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Judicial Backpedaling: Putting the Brakes on California's Law of Wrongful Termination

Lawrence C. Levine*

For more than a century American law has proclaimed that the employment relationship is "at will."¹ Thus, absent an agreement to

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1. The creation of the "at-will" doctrine is credited to Horace C. Wood, who later presented a detailed development of the theory in his 1877 treatise, *Master and Servant*. H. WOOD, *MASTER AND SERVANT* § 134 (1877). By the time the at-will doctrine received its first judicial adoption by the New York high court in 1885, some jurisdictions, such as California, already had statutorily adopted the doctrine. See *infra* note 5. By the end of the 19th century, the doctrine was accepted in every jurisdiction in the United States. See Mauk, *Wrongful Discharge: The Erosion of 100 Years of Employer Privileges*, 21 IDAHO L. REV. 202, 203 (1985).

An "at-will" employee is an employee hired for an unspecified term, who works without the protections afforded by union contracts. Because union collective bargaining agreements typically limit the employer's right to terminate an employee to cases in which there is "just cause" (see *infra* note 46), the approximately 19% of the California work force that is unionized is unaffected by many of the developments discussed in this article. Cal. Dept. Indus. Relations, *Union Report* (1987) (publication forthcoming); CAL. LABOR MARKET BULLETIN STATISTICAL SUPPLEMENT (Aug. 1987). See Bastress, *A Synthesis and a Proposal for Reform of the Employment At-Will Doctrine*, 90 W. VA. L. REV. 319, 321-22 (1988). Nationally, approximately three-fourths of the work force is employed "at will." Mauk, *supra*, at 204. However, even a unionized employee may assert a cause of action for termination in violation of public policy. *Garibaldi v. Lucky Food Stores*, 726 F.2d 1367 (9th Cir. 1983). Some workers, such as government employees who are part of the civil service system or professors with tenure, are also outside the at-will employment sphere.

the contrary, an employer has been free to fire an employee regardless of motive—for bad cause, good cause or no cause at all.² The at-will doctrine was a logical outgrowth of the prevailing climate in the late nineteenth century, a period marked by fast-paced industrial expansion, laissez-faire economics, and social Darwinism.³ Concerned with natural law concepts of contract and property law, the Supreme Court of the United States buttressed this laissez-faire sentiment with a string of decisions finding governmental intrusion into the employment relationship violative of the Constitution.⁴

California followed the national trend of embracing the at-will doctrine, becoming the first jurisdiction to provide a statutory articulation of the doctrine.⁵ Even today, California law provides that “an

2. Lopatka, *The Emerging Law of Wrongful Discharge—A Quadrennial Assessment of the Labor Law Issue of the 80s*, 40 BUS. LAW. 1, 1 (1984); Madison, *The Employee's Emerging Right to Sue for Arbitrary or Unfair Discharge*, 6 EMP. RELAT. L.J. 422 (1980-81); Note, *Employment-At-Will—Employers May Not Discharge At-Will Employees for Reasons that Violate Public Policy*, 1986 ARIZ. ST. L.J. 161, 161 (1986) (the traditional American rule is that employers may discharge an at-will employee “for good cause, for no cause, or even for cause morally wrong . . .”).

3. Mauk, *supra* note 1, at 202; Note, *Employers Beware: The Implied Contract Exception to the Employment At-Will Doctrine*, 28 B.C.L. REV. 327, 327 (1987) (noting that during the mid-1800s U.S. employment law discarded earlier protections afforded by master-servant law and focused on the contractual relationship between the employer and employee because of emerging notions of freedom of contract and an increasing awareness of the economic value of industrial growth). The creation of an “at will” doctrine in the United States departed from English common law, which afforded protections to employees hired for an unspecified term. Mauk, *supra* note 1, at 203; Note, *supra* note 2, at 164.

4. See, e.g., *Lochner v. New York*, 198 U.S. 45 (1905), in which the United States Supreme Court, asserting notions of economic due process, invalidated a New York law setting maximum hours of employment for bakery employees on the ground that the statute unreasonably interfered with the right of contract between employer and employees. The Court asserted that the New York law was “an illegal interference with the rights of individuals, both employers and employees, to make contracts regarding labor upon such terms as they may think best, or which they may agree upon with the other parties to such contracts.” *Id.* at 61. Further, the Court found such interference in the “freedom of the master and employee to contract with each other in relation to their employment [relationship]” violative of the United States Constitution. *Id.* at 64. See also *Adair v. United States*, 208 U.S. 161 (1908). In *Adair*, the Supreme Court struck down a federal statute prohibiting common carriers from dismissing employees for union membership, holding that the constitutional protections prohibiting the deprivation of liberty and property without due process of law restricted the ability of government to compel persons to perform services for another or to accept or retain the services of another. *Id.* at 174. By the mid-20th century, the Supreme Court had reversed its position and upheld legislative protection of workers. See, e.g., *United States v. Darby*, 312 U.S. 100 (1941).

5. See Mauk, *supra* note 1, at 203. Originally enacted in 1872 as part of the California Civil Code, former section 1999 as amended provided: “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 shall mean an employment for a period greater than one month.” 1915 Cal. Stat. ch. 433, sec. 1, at 720. In 1937, when the Labor Code was first enacted, former section 1999 was virtually reenacted as section 2922 of the California Labor Code. See 1937 Cal. Stat. ch. 90, sec. 2922, at 261. The at-will provision of the Labor Code has changed little from its earliest formulation. *Hejmadi v. AMFAC, Inc.*, 202 Cal. App. 3d 525, 532, 249 Cal. Rptr. 5, 15 (1988).

employment, having no specified term, may be terminated at the will of either party on notice to the other.”⁶

In light of a changed social sphere with less of a laissez-faire mentality⁷ and marked by a transformed employment environment,⁸ the at-will doctrine has become highly criticized.⁹ Some of this criticism has been effective, and the employer's once unbridled discretion has been increasingly restricted. Significant limitations have been created by legislative enactments.¹⁰ More recently, the courts have imposed

6. CAL. LAB. CODE § 2922 (West Supp. 1989). Section 2922 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 greater than one month.” *Id.* The Labor Code specifies, however, that an employment contract for a definite term is terminable only for good cause. *See id.* § 2924.

7. *See Rohwer, Terminable-At-Will Employment: New Theories for Job Security*, 15 PAC. L.J. 759, 761 (1984) (“The early part of the twentieth century may have been seen as the zenith of both pure capitalism and pure freedom of contract in the United States. Although neither should be pronounced dead, this century has witnessed an erosion, or at least a softening, of both concepts.”)

8. *See Mauk, supra* note 1, at 204-05. Mauk notes that, because the opportunities for self-employment have continuously decreased over this century, nearly 90% of American wage or salary earners are dependent upon others for almost all income. *Id.* The importance of the evolution of the relationship of the employer and employee cannot be over-stated. As Professor Corbin noted:

The relations between master and servant, employer and employee, have been subject to constant evolution during the history of Anglo-American law. It is not too much to say that this is the most important and far-reaching manifestation of the evolution of society, of human civilization of the legal, social, political, and economic relations of men and women with each other.

A. CORBIN, CONTRACTS, Ch. 34, § 674 (1960).

9. *See, e.g.,* Bastress, *supra* note 1, at 320; Mauk, *supra* note 1, at 202; Note, *Implied Contract Rights to Job Security*, 26 STAN. L. REV. 335 (1974). The at will doctrine places the United States at odds with most other industrialized nations. *See* Gould, *Stemming the Wrongful Discharge Tide: A Case for Arbitration*, 13 EMP. REL. L.J. 404, 408-09 (1988) (“The western European countries, Canada, at least in Quebec and Nova Scotia, among federally covered employees, and Japan provide for some limitation upon employer discretion in dismissal.”); Note, *Protecting At-Will Employees Against Wrongful Discharge: The Duty To Terminate Only in Good Faith*, 93 HARV. L. REV. 1816 (1980). *But see* Larson, *Why We Should Not Abandon the Presumption that Employment is Terminable At Will*, 23 IDAHO L. REV. 219 (1986-87). *See generally* Comment, *From Tamenny to Foley: Time for Constitutional Limitations on California's Employment at Will Doctrine*, 15 HASTINGS CONST. L.Q. 359 (1988).

10. There is extensive legislation passed by the federal government and the California Legislature that greatly affects the right of an employer to terminate an employee. For example, many federal and state statutes prohibit an employer from discriminating against employees on the basis of certain factors, such as sex, age, race, religion and handicap. *See, e.g.,* Civil Rights Act of 1964, 42 U.S.C. § 2000e-2 (1982) (prohibiting discrimination based on race, color, religion, sex, national origin); CAL. GOV'T CODE §§ 12900-12996 (West 1980 & Supp. 1989) (California Fair Employment and Housing Act prohibiting discrimination against employees because of race, color, religion, national origin, physical handicap, medical condition, ancestry, marital status, sex and pregnancy). Thus, legislation has significantly limited the employer's freedom to terminate at will when the motivation for discharge is contrary to “the public good.” Note, *supra* note 3, at 336.

Legislative action in the realm of wrongful dismissal, however, is rare. *See* Perritt, *Wrongful Dismissal Legislation*, 35 UCLA L. REV. 65 (1987). Recent legislative efforts in California seeking

constraints on employers. As a result of these judicial efforts, a majority of jurisdictions in the United States now recognize some non-statutory limitations on the at-will doctrine.¹¹ It is the alleged violation of these non-statutory restrictions by the employer that gives rise to legal actions based upon claims of "wrongful termination."¹²

During the last decade, California stood firmly in the forefront of judicial efforts to protect workers from wrongful termination. Through a series of decisions by the California Supreme Court and the California Courts of Appeal, the legislative pronouncement that the employment relationship in California is "at-will"¹³ became subject to an increasing number of limitations.¹⁴ Three distinct theories of possible recovery for an employee alleging wrongful termination ultimately were fashioned by the courts: termination in violation of public policy,

to limit the broad pre-Foley protections established by California courts have thus far been unsuccessful. *Legislators Fail to Deal with Wrongful Termination*, *The Daily Recorder*, July 19, 1988, at 1, col. 1. In light of *Foley's* limitations on the rights of employees, perhaps the legislative arena will take on added importance in the area of wrongful termination in the near future. See *infra* notes 118-123 and accompanying text.

11. Mauk, *supra* note 1, at 204.

12. Commentators and courts use interchangeably several terms that refer to the general category of actions that an employee may bring for claims of unjust dismissal. Mauk, *supra* note 1, at 207. Here the actions are all referred to as actions for "wrongful discharge" or for "wrongful termination," although a more specific basis for recovery needs to be alleged. See *infra* note 15 and accompanying text. Further, an employee need not be actually discharged from employment to bring a wrongful termination action. If an employee is wrongfully demoted, transferred, or the like, the employee may claim constructive discharge, bringing a wrongful termination action as appropriate. Constructive discharge also may arise where the employer's conduct is so intolerable that the employee feels compelled to resign. See *Brady v. Elixir Indus.*, 196 Cal. App. 3d 1299, 242 Cal. Rptr. 324 (1987). See also *Baxter & Farrell, Constructive Discharge—When Quitting Means Being Fired*, 7 EMP. REL. L.J. 346 (1981-82).

Of course, an employee may have other causes of action—either along with a wrongful termination action or completely separate—that arise from tortious conduct in the workplace, such as defamation and intentional infliction of emotional distress. See, e.g., *Bleeke, Intentional Infliction of Emotional Distress in the Employment At Will Setting: Limiting the Employer's Manner of Discharge*, 60 IND. L.J. 365 (1985). Because such causes of action are not directly affected by the *Foley* decision (except to the extent they take on added importance as other avenues of recovery are limited), they are not discussed in this article.

13. See *supra* note 6.

14. One author has suggested that the exceptions to the at-will doctrine are so broad and numerous that only "bad luck" prevents an unjustly discharged employee from civil recovery. *Bastress, supra* note 1, at 319. Under any realistic interpretation of the judicially-crafted exceptions to the at-will doctrine, the author greatly overstates his case. There clearly remains ample opportunity for an employer to terminate a truly at-will employee without proof of "just cause." *Carley, At-Will Employees Still Vulnerable*, 73 A.B.A. J., Oct. 1987, at 66. See also *Shapiro v. Wells Fargo Realty Advisors*, 152 Cal. App. 3d 467, 199 Cal. Rptr. 613 (1984) (affirming trial court's dismissal of plaintiff's complaint alleging the three bases for wrongful termination). The exceptions, however, established that section 2922 of the California Labor Code creates a rebuttable presumption that at-will employment is terminable at will, subject to rebuttal by specified contract and tort theories. *Hejmadi v. AMFAC, Inc.*, 202 Cal. App. 3d 525, 532, 249 Cal. Rptr. 5, 11 (1988).

termination in breach of an implied-in-fact contract, and termination in breach of the implied covenant of good faith and fair dealing (occasionally referred to as "bad faith breach" or "tortious breach").¹⁵ At the time of the resolution of *Foley v. Interactive Data Corp.*¹⁶ by the California Supreme Court, these theories of recovery had not developed beyond their nascent stage. The undefined parameters of each theory of recovery led to an explosion of wrongful termination lawsuits,¹⁷ which in turn spawned bewildering and often conflicting judicial decisions.¹⁸

The legal community looked forward to clarification and guidance from California's high court in its decision of *Foley*.¹⁹ Recently the badly divided court spoke, rendering an opinion that clearly ends the judicial expansion of tort recovery for wrongful termination law in California. Although the majority of the court restricted tort actions for wrongful termination in several critical ways, some common law

15. Miller & Estes, *Recent Judicial Limitations on the Right to Discharge: A California Trilogy*, 16 U.C. DAVIS L. REV. 65, 68 (1982).

16. 47 Cal. 3d 654, 765 P.2d 373, 254 Cal. Rptr. 211 (1988).

17. Gould, *supra* note 9, at 405.

18. The confusion regarding the state of wrongful termination law arose for several reasons. First, only one of the three recognized theories of recovery—discharge in violation of public policy—emanated from a decision of the California high court. *Tameny v. Atlantic Richfield Co.*, 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980). And that decision left several unresolved issues. *Compare* *Shapiro v. Wells Fargo Realty Advisors*, 152 Cal. App. 3d 467, 478, 199 Cal. Rptr. 613, 618 (1984) (public policy must be grounded in statutory basis) *with* *Hentzel v. Singer Co.*, 138 Cal. App. 3d 290, 295, 188 Cal. Rptr. 159, 161-62 (1982). *See also infra* notes 31-32 and accompanying text. The other theories of recovery—breach of the implied-in-fact contract and tortious breach of an employment contract—were creations of appellate courts and were defined and fashioned in a myriad of ways, largely reflective of the enthusiasm of the appellate panel for wrongful termination causes of action. *Compare* *Newfield v. Insurance Co. of the W.*, 156 Cal. App. 3d 440, 446, 203 Cal. Rptr. 9, 13 (1984) (implied-in-fact theory of contract recovery was barred by the statute of frauds) *with* *Steward v. Mercy Hospital*, 188 Cal. App. 3d 1290, 1295, 233 Cal. Rptr. 881, 884 (1987) (expressly disagreeing with *Newfield* and holding that an implied-in-fact employment contract is not barred by the statute of frauds). *See infra* note 89. *Compare* *Ortiz v. Bank of America Nat'l Trust & Sav. Ass'n*, 852 F. 2d 383, 388 (9th Cir. 1988) (action for tortious breach may arise independently of contract breach) *with* *Hejmadi v. AMFAC, Inc.*, 202 Cal. App. 3d 525, 548, 249 Cal. Rptr. 5, 18 (1988) (breach of contract prerequisite to tortious breach cause of action).

Further, many of the appellate decisions were understandably uncertain about the state of the law on wrongful termination, failing to distinguish causes of action based in tort from those based on contract. As Justice Kaufman, then serving as an appellate court justice in the Fourth Appellate District, noted:

The opinions in a number of decisions addressing liability for 'wrongful discharge' have evinced some ambivalence, if not confusion, as to the legal basis for recovery, often discussing in the same case theories of implied contract, violation of public policy and breach of the covenant of good faith and fair dealing.

Koehrer v. Superior Court, 181 Cal. App. 3d 1155, 1163, 226 Cal. Rptr. 820, 824 (1986). *See also* *Mauk, supra* note 1, at 206.

19. *See* *Foley Decision is Awaited*, *The Daily Recorder*, Sept. 28, 1988, at 1, col. 1; Jensen, *Developments in California Wrongful Termination Law*, 10 INDUS. REL. L.J. 27, 28 (1988).

rights of a discharged at-will employee survive. Indeed, recovery for wrongful discharge based in contract may actually expand in light of the decision. The parameters of these surviving theories will be refined in the years to come.

This article analyzes *Foley*'s impact on California's wrongful termination law. Section One traces the development of wrongful termination law in California, providing a synopsis of the pre-*Foley* state of California wrongful termination law. As will become evident, the pre-*Foley* state of wrongful termination law, particularly as it applied to claims of tortious breach of the implied covenant of good faith and fair dealing, was badly jumbled and ill-defined. The second section examines the *Foley* decision, outlining the most salient features of the opinion and highlighting the impact of *Foley* on each of the previously recognized common-law bases for a wrongful termination claim. The third section evaluates the post-*Foley* state of wrongful termination law in California and delineates several key issues that remain unresolved after *Foley*. The article concludes that, although *Foley* represents a clear move away from the expansionist trend of the courts in the wrongful termination area evidenced earlier in the decade, only later court decisions and legislative action (or inaction) will demonstrate the degree to which employees in California will be limited in their attempts to procure full compensation when wrongfully terminated. The scope of most wrongful termination actions will likely be determined by subsequent judicial interpretation of California contract law, and the court's adherence to "modern" contract principles in *Foley* may signal expanded recovery in the contract realm for the wrongfully terminated employee. To ensure the existence of an appropriate remedy for a wrongfully terminated employee, California contract law must be interpreted in a manner that provides adequate compensation, and which impedes employer efforts to evade or to unduly restrict contractual liability. Further, the *Foley* decision may ultimately spark the legislature into action, involving the legislative branch in an important area that has heretofore been left largely to the courts.

I. THE STATE OF CALIFORNIA WRONGFUL TERMINATION LAW BEFORE *FOLEY*

California courts developed three allegedly²⁰ distinct bases for a wrongful termination action: public policy, implied-in-fact contract,

20. Although each of the three causes of action arose separately, enormous overlap existed

and covenant of good faith and fair dealing. The Supreme Court's decision in *Foley* can only be appreciated with an understanding of the development of these three theories of recovery.

A. *The Public Policy Exception*

The first nonlegislative limitation on the largely unrestricted right of an employer to discharge an at-will employee occurred in the 1959 decision of *Petermann v. Teamsters*.²¹ In *Petermann*, a California appellate court found that an employer could be liable for terminating an employee for that employee's refusal to commit the crime of perjury. While recognizing a broad right of an employer to terminate an "at-will" employee without cause,²² the court, without citation to authority, noted that the employer's right to terminate an employee is limited by "considerations of public policy."²³ The court admitted that a precise definition of the term "public policy" was not possible, and noted that the term connotes "that principle of law which holds that no citizen can lawfully do that which has a tendency to be injurious to the public or against the public good"²⁴ The court concluded that 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 unspecified duration, on the ground that the employee declined to . . . [do] an act specifically enjoined by statute."²⁵ The court did not resolve whether the plaintiff's action sounded in tort or in contract.

It was not until *Tameny v. Atlantic Richfield Co.*²⁶ that the California Supreme Court adopted the *Petermann* rationale. The court

between the cause of action for breach of the implied-in-fact contract and tortious breach of the implied covenant of good faith and fair dealing. It became difficult to distinguish between these two causes of action. See *infra* notes 57-61.

21. 174 Cal. App. 2d 184, 344 P.2d 25 (1959).

22. *Petermann*, 174 Cal. App. 2d at 188, 344 P.2d at 27. The court stated: "Generally, such a relationship is terminable at the will of either party for any reason whatsoever." *Id.* (citation omitted).

23. *Id.*

24. *Id.* (citing *Safeway Stores, Inc. v. Retail Clerks Int'l Ass'n*, 41 Cal. 2d 567, 575, 261 P.2d 721, 722 (1953)). The *Safeway* case went on to explain: "Public policy means . . . anything which tends to undermine that sense of security for individual rights, whether of personal liberty or private property, which any citizen ought to feel is against public policy." *Safeway*, 41 Cal. 2d at 574, 261 P.2d at 726 (citing *Noble v. Palo Alto*, 89 Cal. App. 47, 50-51, 236 P. 529 (1928)).

25. *Petermann*, 174 Cal. App. 2d at 188-89, 344 P.2d at 27.

26. 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980).

held that an action for wrongful termination based upon public policy is based in tort. In *Tameny*, as in *Petermann*, the plaintiff claimed he was terminated for his refusal to engage in criminal conduct.²⁷ Adopting the *Petermann* rationale that an action for wrongful termination lies where an employee is discharged in contravention of "fundamental principles of public policy,"²⁸ the court rejected the defendant's claim that, because the employer-employee relationship was one founded in contract, the plaintiff's remedy for wrongful termination should be limited to contract damages.²⁹ The court concluded that tort damages were appropriate because liability was not imposed for breach of any express or implied promises in the employment agreement, but rather because the defendant breached "a duty imposed by law upon all employers in order to implement the fundamental public policies embodied in the state's penal statutes."³⁰

In the wake of the *Tameny* decision, it remained unclear precisely what constituted "public policy" for purposes of the tort cause of action. *Tameny* clarified that the "public policy" exception included situations where the employer sought to force an employee to violate a public policy encompassed in a state statute, thereby indicating that

27. *Tameny* alleged that he was discharged because of his refusal to engage in an illegal price fixing scheme. *Tameny*, 27 Cal. 3d at 169, 610 P.2d at 1331, 164 Cal. Rptr. at 840.

28. *Id.* at 174, 610 P.2d at 1334, 164 Cal. Rptr. at 843.

29. *Id.* Some jurisdictions, while recognizing a cause of action for wrongful termination in violation of public policy, treat the action as one for breach of contract, thereby limiting the plaintiff's recovery to contract damages. See, e.g., *Brockmeyer v. Dun & Bradstreet*, 113 Wis. 2d 561, 335 N.W.2d 834 (1983) (Wis. 1983) (limiting remedy for public policy for wrongful discharge to reinstatement and back pay). Cf. *De Rose v. Putnam Management Co.*, 398 Mass. 205, 496 N.E.2d 428 (1986) (contract damages to employee discharged in violation of public policy not inadequate).

30. *Tameny*, 27 Cal. 3d at 176, 610 P.2d at 1335, 164 Cal. Rptr. at 844. See *Mauk*, *supra* note 1, at 229 ("The public policies arise from the employment relationship itself, and not from any condition stated in an employment contract. For this reason, actions for wrongful discharge in breach of public policy are best characterized as tort actions . . ."). See also *Koehrer v. Superior Court*, 181 Cal. App. 3d 1155, 1165, 226 Cal. Rptr. 820, 826 (1986).

The impact of the *Tameny* decision came as much from what the court declined to decide as from what the court did decide. In a footnote in the decision, the court expressly left open the question of whether a tort recovery would be available in a wrongful termination action for "breach of the implied-at-law covenant of good faith and fair dealing inherent in every contract." The court noted that such a theory had been recognized in other jurisdictions and had been established in California in the context of insurance contracts. *Tameny*, 27 Cal. 3d at 179 n.12, 610 P.2d at 1337 n.12, 164 Cal. Rptr. at 846 n.12. See also *Madison, The Employee's Emerging Right to Sue for Arbitrary or Unfair Discharge*, 6 EMP. REL. L.J. 422 (1980-81). The Supreme Court in a subsequent case again suggested that an action for tortious breach of contract may lie in the employment context. *Seaman's Direct Buying Corp. v. Standard Oil Co.*, 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984). Later courts seized upon this language as grounds to permit a tort action for breach of the covenant of good faith and fair dealing in the employment context. See, e.g., *Wallis v. Superior Court*, 160 Cal. App. 3d 1109, 207 Cal. Rptr. 123 (1984). See also *infra* notes 108-109 and accompanying text.

the public policy exception was not restricted to incidents where the employer's conduct of terminating the employee was expressly prohibited by statute.³¹ Notwithstanding the broad language used by the *Petermann* court to define "public policy," later California appellate cases disagreed about the appropriate sources of the public policies underlying the cause of action. It was uncertain whether a wrongful termination action had to be based upon discharge in violation of a "public policy" encompassed in a statute, or whether "public policy" transcended statutory definition and could include those situations in which the court determined that the cause of action should be appropriate.³² The bar, the bench and the academicians expected the court to resolve this uncertainty in its decision in *Foley*.

B. Implied-in-Fact Promises

The second judicially-created exception to the at-will doctrine applied general theories of contract law and found, in certain situations, that an employer's words or conduct created a limitation on the employer's right to terminate at will. The general rule provides that an employment relationship in which the duration of employment is unspecified is presumed terminable at the discretion of either the employer or the employee for good cause, for bad cause or for no cause.³³ At the

31. *Tameny*, 27 Cal. 3d at 174, 610 P.2d at 1332, 164 Cal. Rptr. at 842.

32. *Compare* *Shapiro v. Wells Fargo Realty Advisors*, 152 Cal. App. 3d 467, 477, 199 Cal. Rptr. 613, 618 (1984) (no action unless the plaintiff can establish that dismissal was caused by refusal to perform an illegal act (as in *Tameny* and *Petermann*) or because the employer directly violated a statute by dismissing the employee, and courts lack the power to declare public policy in wrongful termination cases without statutory support) *with* *Dabbs v. Cardiopulmonary Management*, 188 Cal. App. 3d 1437, 1443, 234 Cal. Rptr. 129, 133 (1987) (the court, noting that the legislature is not the only source of fundamental principles of public policy, permitted employee's action where employee was terminated in retaliation for refusal to work in an understaffed respiratory care department) *and* *Hentzel v. Singer Co.*, 138 Cal. App. 3d 290, 188 Cal. Rptr. 159 (1982) (permitting plaintiff's action based on the claim that she had been terminated because of her complaints of other employees smoking in the workplace even though there was neither a legislative provision preventing termination for such a protest nor any statute expressly dealing with smoking in the workplace). *Cf.* *Garcia v. Rockwell Int'l Corp.*, 187 Cal. App. 3d 1556, 1561, 232 Cal. Rptr. 490 (1986) (holding that "an employee can maintain a tort claim against his or her employer where disciplinary action has been taken against the employee in retaliation for the employee's 'whistle-blowing' activities, even though the ultimate sanction of discharge has not been imposed").

33. Note, *supra* note 3, at 331-32 (1987). The great majority of employment relationships are entered into through oral agreements that specify wages, hours and, to a varying degree, other matters dealing with the working conditions. These employment agreements typically fail to specify a duration of employment. Courts usually imply an employment relationship terminable at will when the employment contract is silent as to this term. *See* J. CALAMARI & J. PERILLO, *CONTRACTS* § 2.9 (1987). In California, an at-will relationship is presumed and implied based on

same time, the employment relationship is contractual.³⁴ Accordingly, the parties to the contract may mutually agree to define the terms of the employment relationship agreement, such as by limiting the employer's right to discharge the employee to cases where there is "just cause" to do so.³⁵

By the time of the *Foley* decision, California appellate courts had become increasingly willing to find an exception to the at-will doctrine on the basis of an employer's explicit or implicit representations made in the employment context. Based on these representations, employees had been able to assert successfully that they could not be discharged as long as their job performance was satisfactory.³⁶ The at-will presumption can be overcome by express oral representations by the employer to the employee that the employee could only be terminated for good cause. Most of the cases, however, involved allegations that the employer's *conduct* and/or policies created the reasonable expectation in the employee that he or she would be terminated only for good cause. The employee thereby asserted in essence the existence of an implied-in-fact limitation on the at-will relationship.³⁷

Labor Code section 2922. See *supra* note 6. The California Labor Code specifies, however, that an employment contract for a *definite* term is terminable only for good cause. See CAL. LAB. CODE § 2924 (West Supp. 1989).

34. See *infra* note 142.

35. Union employees, who are protected by a collective bargaining agreement, are commonly terminable only for just cause. See *supra* note 1; see also *supra* note 46 (discussing the meaning of just cause). See generally Note, *supra* note 3.

36. See Note, *supra* note 3, at 340.

37. An implied-in-fact promise is created by conduct, as opposed to words, but there is no difference in the consequences. E.A. FARNSWORTH, CONTRACTS, § 3.10 (1982); 1 B. WITKIN, SUMMARY OF CALIFORNIA LAW, CONTRACTS, § 11, (1987). And, as with express promises, the key focus is on what the promisee has reason to believe from the promisor's manifestations. *Id.* Accordingly, an assertion by the employer that he or she did not intend to create an implied-in-fact promise not to terminate absent just cause is irrelevant if the employee reasonably so interpreted the employer's conduct. The employer's subjective awareness that his or her representations constitute assent to an agreement is irrelevant. The focus is on what the employee has reason to believe based upon the actions (and/or statements) of the employer. E.A. FARNSWORTH, *supra* § 3.6. This fundamental rule of contract law applies in California. See, e.g., *Brant v. California Dairies*, 4 Cal. 2d 128, 133-34, 48 P.2d 13, 16 (1935); *Blumenfeld v. R. H. Macy & Co.*, 92 Cal. App. 3d 38, 46, 154 Cal. Rptr. 652, 656 (1979). See also RESTATEMENT (SECOND) OF CONTRACTS § 19 (1981) ("The manifestation of assent may be made wholly or partly by written or spoken words or by other acts or by failure to act.") The reasonable expectations of the parties may be inferred from the conduct of the parties and the surrounding circumstances. *California Food Serv. Corp. v. Great Am. Ins. Co.*, 130 Cal. App. 3d 892, 897, 182 Cal. Rptr. 67, 70 (1982). Regarding the extent to which the employer may avoid liability through disclaimers and written employment contracts, see *infra* notes 163-210 and accompanying text.

Logically, this implied-in-fact theory applies in the employment context beyond the situation where the employee asserts that she may only be dismissed for good cause. For example, if an employer had disciplinary procedures that the employer failed to follow in terminating an employee, an employee might successfully assert a breach of contract action upon showing that compliance with the procedures was an implied-in-fact promise.

The first California articulation of the implied-in-fact exception to the at-will doctrine is found in an appellate decision, *Pugh v. See's Candies, Inc.*³⁸ In *Pugh*, the court admitted that California law creates a "presumption" that the employment relationship is at will.³⁹ Nonetheless, the court found that the presumption is overcome where the parties agree, either expressly or impliedly, that the relationship can be terminated only for good cause.⁴⁰ The court explained that the implied-in-fact exception is created by the confluence of several factors: the length of service,⁴¹ a pattern of promotions and commendations,

38. 116 Cal. App. 3d 311, 171 Cal. Rptr. 917 (1981). In *Pugh*, a managerial employee alleged that he was discharged summarily after thirty-two years of faithful service to the company, in contravention of the practice of the company and the assurances made to him. *Id.* at 318, 171 Cal. Rptr. at 919-20. The scholarly opinion, authored by former Justice Grodin, then an appellate court justice, contains an interesting overview of the historical background of American employment law. *Id.* at 319-21, 171 Cal. Rptr. at 920-22. It was not until *Foley* that the California Supreme Court accepted the opportunity to decide whether an action based on the breach of an implied-in-fact contract is appropriate in the wrongful termination context.

39. *Id.* at 324, 171 Cal. Rptr. at 924. See also *Hejmadi v. AMFAC, Inc.*, 202 Cal. App. 3d 525, 538, 249 Cal. Rptr. 5, 11 (1988) ("Labor Code section 2922 creates a presumption that an employment contract for an indefinite period is terminable at will.")

40. *Pugh*, 116 Cal. App. 3d at 324, 171 Cal. Rptr. at 924 (1981). The court explained:

The presumption that an employment contract is intended to be terminable at will is subject, like any presumption, to contrary evidence. This may take the form of an agreement, express or implied, that the relationship will continue for some fixed period of time . . . [I]t may take the form of an agreement that the employment relationship will continue indefinitely, pending the occurrence of some event such as the employer's dissatisfaction with the employee's services or the existence of 'cause' for termination.

Id. The court also rejected claims that "independent consideration" is required for a contractual limitation on the employer's right to terminate at will, noting that "such a rule is contrary to the general contract principle that courts should not inquire into the adequacy of consideration." *Id.* at 325, 171 Cal. Rptr. at 924-25. The court later added that even if "independent consideration" were required, lengthy past service would be adequate independent consideration. *Id.* at 327 n.20, 171 Cal. Rptr. 925-26 n.20.

41. The court did not propose any minimum tenure for the formation of an implied-in-fact contract. *Pugh* had worked for his employer for over 32 years. Thus, the length of employment, if any, needed to underlie an implied-in-fact promise claim was uncertain. Compare *Harlan v. Sohio Petroleum Co.*, 677 F. Supp. 1021, 1030 (N.D. Cal. 1988) (there is no per se rule barring a short-term employee from recovering for breach of an implied contract) with *Burdette v. Mepeco/Electra, Inc.*, 673 F. Supp. 1012, 1016 (S.D. Cal. 1987) ("California courts recognize that a combination of oral representations to an employee, longevity of employment and an employer's written policies regarding the treatment of long-term employees can produce an implied-in-fact promise that an employee not be discharged without good cause.") and *Newfield v. Insurance Co. of the W.*, 156 Cal. App. 3d, 440, 445-46, 203 Cal. Rptr. 9, 12 (1984) (denying plaintiff's implied contract claim based on several factors, including the fact that the employee had worked for the defendant for less than two years). Because an implied-in-fact promise can arise from an employer's express statements, from the employer's conduct, or from a combination of these, there should not logically be any threshold tenure required before an implied-in-fact promise can be found. The focus is on the employee's reasonable expectations created by the employer's words and/or conduct. Further, it was unclear whether a plaintiff may prevail in an action asserting an implied-in-fact promise by proving only one of the *Pugh* factors, such as longevity. It is usually a variety of factors—employer assurances, conduct and policies—that creates the reasonable expectation in the employee that he or she is terminable only for good

lack of direct criticism of the employee's work, assurances by the employer that the employee has a secure future, personnel policies of the employer⁴² and the practice of the company not to terminate employees absent good cause.⁴³ Finding that Pugh had alleged the existence of most of these factors,⁴⁴ the court upheld the plaintiff's claim that a jury question⁴⁵ existed about whether there was "good cause"⁴⁶ for the discharge.

cause. *But see, e.g.,* Robards v. Gaylord Bros., Inc., 854 F.2d 1152 (9th Cir. 1988) (suggesting that longevity alone may give rise to an implied-in-fact promise).

42. Another factor frequently asserted as a basis for the formation of an implied-in-fact promise not to terminate absent just cause is the existence of personnel policies asserting restrictions on the employer's right to terminate at will. *See, e.g.,* Hejmadi v. AMFAC, Inc., 202 Cal. App. 3d 525, 538, 249 Cal. Rptr. 5, 13 (1988) (plaintiff asserting that employer's policy and procedure manuals applied to his employment and provided that discharge would only be for just cause). *See also* Note, *The Employee Handbook as a Contractual Limitation on the Employment at Will Doctrine*, 31 VILL. L. REV. 335 (1986); Comment, *Employee Handbooks and Employment-At-Will Contracts*, 1985 DUKE L.J. 196 (1985); Rohwer, *supra* note 7, at 768-69 ("Employee manuals, handbooks, or other company-generated documents describing or defining terms and conditions of employment or employment practices can provide implied terms of the employment contracts").

43. *Pugh I*, 116 Cal. App. 3d at 327, 171 Cal. Rptr. at 925-26.

44. The court found that Pugh had alleged the following facts from which a jury could find an implied promise by the employer not to terminate him absent good cause: an employment tenure of 32 years, consistent commendations and promotions, the lack of any direct criticism of his work, assurances given regarding job security, and employer policies not to terminate long-term employees absent good cause. *Id.* at 329, 171 Cal. Rptr. at 927.

45. Where reasonable minds can disagree, the determination of whether good cause became an implied term in the employment contract is a question for the jury. *Hejmadi*, 202 Cal. App. 3d at 541, 249 Cal. Rptr. at 13. *See* Walker v. Northern San Diego County Hosp. Dist., 135 Cal. App. 3d 896, 185 Cal. Rptr. 617 (1982).

A congeries of factual matters must be examined and resolved in order to determine this question [of whether there is an express or an implied-in-fact promise for some form of continued employment absent cause for firing]. This assize should include the documents themselves, the provisions regarding the grievance processes, the personnel practices or policies, the employee's length of service, as well as the practice of the industry in which the plaintiff is engaged. These factual matters are for *the jury* (unless waived), *not the court*, to determine.

Walker, 135 Cal. App. 3d at 905, 185 Cal. Rptr. at 622 (emphasis in original). The determination requires the jury to find that, from all the circumstances surrounding the employment, whether by words or conduct, it is reasonable for the employee to conclude and believe (and the employee did so conclude and believe) that employment would be terminated only for good cause. *See* BOOK OF APPROVED JURY INSTRUCTIONS 10.12 (1987) [hereinafter BAJI]. As a theory founded in the law of contracts, it is the objective manifestations of the parties, not their secret intentions, that control. E.A. FARNSWORTH, *supra* note 37, § 3.6. The jury also must decide whether, given the implied promise, there was "good cause" for the discharge. *See Pugh*, 116 Cal. App. 3d at 329-30, 171 Cal. Rptr. at 927-28.

46. The *Pugh* court did not offer a precise definition of "good cause," noting that the term means "a fair and honest cause or reason, regulated by good faith on the part of the party exercising the power." *Pugh I*, 116 Cal. App. 3d at 330, 171 Cal. Rptr. at 928 (1981). In later litigation this definition was slightly refined; the "employer's good faith dissatisfaction alone is not sufficient to constitute good cause. . . ." *Pugh v. See's Candies, Inc. (Pugh II)*, 203 Cal. App. 3d 743, 769, 250 Cal. Rptr. 195, 212-13 (1988). California courts typically have adopted the *Pugh* definition of "good cause" (or "just cause"), adding that, in order for a jury to

Pugh represented a court's effort to protect non-union employees through the use of modern *contract* law.⁴⁷ Subsequent California decisions reiterated that actions founded upon the breach of an implied-in-fact promise not to terminate except for good cause are based purely on contract law.⁴⁸ Accordingly, plaintiff's recoverable damages were limited to those provided for by contract law.⁴⁹

decide if there is "good cause," the jury should balance the employer's interest in operating the business efficiently and profitably with the interest of the employee in maintaining employment. See BAJI, *supra* note 45, at 10.13. This instruction correctly charges the jury with "the duty to 'balance the employer's interest in operating [its] business efficiently and profitably with the interest of the employee in maintaining his [or her] employment . . . ,' giving substantial weight to managerial discretion. *Pugh II*, 203 Cal. App. 3d at 769, 250 Cal. Rptr. at 212. Ultimately what constitutes "good cause" depends on the case itself and the status of the parties. For example, generally with high level management personnel the courts permit greater leeway in termination than with lower level employees. *Pugh I*, 116 Cal. App. 3d at 330, 171 Cal. Rptr. at 928 ("And where . . . the employee occupies a sensitive managerial or confidential position, the employer must of necessity be allowed substantial scope for the exercise of subjective judgment.") Further, "good cause" in the implied-in-fact promise context differs from the "good cause" required for the termination of a contract entered into for a specified term. See CAL. LAB. CODE § 2924 (West Supp. 1989) ("An employment for a specified term may be terminated at any time by the employer in case of any willful breach of duty by the employee in the course of his employment, or in case of his habitual neglect of his duty or continued incapacity to perform it.").

Following the appellate court decision, *Pugh* received a jury trial on his claims of wrongful termination. At his trial he attempted to base his wrongful termination action on both contract and tort theories, notwithstanding the fact that the original appellate decision (*Pugh I*) sanctioned only retrial on the implied-in-fact contract theory. The jury returned a defense verdict which was affirmed on appeal. *Pugh II*, 203 Cal. App. 3d 743, 250 Cal. Rptr. 195 (1988). Although the *Pugh I* court upheld a non-suit against *Pugh's* claim that he was terminated for his refusal to participate in negotiations for an illegal union contract in violation of public policy, finding that *Pugh's* proffered evidence was "insufficient to establish a prima facie case for retaliatory discharge under *Tameny*" (*Pugh I*, 116 Cal. App. 3d at 322-24, 171 Cal. Rptr. at 922-24), *Pugh* was permitted to assert an action for tortious breach of the implied covenant of good faith and fair dealing in his trial because the *Pugh I* court "found it unnecessary to consider such an action," thereby not foreclosing *Pugh* from advancing the theory on retrial. *Pugh II*, 203 Cal. App. 3d at 750-51, 250 Cal. Rptr. at 199-200.

47. *Pugh II*, 203 Cal. App. 3d at 752, 250 Cal. Rptr. at 201 ("The *Pugh I* court did not reject the rule in Labor Code section 2922 that an at-will employee can be terminated by either party without cause, but it did advance an enlightened interpretation of the rule, thereby enabling a private sector, non-union, at-will employee to seek a contract remedy for unjust discharge.").

48. See, e.g., *Hejmadi v. AMFAC, Inc.*, 202 Cal. App. 3d 525, 540, 249 Cal. Rptr. 5, 13 (1988); *Koehrer v. Superior Court*, 181 Cal. App 3d 1155, 1170-1171, 226 Cal. Rptr 820, 825-26 (1986) (implied-in-fact based action "constitutes nontortious 'wrongful discharge,' a breach of the implied-in-fact promise to discharge only for good cause and, thus, a breach of the employment contract; the damages recoverable are limited to those allowed for breach of contract"). See also Comment, *supra* note 9. In essence, an implied-in-fact promise not to terminate absent just cause constitutes a modification of the original employment contract into which the term that the contract was terminable at will had been implied. See *supra* note 33. Termination without cause thereby constitutes a breach of the implied contract term and gives rise to an action for breach of contract.

49. *Id.* Recoverable damages in this context are "the amount of compensation agreed upon for the period determined to be a reasonable period that plaintiff's employment would have continued but for the breach of the employment contract less any compensation actually earned

C. *Tortious Breach of the Covenant of Good Faith and Fair Dealing*

Prior to its decision in *Foley*, the California Supreme Court had never expressly held that the breach of the implied covenant of good faith and fair dealing gave rise to an action in tort in the employment context. The supreme court had, however, twice suggested that this might well be the case.⁵⁰ In *Cleary v. American Airlines*,⁵¹ a California appellate court became the first to recognize concretely that an implied covenant of good faith and fair dealing existed in every employment

by the employee during that period." BAJI, *supra* note 45, at 10.15. See, e.g., *Pugh II*, 203 Cal. App. 3d 743, 762 n.14, 250 Cal. Rptr. 195, 208 n.14 ("For the breach of an obligation arising from contract, the measure of damages is the amount which will reasonably compensate the [appellant] for all of the economic loss legally caused thereby, or which in the ordinary course of things will be likely to result therefrom. He may recover the total amount of wages and benefits which would have been received under the terms of the employment contract, less any sum which he has earned or could have earned in other employment by reasonable effort."); *Rabago-Alvarez v. Dart Indus.*, 55 Cal. App. 3d 91, 97-98, 127 Cal. Rptr. 222, 225-26 (1976). Punitive damages are not recoverable. CAL. CIV. CODE § 3294 (West Supp. 1989). Contract damages should include compensation for all harm flowing from the breach that was within the contemplation of the parties at the time of contracting. Accordingly, the scope of contract damages in the employment context may be quite significant, though courts have traditionally been quite restrictive in this area. See *infra* notes 211-244 and accompanying text. In light of *Foley's* limitation on the tort bases for a wrongful termination action, the proper scope of recoverable contract damages for the breach of the implied-in-fact contract becomes of even greater moment. Guidance will come from court decisions or by legislative action. See *infra* note 123 and accompanying text.

If the plaintiff pleads and proves an independent tort-based cause of action, such as defamation or intentional infliction of emotional distress, the plaintiff, of course, may be compensated with traditional tort damages for that separate harm as well.

One author suggests that, although the implied-in-fact exception is based in contract law rather than in the law of torts, it is the most far-reaching of the recognized exceptions to the at-will doctrine. Note, *supra* note 3, at 349. The public policy exception and the "good faith and fair dealing" exception only limit the employer's right to terminate for an improper reason; the implied-in-fact exception may be raised when the employee asserts that he or she is being terminated *without* cause. *Id.* While the author may be correct in a general sense, the tort causes of action—public policy and tortious breach of the implied covenant of good faith and fair dealing—potentially provide greater recovery for the plaintiff as they permit the recovery of damages for emotional distress and punitive damages. See *infra* notes 211-220 and accompanying text. Further, the public policy-based action undisputably cannot be evaded by contract provisions asserted by the employer, as this cause of action arises independently from the promises of the parties. *Crossen v. Foremost-McKesson*, 537 F. Supp. 1076 (N.D. Cal. 1982). The degree to which an employer's implied-in-fact contractual liability can be avoided by written contract provisions is uncertain. See *infra* notes 172-199 and accompanying text.

50. See *Seaman's Direct Buying Serv., Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 769 n.6, 686 P.2d 1158 n.6, 1166, 206 Cal. Rptr. 354, 362 n.6 (1984); *Tameny v. Atlantic Richfield Co.*, 27 Cal. 3d 167, 179 n.12, 610 P.2d 1330, 1337 n.12, 164 Cal. Rptr. 839, 846 n.12 (1980).

51. 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980).

relationship, and that its breach could constitute a *tort*.⁵² The *Cleary* court held that, because of the plaintiff's long tenure and the defendant's failure to adhere to its own grievance procedures, the plaintiff could recover tort damages for breach of the implied covenant of good faith and fair dealing.⁵³ The court stated:

In the case at bench, we hold that the longevity of the employee's service, together with the expressed policy of the employer, operate as a form of estoppel, precluding any discharge of such an employee by the employer without good cause. We recognize, of course, that plaintiff has the burden of proving that he was terminated unjustly, and that the employer . . . will have its opportunity to demonstrate that it did in fact exercise good faith and fair dealing with respect to plaintiff. Should plaintiff sustain his burden of proof, he will have established a cause of action for wrongful discharge that sounds in both contract and tort. He will then be entitled to an award of compensatory damages, and in addition, punitive damages if his proof complies with the requirement for the latter type of damages.⁵⁴

The *Cleary* court offered little support for its ready transformation of a traditionally contract-based action into an action sounding in tort beyond citation to cases in the insurance context that permit a tort action.⁵⁵

52. *Cleary*, 111 Cal. App. 3d at 453, 454-56, 168 Cal. Rptr. at 727-30. In *Cleary*, the plaintiff, whose complaint was dismissed upon demurrer, alleged that after 18 years of service he was terminated because of the airline's disapproval of his union activities. *Cleary* also claimed that, in violation of the employer's own policies and procedures, he was not afforded an opportunity to rebut the employer's asserted, but wholly untrue, grounds for his termination which included allegations of theft. *Id.*

53. *Id.* at 456, 168 Cal. Rptr. at 729.

54. *Id.*

55. In finding a basis for an action for tortious breach of the implied covenant of good faith and fair dealing the court looked to cases decided by the California Supreme Court in the insurance contract context. In these cases, the California Supreme Court had held repeatedly that the breach of the implied covenant of good faith and fair dealing—requiring the insurer to accept reasonable settlements and not to withhold unreasonably payments due under the policy—may constitute a tort, because it is an obligation imposed by law, not by the terms of the contract. See *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 56, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973); *Crisci v. Sec. Ins. Co.*, 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967); *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 328 P.2d 198 (1958). See also Diamond, *The Tort of Bad Faith Breach of Contract: When, If at All, Should It Be Extended Beyond Insurance Transactions?*, 64 MAR. L. REV. 425 (1981); Louderback & Jurwika, *Standards for Limiting the Tort of Bad Faith Breach of Contract*, 16 U.S.F. L. REV. 187, 197 (1982); Comment, *Reconstructing Breach of the Implied Covenant of Good Faith and Fair Dealing as a Tort*, 73 CALIF. L. REV. 1291, 1306 (1985).

A key issue thus became the extent to which the employment context approximated the insurance context. See *Wallis v. Superior Court*, 160 Cal. App. 3d 1109, 207 Cal. Rptr. 123 (1984) (finding that the relationship between employer and employee is as inherently unequal as that between insurer and insured so that the breach of the implied covenant is tortious in both contexts). The *Wallis* court noted that tort liability, as opposed to liability sounding in contract,

California attorneys representing discharged at-will employees immediately began asserting tortious breach of the implied covenant of good faith and fair dealing ("tortious breach") as a cause of action in all wrongful termination actions.⁵⁶ *Cleary* left the parameters of the tort action uncertain, and subsequent court decisions offered little consistent guidance regarding the appropriate circumstances for a tort-based action for breach of the implied covenant.⁵⁷ While it appeared evident that not every breach of an implied-in-fact contract to terminate only for good cause gave rise to tort liability, the proper context for tort damages was extremely hazy.⁵⁸ Some courts created strict pre-

arises from the breach of the implied covenant of good faith and fair dealing only in selected situations where several factors can be found:

For purposes of serving as predicates of tort liability, we find that the following "similar characteristics" must be present in a contract:

- (1) the contract must be such that the parties are in inherently unequal bargaining positions;
- (2) the motivation for entering the contract must be a non-profit motivation, i.e., to secure peace of mind, security, future protection;
- (3) ordinary contract damages are not adequate because (a) they do not require the party in the superior position to account for its action, and (b) they do not make the inferior party "whole";
- (4) one party is especially vulnerable because of the type of harm it may suffer and of necessity places trust in the other party to perform; and
- (5) the other party is aware of this vulnerability.

Id. at 1118, 207 Cal. Rptr. at 129. Other courts have permitted an action for tortious breach of the implied covenant of good faith and fair dealing where the court finds a "special relationship" approximating that of the insurer-insured. The results of those cases are uncertain in light of the Court's reluctance to permit an action for the tortious breach in the employment context. *See infra* note 107.

56. As a tort cause of action, recovery was potentially more lucrative for the discharged employee than the *Pugh*-based cause of action. Both damages for emotional distress and punitive damages were recoverable upon appropriate proof. *See infra* notes 211-220 and accompanying text.

57. *Hejmadi v. AMFAC, Inc.*, 202 Cal. App. 3d 525, 543, 249 Cal. Rptr. 5, 14 (1988) ("The theory of tort recovery in a contractual setting has been the source of much confusion and uncertainty when its application has been directed to employment termination cases."). *See generally* Brody, *Wrongful Termination as Labor Law*, 17 Sw. U.L. REV. 434, 460 (1988) ("[T]he scope and applicability of the doctrine have been something of a puzzle ever since [*Cleary*]"); Haggerty, *Breach of the Implied Covenant of Good Faith and Fair Dealing in Employment Contracts: From Here to Longevity and Beyond*, 14 W. ST. L. REV. 445 (1987).

58. As one court explained in its attempt to clarify the distinction:

Ordinarily, where a good cause limitation for termination exists in the employment agreement, the employee's remedy is confined to contractual damages as the harm suffered arises from a breach of a consensual provision of the contract. However, where the employee has pleaded and proved an express or implied good cause limitation on the employer's right to discharge, and a breach thereof, then in certain *limited circumstances* the employee may pursue a tort remedy based upon a breach of the implied covenant of good faith and fair dealing.

Hejmadi, 202 Cal. App. 3d at 548, 249 Cal. Rptr. at 18 (emphasis added). The *Hejmadi* court determined that the tortious breach action could only follow upon the plaintiff's proof that the plaintiff/employee was no longer terminable at will. The court explained that in the ordinary at-will employment relationship, in which the employee is terminable for any reason and at any

quisites to a *Cleary*-based action, mandating a showing of longevity and a violation of employer policy.⁵⁹ Other courts shifted the focus from the employee's period of service and from the employer's policies to the conduct of the employer.⁶⁰ Still other courts combined both of these approaches, looking to longevity and employer policies as giving rise to an implied promise that the employee will be terminated only for just cause, followed by some improper action by the employer in effecting the discharge.⁶¹ It was believed that the California Supreme Court would untangle and clarify this unsettled and confused area in its decision of *Foley*.

II. FOLEY V. INTERACTIVE DATA CORPORATION

A. Factual Context and Procedural History

Daniel Foley, an employee working without an express employment contract specifying the employment term, was terminated after nearly seven years of service to his employer, Interactive Data Corporation (IDC). Throughout his tenure, Foley received regular promotions,

time, doing that which is permissible—terminating the employee—could not constitute breach of the implied covenant of good faith and fair dealing. *Id.* at 544-48, 249 Cal. Rptr. at 15-18. While the court's logic is at first glance persuasive, the court's approach provides no common law legal protection to purely at-will employees who are not terminated on any grounds other than those that would be deemed violative of public policy. *See infra* notes 141-51 and accompanying text. Some courts did not restrict the tortious breach cause of action to cases in which the plaintiff first established a *Pugh* limitation. *See, e.g.,* *Khanna v. Microdata Corp.*, 170 Cal. App. 3d 250, 215 Cal. Rptr. 860 (1985).

59. *See, e.g.,* *Newfield v. Ins. Co. of the W.*, 156 Cal. App. 3d 440, 445, 203 Cal. Rptr. 9, 12 (1984).

60. *See, e.g.,* *Huber v. Standard Ins. Co.*, 841 F.2d 980 (9th Cir. 1988); *Gray v. Superior Court*, 181 Cal. App. 3d 813, 821, 226 Cal. Rptr. 570, 573 (1986) ("Although lengthy satisfactory service is extremely helpful to an employee in establishing breach of a duty of fairness toward him, that factor is not essential to the cause of action."); *Rulon-Miller v. International Business Machs. Corp.*, 162 Cal. App. 3d 241, 208 Cal. Rptr. 524 (1984). *See also Khanna*, 170 Cal. App. 3d at 250, 215 Cal. Rptr. at 860. As the *Khanna* court explained, a *Cleary*-based action may be brought by "bad faith action extraneous to the [employment] contract, combined with the obligor's intent to frustrate the [employee's] enjoyment of contract rights." *Id.* at 262, 215 Cal. Rptr. at 867.

61. *Hejmadi v. AMFAC, Inc.*, 202 Cal. App. 3d 525, 249 Cal. Rptr. 5 (1988); *Koehrer v. Superior Court*, 181 Cal. App. 3d 1155, 226 Cal. Rptr. 820 (1986). *See also Shapiro v. Wells Fargo Realty Advisors*, 152 Cal. App. 3d 467, 479, 199 Cal. Rptr. 613, 619 (1984) (in order to recover for tortious breach there must be conduct by the employer "extraneous" to the contract). Thus, under this approach, more than the lack of just cause was needed before a tort action could lie.

bonuses, pay increases, and superior performance evaluations.⁶² He alleged that because of periodic assurances of fair treatment and continued employment, and due to IDC's "Termination Guidelines," which set forth the grounds for discharge along with a seven-step pretermination procedure, he had an expectation of continued and permanent employment with IDC.⁶³

Foley's discharge followed a conversation he had with his supervisor, Richard Earnest, in which Foley told Earnest that Foley had learned that the person who had been hired to become Foley's immediate supervisor, Robert Kuhne, was under investigation by the Federal Bureau of Investigation for embezzling from his former employer.⁶⁴ Earnest admonished Foley not to discuss "rumors" and to "forget what [he] heard." Within months of this conversation, Kuhne, who had become Foley's immediate supervisor, transferred Foley across the country, only to fire him one week later. Foley alleged that these actions were in retaliation for Foley's disclosure of the FBI investigation of Kuhne's alleged criminal conduct.⁶⁵

Foley sued IDC for wrongful termination, seeking compensatory and punitive damages. He alleged each of the three theories that the California courts had recognized as a basis for a wrongful termination action: A tort cause of action for discharge in contravention of public policy, a contract action for breach of an implied-in-fact contract to terminate only for good cause, and a tort cause of action for breach of the implied covenant of good faith and fair dealing. The trial court sustained the defendant's demurrer to Foley's entire complaint without leave to amend.⁶⁶

In an opinion evidencing strong antipathy for the developments that had been taking place during the previous decade in the California law of wrongful discharge, and warning against allowing the three recognized common law bases for a wrongful termination action "to swallow the [at-will] rule,"⁶⁷ the court upheld the trial court's dismissal

62. Indeed, two days before being discharged, Foley received a merit bonus of nearly \$7,000. *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 663, 765 P.2d 373, 375, 254 Cal. Rptr. 211, 213 (1988).

63. *Id.* at 664, 765 P.2d at 375, 254 Cal. Rptr. at 213.

64. *Id.*

65. *Id.* Several months after discharging Foley, Kuhne pled guilty to a felony count of embezzlement. *Id.* at 765 n.1, 765 P.2d at 375 n.1, 254 Cal. Rptr. at 213 n.1.

66. *Id.* at 659, 765 P.2d at 373, 254 Cal. Rptr. at 211.

67. *Foley v. Interactive Data Corp.*, 193 Cal. App. 3d 28, 35, 219 Cal. Rptr. 866, 870 (1985), *rev. granted*, 712 P.2d 891, 222 Cal. Rptr. 740 (1986), *rev'd in part and aff'd in part*, 47 Cal. 3d 354, 765 P.2d 373, 254 Cal. Rptr. 211 (1988).

of each of Foley's claims. First, the appellate court affirmed the trial court's dismissal of Foley's claim based on discharge in violation of public policy. The court limited such an action to cases in which the plaintiff alleges termination in retaliation for asserting statutory rights, or for refusing the employer's request that the employee perform an illegal act, or cases in which the employer "directly" violates a statute by dismissing the employee.⁶⁸ The appellate court found no statutory basis for the plaintiff's claim and concluded that "the Legislature has indicated by its silence that it does not intend for workers to police their fellows."⁶⁹

The implied-in-fact contract theory received the court's most venomous attack. The court explained that the recognition of a *Pugh* cause of action

destroys the centuries-old solid and settled principle of vast and demonstrated value to employer and employee, to the world of commerce and to the public, of a contract which either can terminate at will. To emasculate its meaning results in a contract terminable at will only by an employee . . . with little or no financial risk to him but generally at considerable risk to the employer.⁷⁰

The appellate court also determined that, because Foley had worked for IDC for nearly seven years, any implied-in-fact contract term would be barred by California's statute of frauds.⁷¹ Finally, Foley's tortious breach claim was deemed properly dismissed because neither his nearly seven-year tenure nor IDC's procedural manual was sufficient to satisfy the prerequisites of longevity of service and employer disregard of its personnel policies.⁷²

In 1986, the California Supreme Court granted a hearing in the case. Given the composition of the court at that time, it is likely that the case was granted review in order to reverse the extremely narrow

68. *Foley*, 193 Cal. App. 3d at 35, 219 Cal. Rptr. at 870. In so concluding, the court expressly chose to ignore *Tameny's* "dictum" that a non-statutory public policy could underlie the action. *Id.* at 35, 219 Cal. Rptr. at 869.

69. *Id.* at 35, 219 Cal. Rptr. at 870.

70. *Id.* at 34, 219 Cal. Rptr. at 869. It is, of course, the conduct or words of the employer that permit the creation of the implied-in-fact term that the employee will only be terminated for just cause. See Note, *Defining Public Policy Torts in At-Will Dismissals*, 34 STAN. L. REV. 153, 154-155 (1982) ("While the implied contract approach reflects a movement away from the harshness of the at-will rule, it by no means represents a rejection of the rule, since it merely allows employees to rebut more easily the presumption that their employment is terminable at will.")

71. *Foley*, 193 Cal. App. 3d at 35-37, 219 Cal. Rptr. at 870-71. See CAL. CIV. CODE § 1624(a) (West Supp. 1989) (an agreement not in writing that by its terms is not to be performed within a year from the making thereof is invalid).

72. *Foley*, 193 Cal. App. 3d at 36-37, 219 Cal. Rptr. at 871.

approach of the appellate court, which was at odds with most of the decisions of California's appellate courts in the area of wrongful termination.⁷³ The case was argued in November 1986. However, before a decision could be rendered, the California electorate removed three of the justices from the court.⁷⁴ The case was reargued before a more conservative court under the stewardship of Chief Justice Malcolm Lucas in April 1987, and a badly divided court rendered its decision on December 29, 1988.⁷⁵

B. The Supreme Court's Opinion

1. Foley and the Public Policy Exception

In *Foley*, the plaintiff alleged that he was terminated because he reported that the person who was about to become his supervisor was

73. The petition for hearing was granted unanimously on June 30, 1986, by a court comprised of Chief Justice Bird, and Justices Mosk, Broussard, Reynoso, Grodin, Lucas and Panelli. *Foley v. Interactive Data Corp.*, 712 P.2d 891, 222 Cal. Rptr. 740 (1986). The appellate decision in *Foley* had given an extraordinarily narrow interpretation to all bases of California's wrongful termination law. The appellate court offered an interpretation of wrongful termination based on a violation of public policy narrower than that envisioned by the *Tameny* court, a decision in which Chief Justice Bird and Justice Mosk had joined the majority. See *supra* notes 26-30. The appellate court further attacked the implied-in-fact promise doctrine of *Pugh*, an opinion authored by Justice Grodin who was then an appellate court justice. The appellate decision also gave a miserly interpretation to the scope of an action for tortious breach notwithstanding suggestions by the California Supreme Court that a tortious breach cause of action may be appropriate in the wrongful termination context. See *Seaman's Direct Buying Serv. v. Standard Oil Co.*, 36 Cal. 3d 752, 769 n.6, 686 P.2d 1158, 1166 n.6, 206 Cal. Rptr. 354, 362 n.6 (1984), in which Justices Mosk, Broussard and Reynoso joined the majority opinion suggesting the propriety of a tortious breach cause of action. See also *id.* at 769, 686 P.2d at 1167, 206 Cal. Rptr. at 363 (Bird, C.J., concurring and dissenting) (Chief Justice Bird contended that an action for tortious breach may be applicable in the context of commercial contracts). The only two justices still on the Court at the time of the rendition of the *Foley* decision, who also were serving at the time of the *Seaman's* decision, Justices Broussard and Mosk, refused to join the majority opinion in *Foley*. Further, the only two current justices also to serve on the Bird court joined the majority opinion in *Seaman's* which intimated an action for tortious breach may be appropriate in the employment context, and filed dissenting opinions in *Foley*. Thus, it is fair to surmise that the petition had been granted to overturn the appellate court's restrictive interpretation of California's wrongful discharge law. How far-reaching the Bird court's opinion would have been will, of course, never be known.

74. The electorate voted against the retention of Chief Justice Bird and Justices Reynoso and Grodin in November 1986. Governor George Deukmejian subsequently elevated Justice Lucas to the position of Chief Justice and appointed Justices Arguelles, Eagleson and Kaufman to the California Supreme Court.

75. The opinion had been under submission for 20 months and was finally released on December 29, 1988, the penultimate working day of the calendar year. The Court was badly split with three of the justices offering stinging dissents to the majority's lengthy opinion. Since the opinion, Justice John Arguelles, one of the justices joining the majority opinion, has left the Court and has been replaced by Justice Joyce Kennard.

being investigated for embezzlement from a prior employer. Foley contended that California has a public policy in favor of reporting relevant information about co-workers to management.⁷⁶

The *Foley* court adhered to the precedent of *Petermann* and *Tameny* by acknowledging the existence of a tort cause of action for the termination of an employee in contravention of public policy.⁷⁷ The court explained that “an employer’s right to discharge an ‘at will’ employee is still subject to limits imposed by public policy, since otherwise the threat of discharge could be used to coerce employees into committing crimes, concealing wrongdoing, or taking other action harmful to the public weal.”⁷⁸ The court also specified that the public policy-based action sounds in tort,⁷⁹ explaining that “[w]hat is vindicated through the cause of action is not the terms or promises arising out of the particular employment relationship involved, but rather the public interest in not permitting employers to impose as a condition of employment a requirement that an employee act in a manner contrary to fundamental public policy.”⁸⁰

Beyond explicitly recognizing the existence of this tort cause of action, the court provides little guidance as to what precisely constitutes a “public policy” for purposes of the cause of action. The court acknowledged that *Tameny* suggested that an action based upon “considerations of public policy” be permitted.⁸¹ The court further recognized the division among the lower courts about the genesis of an appropriate “public policy.”⁸² Nevertheless, the court expressly declined to decide “whether a tort action alleging breach of public

76. *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 669, 765 P.2d 373, 379, 254 Cal. Rptr. 211, 217 (1988).

77. By so doing California continued to adhere to the most widely recognized common law exception to the at-will doctrine. *Bastress*, *supra* note 1, at 326. *See also* *Mauk*, *supra* note 1, at 228 n.20 (listing jurisdictions that adhere to public policy exception). While the employment relationship remains ostensibly “at will,” this theory ultimately disallows certain bad faith terminations—dismissals where the discharge is violative of some public policy.

78. *Foley*, 47 Cal. 3d at 665, 765 P.2d at 376, 254 Cal. Rptr. at 214.

79. The court again adhered to the rationale of *Tameny*, noting that the action sounds in tort, as opposed to contract, because the cause of action does not involve a breach of a promise set forth in the contract itself. Rather, the focus is on a breach of a duty imposed by law, a duty for the employer not to act in contravention of “fundamental public policies.” *Id.* at 667, 765 P.2d at 378, 211 Cal. Rptr. at 216. The court went so far as to criticize the courts in other jurisdictions that limited the public policy-based cause of action to contract damages, noting that these jurisdictions “failed to draw the distinction between contract-based causes of action and those based on policies extrinsic to the terms of the agreement.” *Id.*

80. *Id.* at 667 n.7, 765 P.2d at 377 n.7, 254 Cal. Rptr. at 216 n.7.

81. *Id.* at 668, 765 P.2d at 379, 254 Cal. Rptr. at 216 (citing *Tameny v. Atlantic Richfield Co.*, 27 Cal. 3d 167, 172, 610 P.2d 1330, 1333, 164 Cal. Rptr. 839, 842 (1980)).

82. *See supra* note 32.

policy under *Tameny* may be based only on policies derived from a statute or constitutional provision or whether nonlegislative sources may provide the basis for such a claim.”⁸³ Instead, the court determined that, even where the plaintiff alleges a statutory basis for the action,⁸⁴ the proper focus is on whether there is such a “substantial,” “fundamental,” and “basic” public policy being implicated that a court is justified in imposing tort damages upon the employer.⁸⁵

It is not sufficient that the asserted interests are both “substantial” and “fundamental”—the policy raised has to be “public” as well.⁸⁶ Applying this “rule” to the facts before it, the court simply noted that there is no “substantial public policy prohibiting an employer from discharging an employee for performing [the duty to communicate relevant information to the employer].”⁸⁷ The court focused on the relationship of the parties involved and found that there was no public interest involved, only a private matter between Foley and his employer.⁸⁸

The criteria for determining whether a public policy is substantial enough and, more critically, “public” enough, for the purposes of an action is muddy at best, and will be clarified only by further litigation. Subsequent cases must now focus on the public/private dichotomy, without any clear guidance about how this is to be determined.

2. *Foley and Implied-in-Fact Promises*

The court upheld, and apparently strengthened, the validity of the *Pugh* cause of action,⁸⁹ permitting Foley to proceed on his claim that

83. *Foley*, 47 Cal. 3d at 669, 765 P.2d at 379, 254 Cal. Rptr. at 217. One author suggests that the relevant public policy arises from “common law notions of justice in the work place,” “implied as necessary and consistent with a body of law providing rights and protections in the employment context generally.” Mauk, *supra* note 1, at 228-29.

84. Foley claimed a statutory basis for his action, noting that the Labor Code required that he, as an agent, use “ordinary care and diligence” while employed. See CAL. LAB. CODE § 2854. (West Supp. 1989). Foley contended that “ordinary care and diligence” could only be met if he divulged relevant information to his employer. The Court did not determine whether Foley’s interpretation of the statutory obligation was sound. *Foley*, 47 Cal. 3d at 669, 765 P.2d at 379, 254 Cal. Rptr. at 217.

85. *Foley*, 47 Cal. 3d at 669, 765 P.2d at 379, 254 Cal. Rptr. at 217.

86. *Id.* The court acknowledged that “[e]ven where, as here, a statutory touchstone has been asserted, we must still inquire whether the discharge is against public policy and affects a duty which inures to the public at large rather than to a particular employer or employee.” *Id.*

87. *Id.* at 670, 765 P.2d at 380, 254 Cal. Rptr. at 218. Although there were three dissenting opinions, only one of the dissenters, Justice Mosk, disagreed with the dismissal of the public policy cause of action. *Id.* at 723-24, 765 P.2d at 418, 254 Cal. Rptr. at 256 (Mosk, J., dissenting).

88. *Id.* at 670, 765 P.2d at 380, 254 Cal. Rptr. at 218.

89. The court specifically held that “Pugh correctly applied basic contract principles in

IDC's conduct and personnel policies created an implied-in-fact contract providing that Foley be terminable only for "good cause."⁹⁰ As a contract doctrine, the parties are free to agree to a relationship terminable at will or subject to limitations. Although an employment relationship not specifying any term is presumed terminable at will,⁹¹ the court noted that "the absence of an express written or oral contract term concerning termination of employment does not necessarily indicate that the employment is actually intended by the parties to be 'at will,' because the presumption of at-will employment may be overcome by evidence of contrary intent."⁹²

Further, the court rejected the argument that any implied-in-fact contract needs to be supported by consideration independent of the employee's initial promise to render services. The court, adhering to "modern contract law," noted that "there is no analytical reason why an employee's promise to render services, or his actual rendition of services over time, may not support an employer's promise both to pay a particular wage (for example) and to refrain from arbitrary dismissal."⁹³ Thus, the court concluded that the totality of the

the employment context, and that these principles are applicable to plaintiff's agreement with defendant." *Foley*, 47 Cal. 3d at 676, 765 P.2d at 384, 254 Cal. Rptr. at 222.

The court first determined that the statute of frauds was no bar to such a claim because the employment contract for an indefinite term could be performed within one year. *Id.* at 673, 765 P.2d at 381, 254 Cal. Rptr. at 219. The court explained: "Because the employee can quit or the employer can discharge for cause, even an agreement that strictly defines appropriate grounds for discharge can be completely performed within one year—or within one day for that matter." *Id.*

90. Defendant, Interactive Data Corp., contended that the Court should require proof of an express contractual provision, supported by independent consideration. *Id.* at 678, 765 P.2d 385, 254 Cal. Rptr. at 223. The focus of the defendant's argument, however, is misplaced. The implied-in-fact contract looks to the manifestation of agreement by conduct; whereas, an express contractual provision would require mutual assent by words. J. CALAMARI & J. PERILLO, *CONTRACTS*, at 19 (3d ed. 1987). Had Foley alleged that he and his employer expressly agreed that the employer's termination guidelines were to apply to him, his action would be for an express contract. *Foley*, 47 Cal. 3d 654, 673 n.20, 765 P.2d 373, 383 n.20, 254 Cal. Rptr. 211, 221 n.20. See *infra* note 201 and accompanying text (discussing oral modification). Despite these differences, the effect of an implied-in-fact contract and an express contract is identical. See *supra* note 37.

91. CAL. LAB. CODE § 2922 (West Supp. 1989).

92. *Foley*, 47 Cal. 3d at 677, 765 P.2d at 385, 254 Cal. Rptr. at 223. It is, thus, a question of fact based on the parties' conduct and/or statements whether the parties acted so as to create an implied-in-fact contract. *Id.*

93. *Id.* at 679, 765 P.2d at 386, 254 Cal. Rptr. at 224. The majority again adhered to the prevailing view. Earlier courts held that if the jury finds an implied-in-fact promise not to terminate absent just cause, there is an "obligation on the employer to not fire absent cause or recognizable dissatisfaction . . . regardless of whether there is any classic secondary consideration or not." *Walker v. Northern San Diego Hosp. Dist.*, 135 Cal. App. 3d 896, 904, 185 Cal. Rptr. 617, 622 (1982). See *Pugh v. See's Candies, Inc.*, 116 Cal. App. 3d 311, 325-26, 171 Cal. Rptr. 917, 924-25 (1981). See also CAL. LAB. CODE § 2922 (West 1971 &

circumstances, including plaintiff's tenure,⁹⁴ personnel policies, and defendant's conduct of promoting (i.e., assuring and rewarding the plaintiff), becomes evidence from which a reasonable jury could find an implied-in-fact contract limiting defendant's right to terminate the plaintiff.⁹⁵

The implied-in-fact exception gains added importance under the court's decision. After *Foley*, contract more than tort will be the legal basis by which wrongful termination actions are resolved. Accordingly, the key battleground, now that the contract cause of action has the enthusiastic imprimatur of the high court, will be the damages that are appropriately recoverable for the breach of the implied-in-fact contract,⁹⁶ and the extent to which an employer may "opt-out" of implied-in-fact contractual liability.⁹⁷

Supp. 1989). *Foley's* employment relationship was based on an oral agreement into which a terminable at-will status was implied pursuant to Labor Code section 2922. *Foley* did enter into two collateral written agreements with his employer under which *Foley* was prohibited from employment with a competitor for a year after termination of the employment relationship and under which he would disclose computer-related information to IDC. *Foley*, 47 Cal. 3d at 663, 765 P.2d at 375, 254 Cal. Rptr. at 213. The court suggested that *Foley's* agreement to enter into these collateral agreements may also function as "independent consideration" for the employer's promise not to discharge *Foley* absent cause. *Id.* at 680 n.23, 765 P.2d at 387 n.23, 254 Cal. Rptr. at 225 n.23. If no additional consideration is required for the implied-in-fact contractual modification, the court's reference to these collateral documents appears gratuitous. These agreements could have evidentiary value, however, as further proof that *Foley* was reasonable in believing that he was not a purely at-will employee.

94. In so holding, the majority rejected the employer's claim that an employment tenure of under seven years is too brief to underlie a *Pugh* action. The court stressed that the length of employment is only one factor in the "totality of the circumstances." *Foley*, 47 Cal. 3d at 681, 765 P.2d at 387-88, 254 Cal. Rptr. at 225-26. By so holding, the court thus rejected previous decisions that refused to permit an employee's action based upon the determination that the plaintiff's employment tenure was of inadequate duration. *See supra* note 41.

95. *Foley*, 47 Cal. 3d at 682-83, 765 P.2d at 389, 254 Cal. Rptr. at 227. The court also noted that *Foley's* reliance on IDC's personnel manual and policies could be the basis from which an agreement rebutting the at-will presumption can be inferred. *Id.* The court embraced the implied-in-fact basis for recovery, disagreeing with the appellate court's determination that the doctrine was harmful and unjust to employers. In fact, the court noted the socially beneficial results that permitting the contract-based cause of action will have, explaining that "employers may benefit from the increased loyalty and productivity that such agreements may inspire." *Id.* at 681, 765 P.2d at 387, 254 Cal. Rptr. at 225.

96. *See infra* notes 211-244 and accompanying text.

97. *See infra* notes 163-210 and accompanying text. The *Foley* majority intimated that a written employment agreement specifying that the employment relationship is terminable "at-will" may "preclude enforcement of an implied-in-fact modification" suggesting otherwise. *Foley*, 47 Cal. 3d at 680 n.23, 765 P.2d at 387 n.23, 254 Cal. Rptr. at 225 n.23. It is not so clear that a simple written assertion that employment is at-will will prevent later inconsistent conduct from creating an implied-in-fact contract claim. Similarly, it is critical to consider whether oral words of the employer can modify the at-will arrangement notwithstanding a writing to the contrary. *See infra* notes 172-199 and accompanying text.

3. *Foley and Tortious Breach of the Covenant of Good Faith and Fair Dealing*

Unquestionably, the most surprising and far-reaching portion of the court's lengthy decision⁹⁸ is the majority's treatment of the covenant of good faith and fair dealing. The majority refused to recognize a wrongful termination action based on tortious breach of this implied covenant in the employment contract, and thereby greatly decreased the potential recovery in a wrongful termination action not based on the violation of public policy.⁹⁹

The court adhered to the prevailing view¹⁰⁰ that an implied covenant of good faith and fair dealing is found in every contract in California.¹⁰¹ The court then repeatedly asserted that the breach of this implied covenant gives rise solely to an action in contract because the implied covenant is based on the contract itself, protecting the express promises of the parties; the implied covenant is not protective of a generalized public interest arising from the fact that a legally cognizable interest has been entered into.¹⁰² The court thus found

98. The majority's opinion as originally distributed was 72 pages.

99. See *infra* notes 152-153 and accompanying text.

100. See *infra* notes 155-157 and accompanying text.

101. See *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 686, 765 P.2d 373, 389, 254 Cal. Rptr. 211, 227 (1988).

102. *Id.* at 690, 765 P.2d at 394, 254 Cal. Rptr. at 232. See *id.* at 683, 765 P.2d at 389, 254 Cal. Rptr. at 227 ("The covenant of good faith and fair dealing was developed in the contract arena and is aimed at making effective the agreement's promises."). The parameters of the implied covenant of good faith and fair dealing are blurry, at best. See also, Louderback, *supra* note 55, at 193-95 ("[A]ny attempt to precisely define good faith would unduly restrict its application. Accordingly, the term has been used to exclude heterogeneous forms of bad faith without any precise meaning of their own. . . . [T]he best method of defining what constitutes bad faith is to look at the factual setting of the cases, rather than to attempt to provide a precise definition of the term."). The majority never fully explained why the implied covenant of good faith and fair dealing is so clearly rooted in the law of contract. Indeed, Justice Kaufman bluntly stated that the majority's characterization of the implied covenant as a "contract term" is "simply incorrect under the decisions of this court and the authorities on which they rely." *Foley*, 47 Cal. 3d at 716, 765 P.2d at 413, 211 Cal. Rptr. at 251 (Kaufman, J., concurring and dissenting). In reaching this conclusion Justice Kaufman largely looked to the insurance cases that recognize tortious breach. See *supra* note 55. It does not follow, however, that breach of the implied covenant should sound in tort in all other contexts. In fact, existing law is clear that the breach of the implied covenant of good faith and fair dealing is an action based in contract. See RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981), which, although referring to the good faith obligation as a "duty," nowhere suggests that tort is the appropriate arena for recovery. See also E.A. FARNSWORTH, CONTRACTS, *supra* note 37, at § 8.15. Notwithstanding this blind adherence to the well-settled view that the implied covenant is a contract-based concept, logic may suggest otherwise. The implied covenant does

that damages flowing from the breach of the implied covenant should be limited to contract damages.¹⁰³

The court reaffirmed that the breach of the implied covenant may be tortious in the insurance context,¹⁰⁴ contending that the confluence of several factors justified a “major departure” from the general rule against tort damages for breach of the implied covenant.¹⁰⁵ The majority asserted that a tort recovery for the breach of the implied covenant in the insurance context is appropriate because: (1) the insurer-insured relationship is inherently unbalanced; (2) the adhesive nature of insurance contracts places the insurer in a superior bargaining position; (3) the parties are inherently at odds in their respective goals; (4) the insured enters the contract for protection from calamity, not for commercial advantage; and (5) insurers provide a vital service that is “quasi-public” in nature.¹⁰⁶

not truly arise from any promise of the parties. Rather, it reflects an external standard of conduct being imposed on the parties to the contract because society has determined that conduct in good faith is appropriate. As such, the implied covenant appears closely aligned to concepts based in tort. The majority’s arguments made to support their strong adherence to a tort cause of action for discharge in violation of public policy could be raised in the context of the implied covenant. *See supra* note 79. If the implied covenant of good faith and fair dealing reflects “general social policies” (*Foley*, 47 Cal. 3d at 668, 765 P.2d at 378, 211 Cal. Rptr. at 216), rather than promises set out in the contract, it constitutes a “duty” imposed by law and thus more closely approximates a tort-based concept than a concept arising from the law of contracts. Nonetheless, it is most unlikely that courts will soon transmute the implied covenant into a tort concept in all contexts.

103. *Foley*, 47 Cal. 3d at 684, 765 P.2d at 389, 254 Cal. Rptr. at 227. The court explained: “As a contract concept, breach of the duty [of good faith and fair dealing] led to imposition of contract damages determined by the nature of the breach and standard contract principles.” *Id.* at 684, 765 P.2d at 390, 254 Cal. Rptr. at 228.

104. *Id.* at 684, 765 P.2d at 390, 254 Cal. Rptr. at 228. (“An exception to this general rule [that the breach of the implied covenant is limited to contract damages] has developed in the context of insurance contracts where, for a variety of policy reasons, courts have held that breach of the implied covenant will provide the basis for an action in tort.”)

105. *Id.* at 690, 765 P.2d at 394, 254 Cal. Rptr. at 232.

106. *Id.* at 685, 765 P.2d at 390, 254 Cal. Rptr. at 228. Justice Kaufman summarized the majority’s argument as follows:

First, the majority asserts that a breach in the employment context “does not place the employee in the same economic dilemma that the insured faces” because the insured “cannot turn to the marketplace” while the employee presumably may “seek alternative employment.” Next, the majority argues that an employer, unlike an insurance company, does not sell economic “protection.” The majority also rejects the insurance analogy because an employee, unlike an insured, allegedly does not seek a “different kind of financial security than those entering a typical commercial contract.” Finally, the majority asserts that insurance and employment contracts differ “fundamental[ly]” because the insured’s and insurer’s interests are “financially at odds,” while the employer’s and the employee’s interests allegedly are “most frequently in alignment.”

Id. at 718, 765 P.2d at 414, 254 Cal. Rptr. at 252 (Kaufman, J., concurring and dissenting) (citations omitted). Kaufman begins his strong disagreement with the majority’s analysis by accusing the majority of “an unrealistic if not mythical conception of the employment

The court then examined the claimed similarity between the employment context and that of insurance, concluding:

the employment relationship is not sufficiently similar to that of insurer and insured to warrant judicial extension of the proposed additional tort remedies in view of the countervailing concerns about economic policy and stability, the traditional separation of tort and contract law, and finally the numerous protections against improper terminations already afforded employees.¹⁰⁷

In reaching this conclusion, the court derided the numerous courts that had determined that a discharged employee could recover for

relationship.” *Id.* (Kaufman, J., concurring and dissenting.)

The majority’s claim that the insurer and insured are inherently at odds focuses on the time that the claim is made. The insured receives peace of mind while the insurer receives premiums and there is no tension between the parties until an occurrence leading the insured to make a claim. Where a dispute arises about the proper scope of the employment relationship, the employer and employee are similarly at odds, although they are involved in a symbiotic relationship up to that point.

107. *Id.* at 693, 765 P.2d at 396, 254 Cal. Rptr. at 234. Notwithstanding its recognition of existing protections to discharged workers, the court later acknowledged that there is a notable void in which workers may need additional protections. *Id.* In his dissent, Justice Broussard took issue with the majority’s determination that the breach of the implied covenant should be treated differently in the employment context than in the insurance context. He explained that the key focus should be “whether, as a whole, the contract of employment more closely resembles an insurance contract or an ordinary commercial contract.” *Id.* at 708, 765 P.2d 407, 254 Cal. Rptr. 245 (Broussard, J., concurring and dissenting). He determined that the employment context more closely mirrors that of insurance than the usual commercial contract. *Id.*

Appellate courts have recognized a cause of action for tortious breach of the implied covenant of good faith and fair dealing in contexts other than employment by analogizing to the insurance cases. For example, in *Commercial Cotton Company, Inc. v. United California Bank*, 163 Cal. App. 3d 511, 209 Cal. Rptr. 551 (1985), the appellate court held that a bank was liable in tort for unreasonably claiming that the depositor-plaintiff’s claim against the bank for paying on several checks without unauthorized signatures was barred by the statute of limitations. In reaching this conclusion, the court analogized the banking relationship to that of the insurer/insured. *Id.* at 516, 209 Cal. Rptr. at 554; see generally Note, *Balancing the Checkbook: Re-allocating Economic Power Between Banks and Depositors*, 21 U.C. DAVIS L. REV. 1275 (1988). In another context, an appellate court determined that the breach of a pension agreement could lead to tort damages. *Wallis v. Superior Court*, 160 Cal. App. 3d 1109, 207 Cal. Rptr. 123 (1984).

Notwithstanding its narrow view of tortious breach, the majority adopted the earlier statement that: “No doubt there are other relationships with similar characteristics [of the insurer/insured relationship] and deserving of similar legal treatment [as that afforded to breach of insurance contracts].” *Foley*, 47 Cal. 3d at 687, 765 P.2d at 392, 254 Cal. Rptr. at 230 (citing *Seaman’s Direct Buying Serv. v. Standard Oil Co.*, 36 Cal. 3d 752, 769, 686 P.2d 1158, 1166, 206 Cal. Rptr. 354, 362 (1984)). Yet, in the *Foley* opinion, the majority embraced the language of former Justice Kaus stating that “there are real problems in applying the substitute remedy of a tort recovery—with or without punitive damages—outside the insurance area. In other words . . . under all the circumstances, the problem is one for the Legislature.” *Foley*, 47 Cal. 3d at 700, 765 P.2d at 400, 254 Cal. Rptr. at 239 (citing *White v. Western Title Ins. Co.*, 40 Cal. 3d, 870, 901, 710 P.2d 309, 328, 221 Cal. Rptr. 509, 528 (1985) (Kaus, J., concurring and dissenting)). The status of these appellate decisions is thus uncertain in light of the majority’s hostility to a cause of action for tortious breach outside the insurance context.

tortious breach in certain circumstances, criticizing them for their "uncritical reliance on insurance law," and their "casual extension" of California Supreme Court dictum suggesting that an action for tortious breach would be appropriate.¹⁰⁸ The court berated these

108. *Id.* at 685, 687, 765 P.2d at 390, 392, 254 Cal. Rptr. at 228, 230. The majority went to great lengths to assert that the court had never recognized an action for tortious breach of the implied covenant of good faith and fair dealing in the employment context. *Id.* at 690, 765 P.2d at 394, 254 Cal. Rptr. at 232. The majority further claimed that reliance on statements in *Tameny* and *Seaman's*, suggesting the propriety of such an action was misplaced because the references were "brief" (*id.* at 687, 765 P.2d at 392, 254 Cal. Rptr. at 230), and "tentative at best." *Id.* at 688, 765 P.2d at 392, 254 Cal. Rptr. at 230.

The court's thoughts about the reasonableness of the reliance on *Tameny* and *Seaman's* were revisited recently in the high court's decision of *Newman v. Emerson Radio Corp.*, 48 Cal. 3d 973, 772 P.2d 1059, 258 Cal. Rptr. 592 (1989). In *Newman*, a majority of the California Supreme Court determined that the *Foley* decision was to be applied retroactively. The *Foley* majority had expressly left unresolved the issue of whether the foreclosure of an action for the tortious breach of contract in the employment context was to be applied retroactively. A prospective application of *Foley* would have precluded tort damages for bad faith breach only for cases filed after January 30, 1989 (the date the *Foley* decision became final). Retroactive application bars such a tort recovery in all actions that were pending in the courts at the time of the decision. Not surprisingly, the court split on the retroactivity issue exactly as it split on the issue of tortious breach; the four justices who were in the majority of *Foley* were the four votes for retroactivity, and the three *Foley* dissenters all opposed retroactive application. Although the issue of retroactivity is not an easy one to resolve in the *Foley* context, the author ultimately disagrees with the majority's determination that retroactive application is appropriate.

The retroactivity issue is not an easy one to resolve in this case. The clear "general rule" in California is that decisions of the courts are applied retroactively, thereby affecting all pending, non-final cases. *Evangelatos v. Superior Court*, 44 Cal. 3d 1188, 1221, 753 P.2d 585, 607, 246 Cal. Rptr. 629, 651 (1988) ("The principle that statutes operate only prospectively, while judicial decisions operate retrospectively, is familiar to every law student.") See also *Peterson v. Superior Court*, 31 Cal. 3d 147, 151-52, 642 P.2d 1305, 1308, 181 Cal. Rptr. 784, 787 (1982); *In re Marriage of Brown*, 15 Cal. 3d 838, 850, 544 P.2d 561, 568, 126 Cal. Rptr. 633, 640 (1976); *Kreisher v. Mobil Oil Corp.*, 198 Cal. App. 3d 389, 398, 243 Cal. Rptr. 662, 668 (1988). This presumption of retroactivity arises from a legal system founded on precedent. *Solem v. Stumer*, 465 U.S. 638, 642 (1984); *People v. Guerra*, 37 Cal. 3d 385, 399, 690 P.2d 635, 643, 208 Cal. Rptr. 162, 169-70 (1984), and may arise even where the Supreme Court overrules its own earlier decision. *Mark v. Pacific Gas. & Elec.*, 7 Cal. 3d 170, 177-78, 496 P.2d 1276, 1280, 101 Cal. Rptr. 908, 912 (1972). Most clearly, when the high court merely resolves a split among the lower courts, retroactive application is appropriate. *Donaldson v. Superior Court*, 35 Cal. 3d 24, 36-7, 672 P.2d 110, 117-18, 196 Cal. Rptr. 704, 711-12 (1983) (where a Supreme Court decision resolves "a conflict between lower court decisions there is 'no question' that it should be applied to all pending cases.").

There are, of course, exceptions to the general rule. Where "consideration of fairness and public policy" militate against retroactivity, the decision may be prospective only. *Peterson v. Superior Court*, 31 Cal. 3d 147, 152, 642 P.2d 1305, 1307, 181 Cal. Rptr. 784, 786 (1982). See also *Safeway Stores, Inc. v. Nest Kart*, 21 Cal. 3d 322, 333, 579 P.2d 441, 446-47, 146 Cal. Rptr. 550, 555-56 (1978); *Li v. Yellow Cab*, 13 Cal. 3d 804, 829, 532 P.2d 1226, 1244, 119 Cal. Rptr. 858, 876 (1978); *Kreisher v. Mobil Oil Corp.*, 198 Cal. App. 3d 389, 398, 243 Cal. Rptr. 662, 668 (1988). In measuring these considerations of fairness and public policy, the reliance of the public upon the former state of the law and the ability of litigants to foresee the coming change in the law are paramount considerations. *Peterson*, 31 Cal. 3d at 153, 642 P.2d at 1307-308, 181 Cal. Rptr. at 786-87; *Barber v. State Personnel Board*, 18 Cal. 3d 395, 400, 556 P.2d 306, 308, 134 Cal. Rptr. 206, 208 (1976); *Kreisher*, 198 Cal. App. 3d

courts notwithstanding the fact that every appellate court, or federal court applying California law, that had confronted the issue in the

at 398, 243 Cal. Rptr. at 668. As one court explained: "It is the establishment of a new principle of law, either by overruling clear past precedent on which litigants may have relied . . . or by deciding an issue of first impression whose resolution was not clearly foreshadowed . . . that poses a question of retroactivity." *Schlauch v. Hartford Acc. & Indem. Co.*, 146 Cal. App. 3d 926, 933 n.6, 194 Cal. Rptr. 658, 663 n.6 (1983) (citing *Chevron Oil Co. v. Huson*, 404 U.S. 97, 106 (1971). Where the high court reverses its own precedent, prospective application may be most appropriate. *Casas v. Thompson*, 42 Cal. 3d 131, 140, 720 P.2d 921, 926, 228 Cal. Rptr. 33, 38 (1986); *Guerra*, 37 Cal. 3d at 399, 690 P.2d at 643, 208 Cal. Rptr. at 169-70; *Donaldson*, 35 Cal. 3d at 36-7, 672 P.2d at 117-18, 196 Cal. Rptr. at 711-12 (an issue regarding retroactive application arises if "the decision established new standards or a new rule of law."); see generally *Moradi-Shalal v. Fireman's Fund Ins. Companies*, 46 Cal. 3d 287, 305, 758 P.2d 58, 69, 250 Cal. Rptr. 116, 127 (1988) (refusing full retroactive application of a decision expressly overruling an earlier high court decision creating a new cause of action, "in the interest of fairness to the substantial number of plaintiffs who have already initiated their suits in reliance on [prior case law].").

The propriety of the retroactivity of *Foley* is a thorny issue because the court, unlike in *Moradi-Shalal*, did not overrule its own precedent. The court, however, did completely disassociate itself from its earlier dictum on which appellate courts and litigants had relied. Notwithstanding the majority's dissatisfaction with the many lower courts that recognized a tortious breach cause of action (see *supra* notes 51-61 and accompanying text), the issue of the retroactivity of *Foley* merited especial consideration because the majority's act of abolishing an action for tortious breach "makes a 'clear break' from non-Supreme Court law . . . [as] established in the lower courts . . ." Perrello & Golembiewski, *Retroactivity of California Supreme Court Decisions: A Procedural Step Toward Fairness*, 17 CAL. WEST. L. REV. 403, 422 n.116 (1981). Since the *Cleary* court's recognition of tortious breach in the wrongful termination context, apparently all California courts having confronted the issue have recognized the cause of action. While there was much confusion and debate about the appropriate contours of the bad faith action, the lower courts unanimously agreed that such a cause of action was viable.

Retroactive application of *Foley* will lead to an onslaught of pretrial motions in the California courts. Even if a court had earlier denied a defendant's motion for summary judgment, for example, that party may now make a new summary judgment motion based on the recently decided law. *Pena v. Wolfe*, 177 Cal. App. 3d 481, 485, 223 Cal. Rptr. 325, 327-28 (1986). Further, countless cases have been litigated based on an assumption that a tortious breach cause of action was available. Based on this concern one court had determined before the *Newman* decision, that *Foley* should be applied prospectively only. See *Welch v. Metro-Goldwyn Film Co.*, 207 Cal. App. 3d 164, 254 Cal. Rptr. 645 (1988) (as amended January 13, 1989). In *Welch*, the appellate court determined, in an opinion filed December 23, 1988, that a jury verdict awarding damages for tortious breach should be upheld. Six days after the court's decision, *Foley* was handed down, and the appellate court requested briefing regarding the possible effect of *Foley* on its decision. On January 13, 1989, the appellate court filed an opinion in which the court, relying heavily on the Supreme Court's decision in *Moradi-Shalal*, explained: "[T]he interest of fairness to the substantial number of plaintiffs who have already initiated their suits in reliance on the long-standing case law recognizing a tort cause of action for bad faith discharge requires that the *Foley* decision be prospective only." *Welch*, 207 Cal. App. 3d at 201, 254 Cal. Rptr. at 666. On the other hand, even if the high court had applied *Foley* prospectively only, the lower courts would still have had to grapple with the undefined contours of the bad faith breach cause of action. The appellate courts, however, were able to provide the basic framework for analyzing bad faith breach causes of action before *Foley*, and would assuredly have been able to resolve the disputes before them. Notwithstanding the majority's attempt to pretend that reliance on its prior dictum was misplaced and unthinking, in light of the great reliance litigants and courts had placed on the bad faith breach cause of action, *Foley* should have been applied prospectively only.

last several years believed that a cause of action for tortious breach of the implied covenant existed in the employment context.¹⁰⁹

Three distinct types of contracts merited detailed examination by the court: *commercial* contracts, *insurance* contracts, and *employment* contracts. The public policies implicated by each differ, and, accordingly, the appropriate scope of recovery upon breach may differ as well. The court blurred these critical distinctions by either carelessly or deliberately failing to consider fully the distinctions between employment contracts and commercial contracts.¹¹⁰ The majority disingenuously relied on scholarly works that urged great caution before permitting tort recovery for the breach of a *commercial* contract, in an effort to buttress its assertion that tort damages are impermissible in the context of *employment* contracts. The majority deigned to rely on articles that expressly support a tort recovery in the employment context.¹¹¹ The California Supreme Court itself rather recently warned against ready extension of tortious breach into the realm of commercial contracts because of the need for stability and predictability in that area.¹¹² The law has long recognized and protected the right of a party to a commercial contract to breach and

109. In criticizing the lower courts that had assumed that a cause of action for tortious breach was appropriate in the employment context, the *Foley* majority derides one of its colleagues. In 1986, then appellate Justice Kaufman, noted that tortious breach was a viable cause of action, explaining that: "It appears to be now well established that in appropriate circumstances an action for 'bad faith' discharge based on the implied covenant of good faith and fair dealing will lie in the employment context." *Koehrer v. Superior Court*, 181 Cal. App. 3d 1155, 1168, 226 Cal. Rptr. 820, 828 (1986) (citing *Tameny*, *Seaman's* and five California appellate decisions).

110. See *Foley*, 47 Cal. 3d at 696, 765 P.2d at 398, 254 Cal. Rptr. at 236.

111. See, e.g., Putz & Klippen, *Commercial Bad Faith: Attorney Fees—Not Tort Liability—Is the Remedy for Stonewalling*, 21 U.S.F. L. REV. 419, 475 (1987) (discussing three basic proposals for extending the tort of bad faith beyond insurance and employment context). See also *Foley*, 47 Cal. 3d at 713 n.12, 765 P.2d 410-11 n.12, 254 Cal. Rptr. at 248-49 (Broussard, J., concurring and dissenting).

112. *Seaman's v. Direct Buying Service, Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 769, 686 P.2d 1158, 206 Cal. Rptr. 354, 362-63 (1984). The *Seaman's* majority explained:

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 it is wise to proceed with caution in determining their scope and application.

Id.

to pay the other party compensatory contract damages.¹¹³ Yet, in the realm of insurance contracts, the court has repeatedly held that countervailing interests support the recovery of tort damages.¹¹⁴ At the very least, employment contracts fall somewhere between insurance contracts and commercial contracts. Thus, the focus should be whether employment contracts, as such, merit the same protections afforded insurance contracts, or whether other special protections, or no special protections, are appropriate. Citation by the majority to authorities warning against expanded recovery in the commercial context, however, does not further this inquiry.

After determining the dissimilarity between insurance contracts and employment contracts, the majority embarked upon a discussion of whether the court should nonetheless provide additional remedies in the area of wrongful termination.¹¹⁵ The court concluded that recovery for the breach of the implied covenant should be limited to contractual remedies because of the need for predictability to promote

113. As one author explained:

Commercial case law is filled with cases where a contracting party has attempted to deprive the other party of the benefit of the agreement. When a breach of this kind occurs, the law provides for a remedy in contract; there is no need for further damages in tort. Indeed, from an economic standpoint, breaches of contract, especially where performance of the contract will result in economic waste, are desirable. On the other hand, when a breach threatens a person's financial security or peace of mind under circumstances where the plaintiff was not attempting to exact a profit, then society has a legitimate concern in the transaction.

Louderback, *supra* note 55, at 222 (footnotes omitted). See also Farnsworth, *Legal Remedies for Breach of Contract*, 70 *Col. L. Rev.* 1145, 1146-47 (1970). The California Supreme Court has echoed this sentiment. The Court noted:

Indeed, the assumption that parties may breach at will, risking only contract damages, is one of the cornerstones of contract law. [I]t is not the policy of the law to compel adherence to contracts, but only to require each party to choose between performing in accordance with the contract and compensating the other party for injury resulting from a failure to perform. This view contains an important economic insight. In many cases it is uneconomical to induce the completion of the contract after it has been breached. (Posner, *Economic Analysis of Law* (1972) p. 55.) In most commercial contracts, recognition of this economic reality leads the parties to accept the possibility of breach, particularly since their right to recover contract damages provides adequate protection.

Seaman's Direct Buying Service, Inc. v. Standard Oil Co., 36 Cal. 3d 752, 778, 686 P.2d 1158, 1173, 206 Cal. Rptr. 354, 369 (1984).

114. See *supra* note 55.

115. In so doing the majority conceded that the employment contract raises concerns which are absent in the commercial realm. The court asserted: "The potential effects on an individual caused by termination of employment arguably justify additional remedies for certain improper discharges." *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 693, 765 P.2d at 346-7, 254 Cal. Rptr. 211, 234-35 (1988). The court further acknowledged the "widespread perception that present compensation [to a wrongfully terminated employee] is inadequate." *Id.* at 696, 765 P.2d at 398, 254 Cal. Rptr. at 236.

commercial stability,¹¹⁶ and because of the difficulty in fashioning a rule that "would assure that only 'deserving' cases give rise to tort relief."¹¹⁷

The majority looked at the state of the law of tortious breach in the employment context and found it to be enormously confused. Rather than trying to define the parameters of the cause of action, however, the majority took an easier, though more dramatic step, and dropped the entire morass into the lap of the legislature.¹¹⁸ But the prior state of confusion in the law was largely due to the lack of direction from the supreme court that had enabled each lower court to chart its own course. Under the amorphous state of wrongful termination law, any termination of an employee created a significant potential for a wrongful termination lawsuit. The significant expense of defending unrestricted wrongful termination lawsuits constricts business' right to make fair and necessary employment decisions requiring the discharge of employees. Commentators have suggested

116. *Id.* at 696, 765 P.2d at 398, 254 Cal. Rptr. at 236-37.

117. *Id.* at 697, 765 P.2d at 399, 254 Cal. Rptr. at 237.

118. The majority contended that allowing itself to be bound by pure dicta and unfounded appellate decisions would be inappropriate because the Court would be both "abdicated its role" and improperly usurping legislative prerogative. *Id.* at 689 n.28, 765 P.2d at 393-94 n.28, 254 Cal. Rptr. at 231-32 n.28. Dumping the issue of remedies for wrongful termination into the lap of the legislature is viewed by Justice Broussard as judicial abdication. *Id.* at 712-14, 765 P.2d at 410-12, 254 Cal. Rptr. at 248-49 (Broussard, J., concurring and dissenting). Further, after decades of the court taking sole responsibility for the creation and definition of an action for tortious breach in the context of insurance contracts, the sudden concern for the need for deference to the legislature rings hollow.

At least one commentator urged legislative restraint in the area of wrongful termination so that the courts would have the opportunity to define clearly the parameters of the legal area:

When faced with uncertainty and contradictory directions in common-law decisions on a basic and critical issue such as job security, it is tempting to call out for legislation. In fact, legislation might have been appropriate several years ago when the common law was not moving, and when indefinite employment was still terminable-at-will. As we hover on the brink of judicial solutions to these important problems, however, the wiser course of action may be for the legislative bodies to give the common-law system an opportunity to seek an appropriate solution.

Rohwer, *supra* note 7, at 780-81. The legislative forum has largely lain dormant while the courts have been crafting generalized legal protection for wrongfully discharged workers. Although the legislature has enacted numerous provisions limiting the employer's right to terminate an employee because the employee engaged in certain activities or possesses a specified characteristic (*see supra* note 10), legislative inaction may have resulted from the legislature's reliance on the courts' activity in the employment area. Further, while business interests and unions are well organized and are able to apply pressure upon legislators to provoke legislative action, the non-union worker is not a member of any definite and cohesive body. *See Foley*, 47 Cal. 3d at 714, 765 P.2d at 411-12, 254 Cal. Rptr. at 249-50 (Broussard, J. concurring and dissenting) (After this decision, "the burden of seeking legislative change, which was previously on employers and insurers, two well organized and financed groups, is now on the unorganized worker.").

ways to address this legitimate concern.¹¹⁹ Yet, had the court confronted the hard issues posed by any attempt to define the proper scope of an action for tortious breach, and had they formulated standards in the area of bad faith breach, justifiable cases would still have adequate avenues of redress; frivolous actions or those lacking much chance of success would either not be filed in light of the clarified law or would, at the least, be more readily disposed of early in the litigation process.¹²⁰ Nor can the majority assert that legislative definition of the parameters of wrongful termination causes of action is the norm. The majority conceded that only one state has enacted legislation designed to provide at-will employees protection from arbitrary discharge outside the public policy context.¹²¹ If

119. See, e.g., Gould, *supra* note 17, at 405-406 (1987).

120. Some authors clearly expected this needed clarification to come from the court in their *Foley* decision. See, e.g., Haggarty, *supra* note 57, at 464, Haggarty concludes, after reviewing the confusion among California's appellate courts in their attempt to define the cause of action for tortious breach, that the high court's clarification of the elements of an action based on tortious breach will lead to "a more stable area of the law for both practitioners and the courts alike." *Id.*

Surely, the majority's course is most unusual. It is highly unlikely that the court will resolve confusion in other troubled areas of the law by abolishing the cause of action and urging legislative rebuilding. For example, the California Supreme Court recently rendered the long-awaited decision of *Thing v. LaChusa*, 48 Cal. 3d 644, 771 P.2d 814, 257 Cal. Rptr. 865 (1989), which clarified the blurry area of bystander actions for negligent infliction of emotional distress. It would have been quite remarkable had the court simply eliminated the cause of action, and suggested to the legislature the reinstatement of the cause of action. The court, of course, did no such thing and, as is customary, limited their evaluation and resolution to the dispute before them. Admittedly, the analogy is not perfect. The California Supreme Court itself had expressly created and continued to refine the cause of action for bystander negligent infliction of emotional distress. See, e.g., *Ochoa v. Superior Court*, 39 Cal. 3d 159, 703 P.2d 1, 216 Cal. Rptr. 661 (1985); *Dillon v. Legg*, 68 Cal. 2d 728, 441 P.2d 912, 69 Cal. Rptr. 72 (1968). Nonetheless, on at least two occasions high court dictum had suggested the validity of an action for tortious breach in the employment context. See *supra* note 50. Further, there is nothing remarkable about the court reconstructing a statute of long-standing. For example, in *Li v. Yellow Cab*, 13 Cal. 3d 804, 532 P.2d 1226, 119 Cal. Rptr. 858 (1975), the court rejected the argument that Civil Code section 1714, enacted in 1872, could only be altered by the legislature. In reinterpreting the statute to permit the court to adopt comparative fault, the court explained that:

it was not the intention of the Legislature in enacting section 1714 of the Civil Code, as well as other sections of that code declarative of the common law, to insulate the matters therein expressed from further judicial development; rather it was the intention of the Legislature to announce and formulate existing common law principles and definitions for purposes of orderly and concise presentation and with a distinct view toward continuing judicial evolution.

Id. at 814, 532 P.2d at 1233, 119 Cal. Rptr. at 865.

Justice Kaufman provides an elegant rebuttal to the *Foley* majority's determination that the legislative arena is the appropriate forum for determining the appropriate remedies for a terminated employee. See *Foley*, 47 Cal. 3d 654, 719-721, 765 P.2d 415-17, 254 Cal. Rptr. 211, 253-55 (Kaufman, J., concurring and dissenting).

121. *Foley*, 47 Cal. 3d at 695 n.31, 765 P.2d at 397-98 n.31, 254 Cal. Rptr. at 235-36 n.31. Montana's legislative action followed judicial action affording broad protection to

the legislature is to act in this area, it must outline when a tort recovery is appropriate by explaining what more than breach of an implied-in-fact contract is needed to state a cause of action. Cases where the employer does nothing more than breach a term of a contract should not be transformed into tort actions; there must be some additional conduct evidencing bad faith in the employer's conduct to bring to bear damages sounding in tort. To this end, legislative consideration of *Hejmadi*, *Koehrer* and *Khanna* may prove helpful.¹²²

In essence, the *Foley* court throws the "baby out with the bath-water"; not finding satisfactory parameters for an action for tortious breach, the court simply obliterates the cause of action.¹²³

wrongfully terminated at-will workers. See *Dare v. Montana Petroleum Mktg. Co.*, 687 P.2d 1015 (Mont. 1984).

122. *Hejmadi v. AMFAC, Inc.*, 202 Cal. App. 3d 525, 249 Cal. Rptr. 5 (1988); *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). See generally Summers, *Individual Protections Against Unjust Dismissal: Time for a Statute*, 62 VA. L. REV. 481 (1976).

123. The California Legislature may have begun to heed the court's plea for legislative assistance, however. Several bills have been introduced in the legislature that will have varying degrees of impact on California employment law. But legislative action will not prove the panacea believed by the majority if there is no clear delineation of the remedies to be afforded wrongfully discharged workers. For example, within weeks of the *Foley* decision, Senator Torres introduced legislation (S.B. 181) designed to overrule *Foley's* holding regarding tortious breach. The text of the bill, as introduced, provides: "An employee may bring an action in tort against an employer for bad faith discharge of the employee if the employer breaches an implied covenant of good faith and fair dealing with the employee." S.B. 181, 1988-89 Cal. Leg., Reg. Sess. (Jan. 12, 1989). While this may be some indication that the legislature will get more involved in the employment arena, the bill itself is problematic. The bill simply states an intention to overrule *Foley* so far as it limits tort damages for breach of the implied covenant of good faith and fair dealing. It offers no guidance about the parameters of the tort-based action, throwing the problem back to the courts where the confusion originated. In light of *Foley*, the legislature should specify the appropriate contours of the tortious breach cause of action.

Two other legislative efforts to alter California employment law merit mention. Assembly Member Murray and Senator B. Greene have introduced legislation (A.B. 386, 1988-89 Cal. Leg., Reg. Sess. (Jan. 30, 1989), and S.B. 324, 1988-89 Cal. Leg., Reg. Sess. (Jan. 31, 1989)) that would repeal the longstanding "at will" provisions of California Labor Code section 2922, and would limit employers of more than four employees to terminations for "just cause" in most situations. The bills provide nine broad categories of "just cause" and also provide procedures for termination and for mediation and arbitration. *Id.* Enactment of this legislation would mark a dramatic alteration of existing employment law.

A complete restructuring of current wrongful termination law would follow from the adoption of another highly-detailed bill. Senator Beverly has introduced legislation designed to preempt most of the area of wrongful termination. His bill, S.B. 222, 1988-89 Cal. Leg., Reg. Sess. (Jan. 19, 1989), retains the general proposition of at-will employment but delineates various specific exceptions to the at-will provision. As an example, the bill would permit an exception when a court finds that the employer's discharge of the employee occurred without a good-faith belief by the employer that good cause existed to justify the termination, the employee had worked for the employer for at least 1,000 hours per year for five or more consecutive years, and the plaintiff, at the time of discharge, was receiving total remuneration of less than

III. THE POST-*Foley* State of the Law

With the stroke of the pen, the *Foley* majority blockaded the central avenue to tort recovery for a wrongfully terminated worker. After *Foley*, only two of the former common-law bases for recovery for wrongful termination exist: a contract action based on express and implied promises by the employer, and an ill-defined tort action for terminations contrary to public policy. The majority forecloses any tort-based recovery arising from the breach of the implied covenant of good faith and fair dealing. The court's opinion also suggests an unwillingness to permit a *contract-based* action for breach of the implied covenant of good faith and fair dealing by a purely at-will employee.¹²⁴ Further, the independent significance and vitality of the implied covenant of good faith and fair dealing, in the context of an employee able to assert an implied-in-fact promise that the employer will terminate only for "just cause," is uncertain.¹²⁵

At the same time, the court enthusiastically embraces contract law as the panacea for the ills of most wrongfully terminated employees. A modernized and flexible approach to contract law, seemingly welcomed by the majority,¹²⁶ may inject greater stability into the wrongful termination realm, while ensuring that wrongfully terminated employees are justly compensated. If, however, rigid and antiquated contract principles are applied, allowing employers to undercut the protections afforded employees by the majority's adherence to *Pugh*, the wrongfully terminated employees of California are left with little legal protection.

A. Evaluating "Public Policy" After *Foley*

The *Foley* court posited a new focus for determining when a discharge is violative of public policy, directing the focus toward an evaluation of whether the asserted policy is "substantial," "fundamental," and, most critically, "public" enough to underlie the cause

\$ 100,000. *Id.* Under the bill, the burden of proof on each issue is on the plaintiff-employee. *Id.* The bill also affords limited protection to a narrow category of wrongfully terminated workers and includes mandatory mediation provisions. *Id.*

124. See *infra* notes 141-151 and accompanying text.

125. See *infra* notes 154-162 and accompanying text.

126. See *supra* notes 89-95 and accompanying text.

of action. Yet, the court failed to offer direction or guidance to the lower courts that will now have to struggle to effectuate the court's ambiguous standard. The evaluation of whether an asserted interest is "public" is quite challenging, particularly in view of the court's surprising determination that Foley's claim failed to assert a *public* policy. While Foley's asserted interest in reporting relevant information about co-workers to management on its face reflects no clear public interest, a slightly different characterization of that same interest—asserting an interest to warn potential victims of crime about possible imminent danger so as to aid crime prevention—cannot so readily be discarded as outside the "public interest."¹²⁷

The court's narrow interpretation of Foley's asserted public policy basis places Foley and those situated similarly to him in an untenable position. As an agent, an employee has a fiduciary duty of diligent and faithful service to his principal.¹²⁸ Implicit in the agent-employee's fiduciary duty is the obligation to "use reasonable efforts to give his principal information which is relevant to affairs entrusted to him, and which, as the agent has notice, the principal would desire to

127. Justice Mosk, in his dissent, contended that plaintiff's conduct implicates a public interest. Justice Mosk described Foley's conduct as "advising a state-created corporation of the employ in a supervisory position of a person chargeable with a potential felony . . ." *Foley*, 47 Cal. 3d at 724, 765 P.2d at 418, 254 Cal. Rptr. at 256 (Mosk, J., dissenting). Perhaps Foley's own characterization of his motive for informing his supervisor about Kuhne's criminal record proved to be his undoing. Foley asserted that he informed his superior about the investigation of Kuhne because "he believed that because defendant and its parent do business with the financial community on a confidential basis, the company would have a legitimate interest in knowing about a high executive's alleged prior criminal conduct." *Id.* at 664, 765 P.2d at 375, 254 Cal. Rptr. at 213. So designated, the public interest aspect of crime reporting is minimized.

Although not discussed by the court, perhaps a countervailing public policy would prevent any recognition of Foley's public policy claim. California law expressly prohibits an employer from considering arrests that did not result in conviction "in determining any condition of employment including . . . termination." CAL. LAB. CODE § 432.7 (West Supp. 1989). Thus, an employer may not discharge an employee on the basis of an arrest not leading to a conviction. As one court explained: "The obvious intent of the legislation is to prevent the adverse impact on employment opportunities of information concerning arrests where culpability cannot be proved." *Pitman v. City of Oakland*, 197 Cal. App. 3d 1037, 1044, 243 Cal. Rptr. 306, 309-10 (1988). In *Foley*, Kuhne had not even been arrested at the time of Foley's termination, and a public policy protecting a person from termination absent conviction would, arguably, have been even stronger. *See Foley*, 47 Cal. 3d at 664, 765 P.2d at 375, 254 Cal. Rptr. at 213 (Kuhne was only under investigation at the time of Foley's discharge). This argument is ultimately not particularly compelling in *Foley*, however. It is clear that the purpose of the section is not "to shelter an employee from investigation for serious misconduct" and, accordingly, is inapposite where, as in *Foley*, the arrest leads to a conviction. *See Pitman*, 197 Cal. App. 3d at 1044, 243 Cal. Rptr. at 310.

128. *See* CAL. LAB. CODE § 2854 (West Supp. 1989). Section 2854 provides: "One who, for a good consideration, agrees to serve another, shall perform the service, and shall use ordinary care and diligence therein, so long as he is thus employed." *Id.*

know. . . .'¹²⁹ Thus, Foley would have breached his fiduciary duty to his employer had he failed to report that Kuhne was a suspected embezzler, thereby placing his job in jeopardy and opening himself up to potential liability. By complying with his fiduciary obligation, Foley ultimately placed his job in jeopardy nonetheless. If there is a duty imposed upon an agent-employee to disclose relevant information to the principal-employer, it is ludicrous to allow the principal-employer to terminate the agent-employee for complying with the fiduciary obligation. The public policy of the state seeks to encourage agents to report such information to their principals; allowing principals to terminate agents for acting in a manner consistent with this public policy cannot be condoned as it directly undermines that public policy.

Further, even if a wrongful termination action is not compelling in this instance, the suggested focus of the court is troubling. The court intimated that one way to gauge the public interest is to discern whether an agreement between the employer and the employee that requires the employee *not* to act in accordance with the alleged public interest would be enforceable.¹³⁰ This "test" is unworkable because the goals of the law of contract differ greatly from the aims of tort law. While contract law seeks to enforce the promises of the parties, tort law focuses on society's requirements and sets certain minimal standards of conduct regardless of, and possibly in spite of, any agreement by the parties.¹³¹ The strong presumption favoring the enforceability of contracts¹³² has little vitality in the realm of employer conduct in violation of public policy, conduct conceded to give rise

129. RESTATEMENT (SECOND) OF AGENCY, § 381 (1958). See B. WITKIN, SUMMARY OF CALIFORNIA LAW, AGENCY AND PARTNERSHIP, § 41 (1987) ("An agent is a *fiduciary*. His obligation of diligent and faithful service is the same as that of a trustee. . . . Thus, an agent is required to disclose to the principal all information that he has relevant to the subject matter of the agency.") See also *Chodur v. Edmonds*, 174 Cal. App. 3d 565, 572, 220 Cal. Rptr. 80, 84 (1985) ("An agent as fiduciary is required to disclose to his principal all information he has relevant to the subject matter of the agency."); *Orfanos v. California Ins. Co.*, 29 Cal. App. 2d 75, 80, 84 P.2d 233, 235 (1938) ("It is too well settled to need citation of authority that an agent must disclose to its principal all facts within its knowledge pertaining to the agency.")

130. *Foley*, 47 Cal. 3d at 670 n.11, 765 P.2d at 380 n.11, 254 Cal. Rptr. at 218 n.11.

131. See W. KEETON, D. DOBBS, R. KEETON & D. OWEN, PROSSER AND KEETON ON TORTS § 92 (5th ed. 1984).

132. See *Moran v. Harris*, 131 Cal. App. 3d 913, 919, 182 Cal. Rptr. 519, 522 (1982) (quoting *Stephens v. Southern Pac. Co.*, 109 Cal. 86, 89-90, 41 P. 783 (1895)) ("While contracts opposed to morality or law should not be allowed to show themselves in courts of justice, yet public policy requires and encourages the making of contracts by competent parties upon all valid and lawful considerations, and courts so recognizing have allowed parties the widest latitude in this regard . . .").

to an action sounding in tort. Most critically, the role of "public policy" in contract differs from its role in tort.¹³³ The majority's "test" is underinclusive because it permits an employer to discharge an employee for acting in a manner beneficial to a public interest not reflected by statute.¹³⁴ For example, would Foley have stated a cause of action if he had heard from a reliable source that his immediate supervisor had been stealing equipment from the workplace and Foley had reported this to his employer, thereby creating a closer nexus between the alleged criminal conduct and the employer's interest? Would a different answer follow if Foley had actually seen his supervisor steal equipment from the workplace and had reported this to his employer, thereby minimizing the role of innuendo?¹³⁵ Would (and should) the result differ if Foley contacted the police rather than his employer? Does (and should) the answer to this depend upon the existence of a statute requiring the reporting of a crime?¹³⁶ Finally, would a different conclusion be reached if the

133. LOUDERBACK & JURWIK, *supra* note 55, at 191 ("Public policy plays a major role in determining what particular acts will constitute a tort. By contrast, it is rare when public policy considerations are utilized to interfere with the obligations negotiated by the contracting parties.").

134. Another reason that the proposed test is faulty is because it fails to adequately deter the improper conduct of an employer. Under the majority's analysis of public policy, would there be any tort action possible against an employer who terminates an employee days before that employee was to receive accrued commissions? *Cf. Fortune v. National Cash Register Co.*, 373 Mass. 96, 364 N.E.2d 1251 (1977). Under *Foley*, there is no "wrongful termination" action possible absent finding an implied-in-fact contract term limiting the employer to termination for cause outside of the public policy arena. *See supra* notes 141-148 and accompanying text. If no public policy is implicated, the employee would be limited to the administrative remedies under which the employee may make a claim for wages owed. *See CAL. LAB. CODE* §§ 96.7, 98, 98.6, 98.7, 206 (West Supp. 1989). Under the Labor Code, recoverable damages are generally significantly less than under the common law cause of action. Through this procedure the employee generally can only get little more than that which was already owed to him or her in the first place, and, thus, the statutory provisions have less of a deterrent effect on an employer than would the tort cause of action. Where the employee is terminated before certain benefits accrue, such as a right to profit sharing, there may not even be statutory protection for the employee.

135. Under the court's reasoning, the first example remains purely a "private" matter between the employee and the employer. The second example may lead to a contrary result because it directly involves the reporting of actual criminal conduct which conceivably implicates a clearer public interest. On the other hand, under the majority's analysis *private* crime reporting may arguably never raise a sufficient public interest.

136. California law expressly prohibits retaliation against an employee for reporting suspected crime to the police and would render a discharge for reporting suspected crimes clearly violative of public policy. *See CAL. LAB. CODE* § 1102.5(b) (West Supp. 1989) which specifically prohibits retaliation against an employee for reporting suspected criminal conduct to the police. *Per Foley*, firing the employee for his or her act of reporting the identical conduct to the appropriate supervisor does not violate public policy. *See also Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 723-24, 765 P.2d 373, 418, 254 Cal. Rptr. 211, 256 (1988) (Mosk, J., dissenting).

supervisor was alleged to be stealing from customers, rather than the employer? Would this then implicate a substantial public interest?¹³⁷

While the impossibility of proclaiming a bright-line definition of "public policy" is regrettable, it is not possible to defer entirely to the legislature in this area.¹³⁸ Legislative efforts to define "public policy" have been largely reactive—a problem arises and ultimately legislation is enacted as a specific response.¹³⁹ It is not possible for the legislature to delineate all of the potential public policy grounds that may arise in the wrongful termination context. Nor, as *Foley* indicates, is the existence of a statutory handle necessarily a logical basis for the assertion of the tort cause of action. Courts should be permitted to sanction employer conduct that is clearly in contravention of public policy.¹⁴⁰

137. Unlike Tameny and Petermann, who asserted that they were terminated because they *refused* to perform acts violative of public policy, *Foley* claimed that he was discharged because he *performed* an act favored by public policy. Provided that a substantial public policy is implicated, both situations can logically underlie the cause of action. There is judicial support for a public policy favoring protection of employees against retaliatory termination for expressing "concerns, within an enterprise, concerning the legality or morality of enterprise conduct." *Pugh v. See's Candies*, 116 Cal. App. 3d 311, 324 n.14, 171 Cal. Rptr. 917, 924 (1981).

138. Those who seek to limit the public policy exception to statutory enactments claim that a more amorphous standard will lead to unbridled discretion by the courts, enabling them to decree public policies from the bench, without affording the employer advance notice of what conduct could lead to civil litigation. *See, e.g.*, Note, *supra* note 2, at 179-80. While it is true that the pronouncement of public policy is usually a legislative function, California law has long held that "when neither the Constitution nor the Legislature has spoken on the subject the courts may make the declaration." *Safeway Stores v. Retail Clerks*, 41 Cal. 2d 567, 574, 261 P.2d 721, 725 (1953). Further, the limitation by the *Foley* court, to "significant" or "fundamental" public policies, reduces the risk of lack of notice to an employer because the asserted policy will be one about "which reasonable persons can have little disagreement, [the policy] being 'firmly established' at the time of discharge." *Foley*, 47 Cal. 3d at 668, 765 P.2d at 378, 254 Cal. Rptr. at 218.

139. *See, e.g.*, CAL. LAB. CODE § 450 (West Supp. 1989) (prohibiting discharge for an employee's refusal to patronize employer.)

140. Where an employee asserts that he or she has been terminated in violation of some public interest that is compelling and important, California courts should be able to vindicate the employee's right even in the absence of a statutory basis. In many cases, the plaintiff will seek to assert a statutory basis for the action because, particularly in light of *Foley*, a statute-based claim will greatly aid the plaintiff in his or her efforts to persuade the court of the merits of the cause of action. A statutory basis for the claim of public policy will usually be quite helpful as it will reflect both the fact that the policy is so substantial and fundamental that legislative or administrative action was taken, and that there is a "public" interest at issue. Courts will therefore look to existing statutes and regulations for guidance in this area. While no definition of public policy, broad enough to encompass all meritorious situations and narrow enough to be of value, can be crafted, legislative and judicial action will ultimately define the contours of the cause of action. Further, in addition to having to persuade the judge that the employee's termination was in contravention of a substantial public policy worthy of judicial recognition, the discharged employee will have to *prove* the claim. Despite the facial validity of the claim, the factual record may be lacking. *See, e.g.*, *Pugh v. See's*

After *Foley*, it appears that the key focus turns away from the existence or non-existence of a statutory basis for the "public policy" and toward a determination of whether the public policy is fundamental and substantial, and, most importantly, whether it truly reflects an interest of the public, as opposed to a purely private matter. How this will be decided remains to be seen.

*B. The Purely At-Will Employee*¹⁴¹

A purely at-will employee is unable to rebut the presumption of California Labor Code section 2922 that employment for an unspecified duration is terminable at will. In light of the language of this section, it is unlikely that a purely-at-will employee can challenge termination on any non-statutory ground other than the public policy-based cause of action. Yet, arguably there exists some level of employer conduct in the context of an employee discharge that is so arbitrary that the terminated employee should be able to receive at least contract damages.

In California, an at-will employment agreement constitutes a contract.¹⁴² Like any contract in California, the at-will employment contract includes an implied covenant of good faith and fair dealing.¹⁴³ Seemingly, that implied covenant should restrict certain con-

Candies, Inc., 116 Cal. App. 3d 311, 322-24, 171 Cal. Rptr. 917, 922-24 (1981) (despite facial validity of Pugh's public policy claim that he was terminated for his refusal to participate in negotiations for an illegal union contract, trial court correctly found insufficient evidence for jury consideration of the claim).

141. By this the author refers to those employees who are unable to satisfy the *Pugh* criteria for an implied-in-fact promise not to terminate absent cause.

142. *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 676, 765 P.2d 373, 384, 254 Cal. Rptr. 211, 222 (1988). Typically the employment agreement is silent as to the term of employment. Where there is no express term as to duration of the employment relationship, courts invariably imply a term that the contract is terminable at will. E.A. FARNSWORTH, *supra* note 37 § 7.17. California courts, in so doing, act consistently with the presumption of at-will employment created by Labor Code section 2922 *See supra* note 33.

143. *Foley*, 47 Cal. 3d at 683, 765 P.2d at 389, 254 Cal. Rptr. at 227.

California adheres to the general rule that the covenant is implied in every contract. *See, e.g., Seaman's Direct Buying Serv., Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 768, 686 P.2d 1158, 1166, 206 Cal. Rptr. 354, 362 (1984); *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 809, 620 P.2d 141, 169 Cal. Rptr. 691 (1979). *See also* CAL. CIV. CODE § 1655 (West 1985).

See generally RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981). "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement." The Restatement rule is based upon the Uniform Commercial Code section 1-203, which provides that, "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement." U.C.C. § 1-203 (West 1987). Courts frequently imply terms requiring the parties to act with good faith. Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CH. L. REV. 666,

duct that is not in "good faith" in the employment context.¹⁴⁴ Nevertheless, the court's decision clearly renders the implied covenant utterly impotent in cases of termination of a purely at-will employee. By holding that the covenant of good faith and fair dealing found in the at-will employment relationship can *never* be breached by the employer's termination of an at-will employee, the court bars a plaintiff's right to legal redress even in cases of arbitrary or malevolent discharge.¹⁴⁵ The following arguments constitute the "logic" behind this result. Because termination at will is part of the employment agreement, the employer's act of terminating an employee at will is generally not viewed as actionable. Absent a public policy violation, the employee may neither assert an action for breach of contract, because at-will termination is not a breach, nor a tort or contract action for breach of the implied covenant, because the implied covenant only protects the parties' rights to receive the benefit

667-68 (1963). See also Louderback, *supra* note 55, at 190 ("The concept of good faith and fair dealing pervades many areas of contract law," noting the Uniform Sales Act, the Robinson-Patman Act and the Bankruptcy Act, in addition to the U.C.C.).

144. Although the parameters of the obligation are ill defined, some courts found that there was some minimum level of good faith required of employers, even in the at-will employment context. Falling below this minimal level subjects the employer to liability. As one judge explained: "California courts have properly decided that there does exist *some* point at which they should intervene to prevent unfair treatment of individual employees by their employers. The cases have long since settled this basic question." *Cox v. Resilient Flooring Div. of Congoleum Corp.*, 638 F. Supp. 726, 736 (C.D. Cal. 1986) (applying California law). In *Cox*, Judge Letts, after giving a narrow interpretation to California wrongful termination law, asserted that there is a fundamental obligation arising from the implied covenant that the employer treat an employee "fairly in the overall." *Id.* at 737. Judge Letts then concluded that the "very narrow rule" he advocated requires, per the implied covenant, that "the employer return the terminated employee to the marketplace 'whole,' and free of the detriment necessarily incident to the termination of the employment relation." *Id.* at 738. The court continued:

As to this, it seems appropriate to consider again the fact that by choosing a particular employment an employee ordinarily gives up the right to consider other employment freely and without loss of income. With this in mind it seems proper to suggest that "fair" treatment ordinarily requires that the employer provide the employee with severance which is adequate to provide him a reasonable chance of finding colorable employment without loss of income and that the employer maintain an official posture with respect to the termination which does not unfairly prejudice the employee's future employment prospects.

Id. at 738.

145. If an employer wakes one day and decides to fire a certain redheaded employee because the employer has suddenly developed an antipathy for red hair, or due to an irritable mood opts to discharge every fourth employee as he or she arrives for work, under *Foley* there would be *no* cause of action—neither contract nor tort—unless an implied-in-fact contract limiting termination to just cause had been formed. The employer may, thus, act arbitrarily, at least until the point where the employer's conduct can be deemed to be in contravention of public policy. See *supra* notes 77-80 and accompanying text. Of course, an employer's arbitrary termination of an at-will employee becomes actionable if it constitutes an independent tort, such as intentional infliction of emotional distress or defamation.

of their agreement, which encompasses the right of termination at will. The *Foley* majority explained: “[W]ith regard to an at-will employment relationship, breach of the implied covenant cannot logically be based on a claim that a discharge was made without good cause. If such an interpretation applied, then all at-will contracts would be transmuted into contracts requiring good cause for termination”¹⁴⁶ Or, put another way, because the at-will doctrine permits termination without just cause, the discharged employee is prevented from any recovery for arbitrary, even malicious, discharge. The decision not only forecloses an action for tortious breach in this context¹⁴⁷ but prohibits an at-will employee’s *contract-based* action

146. *Foley*, 47 Cal. 3d at 698 n.39, 765 P.2d at 400 n.39, 254 Cal. Rptr. at 238 n.39. Interestingly, Justices Kaufman and Broussard may also have adhered to the majority’s restrictive view. Justice Kaufman asserted that “[c]learly, no action for breach of the covenant of good faith and fair dealing will lie *unless* it has first been proved that, expressly or by implication, the employer has given the employee a reasonable expectation of continued employment so long as the employee performs satisfactorily.” *Foley*, 47 Cal. 3d at 719, 765 P.2d at 415, 254 Cal. Rptr. at 253 (Kaufman, J., concurring and dissenting) (emphasis in original). Justice Kaufman’s statement, however, is in the midst of his advocacy for the recognition of a *tort* action for breach of the implied covenant, and may, accordingly, suggest that a *Pugh* action must be a prerequisite for an action for tortious breach. Indeed, this interpretation is consistent with Justice Kaufman’s position in *Koehrer v. Superior Court*, 181 Cal. App. 3d, 1155, 1171, 226 Cal. Rptr. 820, 829 (1986). Justice Broussard asserts that “[a] tort action for bad faith discharge also requires that the discharge be wrongful—that is, breach of contract.” *Foley*, 47 Cal. 3d at 710-11, 765 P.2d at 409, 254 Cal. Rptr. at 247 (Broussard, J., concurring and dissenting).

147. In limited situations prior to *Foley*, a recovery in tort for terminating a purely at-will employee was permitted. *See, e.g., Khanna v. Microdata Corp.*, 170 Cal. App. 3d 250, 215 Cal. Rptr. 860 (1985). In *Khanna*, the court found defendant’s bad faith, extraneous to the contract of employment, motivated by an intent to frustrate the plaintiff’s enjoyment of his employment rights, to constitute tortious breach of the implied covenant of good faith and fair dealing. *Id.* at 263, 215 Cal. Rptr. at 868. The defendant allegedly fired the plaintiff for bringing a legal action against the employer and for the purpose of forcing the plaintiff to forego accrued commissions. *Id.* at 257, 215 Cal. Rptr. at 863. The *Khanna* rationale was followed recently in *Hejmadi v. AMFAC, Inc.*, 202 Cal. App. 3d 525, 249 Cal. Rptr. 5 (1988). The *Hejmadi* court, though generally refusing to permit a tortious breach action by a purely at-will employee, acknowledged the validity of the *Khanna* test, noting:

Thus, the lesson of *Khanna* is that the implied covenant tort remedy may be applied to an at-will employment termination case under certain limited circumstances. The elements giving rise to the cause of action are these: (1) the employees have some specific expectation of benefit from the employment contract; (2) the expectation of benefit is not dependent upon a continuous employment relationship which can only be terminated for good cause [because the employee would no longer be at-will in that case]; and (3) bad faith termination coupled with the wrongful intent to deprive the employee of the specialized benefit of the agreement.

Both contractual and policy considerations join to justify imposing an implied covenant tort remedy in an at-will employment termination case where there is a convergence of the elements we have defined. There exists a bargained for contractual benefit which the employee has reason to expect will be observed by the employer, in good faith. There is also an offense against ‘accepted notions of business ethics, where the employer in bad faith and with the wrongful intent to deprive the employee

for the breach of the implied covenant of good faith and fair dealing as well.¹⁴⁸

The *Foley* court correctly expresses concern that permitting even a contract action by a purely at-will employee based on the employee's claim that he or she was terminated without good cause will wholly eviscerate the statutory dictates of section 2922 of the California Labor Code. A more moderate approach can be fashioned by placing limited constraints on the employer's otherwise unfettered rights to terminate, while still leaving the purely at-will employee much more vulnerable to discharge than an employee able to assert he or she is terminable only for good cause. Where an employee asserts an implied promise that he or she is not terminable absent just cause, a jury finding that the employer acted in "good faith" and "nonarbitrarily" is not enough for the employer to escape liability; the defendant is exonerated only upon a jury finding of just cause for the termination.¹⁴⁹ For a purely at-will employee, however, the implied covenant could provide a contract remedy only when the employer acts arbitrarily and unreasonably.¹⁵⁰ This limitation serves to protect the employer who is acting in good faith.

of that contractual benefit terminates the relationship. Such conduct transcends a mere breach of contract and warrants a remedy sounding in tort.

Id. at 552, 249 Cal. Rptr. at 20 (citations omitted).

Though the asserted standards are quite vague, the *Khanna* court and the *Hejmadi* court recognized that in limited situations a tort action was needed to deter an employer's potential "bad faith" conduct.

148. Other undefined conduct not leading to termination may lead to contractual liability for breach of the implied covenant of good faith and fair dealing even in the context of a purely at-will contract. See *Foley*, 47 Cal. 3d at 698 n.39, 765 P.2d at 400 n.39, 254 Cal. Rptr. at 238 n.39. Exactly what conduct would give rise to a breach is uncertain, but would perhaps, for example, consist of employer actions that impede the purely at-will employee's effort to make sales thereby reducing the employee's commissions, or instances where the employee has been demoted or refused a promotion in bad faith.

149. See *Pugh v. See's Candies*, 203 Cal. App. 3d 743, 768, 250 Cal. Rptr. 195, 212 (1988). The *Pugh II* court, relying heavily on *Toussaint v. Blue Cross*, 408 Mich. 579, 292 N.W.2d 880 (1980), held that in an employee's breach of contract action, in which the employee asserts he or she is terminable only for just cause, the jury's appropriate focus is on whether the employer's asserted basis for discharge amounts to good cause and not whether the jury finds the employer's decision to terminate was reasonable. *Id.*

150. One court, construing the implied covenant of good faith and fair dealing to apply generally to the employment context, noted:

Under the common law rule codified in Labor Code section 2922, an employment contract of indefinite duration is, in general, terminable at 'the will' of either party. This common law rule has been considerably altered by the recognition of the Supreme Court of California that implicit in any such relationship or contract is an underlying principle that requires the parties to deal openly and fairly with one another. [citations omitted] This general requirement of fairness has been identified as the covenant of good faith and fair dealing. [citation omitted] The covenant of good faith and fair dealing embraces a number of rights, obligations, and consid-

Ultimately, a re-evaluation of section 2922 may be in order by the legislature which should balance the need for stability in the business sphere, which necessarily includes broad employer discretion in employment decisions, with limitations on the employer's right to remove a person from employment in a wholly arbitrary manner.¹⁵¹

C. *The Employee Asserting an Implied-in-Fact Promise*

While the court's route to the conclusion that the implied covenant will not lead to tort damages in the purely at-will employment relationship is understandable, the same result in the context of an implied-in-fact contract does not follow. Where the *Pugh* criteria are met and an implied-in-fact contract is deemed to exist under which the employee may be terminated only for "good cause," other considerations arise. Liability for breach of contract is strict; the motive or mental state of the party in breach is irrelevant for purposes of contract analysis.¹⁵² The majority's determination that there cannot be a *tort* recovery arising from the breach of the implied covenant of good faith and fair dealing that is found in the implied-in-fact contract greatly reduces the effect of pre-*Foley* law in deterring employers from asserting a pretextual basis for the discharge. In cases where the employer is bound to an implied-in-fact promise not

erations implicit in contractual relations and certain other relationships. At least two of those considerations are relevant here. The duty of fair dealing by an employer is, simply stated, a requirement that like cases be treated alike. Implied in this, of course, is that the company, if it has rules and regulations, apply those rules and regulations to its employees as well as affording its employees their protection. . . .

[T]he fair dealing portion of the covenant of good faith and fair dealing is at least the right of an employee to the benefit of rules and regulations adopted for his or her protection.

Rulon-Miller v. International Business Mach's. Corp., 162 Cal. App. 3d 241, 247-48, 208 Cal. Rptr. 524, 529 (1984). While the *Foley* majority decision is largely at odds with the *Rulon-Miller* case, rendering *Rulon-Miller* of questionable authority, some of the *Rulon-Miller* court's logic remains compelling. Possibly a contract action could lie for the breach of the implied covenant where it is not the fact of discharge that is being challenged, but rather the employer's arbitrary failure to follow its own procedures is the basis of the action.

151. The legislature may have begun to reassess the merits of the at-will provision. See *supra* note 123 and accompanying text. One author suggests that the appropriate focus should turn from statutory efforts to restrict California Labor Code section 2922, to the California Constitution. Comment, *Constitutional Limitations*, *supra* note 9, at 382-86 (asserting that sections 7(a) and 8 of Article I of the California Constitution, prohibiting unequal protection of the laws and discrimination respectively, should be employed by the California courts to mandate just cause for all terminations).

152. E.A. FARNSWORTH, *supra* note 9, § 12.8 ("[C]ontract law is, common in its essential design, a law of strict liability, and the accompanying system of remedies operates without regard to fault.")

to terminate absent cause, the employer will be liable for breach of contract if the jury finds that the employer lacked just cause for the discharge. By asserting a wholly pretextual basis for discharge, the employer either will persuade the jury based on the pretextual basis that there was just cause, or will be liable for the same measure of contract damages that are due from the breach of the implied promise in the first place. Where an employer terminates such an employee without good cause, that employee may sue for breach of contract and recover appropriate contract damages. It matters not that the actor has acted with malice, spite, or vengeance, on the one hand, and innocently, but erroneously, on the other. By foreclosing possible tort recovery in those situations where the employer seeks to terminate an employee for a wholly improper motive, not amounting to a violation of public policy, there is little deterrent factor or sanction under the court's formulation.¹⁵³

D. *The Independent Significance of the Implied Covenant*

The exact scope or function of the implied covenant of good faith and fair dealing is uncertain.¹⁵⁴ California courts have repeatedly asserted that the covenant is implied in every contract.¹⁵⁵ The apparent function of the implied covenant is to ensure that "neither party will do anything which injures the right of the other to receive the benefits of the agreement."¹⁵⁶ Before the implied covenant was viewed as a potential basis for an action in tort, however, it really added little

153. At some point, the employer places himself or herself at risk of committing independent torts such as defamation or intentional infliction of emotional distress. *See, e.g., Rulon-Miller*, 162 Cal. App. 3d at 241, 208 Cal. Rptr. at 524. The *Rulon-Miller* court permitted the plaintiff to recover contract damages for wrongful termination based on breach of an implied contract and tort damages for breach of the implied covenant of good faith and fair dealing. The court also upheld the plaintiff's right to recover for the independent tort of intentional infliction of emotional distress, including punitive damages. The court acknowledged the high threshold of proof required, explaining: "The general rule is that this tort, in essence, requires the defendant's conduct to be so outrageous as to go beyond all possible bounds of decency, and to be regarded as atrocious and utterly intolerable in a civilized society." *Id.* at 254, 208 Cal. Rptr. at 533. The court determined that this standard was met where the employer, violating its own policies designed to protect an employee's right to privacy, terminated the plaintiff because she was romantically involved with a former-IBM employee who now worked for a competitor, yet asserted a pretextual basis for discharge. *Id.* at 254-55, 208 Cal. Rptr. at 534-35.

154. *See supra* note 102.

155. *See supra* note 143.

156. *Seaman's*, 36 Cal. 3d at 768, 686 P.2d at 1166, 206 Cal. Rptr. at 362; *Commercial Union Assurance Co's. v. Safeway Stores, Inc.*, 26 Cal. 3d 912, 918, 610 P.2d 1038, 1041, 164 Cal. Rptr. 709, 712 (1980).

to contract analysis. Often vague references to the implied covenant of good faith and fair dealing meant nothing more than there was a breach of an implied promise, leading appropriately to an action for breach of contract.¹⁵⁷

The majority opinion forecloses a tort action for breach of the implied covenant of good faith and fair dealing even for an employee who successfully asserts an implied-in-fact promise to terminate only for just cause.¹⁵⁸ Nevertheless, the implied covenant may require a minimum level of fairness in this context. A jury might determine that, although the employer's policies do not provide for pre-termination warning and a probationary period, the implied covenant does require such a level of fairness and decency. This argument does not seem foreclosed by *Foley*. Limited to its original contract status, does the implied covenant have any independent significance in the implied-in-fact context?¹⁵⁹ Can the implied covenant independently underlie a breach of contract action in the wrongful termination context after *Foley*? Where an employer has termination guidelines and policies, may an employee assert that the conduct of the employer is inconsistent with these policies, thereby violating the implied covenant?¹⁶⁰

There may be instances in which a plaintiff may state a *Pugh* cause of action, but at trial the employer demonstrates that it

157. See Rohwer, *supra* note 7, at 770-72. Outside the context of tortious breach, reference to the implied covenant of good faith and fair dealing is used in an "off-hand, nontechnical fashion" as "a basis for finding or construing other contract terms." *Id.* at 772 n.72.

158. *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 700, 765 P.2d 373, 401, 254 Cal. Rptr. 211, 239 (1988).

159. The implied covenant of good faith and fair dealing is found in an implied-in-fact contract, as well as an express contract. The implied covenant is implied in all contracts and an implied-in-fact contract is as "real" a contract as an express one. See *supra* note 37.

160. See *Van Komen v. Montgomery Ward & Co.*, 638 F. Supp. 739 (C.D. Cal. 1986). Van Komen, the plaintiff, terminated for poor job performance after not meeting objectives set for him by the employer during two probationary periods pursuant to the employer's procedures, unsuccessfully asserted that the employer "had a long term practice of placing long-term employees in another position in lieu of termination." *Id.* at 741. The court warned against judicial intervention in this area, noting that: "Courts are ill-equipped to judge whether disciplinary policies . . . are the result of corporate good citizenship or merely a reflection of the advice of those in the 'disemployment industry' . . . whose *raison d'etre* is to clothe in a legally-defensible fabric every decision to terminate." *Id.* The judge warned against punishing "the leaders for developing clear policies for dealing with employees whose performance is poor." *Id.* at 741-42.

A related issue arises if all of an employer's personnel policies and statements become construed as binding contractual obligations. If the employer's deviation for any aspect of its policies—the employer's termination procedures—can lead to contractual liability, employees will be worse off because an incentive will be created for employers to avoid any specificity in their procedures. Ultimately, a discharged employee, claiming to have relied on the employer's policies, will be limited to aspects that are deemed "material."

substantially complied with its policies. May a plaintiff still prevail under an argument that even if the employer did not breach any promise created by its policies, the employer's policies were fundamentally unfair, and thus the employer's action breached the covenant of good faith and fair dealing?¹⁶¹ The court did not suggest any weakening of the implied covenant in the contract context where the employee asserts a *Pugh* claim. Accordingly, a jury may find an employer's breach of contract based on the breach of the implied covenant of good faith and fair dealing.¹⁶² Recovery, however, would be limited to damages recoverable in a contract-based action.

*E. Oral Modification of Employment Contracts and Disclaimers
—Can Employers Evade Foley's Protections?*

The *Foley* court directs most wrongfully discharged employees to look to the law of contracts, not to the law of torts, as the appropriate arena of legal protection. Yet, if an employer can "opt out" of liability through written employment contracts or disclaimers included in the employer's personnel policies, asserting rigid and outmoded notions of the law of contract, the court's adherence to contract principles is a Pyrrhic victory for employees indeed.¹⁶³

The *Foley* majority determined that *Foley* stated a claim for breach of an implied-in-fact contract for employment terminable only for just cause by alleging "that a course of conduct, including various oral representations, created a reasonable expectation to that ef-

161. But if a contract action can be based on the breach of the implied covenant in this context, is it logical for it to be foreclosed in the context of the truly at-will employee? See *supra* notes 141-151 and accompanying text.

162. The implied covenant may have special importance in the context of the employer and employee who are in a fiduciary relationship. See *supra* note 128. At one point the *Foley* court acknowledged that "[t]he obligations of good faith and fair dealing encompass qualities of *decency and humanity* inherent in the responsibilities of a fiduciary." *Foley*, 47 Cal. 3d at 685, 765 P.2d at 390, 254 Cal. Rptr. 228 (citing *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 804, 820, 620 P.2d 141, 146, 169 Cal. Rptr. 691, 696 (1974)) (emphasis added). The Court made this reference in the context of insurance contracts, but the employer-employee relationship is also a relationship of trust. Accordingly, the implied covenant's concern for "decency and humanity" may have independent vitality in the realm of employment relationships, though its breach would not give rise to tort damages.

163. See generally Rohwer, *supra* note 7, at 782. Professor Rohwer explains, in advocating the law of contract as "the sole remedy in the garden variety discharge case": "Contract law need not be revolutionized to make it compatible with the perceived needs of employees, but courts must embrace some new or relatively new contract law that has already found its way into cases." *Id.* The *Foley* court clearly embraces a more flexible and liberalized contract law—finding neither a statute of frauds hurdle nor a problem of inadequate consideration in cases of implied-in-fact modification to the employment contract. See *supra* notes 89-94.

fect.”¹⁶⁴ The court clearly recognized that basic contract principles permit the parties to define by agreement the duration and termination terms of the employment contract, allowing them to overcome the law’s at-will presumption if they so desire.¹⁶⁵ Thus, evidence of the parties’ conduct, the employer’s practices, policies, actions or communications arising during the course of the employment relationship, along with the practices of the industry in question, must be evaluated in any determination of the duration and termination terms of the employment contract.¹⁶⁶ Further, the *Foley* court expressly rejected any claim that consideration, apart from the employee’s rendition of services or promise to render services to the employer, is necessary to create an enforceable contractual obligation to terminate on terms other than at-will.¹⁶⁷

The absence of any discussion by the *Foley* court concerning California statutes dealing with contractual modification,¹⁶⁸ as well as the overall tenor of the majority opinion, suggest that the court did not analyze the alleged implied-in-fact agreement not to terminate absent just cause in a modification context. The majority intimated

164. *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 675, 765 P.2d 373, 383, 254 Cal. Rptr. 211, 221 (1988). The court observed that had *Foley* further alleged an express agreement by the parties that these guidelines governed *Foley*’s employment, *Foley* could have also stated a cause of action for breach of “an express oral contract.” *Id.* at 675 n.20, 765 P.2d at 383 n.20, 254 Cal. Rptr. at 221 n.20. As the majority later correctly acknowledged, there is no difference in legal effect of a promise expressed orally, in writing, through conduct, or by any combination thereof. *Id.* at 678 n.21, 765 P.2d at 385 n.21, 254 Cal. Rptr. at 223 n.21 (citing RESTATEMENT (SECOND) CONTRACTS § 4 (1981)). The Restatement provides: “A promise may be stated in words either oral or written, or may be inferred wholly or partly from conduct.” RESTATEMENT (SECOND) CONTRACTS § 4 (1981).

165. *Foley*, 47 Cal. 3d at 675, 765 P.2d at 383, 254 Cal. Rptr. at 221. In so holding, the Court specifically adhered to the reasoning of *Pugh v. See’s Candies*, 116 Cal. App. 3d 311, 171 Cal. Rptr. 917 (1981). See *supra* notes 89-95 and accompanying text.

166. See *Foley*, 47 Cal. 3d at 677, 680, 765 P.2d at 385, 387, 254 Cal. Rptr. at 223, 225.

167. *Id.* at 678, 680-81, 765 P.2d at 385-86, 387, 254 Cal. Rptr. at 224-25. Other collateral writings or agreements may serve as evidence that the parties intended that the employment arrangement not be terminable at will. *Id.* at 680 n.23, 765 P.2d at 387 n.23, 254 Cal. Rptr. at 225 n.23.

168. See, e.g., CAL. CIV. CODE § 1698 (West 1985). That section provides:

(a) A contract in writing may be modified by a contract in writing.

(b) A contract in writing may be modified by an oral agreement to the extent that the oral agreement is executed by the parties.

(c) Unless the contract otherwise expressly provides, a contract in writing may be modified by an oral agreement supported by new consideration. The statute of frauds (Section 1624) is required to be satisfied if the contract as modified is within its provisions.

(d) Nothing in this section precludes in an appropriate case the application of rules of law concerning estoppel, oral novation and substitution of a new agreement, rescission of a written contract by an oral agreement, waiver of a provision of a written contract, or oral independent collateral contracts.

Id.

that the terms of the parties' contract governing termination had been "filled in" during the course of performance,¹⁶⁹ rejecting the "formalistic approach" that "the manifestations of intent must be evidenced by definite express terms if promises are to be enforceable."¹⁷⁰ This approach eases the burden facing an employee meeting

169. *Foley*, 47 Cal. 3d at 679-80, 765 P.2d at 386-87, 254 Cal. Rptr. at 224-25.

170. *Id.* at 679, 765 P.2d at 386, 254 Cal. Rptr. at 224. *Accord*, Rohwer, *supra* note 7, at 769 n.56. The great majority of employment relationships are entered into by oral agreement of the employer and the employee. Nonetheless, the true mechanics of contract formation in this context are a bit of a mystery. Arguably, under the traditional contract analysis, a terminable-at-will agreement is not even really a contract because it can be ended instantly after it is formed, and thus the promises are illusory.

More logically, a contractual arrangement arises from the outset of the relationship with the parties agreeing upon certain elements, such as wages, hours, and to a varying degree, other matters dealing with working conditions. However, these employment agreements typically fail to specify a duration of employment. Courts generally construe an employment relationship as terminable at will when the employment contract is silent as to duration, unless there is evidence of contrary intent. See J. CALAMARI & J. PERILLO, *CONTRACTS*, § 2-9, at 59 (1987); E.A. FARNSWORTH, *CONTRACTS*, § 7.17, at 532 (1982). In California, this presumption of a terminable at will relationship is buttressed by the existence of Labor Code section 2922. See note 6 *supra*. Under this analysis, subsequent conduct or words may modify that at-will provision, creating an agreement under which the employee may be terminated only for cause. See J. MCCARTHY, *PUNITIVE DAMAGES IN WRONGFUL DISCHARGE CASES*, § 3.54, at 205 (1985), in which the author explains:

In most cases, an employee's assent to an offer of employment, thus creating an employment contract if the employee furnished consideration for the contract, is shown by the employee's beginning work in response to the offer. The employee's acceptance can be shown by action as well as by verbal statement. [citations]. [¶] However, an employee will commonly allege that, after his or her beginning work, the employer offered to modify the existing at-will employment contract or create a new contract. Under these circumstances, courts commonly hold that an employee's continuing to work demonstrates assent to the new or modified offer, because the employee could have terminated his or her employment.

It is the employer's external manifestations, not his or her hidden intent, that leads the employee into a reasonable expectation that their employment is terminable only for cause. E.A. FARNSWORTH, *CONTRACTS*, § 3.6. This "objective theory" has long controlled in California. See *Brant v. California Dairies*, 4 Cal. 2d 128, 133-34, 48 P.2d 13, 16 (1935) ("[I]t is now a settled principle of the law of contract that the undisclosed intentions of the parties are, in the absence of mistake, fraud, etc. immaterial, and that the outward manifestation or expression of assent is controlling"). A third theory of contract formation has been suggested. Under this view, the contract formation process is on-going. As one author explains:

Those decisions which take a more broad view of employment contract terms can usually be seen to operate from the assumption that the final statement of the relationship between this particular employer and employee need not be manifested on the first day they entered the employment relationship. The originally indefinite contract began to take on more detailed terms and conditions as the relationship grew. A manual distributed by the boss and initially left unread by the employee will eventually become an established term of the contract after the manual and the relationship continued to coexist for a period of time. Only when viewed as an agreement which is undergoing rather constant modification can an employment contract be understood to contain terms based on such things as assurance, longevity, and general practices and policies of the employer and the industry.

Rowher, *supra* note 7, at 769 n.56. This author finds the second view the most satisfying, though is aware that consideration hurdles can arise if the focus is on modification of contrary

the requirements of form imposed by virtue of California statutory law.¹⁷¹

1. Written Employment Contracts

Written employment contracts may raise potential obstacles to an employee's attempts to assert an implied-in-fact modification. First, the statute of frauds must be satisfied if the contract as modified falls within its provisions.¹⁷² Where the contract is modified from one authorizing termination at will to a contract requiring just cause, no statute of frauds problem arises, however, because the contract can be performed within one year.¹⁷³ If the contract contains a provision initially agreed upon by the parties that expressly requires modifications to be in writing, a "private statute of frauds," an oral modification may nevertheless be enforceable on a waiver or estoppel theory.¹⁷⁴ Other theories that may make the subsequent promise enforceable, notwithstanding the private statute of frauds, include oral novation and substitution of a new agreement, waiver of a provision of a written contract, rescission of a written contract by an oral agreement, or an oral collateral agreement.¹⁷⁵

Second, additional consideration may be required to support the modification. Yet, insofar as consideration is required to support modification,¹⁷⁶ the logic of the majority in *Foley* suggests,¹⁷⁷ if not

terms in written employment contracts. Under the teaching of *Foley*, consideration should not prove to be a problem in these cases, as the employee's continued efforts are enough consideration for the modification. See *supra* notes 164-169 and accompanying text.

171. CAL. CIV. CODE § 1698 (West 1985). See *supra* note 168.

172. *Id.* § 1698(c). California's statute of frauds is found in California Civil Code section 1624, and invalidates "[a]n agreement that by its terms is not to be performed within a year from the making thereof" unless the contract "or some note or memorandum thereof, [is] in writing and subscribed by the party to be charged or by the party's agent." *Id.* § 1624(a) (West Supp. 1989).

173. Cf. *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 671-75, 765 P.2d 373, 381-383, 254 Cal. Rptr. 211, 219-221 (1988).

174. CAL. CIV. CODE § 1698(d) (West 1985). See *D.L. Godbey & Sons Constr. Co. v. Deane*, 39 Cal. 2d 429, 432, 246 P.2d 946, 948 (1952); *Wade v. Markwell & Co.*, 118 Cal. App. 2d 410, 421, 258 P.2d 497, 503 (1953); *Panno v. Russo*, 82 Cal. App. 2d 408, 412, 186 P.2d 452, 454 (1947).

175. See *infra* notes 193-199.

176. See CAL. CIV. CODE §§ 1698 (a), (b), (c) (West 1985). The statute is silent on the issue of whether a written modification of a written contract must be supported by a new consideration.

See CAL. CIV. CODE § 1697 (West 1985) (regarding oral contracts, which constitute the majority of employment contracts). Section 1697 provides: "A contract not in writing may be modified in any respect by consent of the parties, in writing, without a new consideration,

directly holds,¹⁷⁸ that consideration for the modification would be provided by the employee's subsequent rendition of services or promise to render services. The majority's discussion of mutuality of obligation evidences that the employee's subsequent rendition of services, or subsequent promise to provide such services, constitutes consideration for an express or implied-in-fact modification providing that the employee will not be terminated absent just cause. The *Foley* court soundly rejected the defendant-employer's lack of "mutuality of obligation" argument, which claimed that consideration beyond the employee's continued services is required because of the employee's freedom to terminate the employment relationship. Noting that the benefits of greater loyalty and productivity may be obtained by employers, the court rejected any requirement of additional consideration to support a contract on terms other than at will.¹⁷⁹ The majority's analysis, consistent with general contract law, determined that the employee's continued performance of his or her duties, despite the freedom to terminate the relationship, is consideration for the employer's promise modifying the at-will agreement.¹⁸⁰ Some California cases, such as *Malmstrom v. Kaiser Aluminum and Chemical Corp.*¹⁸¹ which held that an alleged oral modification of a written

and is extinguished thereby to the extent of the modification". *Id.* Presumably, an oral modification of an oral contract must be supported by consideration. *See id.* (by negative implication).

177. *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 679, 765 P.2d 373, 386, 254 Cal. Rptr. 211, 224 (1988).

178. *Id.* at 680 n.23, 765 P.2d at 387 n.23, 254 Cal. Rptr. at 225 n.23.

179. *Id.* at 680-81, 765 P.2d at 387, 254 Cal. Rptr. at 225.

180. *Id.* at 680-81, 765 P.2d at 387, 254 Cal. Rptr. at 225. *See Hathaway v. General Mills, Inc.*, 711 S.W.2d 227, 229 (Tex. 1986) (if employee, after notice of changes decreasing employee's commissions continues working, employee has accepted the offer to modify the employment contract); *Pine River State Bank v. Mettille*, 333 N.W.2d 622, 627, 630 (Minn. 1983) (employee's continued performance of his duties despite his freedom to terminate employment constituted acceptance of employer's offer to modify the employment contract making employee terminable only for just cause). *See also Duldulao v. Saint Mary of Nazareth Hosp. Center*, 505 N.E.2d 314, 318 (1987) ("[t]he employee must accept the offer by commencing or continuing to work after learning of the policy statement. When these conditions are present, then the employee's continued work constitutes consideration for the promises contained in the statement, and under traditional principles a valid contract is formed."); J. MCCARTHY, PUNITIVE DAMAGES IN WRONGFUL DISCHARGE CASES § 3.54 (1985).

181. 187 Cal. App. 3d 299, 231 Cal. Rptr. 820 (1986). In *Malmstrom*, the court held that the employee's agreement to relocate to Florida from California did not constitute the new consideration required to support the alleged oral modification of the written employment agreement specifying an at-will employment relationship. The court contended that the relocation was not the result of a bargained for exchange between the employer and the employee; rather, the move was incident to retaining employment in light of the elimination of the plaintiff's position in California. The court did not consider whether the employee's rendition of services, or promise to do so, could constitute consideration for the alleged oral modification. *Id.* at 318, 231 Cal. Rptr. at 829-30. In light of the California Supreme Court's approach to consideration in *Foley*, the *Malmstrom* rationale is highly questionable.

employment contract specifying at-will employment failed for lack of consideration, overly restrict the doctrine of consideration.¹⁸²

Although basic contract principles can support an oral modification to the written employment agreement, employees alleging such a modification limiting the employer's nearly unqualified freedom to terminate will encounter a troubling and analytically muddled body of California case law that arguably suggests that express written contracts preclude subsequent contradictory implied promises as a matter of law.¹⁸³ These cases appear to have confused the cluster of issues arising in the context of the parol evidence rule and contract interpretation with the issues arising in the context of modification.¹⁸⁴

Under the parol evidence rule, prior or contemporaneous oral promises that expressly contradict express written terms of an inte-

182. See *supra* note 93 and accompanying text.

183. See, e.g., *Shapiro v. Wells Fargo Realty Advisors*, 152 Cal. App. 3d 467, 482, 199 Cal. Rptr. 613, 621 (1984) (a written at-will provision precludes an implied-in-fact modification of an on-going employment agreement because "[t]here cannot be a valid express contract and an implied contract, each embracing the same subject but requiring different results"). One author acknowledged that *Shapiro* and other cases asserting that express contract terms bar the formation of an implied contract (see, e.g., *Crain v. Burroughs Corp.*, 560 F. Supp. 849, 852 (C.D. Cal. 1983)) are "confusing the issue" of express and implied-in-fact contracts. J. McCARTHY, *supra* note 180, at 206. The *Foley* majority acknowledged these cases without clear support or criticism. The court noted the ambiguity in the cases stating that *Shapiro* can be interpreted to preclude an implied-in-fact modification of an on-going employment agreement when some express written provision insists on the employee's at-will status. Because *Foley* did not involve a written contract, the court did not analyze the issue. *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 676, 765 P.2d 373, 384, 254 Cal. Rptr. 211, 222 (1988).

Legislation is pending that would expressly alter the effect of cases such as *Shapiro*. Senator Rosenthal's bill, S.B. 115, 1988-89 Cal. Leg. Reg. Sess. (Dec. 22, 1988), narrowly passing out of the Senate Judiciary Committee in early June of 1989, would clarify California law, making certain that an employer's words or conduct creating a reasonable expectation of employment terminable only for just cause in an employee, will modify the at-will employment relationship, notwithstanding a written employment agreement specifying an at-will employment relationship. Although, it is the author's position that *Shapiro* and similar cases are incorrect, based on current California contract law, the legislation would be helpful in clearing up some existing confusion.

184. For example, in *Shapiro*, the plaintiff-employee alleged breach of an implied-in-fact contract not to terminate his employment absent good cause. The employee signed a writing indicating that his employment was terminable at will, but alleged that he was advised, orally by supervisors and in writing through benefit brochures, that he would not be terminated absent just cause. The court's opinion suggested that the alleged oral assurances were made and the benefit brochures distributed subsequent to the execution of the writing. *Shapiro*, 152 Cal. App. 3d at 473, 199 Cal. Rptr. at 615. In upholding the trial court's demurrer to the employee's claim of breach of an implied-in-fact contract, the court observed: "There cannot be a valid express contract and an implied contract, each embracing the same subject but requiring different results." *Id.* at 482, 199 Cal. Rptr. at 622. This language suggests that the subsequent oral assurances and written benefit brochures were inadmissible to contradict the prior written at-will employment agreement. If *Shapiro*, however, was indeed an implied-in-fact modification case, the alleged modification was created by oral and written words following the formation of the original at-will employment agreement. As a result, the evidence of modification clearly would not be barred by the parol evidence rule.

grated agreement may not be introduced into evidence.¹⁸⁵ The parol evidence rule, however, applies only to representations occurring prior to, or simultaneously with, the execution of the written document.¹⁸⁶ Accordingly, *subsequent* oral modifications of the written agreement may be effective.¹⁸⁷ If *Shapiro* was indeed an implied-in-fact modification case, the alleged modification was created by oral and written words following the formation of the original at-will employment agreement. As a result, they would not be barred by the parol evidence rule. While perhaps it is sensible to presume that parties to an employment contract would not make prior or contemporaneous agreements that directly contradict express terms of their written employment agreement, no such presumption can arise regarding *subsequent* express or implied-in-fact promises contradicting the writing.¹⁸⁸ Indeed, subsequent modifications to an employment contract are entirely logical.¹⁸⁹ Thus, the parol evidence rule does not limit subsequent modification of an at-will employment agreement.

Another area which should be considered falls within the realm of contract interpretation, where a debate rages about the meaning of a written contractual term. If the statement — “there cannot be a valid express contract and an implied contract each embracing the

185. See CAL. CIV. PROC. CODE § 1856(a) (West 1983). Section 1856(a) provides: “Terms set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement.” *Id.* See, e.g., *Anderson v. Savin Corp.*, 206 Cal. App. 3d 356, 364, 254 Cal. Rptr. 627, 630-631 (1988); *Malmstrom v. Kaiser Aluminum*, 187 Cal. App. 3d 299, 318, 231 Cal. Rptr. 820, 829 (1986). *But see McLain v. Great American Insurance*, 208 Cal. App. 3d 1476, 256 Cal. Rptr. 863 (1989) (misstating parol evidence as prohibiting the introduction of any extrinsic evidence varying or contradicting terms of integrated written instrument, and thus misapplying the rule to evidence of *subsequent* modification).

186. See, e.g., *In re Gaines' Estate*, 15 Cal. 2d 255, 264-65, 100 P.2d 1055, 1060 (1940); *Marani v. Jackson*, 183 Cal. App. 3d 695, 699 n.2, 228 Cal. Rptr. 518, 520 n.2 (1986); *Beggerly v. Gbur*, 112 Cal. App. 3d 180, 188, 169 Cal. Rptr. 166, 171 (1980). See also CAL. CIV. PROC. CODE § 1625 (West 1985). Section 1625 provides: “The execution of a contract in writing, whether the law requires it to be written or not, supersedes all the negotiations or stipulations concerning its matter which preceded or accompanied the execution of the instrument.” *Id.*

187. See, e.g., *Chahon v. Kersey Kinsey Co.*, 173 Cal. App. 2d 548, 551, 343 P.2d 614, 616 (1959). Nor would collateral or independent agreements be prohibited. See, e.g., *Wright v. Title Ins. & Trust Co.*, 274 Cal. App. 2d 252, 258, 79 Cal. Rptr. 12, 15 (1970).

188. *Gedlund v. Electronic Dispensers Int'l*, 190 Cal. App. 3d 263, 235 Cal. Rptr. 279 (1987).

189. To the extent that an employee, who begins as an at-will employee, progresses successfully over time through a company, receiving continuous praise and bonuses, it is quite logical that the employer would wish to assure that employee's continued service and modify the employment agreement so as to provide job security. *Cf. McLain v. Great American Ins. Co.*, 208 Cal. 3d 1476, 256 Cal. Rptr. 863 (1989) (because employer expressly reserved the right to change terms and conditions of employment, subsequent implied-in-fact modification possible).

same subject, but requiring different results”¹⁹⁰ — which has been asserted by several California courts, has any relevance at all, it is within the realm of interpretation of written agreements. In California, extrinsic evidence, evidence outside the writing itself, is admissible to explain the meaning of a written term only if the term is reasonably susceptible to the proffered interpretation.¹⁹¹ But where the focus is on whether the writing was modified, extrinsic evidence, if relevant to the fact of modification, is necessarily relevant concerning the issue of *contract* modification, since the parties to a written agreement obviously retain the freedom to vary, alter and change, as well as to supplement or delete, terms of a written agreement through contract modification.¹⁹²

A more challenging requirement of form is presented when an employee alleges subsequent express oral promises or subsequent conduct modifying a written agreement *expressly* forbidding oral modifications and insisting that all modifications be in writing—the “private statute of frauds” situation.¹⁹³ Although “no oral modification” clauses in written employment contracts are enforceable,¹⁹⁴ a variety of theories may provide relief to an employee who relies on words or implied-in-fact conduct ostensibly changing the at-will nature of the employment relationship. For example, the employee may assert that the employer is estopped to raise the “no oral modification” clause or that it was orally waived.¹⁹⁵ To enforce an oral

190. See, e.g., *Shapiro v. Wells Fargo Realty Advisors*, 152 Cal. App. 3d 467, 482, 199 Cal. Rptr. 613, 622 (1984). See *supra* note 183.

191. *Pacific Gas & Elec. v. G. W. Thomas Drayage Co.*, 69 Cal. 2d 33, 40, 442 P.2d 641, 644, 69 Cal. Rptr. 561, 564 (1968).

192. In its simplest sense, the *Shapiro* court’s assertion is true. There cannot be conflicting terms simultaneously. The later expression of the parties’ intent supplants the original written term. Indeed, the California Civil Code specifically contemplates the propriety of oral modifications to written terms. See, e.g., CAL. CIV. CODE § 1698(c) (West 1985). Section 1698 provides: “Unless the contract expressly provides, a contract in writing may be modified by an oral agreement supported by new consideration.” *Id.*

Interestingly, this broad statement of California law appears first in *Wal-noon Corp. v. Hill*, 45 Cal. App. 3d 605, 613, 119 Cal. Rptr. 646, 650 (1975), an action focusing on the propriety of the trial court’s grant of restitutionary relief to the plaintiff-lessee. The appellate court reversed the trial court, equated “implied contract” with equitable restitutionary relief, and concluded that recovery on a restitutionary theory was incompatible and inappropriate where there could be no recovery on a contract theory. *Id.* at 615, 119 Cal. Rptr. at 652.

193. See, e.g., *Marani v. Jackson*, 183 Cal. App. 3d 695, 228 Cal. Rptr. 518 (1986); *Beggerly v. Gbur*, 112 Cal. App. 3d 180, 169 Cal. Rptr. 166 (1980).

194. CAL. CIV. CODE § 1698(c) (West 1985).

195. See *id.* § 1698(d). A similar estoppel argument can be made if the modification lacks consideration. See, e.g., *Malmstrom v. Kaiser Alum. & Chem. Co.*, 187 Cal. App. 3d 299, 318, 231 Cal. Rptr. 820, 830 (1986) (narrowly viewing estoppel doctrine and finding it inapplicable under facts of case). See *supra* note 181.

modification on an estoppel or waiver theory, the employee must produce significant evidence of reliance.¹⁹⁶ Alternatively, the employee may argue that the parties impliedly rescinded the written agreement containing the "no oral modification" clause and substituted in its place an oral agreement allowing termination only for cause.¹⁹⁷ Further, the employee might argue that an independent collateral contract providing for termination on a basis other than at-will was formed.¹⁹⁸ Ultimately, it is also possible that written employment policies and personnel manuals may satisfy the requirement of a written modification as long as the writings in issue provide part of the basis for the employee's argument that the contract was modified to provide greater job security than was originally provided in the parties' written agreement.¹⁹⁹

Previous wrongful termination cases have been extremely ambiguous about the contract analysis underlying their determination that the employee may assert an action for breach of an implied-in-fact contract. This uncertainty was largely due to the overlapping, and more lucrative, alternative ground of recovery for tortious breach. After *Foley*, contract analysis will necessarily become the central focus for defining the parameters of most wrongful termination actions and a thoughtful and thorough contract analysis will be critical.

196. *Cf. Monarco v. LoGreco*, 35 Cal. 2d 621, 220 P.2d 737 (1950) (to plead and prove estoppel to assert the statute of frauds, plaintiff must show that unconscionable injury or unjust enrichment would result from failure to enforce the oral contract due to plaintiff's reliance on the oral contract or representations that a writing is not necessary, or will be executed or the statute will not be relied upon as a defense); U.C.C. § 2-209 (5) (West 1987).

197. Novation is the substitution by agreement of a new obligation for an existing one, with intent to extinguish the latter. *People v. Metcalf*, 79 Cal. App. 3d 1, 8, 144 Cal. Rptr. 657, 661-62 (1978); CAL. CIV. CODE §§ 1530-1532 (West 1982); RESTATEMENT (SECOND) OF CONTRACTS §§ 279, 280 (1981). A novation may be oral even though the original contract was in writing. *Tucker v. Schumacher*, 90 Cal. App. 2d 71, 74, 202 P.2d 327, 329 (1949). Rescission is the mutual cancellation of executory contractual rights. RESTATEMENT (SECOND) CONTRACTS § 283 (1981). Although mutual consent is required, it need not be in writing, even if the contract itself was written, but, rather, may be oral or manifested by conduct. *Kane v. Sklar*, 122 Cal. App. 2d 480, 482, 265 P.2d 29, 31 (1954).

198. *Lacy Mfg. Co. v. Gold Crown Mining*, 52 Cal. App. 2d 568, 577, 126 P.2d 644, 649 (1942).

199. *But see Anderson v. Savin*, 206 Cal. App. 3d 356, 364 n.2, 254 Cal. Rptr. 627, 630-31 n.2 (1988) (suggesting that the parol evidence rule prohibits terms of the defendant's operating procedures manual from altering terms of a written employment letter stating employee is terminable at will because the employment letter did not expressly incorporate provision of the manual). The court's point is uncertain — surely subsequent employer conduct or words are unaffected by the operation of the parol evidence rule.

2. Disclaimers

An employer's handbooks, personnel policies, manuals, procedures and termination guidelines have been looked to with increasing frequency as a basis for an employee to assert an implied-in-fact promise that the employee may only be terminated for good cause.²⁰⁰ Indeed, the *Foley* court makes clear that an employer's personnel policies, and conduct consistent with the policies and procedures, alone may create a reasonable expectation in the employee's mind of job security.²⁰¹

200. See *supra* note 142; *Pugh v. See's Candies, Inc.*, 116 Cal. App. 3d 311, 327, 171 Cal. Rptr. 917, 925 (1981). These policies may create expectations that raise employee expectations about matters other than duration of employment as well. See Note, *Employees Handbooks and Employment-At-Will Contracts*, 1985 DUKE L.J. 196, 214 ("[E]mployees who are promised that grievance and termination procedures will be followed cannot be properly discharged, under their employment at-will contracts, without having first been given the benefit of the procedures promised in the handbook.").

201. *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 680, 765 P.2d 373, 387, 254 Cal. Rptr. 211, 225 (1988). Personnel policies can become part of the contractual guarantee if the parties mutually intended to create a contract that such rules are to be followed. These policies may become part of an employee's oral contract of employment. *Burton v. Security Pac. Nat'l Bank*, 197 Cal. App. 3d 972, 977-8, 243 Cal. Rptr. 277, 280 (1988). *Foley's* contract action was premised on the creation of an implied-in-fact term limiting the employer's right to terminate. This implied-in-fact promise developed through a course of conduct and written policies of the employer. An independent contract basis—arising from express oral or written statements of the employer—will often arise in these employment cases, even where the employer has sought to prevent the creation of an implied-in-fact promise. Indeed, the *Foley* majority expressly left this issue open, noting that *Foley* had merely alleged that he "understood" that the employer's guidelines requiring good cause for discharge applied to him. Had he alleged, the court noted, that "the parties expressly agreed that these guidelines governed his employment, he could state a cause of action for breach of an express oral contract." *Foley*, 47 Cal. 3d at 675 n.20, 765 P.2d at 383 n.20, 254 Cal Rptr. at 77 n.20. Though the court claims that *Foley* did not allege facts supporting an oral modification claim, the distinction is quite subtle. *Foley* alleged that the employer's course of conduct, including oral representations, created *Foley's* reasonable expectation that he would be terminated only for cause. A breach of an express oral contract claim would be appropriate had *Foley* alleged "explicit words by which the parties agreed that he would not be terminated without cause." *Id.* It appears that the lack of specificity about the "oral representations" is what prevented the express contract claim. The court does not suggest that *Foley's* recovery would be affected by this additional basis for breach of contract, though it would provide a second contract theory in addition to the implied-in-fact *Pugh* theory. Notably, the court does not suggest that any consideration beyond continued employment is necessary for the creation of an express promise not to terminate absent just cause.

Written or oral statements to an employee objectively manifesting an intent that the employee only be terminated for cause, may lead to the creation of an express promise that the employee cannot be terminated absent cause. A modification leading to a binding promise may arise in other contexts as well. If an employer expressly represents to an employee, for example, that the employee will receive pre-discharge notice, this may become a binding term in their contractual relationship.

Employers are under no obligation to disseminate employee handbooks or manuals, but will be held accountable for the promises made therein.²⁰² As the drafter of the document, the employer chooses the language included in the manual and is free to assert that the manual is not part of any employment agreement and that employment is terminable at will.²⁰³ Properly drafted language has been determined "to preserve the presumption of at-will employment," relieving the employer from any obligation to follow disciplinary procedures outlined in the handbook and enabling the employer to discharge the employee for any reason.²⁰⁴ An employer's assertions, seeking to exclude the manuals from any employment contract, must be very clear and precise.²⁰⁵ Where there is clear language of disclaimer, stressing the at-will nature of the employment, it is difficult for an employee to assert in good faith that he or she formed a legitimate expectation that employment was terminable only for just cause.²⁰⁶

Disclaimers alone, however, will not provide complete protection to the employer. Where there are conduct and assurances that run contrary to the disclaimer, courts have been increasingly willing to find a triable issue of fact about whether, "under the totality of the circumstances," notwithstanding the language of the disclaimer, good cause was required for termination.²⁰⁷ Notably, the *Foley* court, too, stressed that the "totality of the circumstances" will determine if the

202. Employers choose to distribute employee manuals because of the benefits of increased productivity and work force satisfaction which may result from the dissemination of employment manuals. *Wootley v. Hoffman-LaRoche*, 491 A.2d 1257 (N.J. 1985). That court noted also that "[t]he provisions of the manual concerning job security shall be considered binding unless the manual elsewhere prominently and unmistakably indicates that those provisions shall not be binding." *Id.* at 1269.

203. See *Leikvold v. Valley View Community Hosp.*, 688 P.2d 170, 174 (Ariz. 1984).

204. *Bailey v. Perkins Restaurants, Inc.* 398 N.W.2d 120, 123 (N.D. 1986). The disclaimer that was upheld provided: "This Employee Handbook has been drafted as a guideline for our employees. It shall not be construed to form a contract between the Company and its employees. Rather, it describes the Company's general philosophy concerning policies and procedures." *Id.* at 121. See generally Note, *Unjust Dismissal of Employees At Will: Are Disclaimers a Final Solution?* 15 *FORDHAM URB. L.J.* 533 (1987).

205. *Mauk*, *supra* note 1, at 218.

206. See *Batchelor v. Sears, Roebuck & Co.* 574 F. Supp. 1480, 1487 (E.D. Mich. 1983).

207. See, e.g., *Tiranno v. Sears, Roebuck & Co.*, 472 N.Y.S.2d 49 (1984) (notwithstanding written disclaimer in employment application signed by plaintiff, "jury could find, based on the 'totality of the circumstances,' that good cause was required for plaintiff's termination . . ."); *Helle v. Landmark*, 472 N.E.2d 765, 775 (Ohio App. 1984) ("To the extent that the oral assurances . . . conflicted with the manual's disclaimers, or induced [employees] to disregard their significance, we hold that such representations will negate the effect of [these] disclaimers. . ."). See generally, *Scherb, The Use of Disclaimers to Avoid Employer Liability Under Employee Handbook Provisions*, 12 *J. CORP. L.* 105 (1986).

employer's words or conduct have created a reasonable expectation of employment terminable only for just cause.²⁰⁸

Because the issues arising in the realm of implied-in-fact promises are securely anchored in contract, an employer's clear statement to an employee that employment is terminable at will, buttressed by consistent policies and conduct, will prevent the formation of an implied-in-fact contract term that employment may only be terminated for "just cause."²⁰⁹ But when the employers act or speak inconsistently, when the "totality of the circumstances" suggests employees may reasonably believe that they are no longer terminable at will, an employee-manual disclaimer cannot be viewed as a bar to liability.²¹⁰

F. Recoverable Damages After Foley

A central effect of the court's decision is to prevent a wrongfully terminated employee from recovering tort damages, unless there is a discharge in violation of public policy. Typically, tort recovery, which seeks to return the injured party to the position he or she was in prior to the tortious conduct,²¹¹ is more generous to the plaintiff than a recovery in contract. In a tort action the injured plaintiff may recover for all the harm proximately caused, whether or not it could have been anticipated.²¹² Accordingly, recovery of damages for emotional distress are recoverable upon sufficient proof.²¹³ Further, punitive damages may be awarded for outrageous conduct to deter similar conduct in the future.²¹⁴ It was thus no surprise that plaintiffs'

208. *Foley*, 47 Cal. 3d at 680-82, 765 P.2d at 387-88, 265 Cal. Rptr. at 225-26.

209. See *supra* note 37.

210. One author suggests that a disclaimer, though not a bar to litigation, is a defense to be raised during litigation. Note, *The Employment Handbook as a Contractual Limitation on the Employment At-Will Doctrine*, 31 VILL. L. REV. 335, 359 (1986). This focus seems misplaced. While neither a bar to litigation nor a defense, the existence of a disclaimer is important evidence about whether an employee could have reasonably interpreted the employer's words or conduct as creating employment terminable only for just cause.

211. W. KEETON, D. DOBBS, R. KEETON & D. OWEN, PROSSER & KEETON ON TORTS § 92 (5th ed. 1984).

212. See Traynor, *Bad Faith Breach of a Commercial Contract: A Comment on the Seaman's Case*, 8 BUS. LAW NEWS 1 (1984). See also CAL. CIV. CODE § 3333 (West 1970) which provides: "For the breach of an obligation not arising from contract, the measure of damages, except where otherwise expressly provided by this Code, is the amount which will compensate for all the detriment proximately cause thereby, whether it could have been anticipated or not." *Id.*

213. Traynor, *supra* note 212, at 1.

214. See RESTATEMENT (SECOND) OF TORTS § 908 (1979): "Punitive damages are damages,

attorneys enthusiastically attempted to formulate a wrongful termination action as one sounding in tort.²¹⁵ Foreclosed from seeking tort damages absent a violation of public policy, the plaintiff in a wrongful termination action is now limited to the recovery of contract damages. A critical issue thus becomes the scope of contract recovery in wrongful termination cases. While contract law has often kept recovery artificially limited in this context, a more honest and liberalized view of contract damages may ultimately inject greater stability into the wrongful termination arena while providing fair compensation to the wrongfully terminated employee.

Contract remedies are designed to protect the justified expectations of the parties; to put the injured party in the position he or she would have been in had the contract not been breached.²¹⁶ Contract

other than compensatory or nominal damages, awarded against a person to punish him for his outrageous conduct and to deter him and others from similar conduct in the future." California recently narrowed the permissible scope of punitive damage awards in tort actions. Traditionally punitive damages, or "exemplary damages" as they are called in the California statutes, are appropriate where the injured plaintiff proves by a preponderance — that it is more likely than not — that the defendant "has been guilty of oppression, fraud, or malice." See 1987 Cal. Stat. ch. 1498, sec. 5 (amending CAL. CIV. CODE § 3294) (standard for burden of proof for issues of oppression, fraud, or malice is not specified). See, e.g., *Taylor v. Superior Court*, 24 Cal. 3d 890, 598 P.2d 854, 157 Cal. Rptr. 693 (1979). In *Taylor*, the California Supreme Court indicated a willingness to permit punitive damages liberally in tort actions, holding that a defendant's act of driving while intoxicated evidences a "conscious disregard for the safety of others" and, thus, constitutes "malice" for the purpose of awarding exemplary damages. *Id.* at 899-900, 598 P.2d at 859, 157 Cal. Rptr. at 699. As a result of efforts by the defense bar, insurance companies and other business interests, the California legislature recently significantly altered Civil Code section 3294. In addition to increasing the burden of proof on the plaintiff from a preponderance of the evidence to "clear and convincing" evidence, the revised statute, which became effective January 1, 1988, permits recovery of punitive damages only when, in addition to the earlier standards, the defendant's conduct is deemed "despicable." CAL. CIV. CODE § 3294 (West Supp. 1989).

215. *Foley's* limitation on recoverable damages has led to adding statutory and intentional tort claims to wrongful termination complaints. But there has nonetheless been some deterrence to filing wrongful termination cases due to the limited recovery. One attorney admitted that he could no longer "afford to finance cases through a contingent fee agreement where the employee was not earning 'six figures' and the contract losses were small." *Attorneys Still Filing Wrongful Termination Cases*, *The Daily Recorder*, Jan. 19, 1989, at 3.

216. The measure of damages, seeking to provide the "benefit of the bargain," protects the promisee's expectation interest. E.A. FARNSWORTH, *supra* note 9, § 2.1. The objective of contract law is not to compel the promisor to keep the promise nor even to prevent breach by the promisor; rather, the focus of contract law traditionally is to provide a means of redress for breach by the promisee. Farnsworth, *Legal Remedies for Breach of Contract*, 70 *COL. L. REV.* 1145, 1146-47 (1970). Thus, regardless of the breaching party's motive, contract damages generally seek to avoid placing the injured party in a better position than he or she would have been in had the contract been performed. E.A. FARNSWORTH, *supra* note 9, § 12.8; *RESTATEMENT (SECOND) OF CONTRACTS* §§ 344, 347 and 351 (1981). As one author explained:

The traditional view of the contract measure of damages is that the injured party should be put in as good a position as he would have had if performance had been

damages may extend beyond the terms of the contract itself, however. It is well established that the injured party may recover all damages that, at the time the contract was entered into, would foreseeably flow from the breach of the contract as well as those specifically within the contemplation of the parties.²¹⁷ Because of the interests involved, contract damages are typically more narrowly circumscribed than tort damages.²¹⁸ Further, because contract law imposes strict liability and does not seek to punish the breaching party no matter how "reprehensible" the breach, punitive damages are unavailable for breach of contract.²¹⁹ In essence, liability for breach of contract is generally limited to "recovery for pecuniary harm."²²⁰

The court appears unanimous in its recognition that traditional contract damages are inadequate in the context of discharged employees, specifically inviting courts and the legislature to consider the appropriate recovery for a wrongfully terminated employee asserting an action for breach of contract. Although the majority specifically leaves open the appropriate measure of damages in a wrongful

rendered as promised. Usage varies in labeling the components of such damages, but here they will be called (1) the benefit of the bargain as measured by the value of the promised performance (which in the case of a sale is the value of the property if delivered in accordance with the bargain); and (2) consequential damages, comprised of incidental expenses and losses, and gains foreclosed by the breach.

Hill, *Breach of Contract as a Tort*, 74 COLUM. L. REV. 40, 42 (1974) (footnote omitted).

217. This principle is reflected in California's Civil Code section 3294, which provides:

For the breach of an obligation arising from contract, the measure of damages, except where otherwise expressly provided by this Code, is the amount which will compensate the party aggrieved for all the detriment proximately caused thereby, or which, in the ordinary course of things, would be likely to result therefrom.

CAL. CIV. CODE § 3294 (West Supp. 1989). This incorporates the foreseeability limit first established in the well-known English case of *Hadley v. Baxendale*, 156 Eng. Rep. 145 (1854). *Hadley* also permits recovery of damages that, though not ordinarily foreseeable, are actually known to the breaching party at the time the agreement is reached. Note, *Extending the Bad Faith Tort Doctrine to General Commercial Contracts*, 65 B.U.L. REV. 355, 368 (1985) [hereinafter Note, *Bad Faith Tort*].

218. The development of contract law sought to recognize the right of a party to a contract to breach if he or she so chose, strictly limiting the recoverable damages to "compensatory" damages following such a breach to a scope far less than that available in the law of torts. G. GILMORE, *DEATH OF CONTRACT* 14-15 (1974). See also Comment, *Reconstructing Breach of the Implied Covenant of Good Faith and Fair Dealing as a Tort*, 73 CALIF. L. REV. 1291, 1291 n.3 (1985).

219. E.A. FARNSWORTH, *supra* note 37, § 12.8 (1982) ("[N]o matter how reprehensible the breach, damages that are punitive, in the sense of being in excess of those required to compensate the injured party for his lost expectation, are not ordinarily awarded for breach of contract.") See *Crogan v. Metz*, 47 Cal. 2d 398, 405, 303 P. 2d 1029, 1033 (1956); *Frazier v. Metropolitan Life Ins. Co.*, 169 Cal. App. 3d 90, 106-07, 214 Cal. Rptr. 883, 892 (1985). See also CAL. CIV. CODE § 3294 (West Supp. 1989) (expressly prohibiting punitive damages in any action "arising from contract").

220. Note, *Bad Faith Tort*, *supra* note 217, at 368 (citing A. CORBIN, *CONTRACTS*, § 1076 (1964)).

termination action based on breach of contract,²²¹ it acknowledges a “widespread perception that present compensation” under contract doctrine is inadequate for the wrongfully terminated worker.²²² The majority also states its “belie[f] that focus on available contract remedies offers the most appropriate method for expanding available relief for wrongful terminations.”²²³

Working within the accepted contract damage context, more complete compensation for the wrongfully discharged employee can be fashioned. Attorneys representing wrongfully discharged plaintiffs must take care to include all appropriate elements in their damage calculation and argue for a more realistic assessment of those damages foreseeably flowing from breach.

1. Pecuniary Loss

In terms of pecuniary loss, the usual test is that the employee terminated in breach of contract is to recover the “amount of

221. *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 682 n.24, 765 P.2d 373, 388 n.24, 254 Cal. Rptr. at 211, 226 n.24 (1988).

222. *Id.* at 696, 765 P.2d at 398, 254 Cal. Rptr. at 236. *See also id.* at 694, 765 P.2d at 397, 254 Cal. Rptr. at 235 (“The most frequently cited reason for the move to extend tort remedies into this context is the perception that traditional contract remedies are inadequate to compensate for certain breaches.”). The majority makes certain its antipathy to punitive damages in the wrongful termination context, however. *Id.* at 683, 697 n.35, 765 P.2d at 389, 399 n.35, 254 Cal. Rptr. at 227, 237 n.35. Although in a tort-based action the plaintiff had to put on additional proof to recover punitive damages, the majority assumes that an action for tortious breach will lead to the imposition of punitive damages on the employer. *See supra* note 214.

223. *Foley*, 47 Cal. 3d at 699, 765 P.2d at 401, 254 Cal. Rptr. at 239. The court went on to explain:

We are not unmindful of the legitimate concerns of employees who fear arbitrary and improper discharges that may have a devastating effect on their economic and social status. Nor are we unaware of or unsympathetic to claims that contract remedies for breaches of contract are insufficient because they do not fully compensate due to their failure to include attorney fees and their restrictions on foreseeable damages.

Id. *See also* Traynor, *supra* note 212, in which the author suggests several possible bases to expand the contract damage recovery for bad faith breach of contract, while eschewing punitive damages as a possible remedy. He contends that the contract damage focus is the appropriate one noting that

[s]pending energy and refined analysis on whether a breach of contract is also or alternatively a tort diverts attention from the central economic problem, results in unproductive search for an elusive rationale, creates opportunities for clever pleading and position-taking strategems, stimulates litigation over categories such as ‘special relationships’ and ‘denial of the existence of a contract’ and encourages evasion of present statutory mandate that punitive damages are not available for breach of contract.

Id. at 12. Traynor, however, acknowledges the traditional inadequacy of contract damages.

compensation agreed on for the remaining period of service, less the amount the employer affirmatively proves the employee has earned, or with reasonable effort might have earned, in employment of the same or a similar character during the remaining period.”²²⁴ The measure of damages includes lost fringe benefits, calculated at the employee’s cost of replacing them, as well as lost salary.²²⁵ In most cases, the employment relationship is of an unspecified duration and, thus, a preliminary determination must be made about how long the employee would have worked for the employer.²²⁶ The wrongfully terminated employee apparently may recover damages, subject to the employee’s obligation to mitigate damages,²²⁷ for what would have been the duration of that worker’s employment.²²⁸

California law requires that a party injured by the breach of a contract do everything reasonably possible to mitigate his or her own loss, thereby reducing the damages for which the other party has

224. J. MCCARTHY, *supra* note 180, § 3.90. *Accord* Pugh v. See’s Candies, Inc., 203 Cal. App. 3d 762 n.14, 250 Cal. Rptr. 195, 208 n.14 (1988). In *Pugh II*, the court approved the trial judge’s instruction that, if the jury finds an implied contract for employment, the plaintiff is to recover “the total amount of wages and benefits which would have been received under the terms of the employment contract, less any sum which he has earned or could have earned in other employment by reasonable efforts.” *Id.* See also Parker v. Twentieth Century-Fox Film Corp., 3 Cal. 3d 176, 181-82, 474 P.2d 689, 692, 89 Cal. Rptr. 737, 740 (1972). “The general rule is that the measure of recovery by a wrongfully discharged employee is the amount of salary agreed upon for the period of service, less the amount which the employer affirmatively proves the employee has earned or with reasonable effort might have earned from other employment.” *Id.*

225. *Wise v. Southern Pac. Co.*, 1 Cal. 3d 600, 607-08, 463 P. 2d 426, 431, 83 Cal. Rptr. 202, 207 (1970) (plaintiff entitled to recover replacement cost of life insurance, hospital and medical coverage for himself and his spouse). Some jurisdictions calculate the value of lost fringe benefits by evaluating the employer’s cost of providing the benefits. J. MCCARTHY, *supra* note 80, § 3.91. Other types of compensatory contract damages permitted for breach of an employment contract include: intangible fringe benefits, such as the assurance of a 40-hour work week and a comfortable indoor working environment; expenses incurred in searching for new employment; expenses incurred in relocating to new employment; and attorney fees and expenses of litigation. *Id.*

226. This determination is made by considering such factors as the average tenure of workers at the employers place of business, the plaintiff’s testimony about his or her intentions, plaintiff’s past employment history, and the amount of time that the employee had already worked for the defendant.

227. See *infra* notes 229-231 and accompanying text.

228. Some limitation on the time period arises from the initial determination of the employee’s likely tenure and from the duty to mitigate damages. Some arbitrary limit, however, may be set to prevent employer liability for an unduly extended period of time. See, e.g., MONT. CODE ANN., § 39-2-911 (1988), which terminates an employer’s obligation to pay wages and fringe benefits after 4 years from the date of discharge. It should be noted, however, that Montana permits a broader scope of recovery than post-*Foley* California, even permitting punitive damages in certain situations. Some courts limit the duration for which damages are recoverable to “a reasonable time.” J. MCCARTHY, *supra* note 180, § 3.90; Cf. B. SCHBI & P. GROSSMAN, EMPLOYMENT DISCRIMINATION LAW 1434 (2d ed. 1983) (discussing “front pay” for employees discriminatorily terminated).

become liable.²²⁹ In the employment context it is clear, however, that the discharged employee's refusal to accept different or inferior employment will not affect the plaintiff's damage recovery. In fact, the burden of proof is on the defendant to show that the rejected employment was in fact comparable, or substantially similar, to that held by the plaintiff before termination.²³⁰ Where there are few jobs available for a person with the plaintiff's skills, there may be no basis for the discharged employee to mitigate damages.²³¹

2. Emotional Distress Damages

Damages for emotional distress are rarely permitted in an action based in contract.²³² This limitation is not so much the result of considered analysis nor rigid adherence to contract damages law as "[a] limitation more firmly rooted in tradition."²³³ California adheres to the general view that emotional distress damages are not recoverable for breach of contract.²³⁴ In fact, California's adherence to the *Hadley v. Baxendale* limitation on consequential damages²³⁵ had led to infrequent awards of emotional distress damages because generally emotional distress damages are not within the contemplation of the parties at the time of contracting and are, thus, not recoverable in an action for breach of contract. Courts, however, must guard against unthinkingly assuming that in no contract action may the

229. 1 B. WITKIN, SUMMARY OF CALIFORNIA LAW, CONTRACTS § 857 (9th ed. 1987).

230. *Parker v. Twentieth Century-Fox Film Corp.*, 3 Cal. 3d 176, 183, 474 P.2d 689, 692, 89 Cal. Rptr. 737, 740 (1972). Courts appear willing to scrutinize the position asserted by the employer to be similar. *See id.*

231. *See Brewster v. Martin Marietta Aluminum Sales*, 378 N.W.2d 558 (Mich. 1985) (award of \$740,000 in lost compensation appropriate where it had been impossible for the plaintiff to secure comparable employment).

232. E.A. FARNSWORTH *supra* note 37, § 12.17; Note, *Bad Faith Tort*, *supra* note 217, at 369.

233. E.A. FARNSWORTH, *supra* note 37, § 12.17.

234. *Sawyer v. Bank of Am. Nat'l Trust & Sav. Ass'n*, 83 Cal. App. 3d 135, 139, 145 Cal. Rptr. 623, 625 (1978). Unlike punitive damages, there is no statutory limitation barring an award of emotional distress damages in a contract action. *See supra* note 219. In fact, California statutory law suggests that emotional distress damages may be recoverable. *See CAL. CIV. CODE* § 3300 (West 1970) (providing that "for the breach of an obligation arising from contract, the measure of damages, except where otherwise provided by this Code, is the amount which will compensate the party aggrieved for all the detriment proximately caused thereby, or which, in the ordinary course of things, would be likely to result therefrom.") *See also Frazier v. Metropolitan Life Ins. Co.*, 169 Cal. App. 3d 90, 214 Cal. Rptr. 883 (1985) (although plaintiff statutorily barred from punitive damages in contract action, damages for emotional distress recoverable).

235. *See supra* note 217.

plaintiff recover for emotional harm. Indeed, in certain contexts, where the courts have found that the parties to the contract did contemplate emotional distress damages flowing from breach, or where due to the nature of the contract emotional distress damages were particularly foreseeable, California courts have permitted recovery for emotional harm.²³⁶ These cases are consistent with, not in conflict with, the *Hadley* measure of damage.²³⁷

Although adherence to *Hadley* could lead to the recovery of emotional distress damages in the context of breach of an employment contract, courts have been unwilling to permit recovery in the wrongful termination context.²³⁸ Yet, it is well recognized that contract

236. See, e.g., *Ross v. Forest Lawn Memorial Park*, 153 Cal. App. 3d 988, 995, 203 Cal. Rptr. 468, 473 (1984) (defendant's breach of contract to ensure private burial, promising to bar unwanted guests, makes defendant liable for the plaintiff's emotional distress, even absent physical manifestations because the contract by its nature put the defendant on notice that a breach would result in emotional and mental suffering by the plaintiff.); *Windeler v. Scheers Jewelers*, 8 Cal. App. 3d 844, 852, 88 Cal. Rptr. 39, 44 (1970) (jeweler liable for emotional distress damages caused by breach of contract leading to destruction of plaintiff's heirloom where defendant specifically was aware of sentimental value). See generally B. WITKIN, *SUMMARY OF CALIFORNIA LAW, Contracts*, §§ 829-832 (9th ed. 1987).

237. See Goldberg, *Emotional Distress Damages and Breach of Contract: A New Approach*, 20 U.C. DAVIS L. REV. 57 (1986). After announcing her "new test" calling for emotional distress damages when "at the time of contracting, the promisor can foresee that emotional distress will flow from the breach," an application of the traditional *Hadley* test to emotional distress claims, (*Id.* at 57-58), Goldberg goes on to refine the test as follows:

If a contract has an emotional aspect [which she defines as either emotional events, emotional objects, or emotional interests], it is foreseeable that emotional distress will flow from a breach This means that courts cannot preclude emotional distress damages entirely because an element of business is involved, but will award damages commensurate with the emotional aspects known to both parties at the time of contract formation.

Id. at 60. But see Traynor, *supra* note 217, at 12 (suggesting that the *Hadley* rule would need to be relaxed to permit recovery of broader compensatory damages flowing from the breach of an employment contract).

238. See, e.g., *Loehr v. Ventura County Community College Dist.*, 147 Cal. App. 3d 1071, 1081 n.4, 195 Cal. Rptr. 576, 582 n.4 (1983); "It has long been established that an employer cannot be held liable in a breach of contract action for changes to the employee's health, or for injuries to his feelings or reputation, by reason of wrongful discharge, though it be alleged that his discharge was malicious. [*Westwater v. Grace Church*, 140 Cal. 339, 342-43, 73 P. 1055, 1056 (1903)]. To whatever extent plaintiff's complaint alleges that such damages arose from a breach of contract, it fails to state a cause of action." *Id.* See also *Foley v Interactive Data Corp.*, 47 Cal. 3d 654, 702, 765 P.2d 373, 403, 254 Cal. Rptr. 211, 241 (Broussard, J., concurring and dissenting) (although no California case has permitted emotional distress recovery for breach of a promise in the employment setting, "in many cases the employer is aware at the time of the contract that bad faith discharge will create great mental and emotional distress."). It seems difficult to conceive of a situation where a bad faith discharge would not cause emotional upset. Cf. *Cole v. Fair Oaks*, 43 Cal. 3d 148, 160, 729 P.2d 743, 750, 233 Cal. Rptr. 308, 315 (1987) ("Indeed, it would be unusual for an employee not to suffer emotional distress as a result of an unfavorable decision by his employer.").

See also *Valentine v. General Am. Credit, Inc.*, 362 N.W.2d 628 (Mich. 1984). In *Valentine*, the Michigan Supreme Court forthrightly admits that emotional distress damages fall within

damages are compensatory in nature.²³⁹ If the purpose of contract damages is to compensate the injured party, it does not necessarily follow that damages for breach should exclude damages flowing from the breach that will truly compensate the injured party.

The employment context proves a particularly compelling arena for permitting emotional distress damage recovery.²⁴⁰ This is especially true in those situations in which an employee successfully asserts an implied-in-fact agreement not to terminate absent just cause. The factors considered to find the implied-in-fact promise in the first place are factors that render emotional distress particularly foreseeable. The employee's longevity most critically establishes the foreseeability of emotional distress flowing from the employer's breach of contract. The longer a person works for an employer, the more likely it is that the employee has an expectation of continued employment.²⁴¹ Employer assurances, promotions and bonuses may increase the likelihood that emotional distress will also flow from the wrongful termination of the employee. This will be particularly the case where the employer knows that the employee has rejected possible other employment in order to remain with the employer.²⁴² Also, where the employer makes express representations of job security, modifying

the *Hadley* rule as they foreseeably flow from the breach of an employment contract, that failure to permit the plaintiff to recover for emotional harm fails to fully compensate for the harm suffered, and that an employment contract has a "personal element" because "[e]mployment is an important aspect of most persons' lives." 362 N.W.2d at 629. Nevertheless, the court rejected emotional distress damages for breach of an employment contract "because an employment contract is not entered into primarily to secure the protection of personal interests [the court finding that the primary purpose in forming such contracts is economic] and [because] pecuniary damages can be estimated with reasonable certainty." 362 N.W.2d. at 630.

239. See *supra* note 216-220. This is expressly recognized by the *Foley* court. *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 683, 765 P.2d 373, 389, 254 Cal. Rptr. 211, 227 (1988).

240. See *Goldberg*, *supra* note 237, at 95-98.

241. At some point, to be determined on a case by case basis, the employee develops "an interest in security of continuing employment." *Id.* at 98. *Goldberg* suggests that courts may create a statutory presumption that an interest in security arises after a certain number of years of employment, such as five. If the employee has worked beyond the years required for the presumption, the employer must then show that security was specifically precluded. If the employee has worked less than the number of years required for the presumption, then the employee has the burden of showing that an interest in security has arisen. *Id.* While longevity clearly is a compelling factor for the recovery of emotional distress damages, any such presumption should be legislatively created. Further, in most cases the specific nature of the employment relationship needs to be examined to determine what was in the contemplation of the parties.

242. Matters specifically within the knowledge of the employer may create liability for more than emotional distress. If an employer, for example, authorizes a bank loan to an employee because the employee is purchasing a home, subsequent wrongful discharge may make the employer liable for house payments that the discharged employee is now unable to make, as well as for the employee's emotional distress.

the at-will employment contract, emotional distress will likely flow from a subsequent breach.

Further, if the agreement not to terminate absent just cause arises as a result of an express or implied contract modification, it is only reasonable that the foreseeability of the harm be assessed at the time of the modification, rather than at the time the original employment agreement is formed. The harm likely to flow from the breach of an obligation to terminate only for just cause cannot be measured until the contract in issue contains such an obligation — an obligation which is created only at the time of modification.

Accordingly, where a discharged employee establishes breach of a promise to terminate only for just cause, created by express or implied employer manifestations, emotional distress damages may be recoverable depending on the circumstances and what specific knowledge is possessed by the employer. Some suggest that emotional distress damages be permitted only where the defendant's breach is in "bad faith."²⁴³ A more logical approach is to permit emotional distress damages in accordance with the dictates of *Hadley*, when emotional distress damages would be reasonably foreseeable from breach of the employment contract, and to permit emotional distress damages where the employer acts in "bad faith" by asserting a pretextual basis for the discharge, regardless of whether the emotional distress damages fall within the scope of *Hadley*.²⁴⁴

G. *Seaman's After Foley*

In *Seaman's Direct Buying Service v. Standard Oil Co.*,²⁴⁵ the California Supreme Court was expected to decide whether the breach of the covenant of good faith and fair dealing implied in a commercial contract²⁴⁶ could lead to tort damages.²⁴⁷ Rather than forthrightly

243. See *Foley*, 47 Cal. 3d at 702, 765 P.2d at 403, 254 Cal. Rptr. at 241 (Broussard, J., dissenting and concurring) ("[I]n many cases the employer is aware at the time of the contract that bad faith discharge will create great mental and emotional distress.") (emphasis added); Traynor, *supra* note 212, at 13.

244. This would reinstate some of the deterrence against pretextual discharge removed by the *Foley* decision. See *supra* notes 152-153 and accompanying text.

245. 36 Cal. 3d 752, 206 Cal. Rptr. 354, 686 P.2d 1158 (1984). See generally Note, *Sailing the Uncharted Seas of Bad Faith: Seaman's Direct Buying Service, Inc. v. Standard Oil Co.*, 69 MINN. L. REV. 1161 (1985).

246. See *supra* note 155-157.

247. The California Supreme Court had previously held that the breach of the implied covenant could be tortious in the insurance context. See *supra* note 55. The court also had suggested that the same might be true in the employment context. See *supra* note 50.

deciding that issue, the court, instead, held that a "party to a contract may incur tort remedies when, in addition to breaching the contract, it seeks to shield itself from liability by denying, in bad faith and without probable cause, that the contract exists."²⁴⁸

Care must be taken to distinguish a *Seaman's* cause of action for bad faith refusal to recognize the existence of a valid contract ("bad faith refusal") from an action based on tortious breach of the implied covenant of good faith and fair dealing ("tortious breach"). Despite the efforts of the *Seaman's* court to proclaim that its decision was premised on a tort basis distinct from tortious breach,²⁴⁹ later au-

248. *Seaman's Direct Buying Serv. v. Standard Oil Co.*, 36 Cal. 3d 752, 769, 686 P.2d 1158, 1167, 206 Cal. Rptr. 354, 363 (1984). The court contended that it was unnecessary to decide the admitted "principal issue" of "whether and under what circumstances, a breach of the implied covenant of good faith and fair dealing in a commercial contract may give rise to an action in tort." *Id.* at 767, 686 P.2d at 1166, 206 Cal. Rptr. at 362. See *Gomez v. Volkswagen of Am., Inc.*, 169 Cal. App. 3d 921, 928, 215 Cal. Rptr. 507, 512 (1985) (the court did not "decid[e] whether breach of the covenant of good faith and fair dealing would support tort remedies in the ordinary commercial context. . ."); Note, *Bad Faith Tort*, *supra* note 217, at 363 (noting that, although the court extended tort liability to general commercial contracts, it "skirt[ed] the bad faith tort doctrine issue"); Note, *Contort: Tortious Breach of the Implied Covenant of Good Faith and Fair Dealing in Noninsurance, Commercial Contracts—Its Existence and Desirability*, 60 NOTRE DAME L. REV. 510, 520 (1985) ("Thus, in *Seaman's*, the California Supreme Court recognized the new tort of wrongful denial of the existence of a contract, but avoided the question whether a breach of the implied covenant of good faith and fair dealing in a commercial contract always gives rise to an action in tort."); Traynor, *supra* note 212, at 11 ("[T]he court in *Seaman's* recognized a new tort of 'stonewalling' and avoided ruling that the tort results from a breach of the implied covenant of good faith and fair dealing.").

The court's narrow approach has been criticized. See, e.g., Comment, *Reconstructing Breach of the Implied Covenant of Good Faith and Fair Dealing as a Tort*, 73 CALIF. L. REV. 1291, 1302 n.63 (1985) ("*Seaman's* is too narrow, since it creates an artificial distinction between disputing the existence of a contract and disputing duties, performance and other aspects of the bargaining process."). But see *Rulon-Miller v. International Business Mach's Corp.*, 162 Cal. App. 3d 241, 252, 208 Cal. Rptr. 524, 532 (1984) ("The court found it unnecessary [in *Seaman's*] to directly address the issue [of tortious breach], enunciating a broader principle. . .") (emphasis added).

One author suggests that the court was concerned about bad faith conduct by the contracting parties in *Seaman's* but, after having the case under submission for twenty-seven months, was unable to reach "any agreement on the rationale for developing the law coherently," thereby creating the confusing, ill-defined new tort of bad faith denial. Traynor, *supra* note 212, at 12.

249. In fact, the majority advised caution in determining the scope and application of tort remedies arising from the breach of a commercial contract because of the difficulty in distinguishing between breach of the covenant and breach of the underlying contract, and because tort damages might frustrate the contracting parties' expectations. *Seaman's*, 36 Cal. 3d at 768-69, 686 P.2d at 1166-67, 206 Cal. Rptr. at 362-63. Further, it was because the majority refused to base their holding on a finding of tortious breach that former Chief Justice Bird refused to join the full opinion. She took issue with the majority, explaining:

A contracting party should not be able to deny the existence of a valid contract in order to shield itself from liability for breach of that contract. Today, the court holds that an action will lie in tort against such conduct. However, it refuses to acknowledge that its holding is compelled by this court's past decisions analyzing the scope of the implied covenant of good faith and fair dealing.

Seaman's, 36 Cal. 3d at 775-76, 686 P.2d at 1171, 206 Cal. Rptr. at 367 (Bird, C.J., concurring

thorities have expressly or impliedly interpreted *Seaman's* as basing its holding on the implied covenant of good faith and fair dealing.²⁵⁰ By the careful terms of the court, *Seaman's* creates a new tort, separate and independent from tortious breach.²⁵¹

Courts began to attempt to interweave the *Seaman's* rationale into their disposition of wrongful termination cases.²⁵² Once again, confusion arose about the distinction between a bad faith refusal cause of action and an action for tortious breach.²⁵³

and dissenting). She went on to argue that "[w]hen a breaching party acts in bad faith to shield itself entirely from contract damages . . . the duty of good faith and fair dealing is violated." *Id.* at 778, 686 P.2d at 1173, 206 Cal. Rptr. at 369 (Bird, C.J., concurring and dissenting).

250. See *Malmstrom v. Kaiser Aluminum*, 187 Cal. App. 3d 299, 321, 231 Cal. Rptr. 820, 832 (1986) (erroneously stating that the "holding" in *Seaman's* was that "bad faith denial of the existence of a contract breaches the duty of good faith and fair dealing"). See also, B. WITKIN, SUMMARY OF CALIFORNIA LAW, CONTRACTS § 752 (9th ed. 1987) ("The implied covenant of good faith and fair dealing is breached, and a tort action lies, where a party attempts to avoid liability by denying, in bad faith and without probable cause, the contract exists. . . ."), (citing *Seaman's*); Comment, *Sailing the Uncharted Seas of Bad Faith: Seaman's Direct Buying Service, Inc. v. Standard Oil Co.*, 69 MINN. L. REV. 1161, 1179 (1985) (asserting that the *Seaman's* court "should not have extended liability to a breach of the implied covenant of good faith and fair dealing"); see also *infra* note 253.

251. See, e.g., *Elksi v. Kukje Am. Corp.*, 672 F. Supp. 1294, 1296 (N.D. Cal. 1987). As Judge Aguilar notes, the exact parameters of this separate tort are fuzzy; it is uncertain whether the tort may encompass only the bad faith denial of the existence of a contract, or whether the tort also includes bad faith denial of liability. *Id.* at 1296-97. Ultimately, Judge Aguilar decided that the new tort arises only upon bad faith denial of the existence of a contract. *Id.* at 1298. *Accord* *Quigley v. Pet, Inc.*, 162 Cal. App. 3d 877, 208 Cal. Rptr. 394 (1984). On the other hand, the *Seaman's* majority relies on an Oregon case, in which the defendants were liable in tort for threatening to file unjustified litigation unless the plaintiff paid them more than was justifiably due them under the contract. *Adams v. Crater Well Drilling, Inc.*, 556 P.2d 679 (Or. 1976). In this case tort liability arose from the defendants' conduct of obtaining excess payment "without probable cause and with no belief in the existence of the cause of action." *Adams*, 556 P.2d at 681. The case did not involve bad faith denial of the existence of the contract and reliance by the *Seaman's* court on this case may suggest an intent that the cause of action extend beyond bad faith denial of a contract.

The California high court's creation of the new tort has caused significant confusion. As Judge Kozinski bluntly put it: the *Seaman's* tort is a creation of the "Cloud Cuckooland of modern tort theory." *Oki America, Inc. v. Microtech International, Inc.*, 872 F.2d 312, 314. Judge Kozinski continued: "In inventing the tort of bad faith denial of a contract, . . . the California Supreme Court has created a cause of action so nebulous in outline and so unpredictable in application that it more resembles a brick thrown from a third story window than a rule of law. . . . [] It is impossible to draw a principled distinction between tortious denial of a contract's existence and a permissible denial of liability under the terms of the contract." *Id.* at 315. Judge Kozinski may overstate the problem, however. As *Seaman's* itself indicates, there is a distinction between breaching a contract and refusing to recognize the existence of the obligation, although at times the distinction appears blurry.

252. See, e.g., *Hejmadi v. AMFAC, Inc.*, 202 Cal. App. 3d 525, 548-9, 249 Cal. Rptr. 5, 18-19 (1988) (employee's proof of employer's bad faith denial of employment contract may permit recovery for tortious breach); *Koehrer v. Superior Court*, 181 Cal. App. 3d 1155, 1170-2, 226 Cal. Rptr. 820, 829-830 (1986) (where employer asserts good cause for discharge without probable cause and in bad faith, an action for tortious breach will lie); *Rulon-Miller v. International Business Mach's. Corp.*, 162 Cal. App. 3d 241, 252-253, 206 Cal. Rptr. 524, 532-533 (1984).

253. See, e.g., *Hejmadi*, 202 Cal. App. 3d at 548, 249 Cal. Rptr. at 18 (the court held that

Clearly the majority's decision in *Foley* now forecloses a tort action in the employment context based upon the breach of the implied covenant of good faith and fair dealing. The central question that arises is whether the independent *Seaman's* tort of bad faith refusal has continuing vitality in the employment context. Although the exact scope of the cause of action will need to be defined, the bad faith denial cause of action survives the *Foley* decision.

The court in *Foley* does not consider the viability of a *Seaman's* action, although the majority makes clear its disagreement with the approach asserted by the *Koehrer* court that tortious breach can arise in the employment context where there is a pretextual assertion of good cause.²⁵⁴ The *Foley* majority, without explanation or citation to authority, then went on to state:

Koehrer thus extended the expressly circumscribed cause of action established in *Seaman's* based on denial of the existence of the contract, to find a tort cause of action when the dispute related to a contract term, namely the necessity for good cause as a basis for termination. By this broad stroke, made without analyzing the appropriateness of imposing tort remedies in the employment context, the *Koehrer* court broached the possibility of imposing tort damages for the breach of any term of a contract whether for employment or otherwise.²⁵⁵

The majority's point is uncertain and potentially unfounded. To the extent that the majority contends that *Koehrer's* reliance on *Seaman's* as a basis for permitting a tortious breach action is misplaced, the majority is surely correct. Bad faith denial and tortious breach are separate and distinct causes of action.²⁵⁶ The intimation

an employee who has established an implied promise that he or she will not be terminated absent cause may pursue the "implied covenant tort remedy" upon proof of bad faith denial of the existence of a contract). This focus is misplaced, however. The employer's bad faith denial is a tort unto itself; it need not be the basis for an action for tortious breach. See also *Koehrer*, 181 Cal. App. 3d at 1170, 226 Cal. Rptr. at 829 (where the court acknowledges that the *Seaman's* court expressly stated its holding is not based upon breach of the implied covenant, but then proceeds to proclaim that the court did not mean what it said because "it is difficult otherwise to understand its [the court's] repeated reference to 'good faith' and 'bad faith'"). The *Foley* court took issue with the *Koehrer* court's interpretation of *Seaman's*. See *infra* note 254 and accompanying text.

254. *Foley*, 47 Cal. 3d at 688-89, 765 P.2d at 393, 254 Cal. Rptr. at 231. See *supra* notes 152-153 (discussing *Foley's* creation of a lack of deterrence against pretextual discharge). The court took issue with the *Koehrer* court's assertion that the *Seaman's* majority did not mean what it said and did in fact base its holding on tortious breach of the covenant of good faith and fair dealing. *Id.*

255. *Foley*, 47 Cal. 3d at 688-89, 765 P.2d at 393, 254 Cal. Rptr. at 231.

256. See *supra* notes 248-253. The court may be suggesting that the employer's assertion of a lack of liability under a contractual provision, even in bad faith, does not create a *Seaman's*

that a *Seaman's* action, if premised on bad faith denial of the existence of a valid contractual promise not to terminate absent just cause, could not apply in the employment context, does not follow, however. First, the majority's assertion that a bad faith denial cause of action is less appropriate in the employment realm than in the commercial context is bewildering. The *Seaman's* cause of action originated in the context of commercial contracts and, if a *Seaman's* cause of action permitting tort recovery is appropriate in the *commercial* context, there is no logical basis for foreclosing a tort action in the context of *employment* contracts. The commercial contract arena is the area in which courts and commentators urge the greatest caution before permitting a potential tort recovery.²⁵⁷ In the context of employment contracts, which more closely approximate contracts for insurance than do commercial contracts, the distinction is unfounded.

Second, the court's distinction between "contract" and "contract terms" is also unsupported.²⁵⁸ Whether an implied-in-fact promise to terminate only for cause constitutes a separate contract, or whether it constitutes an implied-in-fact modification to the original employment contract, the effect is the same. In fact, it is uncertain what is the appropriate characterization of conduct or words by the employer which leads an employee to reasonably believe he or she may only be terminated for cause despite an employment relationship that was initially terminable at will. If an employment contract, silent about duration is formed at the outset, the law implies a term that it is terminable at will.²⁵⁹ Because of subsequent conduct by the employer, an employee may justifiably assert that he or she is terminable only

cause of action. The employer's conduct instead would be based on breach of the implied covenant of good faith and fair dealing, sounding solely in contract after *Foley*. As one judge explains: "Denial of liability in bad faith and without probable cause is squarely within the realm of the covenant of good faith and fair dealing. To deny liability on a contract is to deny the other party the rightful employment of the benefits of the contract." *Elksi v. Kukje Am. Corp.*, 672 F. Supp. 1294, 1297 (N.D. Cal. 1987). Yet, the distinction between denying the existence of a contract and denying a contractual obligation under an existing contract is not an easy one to make. As one author points out, this distinction is "artificial, and applying it to oral contracts or loosely written contracts seems unworkable." *Traynor*, *supra* note 212, at 11. While the distinction is difficult, later cases will have to tackle this issue and provide guidance as to the proper parameters of the *Seaman's* cause of action.

257. It was precisely because the commercial arena was involved that the *Seaman's* court declined to base their holding on tortious breach. *See supra* note 249. *See also Note, Contort*, *supra* note 248, at 518; *Louderback & Jurika*, *supra* note 55, 16 U.S.F. L. REV. 187, 200-201 (1982). *See also supra* notes 112-113.

258. *See, e.g., Quigley v. Pet, Inc.*, 162 Cal. App. 3d 877, 891, 208 Cal. Rptr. 394, 402 (1984) (*Seaman's* may suggest that the unfounded protest of any contract term is tortious). In fact, the distinction is contrary to contract law.

259. *See supra* note 33 and accompanying text.

for cause. Does the just cause provision create a new implied-in-fact contract, or is there simply an implied-in-fact modification of the original employment contract such that termination solely for cause is only one of several contract terms? Courts have not bothered to make this distinction, speaking about implied-in-fact promises not to terminate absent cause, implied-in-fact contracts and implied-in-fact modification, treating all as identical in effect.²⁶⁰

If the *Pugh* criteria are satisfied, *Foley* makes clear that an implied-in-fact promise not to terminate absent just cause arises. Can there be a tort action arising from the bad faith refusal to recognize this implied-in-fact contract? Although *Seaman's* deals with an express contract, there is no conceptual difference if the underlying contract is implied-in-fact.²⁶¹ Thus, a tort action premised on the employer's bad faith refusal to recognize the existence of a valid implied-in-fact promise not to terminate the employee absent good cause should be actionable.²⁶²

260. The *Foley* court also uses these terms interchangeably. The court notes that, because *Foley* bases his claim that he is terminable only for good cause on the employer's course of conduct, his cause of action is "one for breach of an implied-in-fact contract." *Foley*, 47 Cal. 3d at 675, 765 P.2d at 383, 254 Cal. Rptr. at 221. Later the majority characterizes the situation as one of "implied-in-fact modification." *Id.* at 680 n.23, 765 P.2d 387 n.23, 254 Cal. Rptr. at 225 n.23.

Although the ultimate legal effect is identical, implied-in-fact limitations are based on employer conduct while express contracts can be created by written or oral manifestations. *See supra* note 37.

261. *See Landsberg v. Scrabble Crossword Game Players, Inc.*, 802 F.2d 1193, 1199 (9th Cir. 1986) (applying California law). The court explained: "Defendants argue that to apply the *Seaman's* doctrine to an implied-in-fact contract would unduly extend state law. We reject this argument because under California law implied-in-fact contract is, like an express one, a 'true' contract." *Id.* California law correctly comports with the general law of contract; an implied-in-fact contract is entitled to equal treatment as an express contract, both being formed by mutual assent. J. CALAMARI AND J. PERILLO, *CONTRACTS* § 19 (1987). *See also supra* note 37.

262. *See Pugh v. See's Candies, Inc.* 203 Cal. App. 3d 743, 754, 250 Cal. Rptr. 195, 202 (1988). The *Pugh II* court suggests that a *Seaman's* action may be appropriate in the implied-in-fact context, noting:

See's counsel concede in summation that See's had a long-standing, unwritten policy that employees would not be discharged unless their work performance was unsatisfactory, that is, without good cause. We are cited to no evidence in the record, and we find none, that See's denied the existence of an implied contract to discharge appellant only for good cause. Instead, See's focused its evidence on the issues of whether it acted in good faith and had good cause for the discharge.

Id. Clearly focusing on the bad faith denial of the employment agreement itself is misplaced as there is little likelihood that an employer would deny that there was an at-will contractual employment arrangement between the plaintiff and the defendant. *See supra* note 142. *But see Hejmadi*, 202 Cal. App. 3d at 548-49, 249 Cal. Rptr. at 19 (tortious breach action where defendant without probable cause denies the existence of the *employment contract*.) The *Hejmadi* court appeared generally confused about the proper role of a *Seaman's* action in the employment context. *See supra* note 253.

Although conceptually, there appears no reason why a *Seaman's* action cannot arise in the context of an implied-in-fact contract, it seems factually unlikely that a *Seaman's* cause of action would be viable except in the most unusual of situations. Under *Pugh*, and now *Foley*, the confluence of a variety of factors—the “totality of the circumstances”²⁶³—will lead a court to find, at some undefined point, that there is sufficient evidence from which a jury may reasonably find that an employer's conduct has created an implied-in-fact promise that the employee is terminable only for good cause.

To prevail in an action for bad faith denial it is not enough that the plaintiff shows that the employer's assurances, practices and longevity have reasonably led to an implied-in-fact promise that the employee be terminated only for good cause. Termination absent just cause would be an action for breach of contract. To prove an action sounding in tort, the challenge confronting the plaintiff is proving that the defendant-employer acted in “bad faith,” which in this context is defined as denying the contractual obligation “without probable cause and with no belief in the existence of the defense.”²⁶⁴ An honest, but mistaken, belief that there is a legitimate basis to contest the existence of the contract is enough to foreclose a finding of “bad faith.”²⁶⁵ Thus, a tort action requires greater proof than the actual existence of an implied-in-fact obligation, the existence of which is being disputed by the employer. Because the formation of the implied-in-fact contract is often the result of the convergence of several factors that are deemed to create a reasonable expectation on the part of the employee that he or she is no longer terminable at will, it will be the rare case that the employer's denial of an implied-in-fact obligation to terminate only for just cause will be in “bad faith.”²⁶⁶

Where, however, there is employee reliance on provisions in the personnel policies and handbooks which assert that employees will be terminated only for just cause, leading the employee to assert an implied-in-fact promise to terminate only for cause, a *Seaman's* action

263. *Foley*, 47 Cal. 3d at 681, 765 P.2d at 388, 254 Cal. Rptr. at 226. See also *Burton v. Security Pac. Nat'l Bank*, 197 Cal. App. 3d 979, 977, 243 Cal. Rptr. 277, 281 (1988). See *supra* notes 94-95 and accompanying text.

264. *Seaman's*, 36 Cal. 3d at 770, 686 P.2d 1167, 206 Cal. Rptr. at 363.

265. *Id.* at 770, 686 P.2d at 1165, 206 Cal. Rptr. at 363.

266. If an employer has two employees in identical, or virtually identical, situations and one has successfully sued the employer on a *Pugh* theory, if the employer later discharges the second employee and denies that there is any obligation to terminate that employee solely for just cause, tort damages may then follow since this would arguably be a bad faith denial.

is more tenable. The employer's assertion that there is no such obligation may give rise to a *Seaman's* action provided that there are clear employer policies that are contrary to the employer's assertions. Bad faith may be suggested by the fact that it was the employer who adopted and promulgated the policies in issue. Assertions by the employer that these are inapplicable may prove lack of probable cause.

Another context in which a bad faith denial may lie is where the plaintiff asserts an oral modification. In these cases there may be a stronger basis for recovery than where the basis of the action is an implied-in-fact promise. Where, through words, the employer has modified the employment agreement so that the employee may be terminated only for cause, the employer may be liable in tort for bad faith refusal to recognize this obligation. Termination absent cause would subject the employer to contract damages only after *Foley*; but if the employer asserts in bad faith—without a good cause belief that there is no contractual modification—that there has been no express agreement that the employee is terminable only for just cause, a *Seaman's* action logically may follow.

The bad faith denial cause of action arises when the employer—in bad faith and without probable cause—denies the obligation to terminate only for just cause. This is wholly distinct from cases where the employer terminates an employee who later proves an implied-in-fact promise that he or she will be terminated solely for just cause. The termination absent just cause, though wrongful, constitutes breach of a contract, leading to contract remedies only.²⁶⁷ The bad faith denial action may now also be construed as inapplicable in cases where the employer, though recognizing a promise to terminate the employee only for just cause, has created unfounded and pretextual assertions of good cause.²⁶⁸

In *Foley*, the majority limits a wrongfully discharged employee's tort remedies in the employment context. Nevertheless, the opinion does not erase the bad faith denial cause of action from California law and, indeed, may strengthen the need for the bad faith denial cause of action. Where an employer attempts to avoid liability “for nonperformance of contractual obligations which it privately recog-

267. See *Koehrer v. Superior Court*, 181 Cal. App. 3d 1155, 1171, 226 Cal. Rptr. 820, 830 (1986) (“[A]n allegation that the defendant's discharge of plaintiff was without good cause would charge nothing more than a breach of contract.”).

268. See *supra* note 254.

nized to be binding,"²⁶⁹ the need for a tort cause of action arises. This conduct constitutes more than a "mere breach of contract"; it "offends acceptable notions of business ethics,"²⁷⁰ and is tortious.²⁷¹ Only later cases will define the scope of the *Seaman's* cause of action in this, as well as in other, contexts.

CONCLUSION

The California Supreme Court has breathed a little new life into the highly criticized at-will doctrine, an awkward relic from a time long gone. Simultaneously, the court cautiously acknowledged the need for limitations to the at-will doctrine; implicitly recognizing the need to provide greater protection for workers so that the balance between the employer's "freedom to make economically based decisions about their work force" will be properly weighed against the worker's right to adequate redress in cases of "certain forms of 'wrongful' termination" ²⁷² In suggesting a starting point, the court embraced the law of contracts, modernized and liberalized, as a basis to protect certain employees from unjust termination. Further, the court reviewed the badly muddled decisions providing a tort recovery for breach of the implied covenant in the employment context and, rather than trying to define the parameters of the cause of action, took an easier, though more dramatic step, and abolished the entire cause of action for tortious breach. It is hoped that the court's abdication may lead to legislative action, and, in turn, to a more understandable, coherent and just balance in the employment context. In the interim, California courts will still have to grapple with thorny issues unresolved and, in some cases, created by the *Foley* decision.²⁷³

269. *Seaman's*, 36 Cal. 3d at 771, 686 P.2d at 1168, 206 Cal. Rptr. at 364.

270. *Id.* at 770, 686 P.2d at 1167, 206 Cal. Rptr. at 363.

271. Surely, if a tort action for bad faith denial will not "intrude upon the bargaining relationship or upset reasonable expectations of the contracting parties" in the commercial contract setting, it will surely not do so in the employment context. *See supra* note 257.

272. *Foley*, 47 Cal.3d at 694, 765 P.2d at 397, 254 Cal. Rptr. at 235 (1988).

273. Another effect of *Foley* may be a renewed interest in unionization. The foremost goal of legislation regulating the workplace during this century had been to promote "unionization as a countervailing force against employer power and control." Note, *Protecting At Will Employees*, 93 HARV. L. REV. 1816, 1827 (1980). While union membership has been declining nationally and in California, (*see supra* note 1) the *Foley* decision may have unwittingly created a persuasive argument in favor of a resurgence of unionization. *See Gould, Stemming the Wrongful Discharge Tide: A Case for Arbitration*, 13 EMP. REL. L.J. 404, 417 (1987) (Because union membership is declining, employees turned to wrongful termination actions to redress their injuries.)