in a manner which deprives an employee of the benefits of the employment agreement.

Whether specific statements by an employer concerning job security may be properly characterized as an implied-in-fact modification of the employment contract should be evaluated by the objective manifestations of intent by the employer. If the employer reasonably expects compliance with the terms of a personnel manual or handbook, and by their issuance and dissemination intends to promote an expectation of job security, then courts should treat the provisions as enforceable promises.

The objection that an employee must provide new and independent consideration apart from his contemplated job services should be rejected in favor of the view that a single performance can furnish consideration for multiple promises and that courts should not inquire into the adequacy of consideration. This approach has the further practical advantage of relieving courts of the necessity of making tenuous determinations of whether the independent consideration test is satisfied by an employee's longevity of service, foregoing other job opportunities, or relocating to take the position. Moreover, the objection that mutuality of obligation is lacking because an at-will employee is not bound to continue working for a given employer is similarly outmoded and should be discarded. The relevant inquiry should instead be whether or not the employment contract initially was supported by sufficient consideration.

Implied promises of job security have been rendered unenforceable in certain instances by disclaimers made by employers in the policy manual or

handbook. Application and interpretation of disclaimer provisions has been inconsistent and unpredictable due, in large part, to a fundamental misconception concerning the label "disclaimer" and its proper function. The term "disclaimer" necessarily implies that substantive rights would otherwise be enjoyed by one party but for being excluded or modified by the disclaimer. In the unilateral employment contract setting, though, such a characterization is inaccurate because the provision does not limit or extinguish existing rights. Instead, the "disclaimer" operates to temper statements concerning job security so that they are not elevated to the level of enforceable promises. The distinction is more than a semantic exercise because of certain derivative issues pertinent to disclaimers, such as whether the statement must be "conspicuous," whether inconsistent representations negate its effect, and whether employee reliance and the timing of issuance negate the statements' effectiveness. Courts could avoid these problems by treating "disclaimer" language as evidentiary of whether the employer objectively intended employees to comply with the particular terms. If so, then reliance by all employees on the provisions should be presumed and the language should be implied-in-fact as enforceable promises into the employment contract. If not, then the handbook provisions should not be characterized as binding contractual promises.

The at-will doctrine should be modified to continue to allow the discharge of employees for good cause or no cause, but should be circumscribed by an implied-in-law covenant of good faith and fair dealing which would prevent firings for a "bad cause." The covenant should be implied by courts in all employment contracts and, to have meaning, must be nonwaivable and nondisclaimable.

The policy against bad faith discharges should properly be reflected in both tort and contract rights and duties. The tort duty should be narrowly tailored to provide redress against discharges which either violate public policy or, absent public policy implications, against instances of particularly egregious employer conduct. Courts must recognize that the public policy exception to the at-will rule is not co-extensive with the implied contractual covenant of good faith and fair dealing but merely reflects one aspect of the general policy against bad faith discharges. The public policy exception principally reflects a societal interest in the observance of statutory and constitutional law, while the contractual covenant of good faith safeguards relations of the employer and employee *inter se*.

The policy against bad faith discharges includes protection of the employee's expectancy, reliance, and restitution interests in the employment arrangement. Following the lead of the Massachusetts decisions, courts have begun to recognize that restitutionary principles require that an employer not be unjustly enriched at the expense of an at-will employee. The covenant of good faith, however, must also be recognized to protect the expectancy and



reliance interests of employees. Although at-will employees by definition have no justifiable expectation of continued or life-time employment, nor to be discharged only for "good cause," it is reasonable to expect protection against a bad faith dismissal. Recognition of this expectancy interest properly accommodates the balance between employer discretion in managing a work force and an employee's interest in job security, and is consonant with the overriding principle of good faith contractual performance.