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Khanna v. Microdata Corp.: The Continuing Evolution of Wrongful Discharge

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Khanna v. Microdata Corp.: The Continuing Evolution of Wrongful Discharge

In *Khanna v. Microdata Corp.*,[1] the California Court of Appeal for the First District held an employer liable in tort for violating the implied covenant of good faith and fair dealing.[2] Microdata discharged an employee in retaliation for the employee bringing a lawsuit against Microdata.[3] *Khanna* extended the precedent set in *Cleary v. American Airlines, Inc.*[4] in which the court found an implied covenant of good faith and fair dealing in the employment contract.[5] *Cleary* held that lengthy satisfactory employment together with the existence of a company policy regulating dismissals were the two critical factors that gave rise to a duty not to discharge except for good cause.[6] The court found that these two factors acted as a form of estoppel precluding termination except for good cause.[7] The *Cleary* court also found that, in the circumstances involved in that case, an unjust termination violates the implied covenant of good faith and fair dealing contained in every employment contract.[8] Further, *Cleary* concluded that breach of the covenant of good faith and fair dealing would sound in tort and in contract.[9] The court in *Khanna* broadened the cause of action for wrongful discharge based upon the implied covenant of good faith and fair dealing by eliminating the requirement of the two critical factors relied upon by the *Cleary* court.[10]

Part I of this note summarizes the facts of *Khanna* and reviews the opinion of the court.[11] Part II discusses the legal background of wrongful discharge actions based upon breach of the implied cove-

1. 170 Cal. App. 3d 250, 215 Cal. Rptr. 860 (1985).
2. *Id.* at 258, 215 Cal. Rptr. at 864.
3. *Id.* at 264, 215 Cal. Rptr. at 868.
4. 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980). *See infra* notes 62-66 and accompanying text; *infra* notes 81-83 and accompanying text.
5. *Id.* at 455, 168 Cal. Rptr. at 729.
6. *Id.* at 455-56, 168 Cal. Rptr. at 729.
7. *Id.* at 456, 168 Cal. Rptr. at 729.
8. *Id.* at 455, 168 Cal. Rptr. at 729.
9. *Id.* at 456, 168 Cal. Rptr. at 729.
10. *See Khanna*, 170 Cal. App. 3d at 262, 215 Cal. Rptr. at 867.
11. *See infra* notes 14-49 and accompanying text.

nant of good faith and fair dealing.[12] Finally, Part III of this note examines the legal ramifications of the *Khanna* opinion.[13]

I. THE CASE

A. The Facts

In July 1978, Nand Khanna was a salesman employed by Itel.[14] Richard Manuel, an acquaintance of Khanna, was branch manager of a Microdata Corporation sales office.[15] Manuel offered Khanna the sales account for Van Waters and Rogers as an inducement for Khanna to leave Itel to join Microdata.[16] This offer was confirmed in a letter from Manuel, dated July 12, 1978, which included a description of the commission arrangement that would accompany the account.[17]

Khanna left the employ of Itel to join Microdata because of the inducements offered by Microdata.[18] During his first few months employment with Microdata, Khanna spent time working on the Van Waters and Rogers account.[19] Eventually, Khanna was directed to cease work on the account because other arrangements had been made for the sale.[20] Khanna stopped work on the account, but inquired about his commission due under the compensation plan contained in the letter from Manuel.[21] Manuel attempted to get some compensation for Khanna for time and effort expended on the Van Waters and

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12. *See infra* notes 50-89 and accompanying text.

13. *See infra* notes 90-105 and accompanying text.

14. *Khanna*, 170 Cal. App. 3d at 253, 215 Cal. Rptr. at 861. The facts of this note are taken from the court of appeals decision that viewed the facts most favorably to Khanna. *Id.*

15. *Id.*

16. *Id.* at 253-54, 215 Cal. Rptr. at 861. Van Waters and Rogers was a large consulting firm that negotiated with Microdata for the purchase of several computers. Van Waters and Rogers was expected to purchase from 13 to 15 Microdata computers, bringing Microdata over $1,000,000 in sales. *Id.*

17. *Id.* at 254, 215 Cal. Rptr. at 861. If the account was not in Khanna's sales territory, Khanna was to have six months to close the account. However, if the account was in Khanna's territory the assignment was to last indefinitely; the assignment of the Van Waters and Rogers account was in Khanna's territory. The letter also provided that if there was a sales split between Microdata and ESCOM, a sales company through which Microdata had a preexisting sales agreement, then Khanna was to receive a hardware commission at a rate of four percent. If, however, Microdata was able to arrange an agreement with Van Waters and Rogers without a third party, Khanna was to receive a commission according to the compensation plan in effect at the time the deal was closed. *Id.*

18. *Id.* at 255, 215 Cal. Rptr. at 862.

19. *Id.*

20. *Id.* Khanna was told to cease work on the account because Microdata and ESCOM had reached a final agreement whereby ESCOM was to sell Microdata computers to Van Waters and Rogers and ESCOM was to supply the software. *Id.*

21. *Id.*

Rogers account, but told Khanna to "just forget about the July 12th letter."[22]

Khanna continued to work diligently for Microdata while attempting to get a settlement on the unpaid commission.[23] After failing to obtain compensation under the prior agreement Khanna instituted his first civil action against Microdata.[24] This first lawsuit, however, was dropped after Khanna experienced difficulty with his attorney and hired new counsel.[25] While Khanna was experiencing the difficulty with his first attorney, Microdata terminated him.[26] Khanna then filed a second lawsuit against Microdata.[27] The complaint included causes of action for fraud, wrongful discharge, breach of the implied covenant of good faith and fair dealing, and breach of the employment contract.[28] After trial the jury returned a general verdict in favor of Khanna.[29]

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22. *Id.*

23. *Id.* During this time, Khanna was shown a memo from the president of Microdata, Rene Caron, dated November 7, 1978. The memo provided that Khanna was to receive 60% of the normal commission for direct sales of computers for the units that were sold to Van Waters and Rogers and actually installed within Khanna's territory. This arrangement would have given Khanna from 4.8% to 7.2% of the total sales price, but Khanna objected to the arrangement as being contrary to the terms of the original July 12th letter. One sale was completed from ESCOM to Van Waters and Rogers in December 1978, which, under the terms contained in the memo, would have given Khanna $4,785. Khanna was never credited with the commission for this sale even though Microdata admitted that Khanna should have been paid. *Id.*

24. *Id.* at 255-56, 215 Cal. Rptr. at 863. In November 1979, Khanna wrote to Rene Caron stating that he was entitled to compensation under the letter of July 12, 1978. Caron answered by saying that Microdata would not respect the terms of the July 12th letter but would respect the November 7th memo. Khanna responded by noting that he had never agreed to the terms of the memo and that the memo was issued unilaterally by Microdata. After the exchange of correspondence with Caron, Khanna hired counsel in December 1978. *Id.*

25. *Id.* at 257, 215 Cal. Rptr. at 863. Khanna's attorney neglected to file the required jury fees and the court ordered trial to proceed without a jury. After discovering the attorney's error Khanna fired the lawyer and hired new counsel. *Id.*

26. *Id.* The termination letter from Rene Caron stated:

> [T]ermination is necessary because of your inability to maintain what Microdata considers to be a normal employee relationship. Your actions in bringing suit against Microdata based on totally unfounded representations as to commitments of Microdata and its personnel can only be construed as disloyalty. Such disloyalty cannot be permitted.

Id.

27. *Id.* at 257, 215 Cal. Rptr. at 864. At the time of his dismissal Khanna had pending commissions on nearly $250,000 worth of sales and leases for computers ordered but not yet delivered. According to the agreement signed by Khanna, any pending commission that existed at the time of the termination of the employment was forfeited to Microdata regardless of the reason for the termination of employment. The court noted that all sales personnel were required to sign the agreement and were not given a choice of negotiating more favorable terms. Khanna was unsuccessful in getting compensation for these sales or for the previous sale to Van Waters and Rogers. *Id.*

28. *Id.*

29. *Id.* at 257-58, 215 Cal. Rptr. at 864.

B. The Opinion

The California Court of Appeal affirmed the jury verdict in favor of Khanna, holding that the verdict was supported by the cause of action alleging breach of the implied covenant of good faith and fair dealing.[30] First, the justices found that Khanna was an at-will employee.[31] The court noted that the traditional theory allowing the discharge of an at-will employee for any reason had been modified by case law.[32] The court cited several cases and found three distinct sources of liability for wrongful discharge.[33] The three approaches are: (1) a tort cause of action for wrongful discharge in violation of public policy,[34] (2) a cause of action for the employer's breach of the implied covenant of good faith and fair dealing, sounding in tort and contract,[35] and (3) a cause of action for employer's breach of an implied-in-fact covenant to terminate only for good cause.[36] Although the *Khanna* court found that the facts in the case could sustain any of the three actions, the court nevertheless limited the discussion to the cause of action based on the implied covenant of good faith and fair dealing.[37]

The opinion recognized that the covenant of good faith and fair dealing was implied in every employment contract.[38] Citing *Cleary v. American Airlines, Inc.*,[39] the court noted that a cause of action for violation of the covenant of good faith and fair dealing could sound in tort.[40] The justices, however, rejected the contention by the defense that *Cleary* required a showing that the employee had been satisfactorily employed for a long period, and that the company had an express company policy indicating a duty to discharge only for good cause.[41] The court held that the two factors relied upon in *Cleary*

30. *Id.* at 258, 215 Cal. Rptr. at 864.
31. *See id.* at 259, 215 Cal. Rptr. at 865. An at-will employee is someone employed for an indefinite term whereby either party may terminate the employment at will. CAL. LAB. CODE §2922 (definition of terminable at-will employment contract). *See also infra* notes 50-57 and accompanying text (discussing the at-will employment contract).
32. *Khanna*, 170 Cal. App. 3d at 259, 215 Cal. Rptr. at 865. The court cited two primary cases, Tameny v. Atlantic Richfield Co., 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980) and Cleary v. American Airlines, Inc., 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980), as demonstrating the judicially recognized limits to the discharge of an at-will employee. *Id.*
33. *Khanna*, 170 Cal. App. 3d at 259, 215 Cal. Rptr. at 865.
34. *Id.* (citing *Tameny*, 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980)).
35. *Id.* (citing *Cleary*, 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980)).
36. *Id.* (citing Pugh v. See's Candies, Inc., 116 Cal. App. 3d 311, 171 Cal. Rptr. 917 (1981)).
37. *Id.* at 260, 215 Cal. Rptr. at 865.
38. *Id.* at 261-62, 215 Cal. Rptr. at 866-67.
39. 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980).
40. *Khanna*, 170 Cal. App. 3d at 262, 215 Cal. Rptr. at 867.
41. *Id.*

were not required to establish a breach of the implied covenant of good faith and fair dealing.[42]

Relying on two cases,[43] the court found that the cause of action could be sustained upon a showing that Microdata had exercised bad faith, extraneous to the contract, and had fired Khanna with the intention of frustrating Khanna's enjoyment of the employment contract.[44] The court found that *Cleary* had only provided one set of circumstances among many that would allow recovery by a wrongfully discharged employee.[45] The justices also noted that the factual question of whether an employee has been dismissed in bad faith with the intent to deprive the employee of the benefits of the employment contract is an evidentiary question to be resolved by the jury.[46]

Finally, the court decided that ample evidence supported the conclusion that Microdata had breached the implied covenant of good faith and fair dealing by firing Khanna in retaliation for his lawsuit against Microdata.[47] The justices noted that Khanna was a highly rated salesman at the time of discharge, that Microdata had saved several thousand dollars in earned but unpaid commissions as a result of Khanna's dismissal, and that Khanna was fired at a time when Microdata may have thought that Khanna would abandon his lawsuit.[48] The court stressed that this evidence established the existence of bad faith on the part of Microdata and concluded that the evidence was sufficient to support the jury verdict.[49]

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42. *Id.* The California Court of Appeal for the Second District has recently handed down a decision disagreeing with the position of *Khanna*. The Second District Court held that the factors relied upon by the court in *Cleary* were required for a cause of action based upon breach of the implied covenant of good faith and fair dealing. *See* Foley v. Interactive Data Corp., 174 Cal. App. 3d 282, 219 Cal. Rptr. 866 (1985).

43. Sawyer v. Bank of America NT&SA, 83 Cal. App. 3d 135, 145 Cal. Rptr. 623 (1978); Shapiro v. Wells Fargo Realty Advisors, 152 Cal. App. 3d 467, 199 Cal. Rptr. 613 (1984). In *Sawyer*, the California First District Court of Appeal was the first to state "the tort of breaching an implied covenant of good faith and fair dealing consists in bad faith action, extraneous to the contract, with the motive intentionally to frustrate the obligee's enjoyment of contract rights." *Sawyer*, 83 Cal. App. 3d at 139, 145 Cal. Rptr. at 625. In *Shapiro*, the California Court of Appeal for the Second District cited *Sawyer* and applied the concept of action extraneous to the contract with intent to frustrate directly to employment contracts. *Shapiro*, 152 Cal. App. 3d at 478-79, 199 Cal. Rptr. at 619.

44. *Khanna*, 170 Cal. App. 3d at 262, 215 Cal. Rptr. at 867.

45. *Id.*

46. *Id.* at 263, 215 Cal. Rptr. at 868. On appeal the question is whether substantial evidence exists to support the jury finding of bad faith action by the employer. *Id.*

47. *Id.* at 263-64, 215 Cal. Rptr. at 868.

48. *Id.* at 264, 215 Cal. Rptr. at 868.

49. *Id.* In reaching this conclusion the court did not address the other causes of action. *Id.* at 258, 215 Cal. Rptr. at 864.

50. Union Labor Hosp. Ass'n v. Vance Redwood Lumber Co., 158 Cal. 551, 554-55, 112 P. 886, 888 (1910); Tameny v. Atlantic Richfield Co., 27 Cal. 3d 167, 172, 610 P.2d 1330, 1332, 164 Cal. Rptr. 839, 841 (1980). *See* Comment, *The Covenant of Good Faith and Fair*

II. Legal Background

A. *At-Will Employment Contracts*

Common law provided that an employment contract for an unspecified term was terminable at will by either employer or employee.[50] The at-will concept was derived from the theory of mutuality of obligation.[51] The courts reasoned that if an employee could terminate the employment at any time, the employer should also have that right.[52] Therefore, an employer was allowed to discharge an employee for cause, no cause, or bad cause.[53] California codified the common law approach in an apparent attempt to allow the discharge of an employee for any reason.[54]

While recognizing the codification of the common law at-will doctrine, the California courts have been unwilling to view the statute as authority for an employer discharging an employee for *any* reason.[55] Early employment cases limited the right to discharge an employee

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Dealing: A Common Ground for the Torts of Wrongful Discharge From Employment, 21 Santa Clara L. Rev. 1111, 1116-19 (1981) [hereinafter cited as Comment, *A Common Ground*]; Comment, *Recognizing the Employee's Interests in Continued Employment—The California Cause of Action for Unjust Dismissal,* 12 Pac. L.J. 69, 69-70 (1980) [hereinafter cited as Comment, *The California Cause of Action*]; Comment, *Wrongful Termination of Employees at Will; The California Trend,* 78 Nw. U.L. Rev. 259, 259, 261-65 (1983) [hereinafter cited as Comment, *Wrongful Termination*].

51. Cleary v. American Airlines, Inc., 111 Cal. App. 3d 443, 448, 168 Cal. Rptr. 722, 725 (1980); Comment, *A Common Ground, supra* note 50, at 1118, 1121-24; Comment, *"Good Cause": California's New "Exception" to the At-Will Employment Doctrine,* 23 Santa Clara L. Rev. 263, 263 (1983) [hereinafter cited as Comment, *"Good Cause"*]; *Comment, The California Cause of Action, supra* note 50, at 74-75; Comment, *Wrongful Termination, supra* note 50, at 263.

52. *Union Labor Hosp. Ass'n,* 158 Cal. at 554, 112 P. at 888; Marin v. Jacuzzi, 224 Cal. App. 2d 549, 553, 36 Cal. Rptr. 880, 883 (1964); Mallard v. Boring, 182 Cal. App. 2d 390, 394, 6 Cal. Rptr. 171, 174 (1960). *See Cleary,* 111 Cal. App. 3d at 448-49, 168 Cal. Rptr. at 725; Comment, *A Common Ground, supra* note 50, at 1118, 1121-24; Comment, *"Good Cause", supra* note 51, at 263; Comment, *The California Cause of Action, supra* note 50, at 74-75; Comment, *Wrongful Termination, supra* note 50, at 263.

53. *Union Labor Hosp. Ass'n,* 158 Cal. at 554, 112 P. at 888 (stating, "as may the employee cease labor at his whim or pleasure, and, whatever be his reason, good, bad, or indifferent, . . . so, . . . may the employer discharge, and, whatever be his reason, good, bad, or indifferent"); *Marin,* 224 Cal. App. 2d at 553, 36 Cal. Rptr. at 883 (noting, "his employer can discharge him at any time, with or without cause"); *Mallard,* 182 Cal. App. 2d at 394, 6 Cal. Rptr. at 174. Discharge by employer was allowed even though the reason for discharge was "quite reprehensible." *See* Comment, *A Common Ground, supra* note 50, at 1118.

54. California Labor Code §2922 states:

> 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.

Cal. Lab. Code §2922.

55. *Tameny,* 27 Cal. 3d at 172, 610 P.2d at 1332, 164 Cal. Rptr. at 841-42. "[A]n employer does not enjoy an absolute or totally unfettered right to discharge even an at-will employee." *Id. Cleary,* 111 Cal. App. 3d at 450-54, 168 Cal. Rptr. at 726-28.

by finding that statutes or considerations of public policy may prevent indiscriminate dismissals by employers.[56] Three recent California cases have increased the protection afforded wrongfully discharged employees by finding that a wrongful discharge may give rise to three distinct causes of action.[57]

B. Wrongful Discharge in California

The first action for wrongful discharge was put forward in *Tameny v. Atlantic Richfield Co.*[58] Tameny sued Atlantic Richfield Company (ARCO) after ARCO fired him for refusing to participate in an illegal price-fixing scheme.[59] The California Supreme Court allowed a tort cause of action for wrongful discharge because ARCO discharged Tameny in violation of public policy.[60] Justice Tobriner, writing for the court, concluded that an employer discharging an employee for refusing to commit a criminal act was violating a basic duty imposed by law on all employers and, therefore, the employee could maintain a suit in tort.[61]

The same year that *Tameny* was decided, a California Court of Appeal for the Second District rendered the decision in *Cleary v. American Airlines, Inc.*[62] Cleary had been employed by American Airlines for eighteen years when he was discharged.[63] Cleary sued American Airlines alleging that American Airlines discharged him for union activities, in violation of the policy of the airline governing

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56. Petermann v. International Brotherhood of Teamsters, 174 Cal. App. 2d 184, 188, 344 P.2d 25, 27 (1959) (limiting the right to discharge for reasons of public policy); Kouff v. Bethleham-Alameda Shipyard, Inc., 90 Cal. App. 2d 322, 324, 202 P.2d 1059, 1060 (1949) (limiting an employer's right to discharge when discharge is in violation of an express statutory provision).

57. *Tameny*, 27 Cal. 3d at 178-79, 610 P.2d at 1336-37, 164 Cal. Rptr. at 846 (allowing a tort cause of action when an employer discharged an employee in violation of public policy); Pugh v. See's Candies, Inc., 116 Cal. App. 3d 311, 321-22, 171 Cal. Rptr. 917, 922 (1981) (allowing a cause of action when a discharge violated contractual terms whether implied or express); *Cleary*, 111 Cal. App. 3d at 456, 168 Cal. Rptr. at 729 (allowing a cause of action for a discharge in breach of the implied covenant of good faith and fair dealing). Collectively, *Tameny, Pugh*, and *Cleary* have been termed the "California Trilogy." *See generally* Miller & Estes, *Recent Judicial Limitations On the Right to Discharge; A California Trilogy*, 16 U.C.D. L. REV. 65 (1982).

58. 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980). *See generally* Miller & Estes, *supra* note 57, at 67-83; Note, *Tameny v. Atlantic Richfield Co.: Wrongful Discharge, A New Tort to Protect At-Will Employees*, 8 W.ST. U.L. REV. 91 (1980).

59. *Tameny*, 27 Cal. 3d at 169, 610 P.2d at 1330-31, 164 Cal. Rptr. at 840.

60. *Id.* at 178-79, 610 P.2d at 1336-37, 164 Cal. Rptr. at 846.

61. *Id.*

62. 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980). *See generally* Miller & Estes, *supra* note 57, at 83-97.

63. *Cleary*, 111 Cal. App. 3d at 447-48, 168 Cal. Rptr. at 724-25.

dismissals.[64] The court, in finding that American Airlines could be liable in tort for breach of the implied covenant of good faith and fair dealing, noted that two factors were of paramount importance to the decision.[65] The court stressed that Cleary had been employed for several years and that American Airlines had an express company policy which indicated that American Airlines recognized a duty to discharge only for good cause.[66]

A third cause of action for wrongful discharge in California was established in *Pugh v. See's Candies, Inc.*[67] Pugh, an employee for thirty-two years, was discharged without a stated reason.[68] In reversing a lower court dismissal of the action, the California Court of Appeal for the First District held that an employee could be dismissed only for good cause upon a finding of an implied or express promise not to discharge without good cause.[69] The court found enough evidence for the jury to find an implied promise not to discharge except for good cause.[70] The court, therefore, concluded that it was error for the lower court to dismiss the action on a nonsuit.[71]

C. *The Implied Covenant of Good Faith and Fair Dealing*

For several years California courts have recognized that an implied covenant of good faith and fair dealing exists in contractual relationships.[72] The earliest cases to recognize this concept were insurance cases in which the courts found three reasons for imposition of the implied covenant of good faith and fair dealing.[73] The courts in these

64. *Id.* American Airlines claimed that Cleary was fired because of theft from the company, absence from his workplace, and threats of bodily harm made to a fellow employee. *Id.* at 447, 168 Cal. Rptr. at 724.

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

66. *Id.*

67. 116 Cal. App. 3d 311, 171 Cal. Rptr. 917 (1981). *See generally* Miller & Estes, *supra* note 57, at 97-102.

68. *Pugh*, 116 Cal. App. 3d at 315-19, 171 Cal. Rptr. at 918-20. Pugh testified that he thought he was fired because he objected to the company signing a "sweetheart contract" with a union. The president of See's Candies, who fired Pugh, told him to "look deep within himself to find the answer," and that "[t]hings were said by people in the trade that have come back to us." *Id.*

69. *Id.* at 326, 329, 171 Cal. Rptr. at 925, 927.

70. *Id.* at 329, 171 Cal. Rptr. at 927. The factors relied upon by the court were longevity of employment, commendations, promotions, lack of criticism, assurances, and acknowledged employer policies. *Id.*

71. *Id.*

72. Cumunale v. Traders & General Ins. Co., 50 Cal. 2d 654, 658, 328 P.2d 198, 200 (1958); Brown v. Superior Court, 34 Cal. 2d 559, 564, 212 P.2d 878, 881 (1949). *See* 1 B. WITKIN, SUMMARY OF CALIFORNIA LAW, *Contracts* §576 (8th ed. 1973 and Supp. 1984).

73. Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 820-21, 598 P.2d 452, 457-58,

cases found that a fiduciary relationship existed between the insurance company and the insured, that the contract entered into by the insured was an adhesion contract, and that the insurance industry has a special obligation to the public.[74] The courts noted, however, that the implied covenant of good faith and fair dealing exists in *every* contract, not just insurance contracts.[75]

Recently, courts have recognized that many of the factors involved in insurance cases are similar to those present in other contracts.[76] California courts have concluded that the implied covenant of good faith and fair dealing also is found in certain employment contracts.[77] In particular, *Tameny* and *Cleary* have recognized that a breach by an employer of the implied covenant of good faith and fair dealing could give rise to a tort cause of action by the discharged employee.[78]

D. At-Will Employment and the Covenant of Good Faith and Fair Dealing

Tameny was the first California case to recognize that an employer could be liable for wrongful discharge of an employee in breach of

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157 Cal. Rptr. 482, 487-88 (1979); Note, *Defining Public Policy Torts in At-Will Dismissals,* 34 STAN. L. REV. 153, 164 (1981). *See* Comment, *"Good Cause", supra* note 51, at 275-76.

74. *Egan,* 24 Cal. 3d at 820-21, 598 P.2d 452, 457-58, 157 Cal. Rptr. at 487-88; Note, *supra* note 73, at 164.

75. *Cumunale,* 50 Cal. 2d at 658, 328 P.2d at 200. The court stated:

> There is an implied covenant of good faith and fair dealing in *every* contract that neither party will do anything which will injure the right of the other party to receive the benefits of the agreement.

Id. (emphasis added). The California Supreme Court also has stated: "It is well settled that, in California, the law implies in *every* contract a covenant of good faith and fair dealing." Seaman's Direct Buying Service, Inc. v. Standard Oil Co., 36 Cal. 3d 752, 768, 686 P.2d 1158, 1166, 206 Cal. Rptr. 354, 362 (1984). *See* Rosenfeld, Meyer & Susman v. Cohen, 146 Cal. App. 3d 200, 215, 194 Cal. Rptr. 180, 188 (1983). Even nonfiduciaries must exercise their rights in good faith and fair dealing so as not to injure the rights of the other. *Id.*

76. *Seaman's Direct Buying Service, Inc.,* 36 Cal. 3d at 769, 686 P.2d at 1166, 206 Cal. Rptr. at 362 (stating in dictum, "[n]o doubt there are other relationships with . . . characteristics [similar to those in insurance contracts] and deserving of similar legal treatment"); Wallis v. Superior Court, 160 Cal. App. 3d 1109, 1116-19, 207 Cal. Rptr. 123, 127-29 (1984) (finding a noncompetition contract between a former employee and his ex-employer analogous to insurance cases). *See* Comment, *A Common Ground, supra* note 50, at 1142-48 (finding that insurance contracts and employment contracts are analogous). *But cf.* Note, *supra* note 73, at 165-67 (finding no correlation between insurance contracts and employment contracts).

77. Rulon-Miller v. IBM, 162 Cal. App. 3d 241, 247-48, 208 Cal. Rptr. 524, 529 (1984); Cancellier v. Federated Dept. Stores, 672 F.2d 1312, 1318 (9th Cir. 1982), *cert. denied,* 459 U.S. 859 (1982); Cleary v. American Airlines, Inc., 111 Cal. App. 3d 443, 455, 168 Cal. Rptr. 722, 729 (1980).

78. 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) *(dictum); Cleary,* 111 Cal. App. 3d at 456, 168 Cal. Rptr. at 729; *see infra* notes 79-83 and accompanying text.

the implied covenant of good faith and fair dealing.[79] In holding the employer liable for wrongful discharge, the California Supreme Court, in a footnote, suggested that a tort cause of action could be based upon breach of the implied covenant of good faith and fair dealing.[80] With the footnote in *Tameny* as authority, a California Court of Appeal in *Cleary* expressly recognized the doctrine of wrongful discharge based upon breach of the implied covenant of good faith and fair dealing.[81] The *Cleary* court emphasized that Cleary's long employment, coupled with the employment policy of American Airlines, acted as a form of estoppel to preclude dismissal without just cause.[82] The court, however, did not make clear whether the implied covenant of good faith and fair dealing existed only because of the presence of these two critical factors or whether the covenant could exist independently in the terminable at-will employment contract alone.[83]

Several cases since *Cleary* have discussed causes of action based upon breach of the implied covenant of good faith and fair dealing by an employer.[84] In *Newfield v. Insurance Company of the West*,[85] a California Court of Appeal made special note that the cause of action could not be based upon a "naked covenant" alone.[86] The *Newfield* court found that causes of action for breach of the implied covenant of good faith and fair dealing *always* were predicated upon

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79. *Tameny*, 27 Cal. 3d at 179 n.12, 610 P.2d at 1337 n.12, 164 Cal. Rptr. at 846 n.12 (*dictum*).

80. *Id.* The Supreme Court stated:

> We do note in this regard, however, that authorities in other jurisdictions have on occasion found an employer's discharge of an at-will employee violative of the employer's "good faith and fair dealing" obligations . . . and past California cases have held that a breach of this implied-at-law covenant sounds in tort as well as in contract.

Id. (citations omitted).

81. *Cleary*, 111 Cal. App. 3d at 455-56, 168 Cal. Rptr. at 729.

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

83. *See id.* at 454-56, 168 Cal. Rptr. at 729. *See also Pugh*, 116 Cal. App. 3d at 329, 171 Cal. Rptr. at 927 (holding that *Cleary* did not rest solely on a finding of breach of the the implied covenant of good faith and fair dealing).

84. For decisions rendered after *Cleary* that have recognized the cause of action for breach of the implied covenant of good faith and fair dealing see Khanna v. Microdata Corp., 170 Cal. App. 3d 250, 258, 215 Cal. Rptr. 860, 864 (1985); Rulon-Miller v. IBM, 162 Cal. App. 3d 241, 247-48, 208 Cal. Rptr. 524, 529 (1984); Shapiro v. Wells Fargo Realty Advisors, 152 Cal. App. 3d 467, 475-79, 199 Cal. Rptr. 613, 613-20 (1984).

85. 156 Cal. App. 3d 440, 203 Cal. Rptr. 9 (1984).

86. *Id.* at 445, 203 Cal. Rptr. at 12. "Naked covenant" refers to the implied covenant of good faith and fair dealing alone, without regard to any other obligation such as public policy, statute, or contract. *See id. See also Pugh*, 116 Cal. App. 3d at 329, 171 Cal. Rptr. at 927 (finding that the decision in *Cleary* did not rest solely on breach of the implied covenant of good faith and fair dealing).

public policy grounds, statutory violations, express or implied contract grounds, or upon a combination of elements as the court found in *Cleary*.[87] Though apparently recognizing that factors other than those used in *Cleary* might sustain a cause of action,[88] no court prior to *Khanna* sustained a cause of action without the presence of the *Cleary* factors.[89]

III. Legal Ramifications

Khanna extends prior case law by modifying the requirements for a wrongful discharge cause of action based upon breach of the implied covenant of good faith and fair dealing.[90] To sustain a cause of action for breach of the implied covenant of good faith and fair dealing after *Khanna*, a wrongfully discharged employee will not be required to plead the specific factors relied upon by the court in *Cleary*.[91] Unlike *Cleary, Khanna* clearly finds that the implied covenant of good faith and fair dealing exists in *all* employment contracts including those terminable at-will.[92] In concluding that breach of the covenant alone gives rise to a cause of action, *Khanna* rests only on the "naked covenant," not on any public policy, contractual right, or statutory right.[93] The court in *Khanna*, while not referring specifically to which factors were relied upon to find a breach of the implied covenant, concluded that the factors present in the case

87. *Newfield*, 156 Cal. App. 3d at 445-46, 203 Cal. Rptr. at 12.

88. *Shapiro*, 152 Cal. App. 3d at 478-79, 199 Cal. Rptr. at 619-20. The California Court of Appeal for the Second District found that the plaintiff was correct in asserting that factors other than those present in *Cleary* could be alleged. The court, nevertheless, concluded that the plaintiff had not pleaded enough facts to sustain his cause of action. *Id.*

89. *See Rulon-Miller*, 162 Cal. App. 3d at 247-51, 203 Cal. Rptr. at 529-32. An employee maintained a cause of action based upon dismissal after 12 years service when the discharge was in violation of company policy. *Id.*; Cancellier v. Federated Dept. Stores, 672 F.2d 1312, 1315, 1318 (9th Cir. 1982), *cert. denied*, 459 U.S. 859 (1982) (upholding a cause of action by three employees discharged after 25, 18, and 17 years of employment, in violation of company policy). *But see Shapiro*, 152 Cal. App. 3d. at 478, 199 Cal. Rptr. at 619 (dismissing cause of action by an employee who was employed for only three and one-half years and who failed to allege that company policies were violated).

90. *See Khanna*, 170 Cal. App. 3d at 262, 215 Cal. Rptr. at 867 (finding that the factors stated in *Cleary* are not the *sine qua non* to a cause of action for breach of the implied covenant of good faith and fair dealing). *But see* Foley v. Interactive Data Corp., 174 Cal. App. 3d 282, 219 Cal. Rptr. 866 (1985) (holding that a cause of action based upon breach of the implied covenant of good faith and fair dealing *must* contain the factors cited in *Cleary*).

91. *See id.* at 262-64, 215 Cal. Rptr. at 867-69.

92. *See id.* at 262, 215 Cal. Rptr. at 867.

93. *See id.* at 262-63, 215 Cal. Rptr. at 867-68. The court found that a cause of action could be sustained upon a showing of bad faith action on the part of the employer, extraneous to the employment contract, with the intent to frustrate the employee's enjoyment of the contract. *Id.* at 262, 215 Cal. Rptr. at 867. *See supra* notes 43-46 and accompanying text.

were enough to support a jury finding of bad faith on the part of Microdata.[94]

The *Khanna* court indicated that breach of the implied covenant of good faith and fair dealing could be established when an employer shows bad faith with an intent to frustrate the employee's enjoyment of the contract.[95] The opinion, though lacking specificity, indicates that *any* combination of factors that establishes a bad faith discharge with the intention of frustrating the employee's expectations may support a cause of action for breach of the implied covenant of good faith and fair dealing.[96] The court further indicated that the question whether the facts supported a showing of bad faith on the part of the employer was an evidentiary question to be decided by the jury.[97] The precedent of this opinion, therefore, should prevent lower courts from prematurely dismissing wrongful discharge actions provided the employee can show some factual support for finding bad faith on the part of the employer coupled with an intent to frustrate the employee's contractual rights.[98]

The effect of the decision in *Khanna* on employment in California remains uncertain.[99] Employers may be justifiably concerned that expanded liability for wrongful discharge will interfere with the ability of the employer to conduct business as the employer sees fit.[100] The countervailing consideration, however, is that allowing the employer to retain an unfettered ability to discharge an employee for *any* reason is inherently inequitable.[101] The courts seem to prefer the policy that some limit on the ability of an employer to discharge an

94. *Id.* at 264, 215 Cal. Rptr. at 869.
95. *Id.* at 262, 215 Cal. Rptr. at 867.
96. *See id.* at 262-63, 215 Cal. Rptr. at 867-68.
97. *Id.* at 263, 215 Cal. Rptr. at 868.
98. *See id.* at 262-64, 215 Cal. Rptr. at 867-69.
99. *See* Miller & Estes, *supra* note 57, at 103-04 (finding that the evolving doctrines of wrongful discharge may make employers more formal and cautious in relations with employees); Comment, *Wrongful Termination, supra* note 50, at 282-84 (noting that allowing causes of action for wrongful discharge may cause employers to use less formal grievance procedures to avoid the implication of a promise to be fair); Comment, *"Good Cause", supra* note 51 at 277 (noting that tempering the at-will rule will give the employee more benefits than the employee is entitled); Note, *supra* note 73, at 170-72 (stating that the courts should not question business judgments regarding when to discharge employees because the courts have no expertise in that area).
100. Comment, *A Common Ground, supra* note 50, at 1124-26; Comment, *The California Cause of Action, supra* note 50, at 79-80. *See* Note, *supra* note 73, at 170-72 (suggesting adoption of a business judgment rule that would preclude judicial scrutiny of employee dismissals without a finding of bad cause).
101. *Khanna*, 170 Cal. App. 3d at 259, 215 Cal. Rptr. at 865; *Cleary*, 111 Cal. App. 3d at 448-49, 168 Cal. Rptr. at 725; Miller & Estes, *supra* note 57, at 85.

employee must exist.[102] *Khanna* solidifies the position of California courts that an unjust dismissal of an employee without the exercise of good faith and fair dealing will not be tolerated.[103]

Commentators have suggested that the legislature, not the courts, must define the parameters of causes of action for wrongful discharge.[104] In apparent recognition of the obligation of the legislature, three separate bills have been considered in California, in the current legislative session, to provide a statutory solution to the problem of wrongful discharge.[105] The expansive decision in *Khanna* might spur the legislature to provide a statutory scheme governing wrongful discharge actions in California.

CONCLUSION

The California Court of Appeal for the First District, in *Khanna v. Microdata Corp.*, upheld a lower court decision that allowed a

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102. *See Khanna*, 170 Cal. App. 3d 250, 215 Cal. Rptr. 860 (1985); Pugh v. See's Candies, Inc., 116 Cal. App. 3d 311, 171 Cal. Rptr. 917 (1981); *Cleary*, 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980); Tameny v. Atlantic Richfield Co. 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980). At least one court has rejected approaches like the business judgment rule. The California Court of Appeal for the Second District stated:

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

Crosier v. UPS, 150 Cal. App. 3d 1132, 1140, 198 Cal. Rptr. 361, 366 (1983).

103. *See Khanna*, 170 Cal. App. 3d at 258-64, 215 Cal. Rptr. at 864-69. *See also* Miller & Estes, *supra* note 57, at 104. The authors stated:

> Without a doubt these three causes of action [as defined in *Tameny, Pugh, and Cleary*] have eroded the former rule in California that employment contracts for unspecified terms may be terminated at-will, and we may assume that further judicial application of the *Cleary-Tameny-Pugh* trilogy will clarify the extent of this trend.

Id.

104. *See* Comment, *"Good Cause", supra* note 51, at 284-89 (finding that the judicial creation of exceptions to the at-will rule is a usurpation of legislative authority). *But cf.* Comment, *The California Cause of Action, supra* note 50, at 78 (finding judicially created rules necessary to protect against inequities of majority rule).

105. See S.B. 1348, 1985-86 Leg., 1st Reg. Sess., 1985 Cal. Laws ____; A.B. 1400, 1985-86 Leg., 1st Reg. Sess., 1985 Cal. Laws ____; A.B. 2800, 1985-86 Leg., 2nd Reg. Sess., 1986 Cal. Laws ____. Of the three bills considered in the 1985/1986 legislative session only Assembly Bill 2800 is still viable. Both Senate Bill 1348 and Assembly Bill 1400 died in committee. Assembly Bill 1400 would override specifically case law exceptions to the at-will doctrine. The bill would allow an employee some redress if the employee was terminated in violation of public policy or if the employee was fired without good cause. To qualify for redress under good cause, however, the employee must have worked for an employer for five years and for at least 1,000

wrongful discharge tort claim based upon breach of the implied covenant of good faith and fair dealing. In sustaining the cause of action the Court of Appeal rejected the employer's contention that the employee must have been employed for a long term and that the company had to have a company policy regarding dismissals. By concluding that these factors were not the *sine qua non* for a cause of action based upon breach of the covenant of good faith and fair dealing, the court made a further evolutionary step regarding the tort of wrongful discharge.

This note first examined the decision given by the Court of Appeal in *Khanna*. Next, the historical background of tort recovery for wrongful discharge based upon breach of the implied covenant of good faith and fair dealing was reviewed. Finally, the possible legal ramifications of *Khanna* were explored in the hope of measuring the impact of the decision.

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hours per year. The employee would have the burden of proof in all causes of action under Assembly Bill 2800 and the damages would be limited to back pay. The bill also makes provisions for arbitration. A.B. 2800, 1985-86 Leg., 2nd Reg. Sess., 1986 Cal. Laws ____. Assembly Bill 2800 was a copy of Assembly Bill 1400 and introduced after Assembly Bill 1400 had died in committee. Compare A.B. 2800, 1985-86 Leg., 2nd Reg. Sess., 1986 Cal. Laws ____ with A.B. 1400, 1985-86 Leg., 1st Reg. Sess., 1985 Cal. Laws ____. If Senate Bill 1348 had been enacted, California Labor Code §2922 would have been repealed and an employee could have been discharged only for just cause with the burden of proof on the employer. The legislation also provided for binding arbitration and a limiting of damages to a maximum of two years pay. S.B. 1348, 1985-86 Leg., 1st Reg. Sess., 1985 Cal. Laws ____. At time of publication, Assembly Bill 2800 had not passed either house of the state legislature.