IMPLIED COVENANT: ANACHRONISM OR AUGUR?

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I. INTRODUCTION

This article considers the implied covenant of good faith and fair dealing as a common law wrongful dismissal theory.[1] This covenant provided the framework for the earliest steps in modifying the employment-at-will rule as a substantive limitation on employee recovery for wrongful dismissal. The implied covenant theory is of major significance in wrongful dismissal law[2] because it represents a way to place employment tenure beyond the employer's control and because it widens the spectrum of employer conduct that may be considered to constitute a breach.[3]

The California Supreme Court's decision in the case of *Foley v. Interactive Data Corp.*[4] has revived interest in the implied covenant theory. *Foley* is most often regarded as a setback to the plaintiff bar because it rejected tort damages for breaches of the implied covenant of good faith. But *Foley* could also have

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[1] Some parts of this article are draw from the author's treatise entitled *Employee Dismissal Law and Practice*, which contains an in depth study in the area of wrongful dismissal law.

[2] *See, e.g.*, Wagenseller v. Scottsdale Memorial Hosp., 147 Ariz. 370, 710 P.2d 1025 (1985) (covenant does not depend on party intent); Murphy v. American Home Prod. Corp., 58 N.Y.2d 293, 448 N.E.2d 86, 461 N.Y.S.2d 232 (1983) (rejecting implied covenant as inconsistent with parties' intent); J. CALAMARI & J. PERILLO, HORNBOOK ON THE LAW OF CONTRACTS 19-20 (3d. ed. 1987) ("[a] contract implied in law is not a contract at all but an obligation imposed by law to do justice even though it is clear that no promise was ever made or intended"). *See generally* C. FRIED, CONTRACT AS PROMISE 74-91 (1981) (discussing the doctrine of good faith as a method in revising contractual arrangements).

[3] *Compare* Brockmeyer v. Dun & Bradstreet, 113 Wis. 2d 561, 572-73, 335 N.W.2d 834, 840-41 (1983) (no breach of implied covenant unless clear public policy violated by discharge) *with Wagenseller*, 147 Ariz. 370, 385, 710 P.2d 1025, 1039 (covenant does not require good cause for termination as some California cases do, but not articulating definitive limits); Gates v. Life of Montana Ins. Co., 196 Mont. 178, 184, 638 P.2d 1063, 1067 (1982) (if employer fails to follow handbook procedures that were not contractually binding, breach of implied covenant results).

[4] 47 Cal. 3d 654, 765 P.2d 373, 254 Cal. Rptr. 211 (1988).

adopted objective restrictions on the implied covenant but failed to do so. *Foley* may therefore be a boon to the plaintiff bar because it legitimatizes the basic theory which, even under contract measures of damages, potentially permits hundreds of thousands of dollars to be awarded in any individual case. This article takes a fresh look at the implied covenant doctrine, noting where appropriate how the *Foley* opinion impacts on case analysis and makes projections for the future.

This article initially reviews two other major theories for wrongful dismissal: the implied-in-fact contract and the public policy tort. In addition, this article introduces the implied covenant as the third exception to the employment-at-will rule. Part II reviews use of the implied covenant more thoroughly, from its reception into contract law to its application in the employment termination context. Part III considers the future of the implied covenant, justifying externally imposed limitations on contract rights in general, considering the role of the covenant in a relational view of contracts, and then considering three possible interpretations of the covenant as a limitation on employment terminations: (1) as a source of protection for legitimate employee expectations; (2) as a source of an administrative law type deferential review of employer decisions, and; (3) as a source of obligation to dismiss only for good cause. Part IV explores a just cause interpretation of the covenant in greater detail, considering practical application issues like the allocation of decision-making responsibility in a dismissal controversy among employer, judge, and jury. Part V considers jury instructions for a just cause interpretation and other more deferential interpretations. Part V then observes that, based on a comparison of jury instructions, there may not be a substantial difference between a just cause interpretation and a more deferential interpretation. Part VI considers damages theories, explaining that, even under *Foley*, large front pay awards are conceptually available.

This article concludes in Part VII that, in the absence of a comprehensive statutory reform, the implied covenant will most likely be used to expand the substantive rights afforded at-will employees. This article does not consider the impact of increased transaction costs on employment practices or employment opportunities, except briefly in section III, enumerating the disadvantages of a good cause limitation. Any externally imposed legal standard that increases the opportunities for litigation over employment decisions increases the average

transaction cost of each potentially affected decision. Because resources must be made available to cover these transaction costs, they are not available for employee compensation or for job creation investment.

A. Other Wrongful Dismissal Theories

The implied covenant of good faith and fair dealing is one of three exceptions to the employment-at-will rule,[5] which together constitute the universe of common law wrongful dismissal theories. This section reviews the other two exceptions, which are currently more influential.

1. Implied-in-Fact Contract

Courts in virtually every state recognize an implied-in-fact contract theory of wrongful dismissal.[6] The implied-in-fact contract theory requires a plaintiff to plead and to prove the following: (1) the employer made a promise of employment security;[7] (2) the employee gave consideration for the promise, in the form of detrimental reliance by continuing employment or otherwise;[8] (3) the employer breached the promise by dismissing the employee, and; (4) the employee suffered damages.[9] Under this theory the employment-at-will presumption can be overcome by proof of an informal contract to dismiss only for certain reasons or only through certain procedures.

The promise element can be established by handbook provisions, personnel policies published for employees, or oral assurances by persons authorized to speak for the employer.[10] There is growing acceptance of the proposition that consideration for an informal employer promise can be found in the employee's continuing to work and performing normal duties after knowing of the employer's promise. The rationale is that the continued performance of service is a detriment suffered by the employee

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[5] The employment-at-will rule holds that an employer can dismiss an at-will employee at any time for any reason or for no reason. H. PERRITT, EMPLOYEE DISMISSAL LAW AND PRACTICE § 1.1, at 1 n.1 (2d ed. 1987 & Supp. 1989) [hereinafter H. PERRITT, EMPLOYEE DISMISSAL].

[6] *See id.* § 1.12, at 23-30 (state by state summary).

[7] This can be thought of as an offer.

[8] This can be thought of as acceptance.

[9] H. PERRITT, EMPLOYEE DISMISSAL, *supra* note 5, § 1.2, at 2.

[10] *But cf.* Scott v. Extracorporeal, Inc., 336 Pa. Super. 90, 545 A.2d 334 (1988) (Pennsylvania law does not bar handbook promises as a matter of law, but courts often find oral and handbook statements too general to enforce).

which was bargained for by the employer.[11] Even when the "bargained-for" aspect cannot be met, the employer's promise can be enforced under the promissory estoppel doctrine, contained in section 90 of the *Restatement (Second) of Contracts*, if the employee acted in reasonable reliance on the promise and such conduct should reasonably have been expected by the employer.[12]

Of course, employers are free to avoid promises of employment tenure and may publish disclaimers to foreclose reliance on informal promises.[13] The implied-in-fact contract theory thus is largely under the control of the employer.

2. Public Policy Tort

Courts in all but six states[14] recognize a private right of action for employee dismissals that jeopardize a specific public policy interest of the state. This category of tort liability is called the public policy tort. Intentional tort principles permit a plaintiff to recover only by showing that a legally protected right of the plaintiff was harmed by an act of the defendant and that the defendant lacked justification for his act.[15] Until the public policy tort theory was accepted by the courts, dismissed employees could recover in tort only if they could show that their dismissals were accompanied by conduct or a state of mind sufficient to satisfy traditional tort categories such as intentional interference with contractual relations, intentional infliction of emotional distress, fraudulent misrepresentation, defamation, or invasion of privacy. None of these traditional theories permitted the em-

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[11] In Woolley v. Hoffman-La Roche, Inc., 99 N.J. 284, 491 A.2d 1257, *modified*, 101 N.J. 10, 499 A.2d 515 (1985), the New Jersey Supreme Court determined that provisions included in a policy manual are supported by consideration. *Id.* at 302, 491 A.2d at 1267. Further, the court concluded that a promise to dismiss only for cause was inherent in the nature of the handbook, which apparently was intended to discourage unionization. *Id.* at 307, 491 A.2d at 1269-70. The court held that reliance by employees in general should be presumed and need not be shown in individual cases. *Id. See also* H. PERRITT, EMPLOYEE DISMISSAL, *supra* note 5, §§ 4.12-4.18, at 197-213 (role of consideration as validation device).

[12] *See* H. PERRITT, EMPLOYEE DISMISSAL, *supra* note 5, § 4.17, at 210-13.

[13] *See infra* notes 147-49 and accompanying text for a brief discussion on waivers and disclaimers.

[14] Delaware, Florida, Georgia, Louisiana, Mississippi, and Rhode Island continue to honor the employment-at-will doctrine. These states have, however, expressed a willingness to recognize some exceptions. It is thus unclear whether these states would recognize a private cause of action for wrongful dismissal. H. PERRITT, EMPLOYEE DISMISSAL, *supra* note 5, § 1.12, at 29.

[15] The analytical framework is provided in section 870 of the *Restatement (Second) of Torts* (1979), discussed more extensively in H. PERRITT, EMPLOYEE DISMISSAL, *supra* note 5, §§ 5.5-5.7, at 250-54.

ployee to recover for the dismissal itself. The newer public policy tort theory, a specific application of the prima facie tort,[16] permits a dismissed employee to recover for the dismissal itself,[17] when the dismissal violates a clear public policy of the state.

Public policy tort cases require courts to balance employee, employer, and societal interests under a formula presented in section 870 of the *Restatement (Second) of Torts*. To win a public policy tort case for wrongful dismissal, the employee must show: (1) the existence of a clear public policy, manifested in a state or federal constitution, statute or administrative regulation, or in the common law; (2) that dismissing employees under circumstances like those involved in the plaintiff's dismissal would jeopardize the public policy; (3) that the plaintiff's dismissal was motivated by conduct related to the public policy, and; (4) that the employer lacked any overriding legitimate business justification for the dismissal.[18]

Another way to understand the elements of the public policy tort are to view steps one and two as embodying an inquiry into whether the employee conduct was protected, in the sense that section 7 of the National Labor Relations Act or whistleblower statutes protect only certain conduct.[19] Under this approach to the public policy tort, only employee conduct necessary to promote the public policy is *protected* by the public policy tort concept. Implicit in deciding whether public policy requires the protection of certain conduct are two subordinate inquiries: identifying that public policy and deciding how it would be jeopardized if the conduct in controversy were discouraged by the threat of dismissal. Separating the clarity and jeopardy elements permits more principled decision making as to what conduct is protected than an undifferentiated protected conduct approach. In any event, a balancing process is required.

The balancing process can be symbolized by the scales of

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16 The prima facie tort allows recovery if the employer dismissed the employee with malice and without justification. *See* H. PERRITT, EMPLOYEE DISMISSAL, *supra* note 5, § 5.21, at 288-90. "Malice" is a legal term of art meaning little more than the mental state motivating harmful conduct in the absence of justification.

17 *Id.* §§ 5.5, 5.21, at 250, 288-90.

18 *See* RESTATEMENT (SECOND) OF TORTS § 870 (1979).

19 29 U.S.C. § 157 (1973). *See also* Eastex, Inc. v. NLRB, 437 U.S. 556, 565-66 (1978) (distribution of political leaflets protected); Squire Dist. Co. v. Teamsters Local 7, 801 F.2d 238, 242 (6th Cir. 1986) (reporting embezzlement to sheriff protected when motivated by job security concerns); Love v. RE/MAX of America, Inc., 738 F.2d 383, 387 (10th Cir. 1984) (good faith, protest of discrimination against women protected under Equal Pay Act and Fair Labor Standards Act).

justice. On the employee's side of these scales is an obvious economic interest in employment. On the employer's side is an obvious economic interest in running the business as the employer sees fit. If the employee asserts no other interest, society places an additional interest on the employer's side of the scales—the employment-at-will rule, representing society's interest in market forces as the best way to promote efficient enterprise. This is sufficient to tip the scales in favor of the employer and against the employee. If, however, the employee can add a societal interest to his or her side of the scales, the employee may win, depending on the weightiness of the interest. Of course, the employer may assert additional justification for the dismissal on the employer's side, which may tilt the scales back in the employer's favor. Liability is imposed on the employer whenever the interests of the terminated employee and the public outweigh the interests of the employer.

Reasonably clear alternative rules have emerged for the public policy tort concept. The majority rule, more favorable to employees, involves a flexible interest balancing approach similar to that outlined in the preceding paragraph.[20] The narrower approach, less favorable to employees, denies recovery unless the employee can show that he was dismissed for exercising an explicit statutory right,[21] or for refusing to violate an explicit statutory prohibition.[22]

B. Role of Implied Covenant

The implied covenant is a third common law doctrine enabling an employee to recover for breach of contract[23] when the employer has violated a "covenant of good faith and fair deal-

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20 *See* Novosel v. Nationwide Ins. Co., 721 F.2d 894 (3d Cir.), *reh'g denied*, 721 F.2d 903 (3d Cir. 1983) (applying Pennsylvania public policy tort concept to find triable case for employee fired for refusing to testify before legislative committee according to employer direction based on the public policy of first amendment to the United States Constitution).

21 Buethe v. Britt Airlines, Inc., 787 F.2d 1194, 1197 (7th Cir. 1986); Gryzb v. Evans, 700 S.W.2d 399, 401 (Ky. Ct. App. 1985).

22 Adler v. American Standard Corp., 830 F.2d 1303, 1307 (4th Cir. 1987); Bushko v. Miller Brewing Co., 134 Wis. 2d 136, 141, 396 N.W.2d 167, 170 (1986). *See generally* H. PERRITT, EMPLOYEE DISMISSAL, *supra* note 5, § 5.19A (1990 Supp. 1) (discussing more limited theory).

23 Some courts treat breach of the implied covenant as a tort, but it properly is conceived of as a breach of contract theory, based on a contract term supplied by law. *See* Foley v. Interactive Data Corp., 47 Cal. 3d 654, 765 P.2d 373, 254 Cal. Rptr. 211 (1988) (covenant is essentially a contract theory).

ing," implied in all contracts as a matter of law.[24] Conceptually, the covenant requires that contract rights be exercised in a manner that does not violate the covenant. Thus, even though an employer has the right to terminate an at-will contract for any reason, good or bad, or for no reason at all, the employer also has a duty not to exercise this right in bad faith or unfairly.

Under the broadest view of the doctrine, a dismissed employee need only show: (1) existence of an employment relationship; (2) termination of the employment, and; (3) some aspect of the termination that was unfair or in bad faith. Upon such a showing, a jury is entitled to decide, with only the most general instructions,[25] whether the termination was fair and in good faith. Under the implied covenant, external standards of fairness are used to scrutinize an employer's decision to dismiss an employee and, logically, other employer decisions.

The implied covenant doctrine enjoyed brief popularity and was used by the courts that were the first to relax the employment-at-will rule. But as the more traditional and circumscribed implied-in-fact contract and public policy tort doctrines were developed, the importance of the implied covenant doctrine declined. Now, California, Massachusetts, and Montana are the only states that rely heavily on the implied covenant as the primary wrongful dismissal doctrine. Further, California and Massachusetts impose important limitations on its use. Quite recently, the California Supreme Court, in *Foley v. Interactive Data Corp.*,[26] held that tort damages are not recoverable in implied covenant cases. The Montana courts have been aggressive in using the implied covenant doctrine to impose something close to a just cause requirement.[27] In Montana, an employer is burdened to show a "fair and honest reason" for a dismissal to escape liability under the covenant.[28]

The implied covenant of good faith and fair dealing is a spe-

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[24] *See* H. PERRITT, EMPLOYEE DISMISSAL, *supra* note 5, § 4.11 at 191-97.

[25] *See id.* § 7.28, at 436-39 (example of implied covenant jury instructions). *But see infra* notes 269-91 and accompanying text (regarding how jury instructions can be made more specific).

[26] 47 Cal. 3d 654, 765 P.2d 373, 254 Cal. Rptr. 211 (1988).

[27] *See, e.g.*, Broomfield v. Lundell, 139 Ariz. 349, 767 P.2d 697 (Ariz. Ct. App. 1988) (interposition of leasing company between nurse and physician/former employer did not interrupt employment relationship between nurse and physician for purposes of implied covenant theory).

[28] *See* Stark v. Circle K. Corp., 230 Mont. 468, 751 P.2d 162 (1988) (affirming $270,000 jury verdict for employee who refused to sign probationary notice, the accuracy of which he contested).

cial implied-in-law promise. It is a substitute for an express or implied-in-fact promise by the employer.[29] The implied promise imposes a legally enforceable obligation not to exercise the otherwise unlimited power of termination in bad faith or for reasons offending public policy. This implied covenant concept resembles a tort theory more than a contract theory because it tests the defendant's compliance with a duty imposed through public policy rather than through a voluntary promise. This may explain some of the confusion in early wrongful dismissal cases between contract and tort.[30]

The implied covenant is the strongest manifestation of the relational contract theory in employment law. Contract doctrine applied to all kinds of transactions is becoming more relational in character.[31] Employment contracts are not exempt from this trend, and the implied covenant idea is certain to play an increasing role in deciding employment contract disputes.

Application of the implied covenant is not always detrimental to employer interests. The implied covenant doctrine also imposes the burden of proof on an employee-plaintiff to show bad faith or ulterior motivation. This allocation of the burden of proof is significantly more favorable to employers than that contained in the most recently enacted federal legislation, the Americans with Disabilities Act, which burdens an employer to prove the infeasibility of accommodating employee handicaps.[32]

The next part of this article explores the covenant in greater depth, considering its genesis in contract doctrine generally, as well as considering specific wrongful dismissal cases.

II. Origins of the Implied Covenant Doctrine and Its Application to Employment

This part reviews use of the implied covenant from its recep-

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29 *See* Wagenseller v. Scottsdale Memorial Hosp., 147 Ariz. 370, 381, 710 P.2d 1025, 1036 (1985) (implied-in-law term is imposed where contract silent and it does not depend on parties' intent).

30 *See* Brockmeyer v. Dun & Bradstreet, 113 Wis. 2d 561, 574, 335 N.W.2d 834, 841 (1983); Tameny v. Atlantic Richfield Co., 27 Cal. 3d 167, 174-75, 610 P.2d 1330, 1334-35, 164 Cal. Rptr. 839, 843-44 (1980) (both cases discuss relationship between tort and contract based recovery).

31 The *Restatement (Second) of Contracts* cites the Uniform Commercial Code as an example of the kind of relational contract doctrine which should be applied to contracts in general.

32 Americans with Disabilities Act of 1990, Pub. L. No. 101-336 (S993), 104 Stat. 327 (1990).

tion into contract law to its application in the employment termination context.

A. *Role of Good Faith in Contract Law*

Section 205 of the *Restatement (Second) of Contracts* provides: "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."[33] The commentary to section 205 states:

> Subterfuges and evasions violate the obligation of good faith in performance even though the actor believes his conduct to be justified. But the obligation goes further: bad faith may be overt or may consist of inaction, and fair dealing may require more than honesty. A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of power to specify terms, and interference with or failure to cooperate in the other party's performance.[34]

Earlier, Professor Corbin referred to a standard of fairness and good faith in explaining how courts "prevent the disappointment of expectations that the transaction aroused in one party, as the other had reason to know."[35] To serve this goal, "courts find and enforce promises that were not put into words . . . ."[36] There was, however, no covenant of good faith provision in the *Restatement (First) of Contracts*.[37]

Before its emergence in the employment-at-will context, a good faith standard of contract performance or termination attracted commentary and judicial attention primarily in connection with its inclusion in the Uniform Commercial Code (UCC). Professor Farnsworth reviewed the history of two UCC good faith obligations: good faith purchase and good faith performance.[38] The former originated in English merchant law as a way of importing commer-

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33 RESTATEMENT (SECOND) OF CONTRACTS § 205 comment a (1981). The comment to section 205 cites Fortune v. National Cash Register Co., 373 Mass. 96, 344 N.E.2d 1251 (1977) as an example of an application of the section. *See infra* notes 72-76 and accompanying text for a discussion of *Fortune*.

34 RESTATEMENT (SECOND) OF CONTRACTS § 205 comment d (1981).

35 1 A. CORBIN, CORBIN ON CONTRACTS § 541, at 514 (1952).

36 *Id.*

37 RESTATEMENT (SECOND) OF CONTRACTS § 205 comment a (1981).

38 Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666, 668 (1963).

cial morality into the law.[39] The latter was neglected until its incorporation into the UCC.[40] Farnsworth opined that good faith performance should be judged by "an objective standard based on the decency, fairness or reasonableness of the community, commercial or otherwise, of which one is a member."[41]

Professor Summers considered good faith as a standard of contract performance in the context of the growing interest "in devising legal standards of contractual morality," stimulated in his view by the UCC's express obligation of good faith.[42] He also noted that good faith is applied as a standard in a wide variety of contractual relationships,[43] and reviewed the following types of conduct that have been limited by the good faith standard in the context of contract performance:[44] (1) evading the spirit of the deal;[45] (2) lack of diligence and slacking off;[46] (3) willfully rendering only "substantial" performance;[47] (4) abuse of a power to specify contract terms;[48] (5) abuse of a power to determine compliance;[49] (6) interfering with or failing to cooperate in the other party's performance;[50] (7) conjuring up a dispute;[51] (8) adopting overreaching or "weaseling" interpretations and constructions of contract language;[52] (9) taking advantage of another to get a favorable readjustment or settlement of a dispute;[53] (10) abuse of a right to adequate assurances of future performance;[54] (11) wrongful refusal to accept the other's performance;[55] (12) willful failure to mitigate damages,[56]

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39 *Id.* at 670.

40 *Id.* at 670-71.

41 *Id. See also* Gellhorn, *Limitations on Contract Termination Rights—Franchise Cancellations*, 1967 DUKE L.J. 465 (suggesting unconscionability is a more workable standard than good faith; terminations should be evaluated in terms of rationality of condition for termination and impact on franchisee).

42 Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195 (1968).

43 *Id.* at 197.

44 *Id.* Professor Summers also commented on use of the good faith standard in contract formation. *See id.* at 220-32.

45 *Id.* at 234-35.

46 *Id.* at 235-37.

47 *Id.* at 237-38.

48 *Id.* at 239-40.

49 *Id.* at 240-41.

50 *Id.* at 241-43.

51 *Id.* at 243-44.

52 *Id.* at 244-46.

53 *Id.* at 246-48.

54 *Id.* at 248-49.

55 *Id.* at 249-50.

56 *Id.* at 250-51.

and; (13) abuse of a power to terminate.[57]

Professor Summers argued that good faith is best understood as an "excluder"—a phrase which excludes heterogeneous forms of bad faith,[58] specifically including "arbitrarily and capriciously exercising a power to terminate a contract."[59] Professor Summers did not elaborate on the standards for termination under the covenant, but simply cited Professor Gellhorn.[60]

B. History of Application to Employment Contracts

Although section 205 of the *Restatement (Second) of Contracts* and its commentary do not address employment contracts or the exercise of the power to terminate an employment contract the section's concept can be used to imply an employer obligation not to discharge employees wrongfully. The 1959 California case of *Petermann v. International Brotherhood of Teamsters*[61] frequently is cited as the seminal case in the modern wrongful dismissal revolution.[62] In *Petermann*, the plaintiff was employed by a union as a business agent. He claimed that he was dismissed for refusing to commit perjury before a committee of the state legislature.[63] The trial court granted the defendant's motion for a judgment on the pleadings.[64]

The court of appeals noted that the plaintiff's breach of contract cause of action was predicated on an employment contract that did not contain any fixed period of duration. It quoted the usual rule: "Generally, such a relationship is terminable at the

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57 *Id.* at 251-52 (citing Gellhorn, *supra* note 41, at 495-505).

58 *Id.* at 196.

59 *Id.* at 203 (citing J.R. Watkins Co. v. Rich, 254 Mich. 82, 85, 235 N.W. 845, 846 (1931)). In *Watkins*, the court concluded that the arbitrary termination of a salesman released sureties from contract liability. The court stated: "A provision in a contract for termination at the option of a party is valid. But where the relationship is commercial and does not involve fancy, taste, sensibility, judgment, or other personal features, the option may be exercised only in good faith." *Watkins*, 254 Mich. at 85, 235 N.W. at 846.

60 *Id.* at 252 (citing Gellhorn, *supra* note 41, at 495-505).

61 174 Cal. App. 2d 184, 344 P.2d 25 (1959).

62 A Westlaw search in December, 1989 showed nearly 200 citations to *Petermann*. When *Petermann* was decided, it was well established that the presumption of an indefinite employment contract, terminable at-will, can be overcome by evidence of the parties' intent to restrict the power of termination. H. PERRITT, EMPLOYEE DISMISSAL, *supra* note 5, §§ 1.1-1.17, at 1-39 (discussing the presumption of employment-at-will). *See also id.* §§ 4.6-4.20, at 180-221; 7.17-7.21, at 412-27 (discussing means of rebutting the presumption of an at-will employment through factual evidence).

63 *Petermann*, 174 Cal. App. 2d at 187, 344 P.2d at 26.

64 *Id.*

will of either party for any reason whatsoever."[65] However, the court noted that "the right to discharge an employee under such contract may be limited by statute or by considerations of public policy."[66] The court acknowledged that the public policy concept is vague, but characterized it as "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."[67] The court easily concluded that allowing an employer to dismiss an employee for refusing to commit perjury offends public policy.[68] Thus, in the absence of any factual evidence of an actual promise of employment security, the court implied a promise not to dismiss for policy-offensive reasons.

Monge v. Beebe Rubber Co.[69] was another early case applying the covenant. The Supreme Court of New Hampshire considered a jury verdict in favor of the plaintiff in a suit for breach of an employment contract which was for an indefinite period of time. The court found sufficient evidence for the jury to conclude that the plaintiff's dismissal was motivated by her refusal to "go out with" her foreman.[70] After a brief discussion of the need to modify the employment-at-will rule, the court held "that a termination by the employer of a contract of employment at will which is motivated by bad faith or malice or based on retaliation is not in the best interest of the economic system or the public good and constitutes a breach of the employment contract."[71] Again, the promise of employment tenure was implied-in-law.

In *Fortune v. National Cash Register Co.*,[72] the Massachusetts Supreme Judicial Court held that a trial court committed no error in submitting the issue of bad faith termination of an employment-at-will contract to the jury. The plaintiff was employed under a written salesman's contract which was terminable at-will,

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

66 *Id.* (citations omitted).

67 *Id.*

68 *Id.* at 189, 344 P.2d at 27-28. The employer argued that the employee was not dismissed because of the policy-offensive ground of refusal to commit perjury. Whether it relied in good faith on a legitimate reason for the dismissal was a question of fact.

69 114 N.H. 130, 316 A.2d 549 (1974).

70 *Id.* at 133-34, 316 A.2d at 552.

71 *Id.* at 133, 316 A.2d at 551 (citations omitted). In Howard v. Door Woolen Co., 120 N.H. 295, 297, 414 A.2d 1273, 1274 (1980), the court limited *Monge* to reasons for discharge that clearly offend public policy, thus virtually merging the doctrine with the public policy tort.

72 373 Mass. 96, 364 N.E.2d 1251 (1977). *Fortune* is referred to in the Reporter's notes to section 205 of the *Restatement (Second) of Contracts*.

without cause, by either party on written notice. The defendant apparently admitted the existence of a legally enforceable contract. The court held that the plaintiff, in spite of the literal wording of the contract, was entitled to a jury determination on his employer's motives in terminating him.[73] The premise for the employer's obligation not to discharge in bad faith was a legally implied covenant. In support of its conclusion, the court cited statutory provisions which required good faith in respect to contracts under the UCC, under motor vehicle franchise contracts, and according to a number of cases assuming or implying a requirement of good faith in contract performance.[74] The Massachusetts court also cited *Monge v. Beebe Rubber Co.*[75] and section 231 of the *Restatement (Second) of Contracts*.[76]

The California Court of Appeal observed, in *Cleary v. American Airlines, Inc.*,[77] that employment contracts, like all contracts, include an implied covenant of good faith and fair dealing. Having concluded generally that the plaintiff's contract included a covenant of good faith, the court decided that an important factor in construing the covenant was the plaintiff's eighteen years of service: "Termination of employment without legal cause after such a period of time offends the implied-in-law covenant of good faith and fair dealing."[78]

These early implied covenant cases suggested no real limits to the scope of the implied covenant of good faith and fair deal-

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[73] *Id.* at 101, 364 N.E.2d at 1255-56. The court noted:

> Fortune argues that, in spite of the literal wording of the contract, he is entitled to a jury determination on NCR's motives in terminating his services under the contract and in finally discharging him. We agree. We hold that NCR's written contract contains an implied covenant of good faith and fair dealing, and a termination not made in good faith constitutes a breach of the contract.

Id.

[74] *Id.* at 102, 364 N.E.2d at 1256 (citing U.C.C. § 1-203 ("Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement")); MASS. GEN. L. ch. 93B, § 4(3)(c) (1978) (requiring good faith in motor vehicle franchise termination).

[75] 114 N.H. 130, 316 A.2d 549 (1974).

[76] *See* RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981). This section was identified as section 231 in the tentative draft cited by the *Fortune* court. The court declined to speculate whether the good faith requirement is implicit in every employment-at-will contract. *Fortune*, 373 Mass. at 104-05, 364 N.E.2d at 1257.

[77] 111 Cal. App. 3d 443, 453, 168 Cal. Rptr. 722, 728 (1980).

[78] *Id.* at 455, 168 Cal. Rptr. at 729. *Cleary* has subsequently been construed to imply a covenant of good faith and fair dealing only when (1) longevity of employment is present, or (2) the employer has promulgated a policy for adjudicating employee disputes. *See* Shapiro v. Wells Fargo Realty Advisors, 152 Cal. App. 3d 467, 478, 199 Cal. Rptr. 613, 619 (1984) (affirming demurrer).

ing. Juries apparently were to be allowed to decide for themselves what constituted good faith and to decide if the employer's actions met the standard thus derived by them.[79] Under this approach, the implied covenant doctrine would give employees very broad protection.

C. *Resistance to Covenant*

Courts willing to relax the employment-at-will rule began to raise doubts about the implied covenant theory in the early 1980's. The New York Court of Appeals in *Murphy v. American Home Products Corp.*,[80] opposed implying a promise in a breach of contract action that is inconsistent with the manifest intent of the parties. The court reasoned that "it would be incongruous to say that an inference may be drawn that the employer impliedly agreed to a provision which would be destructive of his right of termination."[81] The court declined to imply such a covenant as a matter of law for the same reasons it declined to recognize a public policy tort theory for wrongful dismissal—its belief that the legislature was the appropriate branch of government to weigh the policy factors involved.[82]

Increasingly, state supreme courts confronted with the question have rejected the covenant, or at least have declined to embrace it.[83] Some courts have questioned the need for the

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79 *See infra* notes 269-291 and accompanying text for a discussion of jury instructions.

80 58 N.Y.2d 293, 304, 448 N.E.2d 86, 91, 461 N.Y.S.2d 232, 237 (1983) (accepting implied-in-fact contract theory, but rejecting implied covenant).

81 *Id.* at 304-05, 448 N.E.2d at 91, 461 N.Y.S.2d at 237.

82 *Id.* at 301, 448 N.E.2d at 89, 461 N.Y.S.2d at 235.

83 *See, e.g.*, Harrell v. Reynolds Metals Co., 495 So.2d 1381 (Ala. 1986) (declining to extend covenant of good faith recognized in insurance cases to employment contracts); Morriss v. Coleman Co., 241 Kan. 501, 738 P.2d 841 (1987) (adopting implied-in-fact contract theory but rejecting implied covenant theory); Greenlee v. Bd. of Cty. Comm'rs, 241 Kan. 802, 740 P.2d 606 (1987) (no covenant of good faith applicable to employment-at-will); Sadler v. Basic Elect. Power Coop., 409 N.W.2d 87 (N.D. 1987) (no covenant of good faith when employment contract contains no express term specifying duration; remanding for trial of fact issues on implied contract claim based on handbook); Hillesland v. Fed. Land Bank Ass'n, 407 N.W.2d 206 (N.D. 1987) (rejecting implied covenant of good faith; finding Wadeson v. American Family Mut. Ins. Co., 343 N.W.2d 367 (N.D. 1984), not inconsistent); Burk v. K-Mart Corp., 770 P.2d 24 (Okla. 1989) (rejecting implied covenant as ill defined; adopting public policy tort theory for employees dismissed for refusing to act in violation of clear public policy or for performing an act consistent with clear and compelling public policy); Hinson v. Cameron, 742 P.2d 549 (Okla. 1987) (facts do not require decision on whether to accept "nationally recognized" public policy tort theory; implied covenant theory rejected; facts do not support implied contract theory) (citing H. PERRITT, EMPLOYEE DISMISSAL, *supra* note 5,

covenant theory now that more traditional theories such as implied-in-fact contract and public policy tort are recognized widely.[84] For example, in *Thompson v. St. Regis Paper Co.*,[85] the Supreme Court of Washington, while adopting the implied-in-fact contract theory and the public policy tort theory, refused to adopt the implied covenant theory because its bad faith concept is "amorphous," and because it might be internally inconsistent with actual conduct or promises.

Other courts have used the covenant grudgingly. The Wisconsin Supreme Court, in *Brockmeyer v. Dun & Bradstreet*,[86] although recognizing the implied covenant doctrine, limited it greatly. The *Brockmeyer* court stressed that implied covenant recovery should be limited to dismissals "contrary to a fundamental and well-defined public policy as evidenced by existing law."[87] In effect, it used the implied covenant theory to limit damages available under the public policy tort theory.[88] In *Bertrand v.*

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§§ 4.12-4.14, at 197-205); Melnick v. State Farm Mut. Auto Ins. Co., 106 N.M. 726, 749 P.2d 1105 (1988) (declining to adopt covenant for employment terminable at-will; reviewing limitations imposed by other states); Blote v. First Fed. Sav. & Loan Ass'n of Rapid City, 422 N.W.2d 834 (S.D. 1988) (personnel manual provisions relating to vacation policy lacked specificity to override bank bylaws permitting dismissal at-will; dissenting opinion criticizes failure to permit recovery on implied covenant theory); Breen v. Dakota Gear & Joint Co., 433 N.W.2d 221 (S.D. 1988) (affirming summary judgment for employer on case showing nothing more than ten years employment with no criticism—fails to meet requirements for implied-in-fact contract; refusing to adopt implied covenant in addition to previously adopted public policy tort and implied-in-fact contract).

84 *See, e.g.*, Hunt v. IBM Mid-Am. Employees Fed. Credit Union, 384 N.W.2d 853 (Minn. 1986) (majority of jurisdictions have rejected covenant for sound policy reasons, suggesting that it might be available if facts imply contract for permanent employment); Hinson v. Cameron, 742 P.2d 549 (Okla. 1987) (refusal to accept implied covenant theory because of its amorphous character); Hillesland v. Fed. Land Bank Ass'n, 407 N.W.2d 206 (N.D. 1987) (rejecting implied covenant theory and expressly approving reasoning of Thompson v. St. Regis Paper Co., 102 Wash. 2d 219, 685 P.2d 1081 (1984)).

Although accepting the implied-in-fact contract theory, the Kansas Supreme Court rejected the covenant as overly broad. Morriss v. Coleman Co., 241 Kan. 501, 738 P.2d 841 (1987). *See also* Burk v. K-Mart Corp., 770 P.2d 24 (Okla. 1989) (rejecting implied covenant theory as ill defined; while adopting public policy tort theory); Melnick v. State Farm Mut. Auto Ins. Co., 106 N.M. 726, 749 P.2d 1105 (1988) (rejecting implied covenant as theory applicable to employment terminable at-will—at least where no "improper motivation" shown); Breen v. Dakota Gear & Joint Co., 433 N.W.2d 221, 224 (S.D. 1988) (rejecting implied covenant theory, and distinguishing it from public policy tort and implied-in-fact contract theory).

85 102 Wash. 2d 219, 685 P.2d 1081 (1984).

86 113 Wis. 2d 561, 335 N.W.2d 834 (1983).

87 *Id.* at 573, 335 N.W.2d at 840.

88 *See id. See also* Melnick v. State Farm Mut. Auto Ins. Co., 106 N.M. 726, 749

Quincy Market Cold Storage & Warehouse Co.,[89] the United States Court of Appeals for the First Circuit concluded that, under Massachusetts law, an implied covenant of good faith and fair dealing is not appropriate where collectively bargained arbitration exists as a remedy for wrongful dismissal. The court reasoned that the collective agreement gave greater protections against wrongful dismissal than the covenant, and therefore, there was no reason to utilize the covenant.[90]

D. Recent Use of Implied Covenant

As previously explained, the covenant declined in popularity as the more conventional and circumscribed public policy tort and the implied-in-fact contract theories matured. Nevertheless, the covenant continues to exist in relatively strong form in California,[91] Arizona, Montana, and possibly Alaska.[92]

In *Foley v. Interactive Data Corp.*,[93] the California Supreme Court held that only contract damages are recoverable for breach of the implied covenant. It did not embrace various restrictions on the covenant developed by the intermediate appellate court, such as limiting the covenant to employees with long service[94]

P.2d 1105 (1988) (rejecting implied covenant as theory applicable to employment terminable at-will—at least where no "improper motivation" shown).

89 728 F.2d 568, 571 (1st Cir. 1984).

90 *Id. See also* Price v. United Parcel Serv., Inc., 601 F. Supp. 20 (D. Mass. 1984) (no implied covenant claim under Massachusetts law for employee covered by collective bargaining agreement); Kamens v. Summit Stainless, Inc., 586 F. Supp. 324 (E.D. Pa. 1984) (no implied covenant cause of action for dismissal allegedly violative of Fair Labor Standards Act and Age Discrimination in Employment Act); High v. Sperry Corp., 581 F. Supp. 1246 (S.D. Iowa 1984) (claim for breach of implied covenant distinct from statutory age discrimination claim, though based on same facts; can be maintained independently of statutory procedures under Iowa law); Azzi v. Western Elec. Co., 19 Mass. App. Ct. 406, 474 N.E.2d 1166, *review denied*, 394 Mass. 1103, 478 N.E.2d 1274 (1985) (implied covenant cause of action does not exist for employee covered by collective bargaining agreement). *See infra* notes 117-46 and accompanying text discussing specific limitations on the covenant.

91 *See* McCabe v. General Foods Corp., 811 F.2d 1336, 1340 (9th Cir. 1987) (California law permits "bad faith" theory of recovery, independent of covenant of good faith, if employee can show retaliation against employee for conduct unrelated to work).

92 *See* ARCO Alaska, Inc. v. Akers, 753 P.2d 1150, 1154 (Alaska 1988) (affirming compensatory damages and reversing punitive damages on implied covenant theory; implied covenant breach not a tort unless public policy involved).

93 47 Cal. 3d 654, 765 P.2d 373, 254 Cal. Rptr. 211 (1988).

94 *Compare* DeHorney v. Bank of Am. Nat. Trust & Sav. Assoc., 777 F.2d 440 (9th Cir. 1985) (employment for nine months insufficient to trigger implied covenant under California law), *withdrawn and rehearing stayed*, 784 F.2d 339 (9th Cir. 1986) *with* Gray v. Superior Court (Cipher Data), 181 Cal. App. 3d 813, 822, 226 Cal. Rptr. 570, 573-74 (1986) (lengthy service not essential to cause of action based on

and/or to employees working in places where some kind of expectation reasonably has arisen that dismissal will be only for certain reasons or will occur only after following certain procedures.[95] *Foley* can thus be read as endorsing a broad substantive view of the covenant, while limiting remedy theories.

The *Foley* court avoided defining what is necessary to demonstrate a breach of the covenant. It noted that the covenant initially was applied as "a kind of safety valve" to which judges could turn to fill gaps and qualify or limit rights and duties otherwise arising under rules of contract construction combined with explicit contract language.[96] The court reviewed some of the standards used by California courts, noting that they did not provide a meaningful way to keep cases away from juries and did not prevent the juries' tendency of ignoring the judge's instructions in favor of using their own conceptions of fairness and good faith. While not embracing the limitations summarized in the preceding paragraph, the *Foley* court rejected using the covenant by itself to impose a good cause requirement on terminable at-will employment contracts in the context of whether tort damages should be available.[97] Moreover, the Ninth Circuit has interpreted California law as permitting breach of the covenant to be shown by little more than absence of good cause for termination.[98] It is not clear, however, whether this precedent survives footnote thirty-nine in *Foley*.[99]

Montana has developed an interpretation of the covenant that is only subtly distinguishable from a just cause interpreta-

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implied covenant). *See also* McCabe v. General Foods Corp., 811 F.2d 1336 (9th Cir. 1987) (covenant requires both longevity of employment and policies of employer; plaintiff failed longevity test because he left employer twice in past); Prevost v. First Western Bank, 193 Cal. App. 3d 1492, 239 Cal. Rptr. 161 (1987) (longevity of service helpful but not essential; reversing summary judgment for employer in covenant case by employee with slightly more than six months service).

95 *See* Shapiro v. Wells Fargo Realty Advisors, 152 Cal. App. 3d 467, 479, 199 Cal. Rptr. 613, 619 (1984) (affirming demurrer; construing Cleary v. American Airlines, Inc., 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980) to imply a covenant of good faith and fair dealing only when (1) longevity of employment is present, or (2) the employer has promulgated a policy for adjudicating employee disputes).

96 *Foley*, 47 Cal. 3d at 684, 765 P.2d at 389, 254 Cal. Rptr. at 228 (quoting Summers, *The General Duty of Good Faith—Its Recognition and Conceptualizations*, 67 CORNELL L. REV. 810, 812 (1982)).

97 *Foley*, 47 Cal.3d at 698 n.39, 765 P.2d at 400 n.39, 254 Cal. Rptr. at 238 n.39 (reading covenant to impose good cause requirement would eviscerate employment-at-will rule and California Labor Code section 2922).

98 Huber v. Standard Ins. Co., 841 F.2d 980, 985 (9th Cir. 1988) (factfinder may infer bad faith from absence of just cause for dismissal).

99 *Foley*, 47 Cal. 3d at 698 n.39, 765 P.2d at 400 n.39, 254 Cal. Rptr. at 238 n.39.

tion.[100] An employer must show a "fair and honest reason" for a dismissal to escape liability under the covenant.[101] In *Gates v. Life of Montana Insurance Co.*,[102] the Supreme Court of Montana used an implied covenant of good faith and fair dealing to obligate the employer to follow policies in its personnel handbook.[103] In *Dare v. Montana Petroleum Marketing Co.*,[104] the court reversed summary judgment for the employer and held that the plaintiff was entitled to a trial on questions of job security and improper reasons for dismissal. The court ruled that the covenant of good faith protects reasonable expectations of job security and that the covenant would be implied where there are "objective manifestations" by the employer of job security which were relied on by the employee. The "objective manifestations" that would implicate the covenant are not limited to promises made in a handbook.[105]

In *Crenshaw v. Bozeman Deaconess Hospital*,[106] the court affirmed a jury verdict of compensatory and punitive damages for a respiratory therapist discharged during a probationary period. The court in *Niles v. Big Sky Eyewear*,[107] affirmed judgment on a jury verdict of $470,000, based on breach of the covenant and misrepresentation for false information given to law enforcement authorities resulting in the plaintiff's arrest and termination. Further, the court approved, by negative implication, a jury instruction that suggested a good cause standard.[108] In *Prout v.*

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100 A just cause interpretation of the covenant is considered *infra* at notes 272-87 and accompanying text.

101 *See* Stark v. Circle K. Corp., 230 Mont. 468, 474, 751 P.2d 162, 167 (1988) ("employer need only show fair and honest reason;" $270,000 jury verdict affirmed for employee who refused to sign probationary notice the accuracy of which he contested).

102 196 Mont. 178, 638 P.2d 1063 (1982), *rev'd and remanded*, 205 Mont. 304, 668 P.2d 213 (1983) (breach of covenant constitutes a tort and permits punitive damages).

103 *Id.* at 183, 638 P.2d at 1067. The court noted that the handbook policies were not enforceable on a traditional contract theory because the handbook was distributed after plaintiff was hired. *See also* Kerr v. Gibson's Prods. Co., 226 Mont. 69, 733 P.2d 1292 (1987) (affirming jury verdict for plaintiff on covenant theory; satisfactory work evaluations and handbook, though distributed after hire, created reasonable expectations of job security sufficient to implicate covenant).

104 212 Mont. 274, 687 P.2d 1015 (1984).

105 *Id.* at 283, 687 P.2d at 1020. The plaintiff alleged no specific promise of employment security, but only cited to raises and other conduct indicating satisfaction with performance.

106 213 Mont. 488, 693 P.2d 487 (1984).

107 236 Mont. 455, 771 P.2d 114 (1989).

108 *See id.* at 460, 771 P.2d at 118. The *Niles* court approved a jury instruction that: "[E]mployment may be terminated at any time by an employer in the event of

Sears, Roebuck & Co.,[109] the court held that firing for a false reason breaches the covenant, even though the employer would have been free to dismiss for no reason.[110] In *Hobbs v. Pacific Hide & Fur Depot*,[111] the Montana Supreme Court found reversible error in the lower court's failure to instruct the jury that the covenant arises from objective manifestations by an employer, leading to reasonable employee expectations.[112] Significantly, the court in *Flanigan v. Prudential Federal Savings & Loan Association*,[113] found that long term employment, by itself, was sufficient to create the expectations protectable by the covenant.[114]

This line of cases suggests that the covenant of good faith and fair dealing can be used to impute a promise of employment tenure which cannot be proven from the facts. Such use of the implied covenant theory is potentially more far-reaching than either the implied-in-fact contract or the public policy tort doctrines.[115] The Montana Supreme Court has held, however, that the implied covenant theory cannot be utilized to enforce employer promises of promotions and salary increases.[116] It is available only to contest employment terminations.

E. Limitations on Covenant

Outside California and Montana, the implied covenant theory is hedged with various restrictions.[117] The supreme courts of

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any willful breach of duty by the employee in the course of employment or if the employee habitually neglects or is incapable of performing the duties of the employment. However, an employer has a duty to act in good faith and deal fairly in discharging an employee.").

109 236 Mont. 152, 772 P.2d 288 (1989).

110 *Id.* at 157, 772 P.2d at 292 (quoting Crenshaw v. Bozeman Deaconess Hosp., 213 Mont. 488, 498-99, 693 P.2d 487, 492 (1984)).

111 236 Mont. 503, 771 P.2d 125 (1989).

112 *See id.* at 508, 771 P.2d at 129-30 (quoting suggested language for instruction on remand).

113 221 Mont. 419, 720 P.2d 257 (1986).

114 *See id.* at 426, 720 P.2d at 261-62 (citing Dare v. Montana Petroleum Mktg. Co., 212 Mont. 274, 687 P.2d 1015 (1984)).

115 *See* Crenshaw v. Bozeman Deaconess Hosp., 213 Mont. 488, 693 P.2d 487 (1984) (plaintiff need not show violation of public policy to prove breach of covenant of good faith and fair dealing).

116 Frigon v. Morrison-Maierle, Inc., 233 Mont. 113, 760 P.2d 57 (1988) (affirming summary judgment for employer).

117 *See, e.g.*, Sterling Drug, Inc. v. Oxford, 294 Ark. 239, 743 S.W.2d 380 (1988), *reh'g denied*, 294 Ark. 239, 747 S.W.2d 579 (1988) (recognizing public policy tort concept, but restricting it to contract remedies under implied covenant doctrine; employee dismissed allegedly for reporting employer violations of federal contracting standards); K Mart Corp. v. Ponsock, 103 Nev. 39, 732 P.2d 1364 (1987) (affirming judgment for breach of implied covenant on evidence showing employer

Arizona,[118] Connecticut,[119] and North Dakota[120] have expressly disavowed the notion that a breach of the covenant can be established merely by proving dismissal without good cause. Other recent cases also reject claims that the covenant is violated unless the employer can demonstrate good cause.[121]

Four principal ways of limiting the covenant have evolved. First, a breach of the covenant can only be established by showing that an employer failed to follow employer promulgated procedures, upon proof of some other type of employer conduct, or by communication that has led to reasonable expectations of employment security.[122] Other states require a showing that the employer has violated some understanding about how employees would be handled.[123] The Supreme Court of Montana, in *Gates v. Life of Montana Insurance Co.*,[124] found that an implied covenant of good faith and fair dealing would be breached by the employer's

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motive to dismiss to avoid paying retirement benefits); Carbone v. Atlantic Richfield Co., 204 Conn. 460, 528 A.2d 1137 (1987) (implied covenant covers essentially same cases as public policy tort or implied-in-fact contract; facts support no claim on any of three theories).

118 Wagenseller v. Scottsdale Memorial Hosp., 147 Ariz. 370, 385, 710 P.2d 1025, 1040 (1985) (accepting covenant but declining to require only good cause termination to escape liability).

119 Magnan v. Anaconda Indus., Inc., 193 Conn. 558, 572, 479 A.2d 781, 788 (1984) (no action for breach of implied covenant simply upon discharge without good cause).

120 Wadeson v. American Family Mut. Ins. Co., 343 N.W.2d 367, 370 (N.D. 1984) (approving jury instruction on good faith; rejecting the unsuccessful plaintiff's argument that the covenant requires the employer to discharge only for good cause).

121 *See generally* Zick v. Verson Allsteel Press Co., 623 F. Supp. 927, 929 (N.D. Ill. 1985), *aff'd without opinion*, 819 F.2d 1143 (7th Cir. 1987) (covenant of good faith does not impose an obligation to "be nice or to behave decently in a general way"); Wadeson v. American Family Mutual Ins., 343 N.W.2d 367 (N.D. 1984) (rejecting argument that the covenant of good faith and fair dealing imposes an obligation on the employer to discharge only for just cause); Rompf v. John Q. Hammons Hotels, Inc., 685 P.2d 25, 28 (Wyo. 1984) (implied covenant not breached by discharge for economic reasons).

122 *See also* Rulon-Miller v. IBM, 162 Cal. App. 3d 241, 208 Cal. Rptr. 524 (1984) (affirming $300,000 verdict for employee dismissed for dating employee of a competing firm; dismissal violated implied covenant because it contravened the employer's established policy of not interfering in employee's private, off-the-job conduct); Gates v. Life of Montana Ins., 196 Mont. 178, 638 P.2d 1063 (1982) (dismissal without following handbook procedures that were not contractually binding nonetheless a breach of implied contract). *See also* Murphy v. American Home Prod. Corp., 58 N.Y.2d 293, 448 N.E.2d 86, 461 N.Y.S.2d 232 (1983) (rejecting implied covenant as inconsistent with parties' intent: "no obligation can be implied . . . which would be inconsistent with other terms of the contractual relationship").

123 *See* Gray v. Superior Court (Cipher Data), 181 Cal. App. 3d 813, 821, 226 Cal. Rptr. 570, 573 (1986) (jury, not court, decides whether failure to follow procedures in personnel manual is breach of covenant).

124 196 Mont. 178, 638 P.2d 1063 (1982).

failure to follow the policies in its personnel handbook.[125] The Nevada Supreme Court used the covenant to permit both contract and tort damages for a "bad faith" breach of a commitment to pay retirement benefits.[126]

Second, a number of California intermediate appellate cases suggest that the covenant is available only for employees with long service.[127] In *Pugh v. See's Candies, Inc.*,[128] and *Cancellier v. Federated Department Stores, Inc.*,[129] the courts found a breach of the implied covenant because a long-term employee was discharged without notice or compliance with customary procedures. It is not altogether clear from the case law whether dismissal after long service suffices to establish a breach, or whether it must be accompanied by employer conduct creating a legitimate expectation of employment security. Further, while five years appears to be sufficient, it is not clear what qualifies as long service. The California Supreme Court in *Foley*, however, has not adopted these limitations.

The third mode of limiting the covenant is to allow recovery only in cases where an employee was deprived of compensation for past service. This approach, appearing mainly in Massachusetts decisions,[130] would transform the covenant from wrongful

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125 *See id.* at 184, 638 P.2d at 1067. The court found that the handbook policies were not enforceable on a traditional contract theory because the plaintiff was hired two years prior to distribution of the handbook. *Id.* at 183, 638 P.2d at 1066.

126 K Mart Corp. v. Ponsock, 103 Nev. 39, 45, 732 P.2d 1364, 1369-70 (Nev. 1987) (breach of covenant found because of evidence that employer's motive was to evade duty to pay retirement benefits; no discussion of public policy regarding retirement benefits suggests public policy tort not necessary).

127 *See* McCabe v. Gen. Foods Corp., 811 F.2d 1336, 1340 (9th Cir. 1987) (covenant requires both longevity of employment and policies of employer; plaintiff failed longevity test because he left employer twice in past); DeHorney v. Bank of Am. Nat'l Trust & Sav. Ass'n, 777 F.2d 440, 448 (9th Cir. 1985) *withdrawn and rehearing stayed*, 784 F.2d 339 (9th Cir. 1986) (employment for nine months insufficient to trigger implied covenant under California law); Shapiro v. Wells Fargo Realty Advisors, 152 Cal. App. 3d 467, 479, 199 Cal. Rptr. 613, 619 (1984) (affirming demurrer; construing *Cleary* to imply a covenant of good faith and fair dealing only when (1) longevity of employment is present, or (2) the employer has promulgated a policy for adjudicating employee disputes); Prevost v. First Western Bank, 193 Cal. App. 3d 1492, 239 Cal. Rptr. 161, 168 (1987) (longevity of service helpful but not essential; reversing summary judgment for employer in covenant case by employee with slightly more than six months service). *But cf.* Gray v. Superior Court (Cipher Data), 181 Cal. App. 3d 813, 226 Cal. Rptr. 570, 573-74 (1986) (lengthy service not essential to cause of action based on implied covenant).

128 116 Cal. App. 3d 311, 171 Cal. Rptr. 917 (1981).

129 672 F.2d 1312 (9th Cir. 1982), *cert. denied*, 459 U.S. 859 (1982).

130 *See infra* note 132 (listing Massachusetts cases). *See also* Wakefield v. Northern Telecom, Inc., 769 F.2d 109 (2d Cir. 1985) (New York law permits implied cove-

dismissal into a quasi-contract doctrine.[131] Massachusetts courts have suggested that a breach of the covenant can be shown only when the employer has acted to deprive the employee of compensation that has been earned by past performance.[132]

The fourth approach, reflected in the decisions of a number of states, posits that breach of the covenant can be shown only by a violation of a public policy.[133] This was, of course, the factual context of *Petermann v. International Brotherhood of Teamsters*,[134] which gave the implied covenant its start as a wrongful dismissal doctrine. More recent decisions limit the implied covenant to situations jeopardizing public policy. Borrowing a statutory age discrimination standard to determine the boundaries of the contractual good faith obligation, the United States District Court for the District of Massachusetts, in *McKinney v. National Dairy Council*,[135] approved a jury finding that the covenant of good faith was breached by a dismissal based on age.[136] In *Maddaloni v. Western Massachusetts Bus Lines, Inc.*,[137] a Massachusetts appeals court approved a jury finding of a breach of the good faith covenant where the employee was terminated in order for the employer to avoid payment of bonuses.[138] In Wisconsin, the

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nant claim for a dismissal motivated by desire to deprive employee of commissions).

131 *See* RESTATEMENT (SECOND) OF CONTRACTS § 4 comment b (1981) (distinguishing quasi-contract from implied contract).

132 *See* McCone v. New England Tel. & Tel. Co., 393 Mass. 231, 234, 471 N.E.2d 47, 50 (1984) (suggesting that an implied covenant claim lies only to deny employer financial windfall resulting from denial of compensation for past services); Siles v. Travenol Laboratories, Inc., 13 Mass. App. Ct. 354, 433 N.E.2d 103 (1982), *appeal denied*, 386 Mass. 1103, 440 N.E.2d 1176 (1982) (evidence did not support jury finding of wrongful dismissal; no evidence that employer terminated employee to retain sales commissions for itself).

133 *See* Wagenseller v. Scottsdale Memorial Hosp., 147 Ariz. 370, 710 P.2d 1025 (1985) (holding that nurse dismissed for refusing to engage in behavior that might violate indecent exposure statute could recover on implied covenant theory because public policy would be violated; declining to accept broader California implied covenant doctrine).

134 174 Cal. App. 2d 184, 344 P.2d 25 (1959).

135 491 F. Supp. 1108 (D. Mass. 1980). The employee claimed that the employer indicated to him in his job interview that NDC could provide him with stable employment. The court construed those representations into an implied covenant of good faith and proceeded to apply MASS. GEN. L. ch. 149, § 24A (West 1978) which prohibits age discrimination as a means to define stable employment. *McKinney*, 491 F. Supp. at 1118.

136 *Id.* at 1121.

137 12 Mass. App. 236, 422 N.E.2d 1379 (1981), *modified*, 386 Mass. 877, 438 N.E.2d 351 (1982).

138 *Id.* at 241, 422 N.E.2d at 1382 (citations omitted). The employee brought an action against the employer for breach of a written contract which the employer

covenant is used instead of the public policy tort in order to limit damages. In *Brockmeyer v. Dun & Bradstreet, Inc.*,[139] the Wisconsin Supreme Court held that the covenant of good faith and fair dealing is violated when the discharge "is contrary to a fundamental and well-defined public policy as evidenced by existing law."[140] The New Hampshire Supreme Court, in *Howard v. Door Woolen Co.*,[141] similarly limited the scope of the implied covenant.

In *Magnan v. Anaconda Industries, Inc.*,[142] the Supreme Court of Connecticut hinted that a cause of action for breach of the implied covenant is identical to a public policy tort,[143] while rejecting a claim of breach of the implied covenant based solely upon a discharge without just cause.[144] Later, the court suggested that the implied covenant overlaps both the public policy tort and the implied-in-fact contract theories.[145]

Another stratagem for limiting the implied covenant is to permit it only for fixed term employment contracts and not for at-will or indefinite term contracts.[146] This approach is inconsistent with the *Restatement (Second) of Contracts* which clearly contemplates the application of the covenant to powers reserved to one party under the contract. Such reserved powers conceptually include the power to terminate.

F. Waivers and Disclaimers

Employers are free to avoid promises of employment tenure

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terminated at-will. The contract provided for enhanced compensation to the plaintiff upon the acquisition of Interstate Commerce Commission rights deemed advantageous by the employer. Once acquired, the employer dismissed the plaintiff to end the extra pay.

139 113 Wis. 2d 561, 335 N.W.2d 834 (1983).

140 *Id.* at 573, 335 N.W.2d at 840.

141 120 N.H. 295, 297, 414 A.2d 1273, 1274 (1980) (limiting the Monge v. Beebe Rubber Co., 114 N.H. 130, 316 A.2d 549 (1974), approach to reasons for discharges that clearly offend public policy).

142 193 Conn. 558, 479 A.2d 781 (1984).

143 *See id.* at 577 n.25, 479 A.2d at 791 n.25.

144 *Id.* at 572, 479 A.2d at 788.

145 Carbone v. Atlantic Richfield Co., 204 Conn. 460, 470-71, 528 A.2d 1137, 1142 (1987) (no implied covenant claim absent public policy jeopardy or employer conduct defeating reasonable expectations of employee). *See also* Sterling Drug, Inc. v. Oxford, 294 Ark. 239, 743 S.W.2d 380 (1988), *reh'g denied*, 294 Ark. 239, 747 S.W.2d 579 (1988) (recognizing implied covenant where employee was dismissed for reporting employer violations of federal contracting standards; following Brockmeyer v. Dun & Bradstreet, 113 Wis. 2d 561, 335 N.W.2d 834 (1983)).

146 *See* Vallone v. Agip Petroleum Co., 705 S.W.2d 757, 759 (Tex. Ct. App. 1986) (good faith obligation may be implied in contracts for a fixed term, but not in contracts for an indefinite term).

and to publish disclaimers to foreclose reliance on informal promises. Disclaimers are express statements, typically found in employment applications or employee handbooks, that put employees on notice that general statements or conduct suggesting a commitment of employment security should not be relied upon by the employees.[147] Only a handful of cases have considered the effect of disclaimers on the implied covenant. Most have held that the implied covenant cannot be disclaimed or waived.[148] This conclusion, while consistent with tort obligations, is not consistent with contract obligations. If the implied covenant is a contract term supplied by law in the absence of a contrary manifestation of intent by the parties, it should be waivable. Consequently, the cases limiting waiver of the covenant should be understood as treating the covenant as a tort concept[149] or simply as wrongly decided.

III. THE FUTURE OF THE IMPLIED COVENANT AS A SOURCE OF EMPLOYER OBLIGATION

The courts in most jurisdictions which have accepted the implied covenant have not afforded definitive guidance as to the limits of the implied covenant doctrine, cautiously adopting it in particular cases. The covenant remains potentially available for egregious cases not meeting the requirements of the implied-in-fact contract or the public policy tort. The covenant might also evolve into a duty to dismiss only for good cause.

One of the major problems with the implied covenant theory is its vagueness. It is difficult to limit a jury to the implication of specific criteria for employer decisions. The same difficulty sends too many cases to the jury because there are no real standards for dismissal of complaints or summary judgment.

This section considers the future of the implied covenant, justifying externally imposed limitations on contract rights in general and discussing the role of the covenant in a relational

147 *See* H. PERRITT, EMPLOYEE DISMISSAL, *supra* note 5, § 4.10 at 189-90, §§ 8.7-8.8, at 468-72.

148 *See* Prout v. Sears, Roebuck & Co., 236 Mont. 152, 772 P.2d 288 (1989) (at-will disclaimer permitted employer to dismiss employees for no reason, but not for a "false" reason; dismissal for dishonesty violated covenant because employee not given chance to offer defense); Stark v. Circle K. Corp., 230 Mont. 468, 751 P.2d 162 (1988) (affirming $270,000 verdict for employee dismissed for refusing to sign contested probation notice; covenant cannot be waived by disclaimer, and does not depend on employer representations).

149 *See* Gates v. Life of Montana Ins. Co., 205 Mont. 304, 668 P.2d 213 (1983) (holding that breach of the covenant is a tort).

view of contracts. This part will then consider three possible interpretations of the covenant as a limitation on employment terminations: as a source of protection for legitimate employee expectations; as a source of an administrative law type deferential review of employer decisions, and; finally as a source of an obligation to dismiss only for good cause.

A. Theoretical Justification for Externally Imposed Obligations

Labor and employment law abounds with limitations on the exercise of acknowledged contract rights. The implied covenant of good faith and fair dealing may limit an employer's exercise of the right to terminate an employee-at-will. Similarly, the National Labor Relations Act and the Railway Labor Act limit the exercise of employer rights under collective bargaining agreements and also limit original property concepts when the exercise of those rights impedes collective bargaining. The Employee Retirement Income Security Act of 1974 (ERISA) also imposes fiduciary obligations on employee benefit plan administrators who exercise discretionary authority.[150]

1. Comparison with Fiduciary Obligations

While the standards of good faith and fair dealing are not necessarily the same as fiduciary standards, the ideas are similar in that contracting parties may not be able to escape from the obligation by reserving rights in the contract.[151] Moreover, both concepts are rooted to some degree in equity and fairness principles.

The examples of good faith given in the *Restatement (Second) of Contracts* commentary to section 205 demonstrate the overlap between the covenant and fiduciary duties. The covenant pro-

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150 *See* H. PERRITT, EMPLOYEE BENEFITS CLAIMS LAW AND PRACTICE § 4.13, at 203-09 (1990) [hereinafter H. PERRITT, EMPLOYEE BENEFITS]. Trustees must administer benefit trusts only in the interest of the beneficiaries, without serving conflicting interests. The exclusive benefit standard obviously does not permit self-dealing by the trustee or other fiduciaries. Brink v. DaLesio, 667 F.2d 420, 426 (4th Cir. 1982) (violation of fiduciary standard for trustee to negotiate for rental of office space with fiduciary who provided free condominium use to trustee). Circuit Judge Friendly analyzed this duty in the context of a corporate pension plan trusteed by senior officers of the employer sponsor in Donovan v. Bierwirth, 680 F.2d 263 (2d Cir. 1982), noting that trustees of an express trust have the highest fiduciary obligation known to the law. *Id.* at 272 n.8 (citing RESTATEMENT (SECOND) OF TRUSTS § 2 comment b (1959)).

151 *But see supra* notes 147-49 and accompanying text (regarding disclaimers). Before ERISA was enacted, trust law permitted some fiduciary obligations to be waived. *See* H. PERRITT, EMPLOYEE BENEFITS *supra* note 150, § 4.14, at 210.

hibits a contracting party from interfering with the other party's performance, from neglecting the contractual rights of performance and from acting inconsistently with the purpose of the bargain.[152] These requirements are analogous to those embodied in fiduciary duties.[153] The only exception to the general similarity between good faith and fiduciary duties is the duty of loyalty—in ERISA terms, the duty to act for the exclusive benefit of the other parties (beneficiaries or participants).[154]

Generally, the common law trust fiduciary obligations[155] which are incorporated into a branch of labor and employment by ERISA[156] impose duties of loyalty to beneficiaries and duties of care in administering the trust.[157] Derived from the duty of care is a duty to preserve and maintain trust assets, including an obligation to discover and control the location of trust property, as well as a duty to investigate the identity of any uncertain beneficiaries and to notify beneficiaries of new gifts.[158] The duty of care also includes a duty to supervise any agent the trustee may retain, such as an administrator.[159]

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152 *See* RESTATEMENT (SECOND) OF CONTRACTS § 205 comments a, c, d (1981).

153 One reason for imposing fiduciary type obligations on contract promisors is to expand the range of available damages. This essentially was what the plaintiff sought in *Foley*, and is a result of an independent claim for breach of a fiduciary obligation under ERISA. *See* 29 U.S.C. § 1104 (1982) (damages imposed on individual fiduciary).

154 29 U.S.C. § 1104 (1982).

155 The *Restatement (Second) of Trusts* recognizes 23 duties which arise from the nature of the fiduciary duty. For a listing of the duties imposed upon the trustee, see *Restatement* sections 169-85. Among the most important are the duty to keep and produce accurate records pertaining to the trust; the duty to administer the trust solely in the interest of the beneficiary; the duty to furnish information to beneficiaries; the duty to exercise reasonable care and skill; the duty to take trust property and to enforce claims; the duty to segregate trust property; the duty to make trust property productive; the duty to deal impartially with multiple beneficiaries; the duty to participate with co-trustees and to prevent co-trustees from committing breach of trust; the duty to act under instructions of persons authorized by trust instrument to control trustee actions unless the instructions violate terms of the trust or cause a violation of a fiduciary duty.

156 *See generally* Massachusetts Mut. Life Ins. Co. v. Russell, 473 U.S. 134, 148, 152 (1985) (Brennan, J., concurring in the judgment) (Congress intended to incorporate fiduciary standards of trust law into ERISA); Central States, Southeast and Southwest Areas Pension Fund v. Central Transp., Inc., 472 U.S. 559, 570 (1985) (instead of explicitly enumerating all powers and duties of employee benefit plan trustees, Congress invoked the common law of trusts).

157 *Central States*, 472 U.S. at 570-71 (characterizing duties incorporated into ERISA from common law).

158 *Id.* at 570-72.

159 *See* Leigh v. Engle, 858 F.2d 361, 364 (7th Cir. 1988) (trustees breached fiduciary obligations by not correcting situation when they knew administrator was investing trust assets out of motive for personal gain).

The fiduciary obligations under ERISA are more demanding than the covenant of good faith in one important respect. While the fiduciary obligation of loyalty requires that fiduciaries act for the exclusive benefit of the promisee,[160] the implied covenant of good faith and fair dealing only requires that the promisor act without malice and without ulterior motives which may be irrelevant or extrinsic to the contractual relationship. There is, however, some similarity. In order to pursue contract objectives faithfully, one must be loyal to the interests of the other party recognized in the contract. Loyalty to the relationship is therefore a must. Requiring loyalty to the interests of benefit plan participants is not a requirement of loyalty to their interests in general, only loyalty to their interests in the plan or relationship.

There are two ways to harmonize the covenant with the fiduciary's duty of loyalty. One theory favorable to employees is to conclude that contracts of employment are special relationships, and thus, are equivalent to fiduciary relationships. Then the contract party's implied covenant *is* a fiduciary obligation. The California Supreme Court, however, rejected this approach in *Foley*.[161] The *Foley* court was motivated by the desire to exclude tort damages for breaches of the covenant. Therefore, the court's discussion of special relationship criteria is not entirely convincing. Indeed, many of the criteria identified by the court which led it to reject a special relationship finding appear to be met by most employment relationships.

The four features identified by the *Foley* court were: (1) one of the parties to the contract enjoys a superior position in the formation of the contract to the extent that the party is able to dictate the terms of the contract; (2) the weaker party does not

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160 As of yet there are few cases which have applied the fiduciary standard under ERISA to contract promisors, rather than to persons qualifying as common law trustees. The courts, confronted with the issue, have frequently used artificial distinctions between multiple roles performed by the same person or entity and fiduciary obligations, arguing that if an employer serves its own interest at the expense of plan participants, it is not acting as a fiduciary. This, of course, avoids the fiduciary requirement for exclusive pursuit of the interests of the plan participants. *See* Dzinglski v. Weirton Steel Corp., 875 F.2d 1075 (4th Cir. 1989) (plan entitled only non-dismissed employees to early retirement benefits; trustees have no discretion regarding dismissal; company not acting in fiduciary capacity but as employer when it decides to dismiss); Hlinka v. Bethlehem Steel Corp., 863 F.2d 279, 285 (3d Cir. 1989) (approving provision permitting early retirement, among other things, when employer determined that its interest would be served by early retirement; employer decisions about business interests are business decisions not fiduciary decisions).

161 47 Cal. 3d 654, 765 P.2d 373, 254 Cal. Rptr. 211 (1983).

enter into the contract primarily for profit, but to secure an essential service or product, financial security or piece of mind; (3) the relationship that evolves is one in which the weaker party places its trust and confidence in the larger entity, and; (4) the stronger party's conduct indicates an intent to frustrate the weaker party's enjoyment of the contract rights.[162]

In most employment relationships the employer enjoys a relatively stronger position which enables it to dictate the terms of the employment contract. While the employee's purpose in entering into an employment relationship generally is profit, the sought after benefit is not usually of an entrepreneurial character. Rather, it is to enjoy minimal financial security and well-being. In most instances, the employee places trust and confidence in the employer, at least to the extent of permitting this larger entity to adjust the terms of the relationship. Further, employees allow employers to organize and direct the fortunes of the enterprise, an organization in which both have a stake. The presence of the final criterion, the employer's desire to deprive an employee of benefits, varies depending on the motive behind the termination of employment.

The *Foley* court concluded that these factors do not exist in the usual employment relationship.[163] It did, however, distinguish between insurance and employment relationships. The court posited that an employee can turn to the marketplace in order to find other work. Alternatively, an insured cannot turn to the marketplace to find another source of reimbursement for a suffered loss. Further, it is likely that the financial interests of the employer and the employee will converge, while that of the insurer and the insured are fundamentally opposed.[164]

Interpreting the duty of loyalty broadly is another means by which to close the gap between fiduciary duties and the implied covenant on the duty of loyalty. Employers and employees share a common goal in the success of the enterprise. An employer generally owes the employees a certain duty of loyalty. This duty mandates that the employer run an efficient enterprise, weeding out incompetent or misbehaving individual employees. Thus, the duty of loyalty is akin to the duty of loyalty in an employee benefit plan where the fiduciary serves the interests of the benefi-

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162 *Id.* at 691-92, 765 P.2d at 394, 254 Cal. Rptr. at 232-33.

163 *Id.* at 692, 765 P.2d at 395, 254 Cal. Rptr. at 234.

164 *Id.* at 693, 765 P.2d at 396, 254 Cal. Rptr. at 234.

ciaries by rejecting certain individual benefit claims.[165]

2. Comparison with Prima Facie Tort

The scope of the implied covenant is similar to the scope of the prima facie tort when applied to an employment relationship. Both incorporate the idea that conduct that is not ordinarily actionable can become actionable because of the state of mind of the actor. Both the implied covenant and the prima facie tort allow employees to recover damages when a dismissal was based on ulterior motives or accompanied by a subjective intent to injure.[166] Under both theories, an employer can escape liability by demonstrating a legitimate economic justification for the dismissal.

An analysis using a good faith or a fiduciary standard to evaluate the defendant's conduct is difficult to distinguish from the kind of inquiry involved in both a prima facie tort analysis and an intentional interference with contract tort analyses.[167] When confronted with either type of tort allegation, the court must determine if the defendant was motivated by illegitimate considerations or used improper means. This is done through a balancing of the interests of the plaintiff and the defendant. This inquiry may be broader than the good faith inquiry depending on whether the existence of ulterior motives implies bad faith. A motive is ulterior whenever it is not legitimate. The fiduciary standard is more demanding than either the propriety or good faith standards because a simple showing of motive other than for the benefit of the plaintiff is enough to establish a breach of

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165 The exclusive benefit standard permits consideration of the future interests of all plan beneficiaries. *See* Foltz v. U.S. News & World Report, Inc., 865 F.2d 364, 373-74 (D.C. Cir. 1989) (exclusive benefit includes interests other than narrow pecuniary interest; rejecting a fiduciary breach claim against profit sharing plan administrator for stock evaluation). For example, a plan administrator may consider the effect of a request on the actuarial soundness of a trust fund. *See* Hansen v. Western Greyhound Retirement Plan, 859 F.2d 779, 782 n.3 (9th Cir. 1988) (approving consideration of actuarial underpinnings of plan).

166 *See* Paul v. Lankenau Hosp., 375 Pa. Super. 1, 16, 543 A.2d 1148, 1156 (1988) (expressly recognizing that Pennsylvania prima facie tort theory is independent of public policy tort, but affirming nonsuit because employer malice not shown); Rinehimer v. Luzerne County Community College, 372 Pa. Super. 480, 491-92, 539 A.2d 1298, 1303-04 (1988) (accepting idea that recovery can occur for ulterior employer motive, independent of public policy, but finding legitimate motive from evidence).

167 *See* H. PERRITT, EMPLOYEE DISMISSAL, *supra* note 5, §§ 5.21-5.22, at 288-94.

the requisite mental state standard.[168]

The covenant of good faith need not be viewed as a source of obligation fully external to the contract. Professor Fried pointed out that the obligation to perform in good faith can be interpreted as reinforcing the purposes of the contract and requiring the parties to conduct themselves consistent with their bargain.[169] The covenant of good faith thus can be understood as an aid to contract interpretation, essentially reinforcing purpose, trade custom, and course of dealing pre-and post-bargain as standards by which party performance can be judged. This is a limited view of the covenant, within a classical or neoclassical view of contract law. The covenant can be given wider sway, still within contract rather than tort law, under a relational view of contract.

B. Relational Contract Model

The implied covenant of good faith was noted in the introduction as a prominent reflection of the relational contract doctrine. In the relational contract school, "parties treat their contracts more like marriages than like one-night stands."[170] Stewart Macauley and Ian Macneil emphasized that parties to real world transactions do not concern themselves with the traditional, classical, model of contract formation and administration. Rather, they work things out in order to maintain continuing relationships.

Obligations are not frozen in an initial bargain. They evolve over time as circumstances change, guided by norms of the particular community within which the relation exits. The object of contracting is to establish and define a cooperative relationship, not merely to allocate risk. If performance is neglected by either party, the other party is expected to be accommodating rather than to insist on technical performance. The sanction for unacceptable performance is to terminate the relationship and to refuse to deal in the future.[171] The coercive power of the state, activated through breach-of-contract litigation, exists as a means of changing bargaining power, but it does not preoccupy the par-

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168 *See infra* notes 249-71 and accompanying text for a discussion of the standards for determining a breach.

169 *See* C. FRIED, *supra* note 2, at 85 (explaining how good faith derives its meaning from the contract itself).

170 Gordon, *Macaulay, Macneil, and the Discovery of Solidarity and Power in Contract Law*, 1985 WIS. L. REV. 565, 568-69.

171 *Id.* at 569.

ties in defining their relationship or in seeking remedies for disappointment.[172]

Professor Macneil identified ten traditional contract norms: (1) role integrity (requiring consistency, involving internal conflict, and being inherently complex); (2) reciprocity (simply stated as the principle of getting something back for something given); (3) implementation of planning; (4) effectuation of consent; (5) flexibility; (6) contractual solidarity; (7) the restitution, reliance, and expectation interest (the linking norms); (8) creation and restraint of power (the power norm); (9) propriety of means, and; (10) harmonization with the social matrix.[173]

He also identified five significant norms in established contractual relations: (1) role integrity; (2) preservation of the relation; (3) harmonization of relational conflict; (4) propriety of means, and; (5) supracontract norms.[174] These are the main relational contract norms. Professor Macneil acknowledged that relational and discrete contract theories are not entirely separate.[175] Significant aspects of the contract-as-promise analysis acknowledge the relational characteristics of modern contract law.[176]

Preservation of the relation is "an intensification and expansion of the traditional norm of contractual solidarity."[177] The preservation norm in relational contract theory encompasses the reciprocity norm of traditional contract theory. This is so because "contractual relations cannot continue without reciproc-

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172 *Id.* at 572.

173 Macneil, *Values in Contract Internal and External*, 78 NW. U.L. REV. 340, 347 (1983) [hereinafter Macneil, *Values in Contract*].

174 *See id.* at 361.

175 Macneil, *Relational Contract: What We Do and Do Not Know*, 1985 WIS. L. REV. 483 [hereinafter Macneil, *Relational Contract*].

176 Beyond that, much of the relational contract literature, especially that of the critical legal studies advocates, is negative. It criticized discrete contract and contract-as-promise views without substituting a unified analytical framework of its own. In addition, of course, much of the critical legal studies relational contract analysis has a strong ideological cast, for example, rejecting the legitimacy of employer control over the workplace because it rejects the managerial view of the firm. *See, e.g.*, Singer, *The Reliance Interest in Property*, 40 STAN. L. REV. 611, 621 n.34, 636, 721 (embracing relational view and expressing more sympathy with critical legal studies movement than with market models in developing property theory to protect employees threatened with plant closings). Professor Macneil viewed the most desirable direction of relational contract development as toward "smallness," apparently meaning relatively autonomous units of self-governance. Macneil, *Values in Contract*, *supra* note 173, at 418.

177 Macneil, *Values in Contract*, *supra* note 173, at 362.

ity."[178] Consideration is a manifestation of the reciprocity norm, but it operates in the background of an ongoing contract relation.[179] Part III, F of this article reformulates some of these relational theory value concepts into rules, at least in the form of rebuttable presumptions.

Macneil identified labor and employment law commentators Clyde Summers, Philip Selznick, and David Feller, among others, as intellectual members of the relational contract school.[180] The Feller and Cox formulations, for example, fit comfortably into the Macneil formulation of relational contract. David Feller noted the tendency of the United States Supreme Court to view collective bargaining agreements as a kind of governmental code rather than as a contract,[181] while acknowledging that some aspects of labor law continue to embrace a contract notion.[182] He emphasized that employers and unions do not write collective bargaining agreements primarily as documents to be applied in court,[183] but rather to establish a system of ongoing rules to govern the workplace.[184] Archibald Cox, writing earlier,[185] agreed.[186] And, of course, the Supreme Court's treatment of collective agreements as a kind of "constitution" for the workplace in the *Steelworkers Trilogy*,[187] was a highly relational outlook.

Some anomalies in applying a classical promise-based con-

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178 *Id.* at 363.

179 *Id.*

180 *See* Macneil, *Relational Contract, supra* note 175, at 494 n.40, 497, 498 n.59 (noting Lon Fuller and Karl Llewellyn as incorporating relational contract ideas into promise-centered neoclassical contract theory); Macneil, *Relational Contract, supra* note 175, at 494 n.40 (citing Summers, *Collective Agreements and the Law of Contracts*, 78 YALE L.J. 525 (1969)); Macneil, *Relational Contract, supra* note 175, at 498 n.59 (citing Shulman, *Reason, Contract and Law in Labor Relations*, 68 HARV. L. REV. 999 (1955); Cox, *The Duty to Bargain in Good Faith*, 71 HARV. L. REV. 1401 (1958)).

181 Feller, *A General Theory of the Collective Bargaining Agreement*, 61 CALIF. L. REV. 663, 704 (1973) (rejecting Justices Black and Fortas' views embracing a self-government view of the collective agreement).

182 *Id.* at 718 (when union presents employee's claim, collective agreement is viewed as instrument of government; when employee sues both union and employer, collective agrement is viewed as contract).

183 *Id.* at 720.

184 *Id.* at 720-71 (function of rules, rule-modifying, and rule-applying institutions in meeting needs of employers, unions, and employees in ongoing relationship).

185 Cox, *Rights Under a Labor Agreement*, 69 HARV. L. REV. 601 (1956).

186 *Id.* at 605 (principles for handling collective agreements should not be imposed from traditional legal doctrine; "they should be drawn out of the institutions of labor relations and shaped to their needs").

187 Steelworkers v. Enterprise Wheel & Car Corp., 363 U.S. 593 (1960); Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574 (1960); Steelworkers v. American Mfg. Co., 363 U.S. 564 (1960).

tract theory to major employment contractual controversies can be resolved by using the relational contract theory. For example, an attractive feature of the relational theory for employment contracts is the ease with which it accommodates the past practice concept in interpreting collective bargaining agreements and statutory status quo obligations under sections two and six, of the Railway Labor Act[188] and section 8(a)(5) of the National Labor Relations Act.[189] Under the relational theory, the parties expect that the terms of their relationship will evolve. There is no need for formalities to validate new practices to make them part of the contract. If it is unobjectionable, simply doing something becomes part of the contractual relationship and a stronger obligation evolves the longer the action continues. The classical contract-as-promise theory is able to accommodate this idea, but with more difficulty. Classical and neoclassical theory use course-of-dealing and trade usage as a means of interpreting the terms of pre-existing contracts.[190] The broad use of extrinsic evidence

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188 45 U.S.C. §§ 152, 156 (1986). The United States Supreme Court revisited the basic question of practices becoming terms of collective bargaining agreements in two cases decided in the 1988 term: Conrail v. Railway Labor Executives' Ass'n, 109 S. Ct. 2477 (1989) and Pittsburgh & Lake Erie Ry. v. Labor Executives' Ass'n, 109 S. Ct. 2584 (1989). The analysis in these two cases reopened the once debated issue between Justice Harlan and the majority concerning whether rules for contract interpretation within the Railway Labor Act should generally take an objective or subjective view of party expectations derived from conduct. *See* Detroit & Toledo Shore Line v. UTU, 396 U.S. 142, 155 (1969). This is a transplanting of a much earlier debate between Williston and Corbin. In *Conrail*, the Court acknowledged that collective bargaining agreements may include implied as well as express terms. *Conrail*, 109 S. Ct. at 2483. "Furthermore, it is well established that the parties' 'practice, usage and custom' is of significance in interpreting their agreement." *Id.* at 2485 (citing Transportation Union v. Union Pacific R.R., 385 U.S. 157, 161 (1966) (collective agreements not like common law contracts; must use course of performance, course of dealing and other workplace realities to develop common law of the workplace; adjustment board must address competing claims of two unions)). The *Conrail* Court also acknowledged the legal significance but did so without resolving the dispute regarding whether past practices have risen to the level of an implied contract term. *Id.* In *Pittsburgh & Lake Erie*, the majority quoted Justice Harlan's dissent in *Detroit & Toledo Shore Line*, implying agreements from practice. *Pittsburgh & Lake Erie*, 109 S. Ct. at 2584, 2593. The context of the brief discussion in *Pittsburgh & Lake Erie* suggests that the Court viewed the status quo obligation as attaching only to those practices to which an actual subjective agreement can be implied. *See id.* The *Conrail* Court determined that "reporting at Lang Yard, we thought, had been the unquestioned practice for many years, and we considered it reasonable for employees to deem it sufficiently established that it would not be changed without bargaining and compliance with the status quo provisions of the RLA." *Conrail*, 109 S. Ct. at 2594 (explaining basis for *Shore Line* majority reasoning and hinting at a criticism of it).

189 29 U.S.C. § 158(a)(5) (1973).

190 RESTATEMENT (SECOND) OF CONTRACTS §§ 219-23, at 146-60 (1981).

is a relational approach.[191] But this interpretation approach has difficulty dealing with consensual practices that deviate significantly from the express terms of the written instrument. It is ironic to say that conduct "interprets" terms when it practically rebuts express terms or dramatically changes them.

Consideration is obviously a reflection of the reciprocity norm. The reciprocity norm in relational contracts is easily satisfied. The fact that the parties deal with each other in the context of a relationship is enough to give validity to the commitments they make to each other.

The good faith and fiduciary obligation concepts are an integral part of the relational theory, and therefore, they are compatible. Under the relational theory, parties are obligated to behave in a way that promotes the relationship, and in a way that is consistent with the needs and expectations of both parties. This is a central concept of the relational theory and a virtual restatement of the good faith idea. The covenant idea is embodied in Macneil's preservation-of-the-relationship and propriety-of-means norms.[192]

The author's main problem with the relational theory of contract is that it does not provide doctrinal rules to help decide cases.[193] In effect, the relational theory meshes the sharp distinctions of classical or neoclassical contract theories by providing useful insights on how real world parties formulate and administer contracts. But these insights simultaneously intensify the difficulty in deciding a particular dispute. One reality may be Professor Macauley's concept that the employers and employees are not preoccupied with classical contract doctrines. Courts, however, understand classical and neoclassical contract doctrines and seek legitimate methods under such doctrines to enforce contracts.

Professor Barnett has considered the relationship between the practical necessity to decide cases under the rule of law and

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191 Macneil characterized the *Restatement (Second) of Contracts* as "the largest body of American relational contracts scholarship." Macneil, *Relational Contract*, *supra* note 175, at 497. Dean Murray emphasized the difference between the approaches of the *Restatement (First)* and *Restatement (Second)* on contract interpretation, with the latter *Restatement* which was significantly more hospitable to extrinsic evidence as a guide to interpretation. J. MURRAY, MURRAY ON CONTRACTS § 106-07, at 229-33; § 109-14, at 238-46 (1974).

192 Macneil, *Values in Contract*, *supra* note 173, at 340-61.

193 Macneil himself acknowledged that relational contract theories lack a core theme like discreteness for the classical and neoclassical theories. *Id.* at 383. The relational theorists agree mainly on their criticisms of other theories. *Id.*

under legal theories.[194] In Barnett's view, the law evolves from the litigation of human disputes. Sometimes judges feel cognitive dissonance between existing legal doctrine and justice. It is in these situations that judges change legal doctrine. For example, the employment-at-will rule was sometimes narrowed in this manner by the recognition of the three wrongful dismissal theories. Alternatively, cognitive dissonance is sometimes expressed by commentators and the public when judges faithfully apply an accepted legal doctrine even though the result seems unjust. In these situations, commentators or legislators may seek changes in the law. In addition, commentators develop new theoretical justifications for judicial decisions which serve practical reality, but are inconsistent with current legal theory. This is perhaps the best way to view relational contract theory.

Relational contract theory is not a replacement for classical and neoclassical contract theory in labor and employment law. Relational contract theory is a way to reduce the artificiality of applying formal contract law doctrines to continuing legal relationships that are best thought about in contractual terms. While relational contract theory is in its infant stage in terms of a comprehensive body of legal rules and doctrine, it has legitimated some begrudgingly recognized doctrines. The implied covenant is one such doctrine.

Relational contract theory adds to the assessment of the implied covenant by clarifying the ways in which the covenant should be understood and applied in actual cases. Relational contract theory legitimates the implied covenant and assists in directing its further evolution. The covenant, as a manifestation of the relational aspect of employment contracts, obligates both parties to act in a way which serves the original purpose of the relationship[195] and to preserve the relationship whenever practicable.[196]

C. Administrative Law Model

A limited role for the covenant is to reinforce a perceptible trend in employment contract law toward an administrative law model of contract formation and modification. Under this

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194 *See* Barnett, *Foreword: Of Chickens and Eggs—The Compatibility of Moral Rights and Consequentialist Analyses*, 12 HARV. J.L. & PUB. POL'Y 611, 622, 630 (1989).

195 *See* RESTATEMENT (SECOND) OF CONTRACTS § 200, at 82 (1981) (contracts should be interpreted to serve their purposes).

196 *See infra* notes 215-20, and accompanying text (exploring relationship as it relates to breach).

model, an employer is like an administrative agency and employees are like persons affected by administrative agency decisions. The employer unilaterally sets terms of the employment contract; an administrative agency unilaterally promulgates regulations. These terms of employment are enforceable against the employer; administrative rules are enforceable against the agency promulgating them.[197] The employer can change the terms of employment through the same processes used to promulgate them initially; an administrative agency can amend its regulations through the same processes used to promulgate them initially.[198] An employee has no vested right in the maintenance of a particular term of employment unless a condition precedent specified in the term has occurred before the term is modified. Similarly, a person affected by an administrative regulation has no vested interest in the maintenance of the regulation unless a particular event leading to the creation of rights under the original regulation has occurred before the regulation is amended. The administrative law model is consistent with the relational contract model of the employment relation and the bureaucratization of work.[199]

This view of employment contract formation and modification is entirely consistent with the way ERISA is applied to employee benefit plans. Employers must publish plans in writing. They may amend them, absent some direct conflict with a provision of ERISA, and assuming they have reserved the right to

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197 *See generally* Jean v. Nelson, 472 U.S. 846, 857 (1985) (agency must follow its own rules); Levin, *Scope-of-Review Doctrine Restated: An Administrative Law Section Report*, 38 ADMIN. L. REV. 239, 249 (1986) (agency must follow its own rules).

198 *See* Motor Vehicle Mfrs' Ass'n v. State Farm Mut., 463 U.S. 29, 41-42 (1983) (applying same standard for judicial review of seat belt rule revocation as for initial promulgation of rule).

199 Linzer and others have commented on the role of contract law and direct government regulation in an increasingly bureaucratized employment relation. Professor Matthew Finkin analyzed the evolution of wrongful dismissal common law as a natural by-product of the bureaucratization of work. *See* Finkin, *The Bureaucratization of Work: Employer Policies and Contract Law*, 1986 WIS. L. REV. 733 (arguing that no legal principles changed when it became common for employees to enforce implied contract rights based on employee manuals and handbooks; rather, the nature of the employment relation changed, with internal labor markets largely replacing external labor markets). Professor Linzer developed an integrated view of public and private law theories, using employment-at-will as a case study of what he views as the breakdown of private law theory. *See* Linzer, *The Decline of Assent: At-Will Employment as a Case Study of the Breakdown of Private Law Theory*, 20 GA. L. REV. 323 (1986); S. JACOBY, EMPLOYING BUREAUCRACY: MANAGERS, UNIONS, AND THE TRANSFORMATION OF WORK IN AMERICAN INDUSTRY 1900-1945 (1985).

amend them. Courts hearing ERISA cases do not concern themselves much with traditional contract formation issues. Courts typically ignore issues of whether a plan participant had knowledge of a particular plan provision he seeks to enforce or whether he gave consideration.

The wrongful dismissal implied contract case law is less clear. There is, however, a branch of implied-in-fact contract doctrine, exemplified by the New Jersey Supreme Court's case of *Woolley v. Hoffman-La Roche, Inc.*,[200] that closely follows the administrative law model, while not expressly identifying the analogy. Under the *Woolley* doctrine, the fact that an employer puts a term of employment in a handbook gives it special status and makes it enforceable without any need to prove knowledge of the term. The California Supreme Court's decision in *Foley* is consistent with this analysis. In fact, most state courts are following *Woolley*.[201]

The covenant facilitates the administrative law paradigm because it removes the doctrinal awkwardness of dispensing with an actual plaintiff knowledge requirement in the context of bargain-based or reliance-based contract validation. There are two types of problems with this approach. First, the policies supporting administrative law concepts are considerably different from the policies supporting employment contract enforcement. Second, the administrative law model fails to protect employee expectations in a variety of common circumstances.

The policies supporting administrative law concepts are rooted in the need to ensure accountability for official decisions

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200 99 N.J. 284, 491 A.2d 1257, *modified*, 101 N.J. 10, 499 A.2d 515 (1985).

201 *See, e.g.*, Coelho v. Posi-Seal Int'l, Inc., 208 Conn. 106, 118, 544 A.2d 170, 176 (1988) (promise of employment security becomes enforceable as soon as employee enters employment; no reliance beyond performance of regular services legally required as consideration); Cannon v. National By-Products, Inc., 422 N.W.2d 638 (Iowa 1988) (rejecting requirement for special consideration to support promise to dismiss only for good cause or to support post-employment incorporation of personnel policies; facts and discussion suggest continuing employment enough); Jackson v. Action for Boston Community Dev., 403 Mass. 8, 525 N.E.2d 411 (1988) (remaining with employer after, or commencing employment upon, receiving employee manual can supply necessary consideration to incorporate manual's terms into employment contract; denying recovery on facts of case); Stratton v. Chevrolet Motor Div., 229 Neb. 771, 774, 428 N.W.2d 910, 913 (1988) (employee can "accept" written or oral limitations on at-will termination right by continuing employment after knowing of them; no knowledge and no breach in instant case); Panto v. Moore Business Forms, Inc., 130 N.H. 730, 735-39, 547 A.2d 260, 264-66 (N.H. 1988) (adopting general principle that employee accepts employer offer by continuing normal work; characterizing *Woolley* as relaxing traditional contract principles; applying traditional unilateral contract principles in layoff compensation case).

and conduct. Because the legislature is accountable through the elective process and administrative agencies are not, administrative agencies lack the power to make rules unless they can demonstrate a delegation of authority from the legislature in sufficiently specific terms so that courts can ascertain whether the agency rules are within the power delegated.[202] Reinforcing this idea of accountability is the notion that official decisions should be rational, and that even if agency rules are within delegated powers, they also must be supported by logical explanation and factual support. These legal concepts are not supplemented by any idea that persons affected by agency rules have a contractual relationship with the agency. Even though the end point may be similar between agency rule making and employment terms set by employers, the starting points are entirely different.

The law enforces employment contracts like other contracts to protect private expectations based on promises. Adoption of the administrative law model is not inconsistent with this goal, but it cuts off the enforcement of many types of expectations that deserve enforcement according to traditional contract principles. If, for example, an employee makes a specific inquiry of appropriate employer authority about the terms of his benefit plan or about the circumstances under which he can be dismissed and receives specific oral promises in return, the employee is likely to form much greater and stronger expectations around this oral exchange than around particular language in a long and legalistic employee benefit plan or handbook written by non-lawyer personnel specialists.

Yet the administrative law model of employment contract formation would not protect the expectation. The same result is obtained, of course, under the case law manifesting reluctance to enforce oral commitments in connection with employee benefit plans.[203]

D. The Expectations Enforcement Model

Enforcing employment contracts, like the general law of contracts itself, is justified in terms of social goals. The law has not always enforced promises[204] and has not enforced informal em-

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202 *See, e.g.*, Industrial Union Dept. v. American Petroleum Inst., 448 U.S. 607 (1980) (OSHA health standard for benzene not within delegated authority).

203 *See* H. PERRITT, EMPLOYEE BENEFITS, *supra* note 150, § 3.25, at 164.

204 *See* H. HAVIGHURST, THE NATURE OF PRIVATE CONTRACT 45-46 (1961). *See generally* C. FRIED, *supra* note 2, at 16-17 (concepts of fairness and justice were the only

ployer promises until relatively recently.[205]

The law began to enforce certain promises as society became larger and more complex and individuals found it difficult to reach their desired goals without the help of others.[206] In order to rationalize an increasingly interdependent society it was necessary to create a system which bound individuals to their promises.[207] Otherwise, individuals would be less likely to make reciprocal promises and the interdependent economic framework would function inefficiently. This general description of the policy motivations for contract law fits the evolution of the American workplace.

Modern rules of contract construction and contract formation serve the expectation goal by abandoning formalities in favor of giving effect to objective indications that expectations were reasonably induced by promises under circumstances that should leave a promisor to anticipate that the promise would have an effect. The clear trends in wrongful dismissal implied-in-fact contract law is to embrace these ideas permitting flexible proof of employer statements or conduct that might give rise to expectations of employment security in the total context of the employment relation.[208]

Hobbs v. Pacific Hide & Fur Depot[209] is a relatively pure example of an expectations approach to the covenant. In *Hobbs*, the Montana Supreme Court reversed the lower court's decision based on inadequate instructions regarding an employer's implied covenant of good faith. The court found that the jury instructions neglected to include the fact that the covenant arose from objective manifestations by an employer which gave rise to

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conventions binding a person to his work before the law undertook to enforce contracts).

205 *See* H. PERRITT, EMPLOYEE DISMISSAL, *supra* note 5, §§ 1.2-1.12, at 2-30 (reviewing erosion of the employment-at-will rule and partial replacement by implied-in-fact contract theory).

206 L. FULLER & M. EISENBERG, BASIC CONTRACT LAW 98 (3d ed. 1972).

207 Harold Havighurst noted that, with increased technology and a greater division of labor, groups become larger and intercourse with other groups becomes more extensive. H. HAVIGHURST, *supra* note 204, at 15. With this division and specialization human objectives become more individualized and complex. *Id.* Without the legal obligations created by contracts this system would not function as satisfactorily.

208 *See* Foley v. Interactive Data Corp., 47 Cal. 3d 654, 765 P.2d 373, 254 Cal. Rptr. 211 (1983).

209 236 Mont. 503, 771 P.2d 125 (1989).

reasonable employee expectations.[210]

The real problem with a pure employee expectations approach is the possibility of selective or imaginative recollection of statements on the part of plaintiffs. Indeed this concern provided the original motivation for the parol evidence rule as well as for the statute of frauds. The weight accorded to subjective employee expectations in formulating a breach standard for the implied covenant should therefore be influenced by the degree to which one believes the motivations for those two old common law rules apply in the modern employment context.

E. Implied Covenant as a Source of an Obligation to Dismiss Only for Good Cause

Although the argument that a breach of the covenant can be shown merely by proving a dismissal without good cause has been rejected by three state supreme courts,[211] the implied covenant idea is broad enough in theory to impose an obligation to dismiss only for good cause on employers as a matter of law.[212] It is a small theoretical step, albeit a major policy step, to translate "good faith and fair dealing" into terminating employment only for legitimate employer related reasons, i.e., good cause.

1. Disadvantages of Implied Good Cause Interpretation of Covenant

The principal argument against using the implied covenant to impose a good cause requirement is that employers will be discouraged from dismissing employees who should be dismissed, therefore causing the efficiency of the economic system to suffer. This is a concern that should be taken seriously. Too often social commentators view work as an activity aimed at pro-

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210 *Id.* at 508, 771 P.2d at 129-30 (quoting suggested language for instruction on remand).

211 *See* Wagenseller v. Scottsdale Memorial Hosp., 147 Ariz. 370, 385, 710 P.2d 1025, 1040 (1985) (accepting covenant but declining to interpret it so as to require good cause to escape liability); Magnan v. Anaconda Indus., Inc., 193 Conn. 558, 559, 479 A.2d 781, 782 (1984) (no action for breach of implied covenant wholly upon discharge without just cause); Wadeson v. American Family Mut. Ins. Co., 343 N.W.2d 367, 370 (N.D. 1984) (approving jury instruction on good faith, rejecting the unsuccessful plaintiff's argument that the covenant requires the employer to discharge only for good cause).

212 *See Wagenseller*, 147 Ariz. at 384, 710 P.2d at 1039 (California cases come close to good cause interpretation of covenant). *But see* Huber v. Standard Ins. Co., 841 F.2d 980, 985 (9th Cir. 1988) (factfinder can infer breach of covenant from the absence of good cause).

viding benefits to employees and capitalists only. Work is more than that. Work is the way in which the society is organized. Work produces and delivers food, clothing, housing, healthcare, childcare, and recreational activities. When work is performed inefficiently or incompetently because of labor and employment law, labor and employment law harms consumers.

The efficiency detriment resulting from a good cause dismissal requirement does not arise because the rule directly prevents dismissing inefficient or misbehaving employees. Indeed, a good cause rule should improve efficiency because it theoretically prevents dismissal of employees whose retention will improve employer performance. The detriment results from added transaction costs when employees are dismissed for cause and cause actually exists. In a certain proportion of these cases, an employee who deserves to be fired nevertheless contests the dismissal and employers must litigate. Even when the employer wins, litigation costs can be significant. Even when an employee does not contest the dismissal, internal review costs before dismissal decisions are likely to be increased by any new restriction on employment terminations.

It is appropriate to be concerned about these costs, but it also is appropriate to know their magnitude. The marginal costs associated with moving from the status quo to a good cause rule may be low. Most large employers already review terminations and apply their own internal prohibition against dismissals without good cause. For such employers, the marginal cost in terms of reviewing dismissal decisions before they are effectuated would be zero. A certain proportion of dismissed employees are motivated to challenge their dismissals under existing law, alleging race, sex, age, or handicap discrimination or asserting a common law wrongful dismissal claim. Also, one should not forget possible litigation over unemployment compensation. It may be that a proportion of dismissed employees motivated to sue would not be higher if a good cause standard were substituted for the present diversity of prohibitions.

2. Advantages of Interpreting Covenant as Good Cause Obligation

The easiest way to simplify employee dismissal is to apply an across the board good cause standard for dismissal. This would relieve employers and employees of the guessing game they must play on multiple occasions when the dismissed employee perse-

veres in his or her claim. The best way to establish an across the board good cause standard is through legislation. But, failing legislation, the implied covenant also provides a way to establish a standard, as the Montana Supreme Court has shown. In Montana employers are burdened to show a "fair and honest reason" for a dismissal to escape liability under the covenant.[213]

There is an additional benefit of interpreting the implied covenant to burden the employer to establish good cause: it creates an incentive for the employer community to favor balanced legislation. A difficulty with such an interpretation of the covenant is that it creates a disincentive for the plaintiff bar to favor legislation, although limiting damages as the *Foley* court did, leaves some bargaining room for plaintiff lawyers as well as employer lawyers.

F. Covenant as a Rebuttable Good Cause Presumption

The Corbin view, discussed earlier, suggested that the covenant is a way of fleshing out the express terms of a contract, in order to fulfil expectations created by the overall contractual relation—a highly relational view, though Corbin did not use that term.

According to this concept, it would be most appropriate to treat the covenant as a rebuttable presumption of good cause, when that seems most consistent with the employment relationship, and as something else when that seems most appropriate. A day laborer, for example, hardly could be said to have reasonable expectations, foreseeable to the employer, that he would have job security beyond the day in question. It is not faithful to the Corbin view to impose a job security obligation through the covenant under such circumstances. On the other hand, the day laborer may have legitimate expectations that he will not be terminated before the day is over and it does make sense to give the covenant that interpretation.

Under this view of the covenant, all of the circumstances of the relation should be significant to defining the good faith and fair dealing obligation; handbook language or other express commitments may be helpful, but they are not the focus of the

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[213] *See* Stark v. Circle K. Corp., 230 Mont. 468, 475-76, 751 P.2d 162, 167 (Mont. 1988) (affirming $270,000 jury verdict for employee who refused to sign probationary notice the accuracy of which he contested; employer must show "fair and honest reason for termination"). After the covenant developed in Montana, its legislature enacted comprehensive wrongful dismissal legislation.

inquiry, as in the implied-in-fact contract doctrine. The way in which the employer has historically treated other employees similarly situated to the plaintiff is more important to the plaintiff's expectations than what a particular supervisor or the personnel department said to the employee.

IV. COVENANT AS GOOD CAUSE OBLIGATION IN PRACTICE

This part explores a good cause interpretation of the covenant in greater detail, considering the practical issues of the allocation of decision-making responsibility in a dismissal controversy among employer judge, and jury. The preceding section presented some ideas for making application of the implied covenant more principled. The following section considers how some of those limitations can be applied in practice.

The covenant can give effect to the relational theory of contract by being interpreted to obligate the parties to act so as to maintain and preserve the relationship. Thus, the covenant would obligate an employer to use progressive discipline and other rehabilitative approaches, much as arbitrators imply such obligations into a good cause commitment.[214] On the other hand, when the employee or employer acts to repudiate the relationship, the covenant and the relational contract theory also embrace the idea that terminating the relationship is the most appropriate remedy. The difficulty is deciding what kind of conduct or performance falls on one side of the line or the other.

This part assumes that the covenant of good faith has evolved into an implied good cause requirement. It considers how such an implied requirement would operate in practice, focusing especially on the responsibility for deciding what constitutes good cause for dismissal.

A. What Constitutes a Breach?

Traditional interpretations of good cause obligations require an employer to continue the contract of employment until the occurrence of one of the following conditions subsequent:[215] the employer no longer has the economic need for anyone in the em-

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214 *See* H. PERRITT, EMPLOYEE DISMISSAL, *supra* note 5, § 3.5, at 128-30.

215 J. CALAMARI & J. PERILLO, THE LAW OF CONTRACTS 385 (3d ed. 1977). A condition subsequent is any fact, the existence or occurrence of which by agreement of the parties operates to discharge a duty of performance after it has become absolute.

ployee's job;[216] the employee engages in misconduct, or; the employee's job performance is unsatisfactory. All three items are classified as good cause for dismissal. Alternatively, of course, the employer could be obligated only to follow certain procedures in terminating employees.[217] In the case of a promise to follow procedures, dismissal of an employee without following the procedures constitutes a breach.

Conceptually, the implied-in-law covenant of good faith and fair dealing is breached when an employer terminates an employee without a reason which is rationally related to the employer's legitimate business interests. Professor Macneil's relational contract values, applied in the following paragraphs, develop a breach-of-covenant theory for the employment relation.[218]

The reciprocity norm means that past exchange between the parties justifies imposing future restrictions on the employer's right to terminate. The longer the relationship, the more appropriate the restrictions. Conversely, the covenant applied to a day laborer should impose few restrictions on the employer's power to dismiss.

The power relationship norm requires a counterpoise to employer power. If an adequate counterpoise exists because of bargaining power evidenced through an individual contract of employment or because of a collective bargaining representative, then there is less need to impose limitations through the covenant.

The legitimacy of means norm[219] requires something similar to what arbitrators require as due process. On the other hand, if an employer has promised a facially fair procedure for deciding disputes and requires at least that an objectively reasonable basis for employer decisions be found to exist in such procedure, then the law should not substitute a different standard of employer conduct.

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216 In Grubb v. W.A. Foote Memorial Hosp., 741 F.2d 1486 (6th Cir. 1984), the Sixth Circuit suggested that the rationale of *Toussaint* did not extend to a layoff. *Id.* at 1500. Rather, the court observed, that *Toussaint* involved removal of an employee from a position that continued to exist, while a layoff involves elimination of the position itself. *Id. See also* Rompf v. John Q. Hammons Hotels, Inc., 685 P.2d 25, 29 (Wyo. 1984) (no breach of handbook procedures by discharge for economic reasons).

217 *See* Pine River State Bank v. Mettille, 333 N.W.2d 622, 631 (Minn. 1983).

218 Macneil, *Values in Contract*, *supra* note 173, at 374-76.

219 *See id.* at 378.

These propositions track the common law more than they do statutory law. But the main point is that an interpretation of the covenant reflecting these relational contract values is not necessarily more intrusive than ordinary tort doctrine.

In tort cases, courts decide whether employer-defendants acted for improper motives or used improper means. The courts decide the existence of these states of mind by weighing the interests of the plaintiff and the defendant. Depending on whether ulterior motives necessarily mean bad faith, this may or may not be a broader inquiry than the good faith inquiry derived from application of relational contract values.

The fiduciary standard is more demanding than either the tort or relational contact standards in that a simple showing of motive other than for the benefit of the plaintiff is enough to establish a breach of the requisite mental state standard.[220]

B. Scope of Employer Discretion

The breach issue raises important questions of institutional responsibility regardless of how the covenant limits employer power.[221] Potentially, the court and jury are in the position of making decisions as to what efficient management of the employer's enterprise reasonably requires, balancing legitimate employer needs against legitimate employee interests.[222] When the obligation not to dismiss for certain reasons arises from the implied covenant, the court and jury decide whether the external standard was met, giving more or less latitude to the term "good faith."

One important way to limit the implied covenant, even as a source of good cause obligation, is to instruct the jury explicitly that employers must retain the discretion to set standards of performance and workplace rules. Only if employers abuse this discretion or use it as a pretext for ulterior motives can they be held liable. This approach eliminates many cases because presumably an employee's claim which does not evidence bad faith or pretext will not be presented before the jury. An alternative formulation, of course, would permit cases to go to the jury without such spe-

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220 *But see supra* notes 151-65 and accompanying text (explaining different ways of interpreting fiduciary duty of loyalty and implied covenant to bring them into closer accord).

221 These questions also arise under the implied-in-fact contract theory. *See* H. PERRITT, EMPLOYEE DISMISSAL, *supra* note 5, §§ 7.24-7.27, at 430-36.

222 *See generally id.* §§ 7.22-7.28, at 427-39 (a more complete treatment of a breach and the respective roles of judge and jury).

cific evidence, simply including the judge's caution to the jury about what inferences it should draw from dismissal for a reason that the jury would not find to be just cause.

Another formulation would permit the jury to evaluate *de novo* whether the employee in fact did what the employer contended, but not allow it to evaluate the standards set by the employer. Accordingly, if an employer fires an employee for off duty drug use, the jury would be permitted to decide whether or not the employee used drugs off duty, but not to decide whether the rule providing for dismissal for such conduct constitutes good cause. The foregoing theory is not entirely inconsistent with the Montana Supreme Court's analysis in *Gates II*. The Montana courts have suggested, however, that the standard for interpreting the terms "just cause" and "good cause" should be whether the employer had a fair and honest reason for dismissal.[223] The Montana courts have contrasted this standard with an objective standard.[224]

In *Prout v. Sears, Roebuck & Co.*,[225] the Montana Supreme Court, purportedly giving effect to a disclaimer reserving the right to dismiss at-will, held that dismissal of an at-will employee for a dishonest reason rather than without cause can violate the covenant. The court further stated that if an at-will employee is dismissed for dishonesty, the covenant requires that the employee be given a chance to prove innocence. A somewhat similar approach was used by a California court in *Ketchu v. Sears, Roebuck and Co.*[226] The *Ketchu* court held that a breach of covenant can be established by showing that the employer did not in good faith and with probable cause believe that there was good cause for dismissal.

Courts and juries can decide whether cause for dismissal exists by considering the body of labor arbitration precedent, much of which involves interpretation of express or implied commitments to dismiss only for good cause.[227] In determining whether

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223 Flanigan v. Prudential Fed. Sav. & Loan Ass'n, 221 Mont. 419, 426-27, 720 P.2d 257, 261-62 (1986).

224 *Id.*

225 236 Mont. 152, 772 P.2d 288 (1989) (reversing summary judgment for employer and remanding).

226 186 Cal. App. 3d 1644, 231 Cal. Rptr. 581, 586 (1986).

227 *See* H. PERRITT, EMPLOYEE DISMISSAL, *supra* note 5, §§ 3.2-3.4, at 121-28. *See also* Staton v. Amax Coal Co., 122 Ill. App. 3d 631, 634-35, 461 N.E.2d 612, 615 (1984) (reversing summary judgment for employer, remanding for trial of whether "cause" for dismissal existed, suggesting standards be borrowed from labor arbitration decisions).

an employer's discipline of an employee was for cause, an arbitrator usually considers two elements. First, the arbitrator must make a factual determination as to whether the employee committed the act alleged.[228] Second, the arbitrator must make a policy determination as to whether the act committed was of a character which warranted the discipline imposed.[229]

In all types of disputes over the existence of good cause for dismissal, there are two separate questions: (1) whether the employee engaged in the conduct the employer alleges, and; (2) whether the conduct constituted just cause for termination of employment. The first question is a straightforward fact issue. The second question requires the balancing of employer interests against employee interests, with appropriate consideration of the public interest on both sides.[230] The same two elements of cause regularly receive consideration in civil service cases, public employee constitutional cases, and statutory discrimination cases.[231] There also, courts differentiate between factual questions relating to employee conduct or performance and policy questions relating to whether such conduct or performance constitutes cause for termination. Substantially more discretion is given to the employer on the policy question.[232]

1. Who Decides What the Employee Did?

In *Toussaint v. Blue Cross & Blue Shield*,[233] the seminal implied-in-fact contract case, the Michigan Supreme Court discussed the facts of the breach issue as follows:

> Where the employer claims that the employee was discharged for specific misconduct—intoxication, dishonesty, insubordination—and the employee claims that he did not commit the misconduct alleged, the question is one of fact for the jury: did the employee do what the employer said he did?
>
> Where the employer alleges that the employee was discharged for one reason—excessive tardiness—and the employee presents evidence that he was really discharged for another reason—because he was making too much money in

228 *See* H. PERRITT, EMPLOYEE DISMISSAL, *supra* note 5, § 3.5, at 128-30.

229 *Id.*

230 *See generally id.* §§ 7.13-7.35, at 367-456 (discussing justification idea).

231 *See generally id.* §§ 2.1-2.38, at 41-117 (statutory claims); §§ 6.1-6.20, at 323-65 (public employee dismissal cases).

232 *See id.* § 6.13, at 349-351 (substantive due process).

233 408 Mich. 579, 292 N.W.2d 880 (1980). The *Toussaint* court discussed the question in terms of what a jury should decide, but its analytical framework is equally applicable to a bench trial.

> commissions—the question also is one of fact for the jury. The jury is always permitted to determine the employer's true reason for discharging the employee.[234]

In *Simpson v. Western Graphics Corp.*,[235] the Oregon Supreme Court agreed that the question of breach of a good cause promise involves the two questions posed earlier in this section.[236] The Oregon court concluded, however, that it was for the employer, and not for the court, to decide the factual question of what conduct occurred. This affirmed a trial court conclusion that "to constitute 'just cause,' the employer . . . must make a good faith determination of a sufficient cause for discharge based on facts reasonably believed to be true and not for any arbitrary, capricious, or illegal reason."[237] The court did not expressly address the issue of who determines good cause, but merged the two parts of the good cause inquiry.[238]

2. Who Decides What Is Good Cause?

The *Toussaint* court had more difficulty with the second question regarding what constitutes good cause. When an employer, as was the case in *Toussaint*, has promised to dismiss only for cause, a court cannot decide the breach issue without, to some extent, second-guessing the policy question of what amounts to good cause for termination. If the judicial factfinder is permitted to decide *de novo* whether there was good cause for discharge, there is a danger that the factfinder will substitute its judgment for the employer's. Thus, "[w]hile the promise to terminate employment only for cause includes the right to have the employer's decisions reviewed, it does not include a right to be discharged only with the concurrence of the communal judgment of the jury."[239] On the other hand, if the factfinder is prohibited from finding a breach when the employer's decision to dismiss was not unreasonable under the circumstances, the promise to dismiss only for good cause effectively is transformed into a satisfaction contract.[240] The *Toussaint* court opted to let the factfinder decide whether the reason proffered by the employer amounts to good

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234 *Id.* at 622, 292 N.E.2d at 896 (footnote omitted).

235 293 Or. 96, 643 P.2d 1276 (1982).

236 *Id.* at 100, 643 P.2d at 1278.

237 *Id.* at 99, 643 P.2d at 1278.

238 *See id.*

239 Toussaint v. Blue Cross & Blue Shield of Michigan, 408 Mich. 579, 622, 292 N.W.2d 880, 896 (1980).

240 *Id.* at 622-23, 292 N.W.2d at 896.

cause.[241]

In *Flanigan v. Prudential Federal Savings & Loan Association*,[242] the Montana Supreme Court distinguished between dismissal without good cause, which it rejected as a standard for breach of the implied covenant, and arbitrary dismissal, which it found proven from conflicting employer testimony that the employee was dismissed for poor performance and as part of a layoff without concern for performance.[243]

A useful model of the appropriate role for the jury is *Video Electronics, Inc. v. Tedder*.[244] *Video* dealt with a breach of a written employment contract. The *Video* court found that (1) the court, rather than the jury, should construe the contract, and (2) the jury should decide whether the employer's decision to dismiss was reasonable, unless the employer had reserved the right in the contract to be the sole judge as to the grounds for dismissal.[245] In later situations, the jury could decide only whether the employer acted in good faith.

The best approach is for an implied covenant jury to engage in a limited review of the employer's interpretation of the good cause standard. To do otherwise would vitiate the employer's promise, as the *Toussaint* court observed.[246] The jury should not, however, substitute its judgment for the employer's in defining good cause. A jury instruction on this question should require the jury to consider the nexus between the conduct asserted by the employer as justifying dismissal and the legitimate needs of the employer's business.[247] Regardless of the jury's role, there must be evidence to support its verdict.[248]

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241 *Id.* at 623, 292 N.W.2d at 896.

242 221 Mont. 419, 720 P.2d 257 (1986).

243 *Id.* at 424-25, 720 P.2d at 260.

244 470 So.2d 4 (Fla. App. 1985).

245 *Id.* at 6.

246 *See* Toussaint v. Blue Cross & Blue Shield of Michigan, 408 Mich. 579, 622-23, 292 N.W.2d 880, 896 (1980).

247 *See* Staton v. Amax Coal Co., 122 Ill. App. 3d 631, 635, 461 N.E.2d 612, 615 (1984). In *Staton*, the court suggested that cause existed only when: (1) notice has been given as to the ground for dismissal; (2) similar conduct by different employees is treated similarly; and (3) conduct was detrimental to the discipline and efficiency of the employer. Thus, the court reversed summary judgment for the employer and remanded for trial the issue of whether "cause" for dismissal existed. The court also noted that the burden of proof is on the employer to show cause. This is the same approach followed in public employee dismissal cases in which civil service statutes or regulations require cause as a prerequisite to dismissal. *See* H. PERRITT, EMPLOYEE DISMISSAL, *supra* note 5, §§ 6.2-6.5, at 324-33.

248 *See* Ferraro v. Koelsch, 119 Wis. 2d 407, 350 N.W.2d 735 (Wis. Ct. App. 1984), *aff'd on other grounds*, 124 Wis. 2d 154, 368 N.W.2d 666 (1985) (no evidence

C. *Proving a Breach: Burdens of Proof*

The burden of proof, on the issue of the existence of cause for termination, can be placed on either the plaintiff-employee or the defendant-employer. The plaintiff is burdened to plead and prove the absence of cause if the question is viewed as an essential part of establishing a breach of the legally implied employer promise of employment security.[249] The defendant, on the other hand, is burdened to plead and prove cause for dismissal if the question is viewed as one of establishing a condition subsequent that excuses the defendant's obligation to perform the promise of continued employment.[250] Treating existence of cause as a condition subsequent is probably more appropriate for promises of life employment or for a definite term than for promises to employ until cause for dismissal exists.

The resolution of this burden of proof question is frequently outcome-determinative. It is not beyond the realm of possibility, for example, that neither the plaintiff, nor the defendant-employer will have evidence on the reason for the plaintiff's discharge, if the employer assumed at the time that no cause was legally necessary to justify termination of what it viewed as an employment-at-will. Such a case might go to the factfinder with no evidence on the cause question. The party on whom the burden of production is imposed would therefore lose as a matter of law.

Precedent from arbitration hearings imposes the burden on the employer to prove cause for discharge.[251] Evidence law commentators suggest that the placement of burdens of proof should turn on several factors, such as the "policy of handicapping disfavored contentions,"[252] imposing the burden on the party with the

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to support jury verdict for employee; all evidence showed that employee violated rules explicitly which set forth in handbook as grounds for dismissal, and that employer met its obligation to investigate).

249 *See* C. MCCORMICK, HANDBOOK OF THE LAW OF EVIDENCE § 337, at 785 (E. Cleary 2d ed. 1972). *See also* Wyman v. Osteopathic Hosp. of Maine, Inc., 493 A.2d 330, 335 (Me. 1985) (affirming judgment for employer based on employee's failure to sustain burden of proof that dismissal was without just cause).

250 *See* RESTATEMENT (SECOND) OF CONTRACTS § 224 comment e (1981). Comment e explains that the term "condition subsequent" is not used in the *Restatement (Second)*. Rather, the concept is treated in section 230 under the heading, "Event that Terminates a Duty."

251 F. ELKOURI & E. ELKOURI, HOW ARBITRATION WORKS 621 (3d ed. 1973).

252 *See* C. MCCORMICK, *supra* note 249, § 337, at 786-87. The policy probably accounts for the requirement that the defendant bears the burden with respect to matters such as contributory negligence, the statute of limitations, and truth in defamation cases.

best access to relevant knowledge,[253] and imposing the burden in accordance with "judicial estimate of the probabilities of the situation."[254] The first and third of these factors militate in favor of imposing the burden of proving the absence of cause for dismissal on the plaintiff.

Several cases offer guidance as to the burdens of proof imposed on plaintiff and defendant concerning good cause for termination. In *Pugh v. See's Candies, Inc.*,[255] the California Court of Appeal, concluding that there were facts from which a jury could determine the existence of an implied promise of continued employment,[256] gave guidance on burdens of proof which the trial court might confront on remand. The court noted that the plaintiff bears the ultimate burden of proving that the termination was wrong.[257] The court then cited a Title VII case[258] in support of allocating the order of proof. After the plaintiff has demonstrated a prima facie case of wrongful termination in violation of the employment contract, the burden of production shifts to the defendant to show the reason for the termination.[259] Next, the plaintiff might attack the defendant's proffered explanation, either on the grounds that it is a pretext or on the grounds that it is insufficient to meet the employer's obligation under the contract or applicable legal principles. The court cautioned, however, that the legitimate exercise of managerial discretion not be infringed upon and that "good cause in the context of Mr. Pugh's case is 'quite different from the standard applicable in determining the propriety of an employee's termination under a contract for a specified term.' "[260] The court then characterized the appropriate standard of cause as "a fair and honest cause or reason,

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253 *Id.* at 787. Usually, the defendant must bear the burden of proof of payment of discharge in bankruptcy and in license cases. But very often a party is required to plead and prove matters peculiarly within the opponent's knowledge.

254 *Id.* The risk of failure of proof may be placed on the party who contends the more unusual event occurred. For instance, where a gift is alleged in a business relationship, the burden of proving donative intent is placed on the party claiming the gift.

255 116 Cal. App. 3d 311, 171 Cal. Rptr. 917 (1981).

256 *Id.* at 329, 171 Cal. Rptr. at 927 (there were facts in evidence from which the jury could determine the existence of such an implied promise: the duration of employment; commendations and promotions received; the apparent lack of any direct criticism of work; the assurances given; and the employer's acknowledged policies).

257 *Id.* at 329-30, 171 Cal. Rptr. at 927.

258 *Id.* at 330, 171 Cal. Rptr. at 927 (citing McDonnell Douglas Corp. v. Green, 411 U.S. 792 (1973)).

259 *Id.* at 329, 171 Cal. Rptr. at 927.

260 *Id.* at 330, 171 Cal. Rptr. at 928. The court added that where, as here, the

regulated by good faith on the part of the [employer]."[261]

In *Kravetz v. Merchants Distributors, Inc.*,[262] the Massachusetts Supreme Judicial Court reversed a judgment entered on a jury verdict for the plaintiff in a wrongful dismissal suit. The trial judge instructed the jury that the defendant-employer had the burden of proving that the plaintiff-employee did not perform satisfactorily. This was prejudicial error, the appellate court concluded, because "[t]he jury may well have concluded, incorrectly, that [the employer] had the burden of proving that it had good cause to discharge [Kravetz]."[263] The supreme court, however, reversed stating that the employer was entitled to a clear instruction that the burden was on the plaintiff to prove that the defendant terminated the employment without cause.[264]

This burden on the plaintiff to prove the absence of cause may not be as onerous as it seems. In an early Vermont case,[265] the Vermont Supreme Court held that the plaintiff has the burden of proving "his faithful performance of that contract and his wrongful discharge from the engagement by the defendant."[266] The court went on, however: "Had the plaintiff satisfied the jury of his adequate fulfillment of his undertaking, in the absence of anything to the contrary, the jury might infer that there was no sufficient cause for the defendant to discharge him."[267] This observation raises the possibility that a wrongfully discharged plaintiff could satisfy his burden by showing good job performance. For example, the plaintiff could introduce evidence of satisfactory performance appraisals. This showing would not only overcome the plaintiff's burden, but would effectively shift the burden of production to the defendant to articulate the cause for the discharge. The court held, however, that it was an error for the trial court to establish a presumption in the plaintiff's favor.

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employee occupied a sensitive managerial and confidential position, the employer must be allowed substantial scope in the exercise of subjective judgment.

261 *Id.* *See* Capone v. Cheesbrough Ponds, Inc., 112 A.D.2d 779, 492 N.Y.S.2d 277 (N.Y. App. Div. 1985) (absence for 31% of available working time is good cause for dismissal), *app. dismissed*, 67 N.Y.2d 904, 492 N.E.2d 1230, 501 N.Y.S.2d 814, (1986).

262 387 Mass. 457, 440 N.E.2d 1278 (1982).

263 *Id.* at 462, 440 N.E.2d at 1281.

264 *Id.* at 462-63, 440 N.E.2d at 1281.

265 Lambert v. Equinox House, Inc., 126 Vt. 229, 227 A.2d 403 (1967) (reversing wrongful discharge judgment for plaintiff).

266 *Id.* at 231, 227 A.2d at 404.

267 *Id.* *See* Washington Welfare Ass'n, Inc. v. Wheeler, 496 A.2d 613, 616 (D.C. 1985) (jury could infer lack of good cause for dismissal on conflicting evidence regarding whether plaintiff was disruptive).

Therefore, the court reversed because of the following jury instruction:

> The burden of proving just cause of the discharge of the employee generally rests upon the employer, and where the employee enters upon his duties and continues until he is dismissed, he need not prove that he performed his duties as a presumption arises that such is the fact, and the burden of proving a sufficient cause of his discharge is on the employer, and this burden does not shift to the employee by reason of the allegations in his complaint that he was dismissed without good cause.[268]

V. JURY INSTRUCTIONS

Although in the abstract, it seems that a good cause interpretation of the covenant is dramatically different from a more deferential interpretation, the jury instructions explored herein show that the difference may be more apparent than real. The prevailing view of the good cause standard suggests that factfinders should defer substantially to employer determinations on the facts of employee performance and conduct and on the policy decision as to what should constitute good cause for eliminating a particular employment relationship.

In an implied covenant case,[269] one of two types[270] of jury instructions can be given on the breach issue, a good cause instruction, and a specific mental state instruction.[271]

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[268] *Lambert*, 126 Vt. at 231, 227 A.2d at 404. *See also* Schmidly v. Pery Motor Freight, Inc., 735 F.2d 1086, 1087 (8th Cir. 1984) (affirming, as consistent with Arkansas law, jury instruction burdening plaintiff to prove absence of wilful misconduct or employer's lack of good faith in believing that employee conduct detrimental to employer).

[269] A variety of jury instructions can be found in M. DICHTER, A. GROSS, D. MORIKAWA, & S. SAUNTRY, EMPLOYEE DISMISSAL LAW: FORMS AND PROCEDURES §§ 8.47-8.69 (1986) [hereinafter M. DICHTER].

[270] A third type limits the covenant to public policy jeopardy. A public policy type is illustrated by the portion of the Cloutier v. Great Atl. & Pac. Tea Co., 121 N.H. 915, 436 A.2d 1140 (1981) instruction quoted in H. PERRITT, EMPLOYEE DISMISSAL, *supra* note 5, § 7.16, at 408. A jury instruction defining good faith in terms of public policy was reviewed sympathetically in Magnan v. Anaconda Indus., Inc., 193 Conn. 558, 479 A.2d 781 (1984), where the Supreme Court of Connecticut held that an employee, hired under a contract of indefinite duration, could not maintain a cause of action in contract for breach of an implied covenant of good faith and fair dealing based wholly upon a discharge without just cause. *Id.* at 559, 479 A.2d at 782.

[271] It would be simpler to call this a "malice" instruction, but the term "malice" has so much baggage from defamation law and elsewhere that it may confuse the issue to use that term.

A. Good Cause Instruction, with Three Variations

The first type, a good cause instruction, permits a verdict for the plaintiff-employee if the jury concludes that the dismissal was not supported by good cause. There are three subtypes of good cause instruction: the first leaving the jury a free hand; the second leaving the employer a relatively free hand to determine what is good cause and to decide the facts constituting such cause, and; the third intermediate instruction between those two extremes. In *Fortune v. National Cash Register Co.*,[272] the court approved submitting the question of motive to the jury in simple terms: "Did the Defendant act in bad faith . . . when it decided to terminate the Plaintiff's contract . . .?"[273] The court permitted the jury to infer bad faith—an intent to deprive the plaintiff of legitimately earned commissions—from the termination of the plaintiff one day after a large order was obtained on which commissions would have been due.[274] Similarly, in *Monge v. Beebe Rubber Co.*,[275] the court gave the jury a fairly free hand in finding bad faith or malice from the circumstances.[276] The dissent disagreed that such an inference rationally could be drawn from the evidence.[277] The Montana Supreme Court in *Prout v. Sears, Roebuck & Co.*[278] approved a jury instruction that encourages a jury to apply a good cause standard with little principled guidance.

The instruction presented in *Pine River State Bank v. Met-*

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272 373 Mass. 96, 364 N.E.2d 1251 (1977).

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

274 *Id.* at 103, 364 N.E.2d at 1257 (fact that dismissal was after portion of bonus vested still created question for jury on defendant's motive in terminating employment). *But see* Tenedios v. Wm. Filene's Sons Co., 20 Mass. App. Ct. 252, 254, 479 N.E.2d 723, 726 (1985) (arbitrary firing for suspicion of theft from employer does not breach covenant under *Fortune* doctrine).

275 114 N.H. 130, 316 A.2d 549 (1974).

276 *Id.* at 133-34, 316 A.2d at 552 (holding that foreman's overtures and capricious firing, the seeming manipulation of job assignments, and the apparent connivance of the personnel manager in this course of events collectively support the jury's conclusion that the dismissal was maliciously motivated). *See also* Gray v. Superior Court (Cipher Data), 181 Cal. App. 3d 813, 226 Cal. Rptr. 570 (1986) (employee offered insufficient evidence to show violation of public policy in state discrimination statute by showing employee was not insubordinate and handbook procedures not followed, but had stated claim for breach of implied covenant because these claims were based on questions of fact, not law).

277 *Monge*, 114 N.H. at 134-35, 316 A.2d at 552. The dissent argued that a reasonable person could not find for the plaintiff on the evidence of the case, that the substance of the plaintiff's claim is that she was dismissed because she did not accept an invitation by her foreman to go out with him, and that it is not reasonable to find that this single refusal was the reason for the termination of plaintiff's employment.

278 236 Mont. 152, 772 P.2d 288 (1989).

tille[279] is a good example of the second subtype of good cause instruction. This instruction yields more latitude to the employer:

> It is the law that . . . an employer has the right to establish its own standards of performance, and if the defendant [employee] was not performing his work according to those standards, the bank would have good or just cause to terminate him for non-performance. And this is true even though some other employer might not have had as high standards, and it's true even though you, the jury, might feel that the bank's standards were too high. In order to breach standards of performance, an employee must know what the standards are, and in order to terminate for good cause, an employee must not only have breached the standards of performance, but the employer must have uniformly applied its standards of performance to all employees. If you find that the [employee] has sustained his burden of proof and has proven that the bank terminated him without good or just cause under the circumstances shown by the evidence and the law I have just given you, [then your verdict should be for the employee].[280]

In *Osterkamp v. Alkota Manufacturing Co.*,[281] the court approved the following instruction in a case where the breach allegation was premised on the employer's failure to follow the procedures in a personnel handbook:

> The reason for Plaintiff's discharge is not material to the resolution of the issue in this case. The only issue to be resolved by you is whether or not Plaintiff's discharge from his employment was in violation of Defendant's own rules and regulations, and if so, whether or not Plaintiff sustained any damages thereby.[282]

These instructions reserve to the employer virtually unlimited latitude to define good cause. An intermediate allocation of decision-making responsibility, a third subtype of good cause instruction,[283] requires that the cause asserted by the employer bear a reasonable relationship to the employer's business needs. Thus, the

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279 333 N.W.2d 622 (Minn. 1983). The appellate court found the just cause instruction to be in error because the employer was found not to have promised to terminate only for cause. Nevertheless, the instruction is a good example of an instruction where the existence of cause appropriately is at issue.

280 *Id.* at 622. The court affirmed the instruction given by the trial court. The instruction was not quoted by the court in the appellate division's opinion.

281 332 N.W.2d 275, 277 (S.D. 1983).

282 *Id.*

283 The third subtype of just cause instruction is hard to distinguish from the specific mental state instructions discussed *infra* in this section.

instruction quoted above can be supplemented by the following language:

> You may not find that the employer had cause to discharge the plaintiff unless you find that the reason given by the employer for the dismissal related to the employer's business. If you find that the reason given related only to the employee's off-the-job activities, and that the employer has no legitimate interest in those activities, then you may not find that cause existed.[284]

This intermediate approach was followed in *Roach v. Consolidated Forwarding Co.*,[285] in which the court affirmed the following jury instruction on the meaning of good cause:

> As used in these instructions, the term "just cause" means a real cause or basis for dismissal as distinguished from an arbitrary whim or caprice—that is, a cause or ground that a reasonable employer, acting in good faith under the collective bargaining agreement here in question, would regard as good and sufficient reason for terminating the services of an employee.[286]

On remand, the trial court in *Pugh* gave an intermediate type of good cause instruction:

> Appellant's second theory is that See's breached the covenant of good faith and fair dealing implied by law in any employment contract. Under this theory, appellant has the burden of establishing by a preponderance of the evidence all of the facts necessary to prove the following issues: (1) the existence of an implied contract of employment; (2) that the circumstances of appellant's termination by See's revealed bad faith and were contrary to the duty of good faith and fair dealing; and (3) damages legally caused by that bad faith termination. The question of what is or is not good faith and fair dealing between an employer and an employee, or what constitutes good cause for termination is for you to decide under all the circumstances of this case, and in light of the evidence that has been presented. You are not to decide whether or not in your opinion the appellant's work performance was or was not satisfactory. It is not appropriate for you to substitute your opinion for that of the company management in evaluating appellant's work performance. You shall examine the reasons given by the employer as to why the appellant was terminated for unsat-

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284 *See* H. PERRITT, EMPLOYEE DISMISSAL, *supra* note 5, § 7.28, at 438.

285 665 S.W.2d 675 (Mo. App. 1984) (suit for breach of fair representation by union, and breach of collective bargaining agreement by employer).

286 *Id.* at 679 n.2.

> isfactory work performance, and to determine whether or not the employer acted in good faith and not arbitrarily. The phrase "good faith" of the employer describes the state of mind of the employer which is honest of purpose, free from an intention to defraud, and in keeping with one's duty of reasonability. The phrase "bad faith" is the opposite of "good faith" and describes a state of mind of the employer which is fraudulent or designed to mislead or deceive, or one in which the neglect or refusal to fulfill some duty or contractual obligation is not the result of an honest mistake, but arises out of a sinister or evil motive.[287]

In *Wadeson v. American Family Mutual Insurance Co.*,[288] the court approved a jury instruction on good faith, rejecting the plaintiff's argument that the covenant required the employer to discharge only for good cause.[289] It impliedly approved the following jury instruction:

> North Dakota law recognizes an implied covenant of good faith and fair dealing in all contracts. In employment contracts, this means that neither party may do anything in bad faith that will injure the rights of the other to receive the benefits of the employment agreement. In order for Wayne Wadeson to prevail on this count, the preponderance of the evidence must show that he was dealt with unfairly and in bad faith in the termination of his employment contract. Factors which you may consider in determining whether Defendants breached their duty of good faith and fair dealing to Wayne Wadeson are duration of employment, commendations and promotions or lack thereof, employee evaluations, job performance, existing personnel policies, and any assurances or representations by the defendants that shows an implied promise by the employer not to act arbitrarily or unfairly in terminating his employment contract. *The law, however, does not forbid a termination for legal cause related to the employer's legitimate interest in running the business.*[290]

The Montana Supreme Court suggested the following instruction on breach of the covenant:

> In determining whether the defendant violated the duty of good faith and fair dealing, you must balance the interests of

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287 Pugh v. See's Candies, Inc., 203 Cal. App. 3d 743, 755, 250 Cal. Rptr. 195, 206-07 (1988) (quoting and approving jury instructions).

288 343 N.W.2d 367 (N.D. 1984).

289 *Id.* at 370.

290 *Id.* at 369 (emphasis added). *See also* Ketchu v. Sears, Roebuck & Co., 186 Cal. App. 3d 1644, 231 Cal. Rptr. 581, 586 (1986) (quoting employer's proffered jury instruction on covenant and reversing trial court for failing to give it).

> the defendant in controlling its work force with the interest of the plaintiff in job security. An employer such as Pacific is entitled to be motivated by and to serve its own legitimate business interests, and must be given discretion in determining who it will employ and retain in employment. Thus if the employer is motivated to discharge the employee for reasons unfair or not honest, the employee is entitled to recover damages proximately caused by the breach. On the other hand, if the employer was motivated by honest business reasons in discharging the employee, the employer had the right to terminate the employment on the same day as notice is given for the discharge.[291]

The third subtype of implied covenant instruction would permit the jury to find a breach if it finds that the employee was dismissed for off-duty conduct bearing no relation to legitimate employer interests.[292]

B. Subjective Good Faith Instruction

The second type of implied covenant instruction, a subjective good faith instruction, is fundamentally different in concept from a good cause instruction, though similar in reality to the third subtype of good cause instruction, as a comparison with the *Pugh* instruction demonstrates. This second basic type of instruction permits a verdict for the plaintiff-employee only if the jury finds a specific mental state. This approach is illustrated by the *Cloutier* instructions:

> Was the termination of the employment, the contract of employment at will, by the employer, A & P, motivated by bad faith or malice or based on retaliation? Now, I have just used a term of art, and that word "malice" may bother some. So I am going to define that for you as meaning actual malice or ill will, hatred, hostility, or some evil motive on the part of the defendant . . . .[293]

Depending on the role of the judge and jury in deciding *de novo* what constitutes good cause, there may not be much difference between a good cause standard and a subjective good faith standard. As the quoted instructions illustrate, one view of the jury's role in

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291 Hobbs v. Pacific Hide & Fur Depot, 236 Mont. 503, 508, 771 P.2d 125, 129-30 (1989) (reversing judgment on jury verdict for employer because of error in implied covenant instruction, which failed to emphasize that standard is legitimate expectations of parties). Earlier parts of the suggested instruction on determining whether the covenant should be applied are omitted.

292 *See* M. DICHTER, *supra* note 269 § 8.62, at 338 (citing Rulon Miller).

293 *Id.*

enforcing a good cause standard is to determine whether the employer decided in good faith that particular circumstances and factual inferences constituted good cause. It is difficult to distinguish this kind of jury question from presenting the jury with the question of whether the employer acted in good faith. The degree of jury intrusion into employer management of the workplace depends not on whether one adopts a good cause or subjective good faith approach, but on the degree to which one instructs the jury to defer to employer rules of conduct and performance.

VI. DAMAGES

Compensation in the form of money damages for disappointed expectations is the usual remedy for breach of contract. Expectation damages are measured by the financial position the plaintiff would have occupied had the contract been fully performed. Expectation damages in a wrongful dismissal case require the factfinder to project how long the employee would have been employed but for the employer's breach. Damages for the period of time after the trial are referred to as front pay. Quantifying front pay is an inherently speculative undertaking.[294] Some courts deny front pay.[295] There is a trend, however, in implied contract cases, like statutory employment discrimination cases, to award front pay.[296] *Stark v. Circle K. Corp.*[297] is a recent example where the court affirmed a $230,000 jury verdict for an employee dismissed for refusing to sign a contested probation notice.

Foley has been controversial because the plaintiff bar had hoped that the implied covenant theory would prove to be a broad means of challenging the propriety of dismissals while also generating sufficient damages in meritorious cases to compen-

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294 *Compare* Washington Welfare Ass'n, Inc. v. Wheeler, 496 A.2d 613, 617 (D.C. 1985) ($26,000 jury award for future earnings under contract terminable only for just cause allowed to stand) *with* Gram v. Liberty Mut. Ins. Co., 391 Mass. 333, 334, 461 N.E.2d 796, 798 (1984) (reversing $325,000 judgment for dismissed employee on grounds that proper measure is not same as earnings for lifetime employment).

295 *See, e.g.*, Sterling Drug, Inc. v. Oxford, 294 Ark. 239, 251, 743 S.W.2d 380, 386 (1988) (reviewing cases rejecting front pay as too speculative). In Brockmeyer v. Dun & Bradstreet, 113 Wis. 2d 561, 335 N.W.2d 834 (1983), the court concluded that reinstatement and backpay were the most appropriate remedies for wrongful dismissal in violation of a public policy. *Id.* at 575, 335 N.W.2d at 841.

296 *See, e.g.*, Ritchie v. Michigan Consol. Gas Co., 163 Mich. App. 358, 372-74, 413 N.W.2d 796, 803 (1987) (approving front pay in implied contract case); H. PERRITT, EMPLOYEE DISMISSAL, *supra* note 5, § 4.28, at 236-41.

297 230 Mont. 468, 476, 751 P.2d 162, 167 (1988) (an employer must proffer a "fair and honest reason" for termination in order to escape liability under the covenant).

sate the plaintiff bar.[298] The California Supreme Court disappointed these plaintiff lawyers. The *Foley* court was not wrong; the implied covenant is a contract theory. All the covenant does is to impose a term of the employment contract that the parties themselves did not establish.

It is true, of course, that something like the covenant has been associated with tort damages in insurance law. In order to make the case for a broader range of damages in connection with wrongful termination from employment, one must begin with the different purposes of contract enforcement and tort law in the legal system. Generally, people think of contract law as protecting expectations, while tort law is associated with protecting the public interest. This, of course, justifies awarding larger damages in public policy tort cases than in implied contract or implied covenant cases where the only interest involved is that of the individual employee.

There are two ways to get what the plaintiff bar wants. One way is to elevate the interests of the individual employee to broader societal interests, thereby justifying tort damages for breach of employment contracts. A more feasible way is to recognize that front pay should be the usual remedy in breach of contract cases. Absent proof that an employee's tenure was likely to be cut short, the employee's benefit of the bargain is continuation of employment, and damages for breach of the bargain are the wages and benefits the employee would have received while the employment continued.

VII. CONCLUSION

In the absence of comprehensive statutory reform, the implied covenant of good faith and fair dealing will most likely be used to expand the substantive rights afforded at-will employees. The implied covenant recognizes the relational character of employment contracts, something already well recognized through trends in statutory law and in the collective bargaining relationship. The covenant is broad enough conceptually to require cause for dismissal of long-term employees. Interpreting the covenant to require cause for termination is really a small doctri-

298 Foley v. Interactive Data Corp., 47 Cal. 3d 654, 765 P.2d 373, 254 Cal. Rptr. 211 (1988) (only contract damages recoverable for breach of implied covenant; public policy tort must be based on rights and obligations affecting the public rather than on internal employer operations; statute of frauds no bar to implied-in-fact contract enforcement).

nal step beyond what is already done for nonemployment contracts. Imposition of a simple good cause standard actually may reduce transaction costs of a termination decision compared with the status quo, because employers face such a diverse array of fragmentary duties to employees. It may be appropriate under this interpretation to apply the covenant only to long-term employees, for example those with service in excess of five years. If the covenant is interpreted to require good cause, courts should instruct juries to defer to employer determinations of performance and conduct standards, unless they are arbitrary or irrational.

Articulating a test of arbitrariness for employer rules also invites interpreting the covenant to legitimate a kind of review of employer dismissal decisions analogous to judicial review of administrative agency decisions. Either a good cause approach or an administrative law model protects legitimate employee expectations, while limiting the danger of ignoring legitimate employer expectations and the risk of unacceptable increases in employment costs.