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IS CALIFORNIA STILL AN AT-WILL EMPLOYMENT STATE?

Answer: Probably not -- the Implied-in-Fact Exception seems to have swallowed the rule.

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According to the California Labor Code, California is an "at-will" employment state. Under the at-will presumption, a California employer, absent an agreement or statutory or public policy exception to the contrary, may terminate an employee for any reason at any time.

However, California courts have progressively eroded the at-will employment doctrine by carving out exceptions that restrict an employer's ability to freely terminate an employee without a "for cause" or fairness basis. Indeed, the exceptions have nearly "swallowed" the at-will rule. This article will discuss these exceptions, and focus particularly on the implied-in-fact contract exception -- the particular exception which threatens to swallow the rule. California courts struggle with interpreting the implied-in-fact contract exception and have a long history of contradictory judicial interpretations of it.

I. California's At-Will Employment Doctrine and Its Routine Exceptions

The at-will employment doctrine enables an employer or employee to end the employment relationship at any time. Under the California Labor Code:

> An employment, having no specified term, may be terminated at the will of either party on notice to the other. Employment for a specified term means an employment for a period greater than one month.

CAL. LAB. CODE § 2922 (2005) (first enacted 1937).

This presumption of at-will employment may be overcome by (1) express agreement, (2) statutory exceptions, or (3) public policy. First, parties may expressly agree to requisite conditions, provided they are lawful, for termination. See Guz v. Bechtel National, Inc., 24 Cal. 4th 317, 336 (Cal. 2000).

Secondly, the at-will presumption may be defeated by statutory exceptions. For example, Title VII of the Civil Rights Act of 1964 (42 U.S.C. § 2000e et seq.) prohibits termination at will if the

termination is based on protected status such as race or ethnicity. Similarly, the National Labor Relations Act (29 U.S.C. § 151 et seq.) forbids firing for engaging in union and protected concerted activity, and for filing charges and testifying under the Act. See Foley v. Interactive Data Corp., 47 Cal. 3d 654, 665 n.4 (Cal. 1988).

Finally, public policy exceptions have been found to preclude termination at will. For example, an employee cannot be terminated by his employer for refusing to engage in illegal price fixing in violation of the Sherman Antitrust Act and the Cartwright Act. See Tameny v. Atlantic Richfield Co., 27 Cal. 3d 167 (Cal. 1980).

Despite their power to transform an at-will employment relationship into one for cause, these three exceptions are fairly routine. They are not difficult for courts, employers or employees to apply. However, California courts also recognize a fourth exception: the implied-in-fact contract. This exception has not only greatly hamstrung managerial discretion in the workplace, but has also created much confusion in the courts.

II. The Implied-In-Fact Exception to the At-Will Employment Doctrine

In the 1980's, California courts decided two key cases that applied the implied-in-fact exception to the employment arena: Pugh v. See's Candies, Inc., 171 Cal. Rptr. 917 (Cal. Ct. App. 1981) (overruled in part by Guz, 24 Cal. 4th 317, 351) and Foley, 47 Cal. 3d at 654.

A. Pugh v. See's Candies, Inc.: "Totality of the Circumstances"

In Pugh, the appellant employee worked his way up the corporate ladder from dishwasher to vice president, and was fired after 32 years of employment. Pugh, 171 Cal. Rptr. at 918. In a breach of employment contract action against his employer and the union, Pugh alleged he was discharged for objecting to his employer's various proposals to modify its contract with the union. Id. at 920. Pugh argued that he was wrongfully terminated because his employer frequently assured him of job security; maintained a practice of not firing administrative personnel except for good cause; never notified him of a problem that he needed to correct; never formally criticized his work; and never denied him a bonus. Id. at 919-20.

The trial court granted the defendants' motions for nonsuit, and the California Court of Appeals, relying on contract principles, reversed. The appellate court held that though Pugh and his employer had not expressly agreed to a for cause employment relationship, nonsuit was improper since a jury could conclude from the factual evidence that the employer impliedly promised to refrain from treating his employees in an arbitrary manner. Id. at 927. In particular, the court explained that an implied-in-fact contract can arise from such factors as the employer's acknowledged policies and practices, the longevity of the employee's service, promotions, assurances, and absence of direct criticism. Pugh, 171 Cal. Rptr. at 927. However, the court cautioned that the totality of the employment relationship -- not just abstract language standing alone -- must first be scrutinized in order to determine whether the parties had formed an implied-in-fact contract. Id.

B. Foley v. Interactive Data Corp.: "Actual Intent" and New Factors

Seven years later, in Foley v. Interactive Data Corp., 47 Cal. 3d 654 (Cal. 1988), the California Supreme Court affirmed Pugh, but expanded the types of situations in which the implied-in-fact contract exception could apply. Specifically, the court reiterated that implied-in-fact agreements are proven by fact-based arguments, applying a "totality of the circumstances" approach to the parties' conduct. Foley, 47 Cal. 3d at 681. In Foley, the plaintiff employee received steady salary increases, promotions, awards, and excellent performance evaluations during his 6 years and 9 months of employment. Id. at 663. The company decided to replace Foley for "performance reasons" shortly after he voiced his suspicions that his new supervisor previously engaged in criminal activity. Id. at 664. Ultimately, Foley was given the choice to either resign or be fired. Id.

Foley first argued that he was discharged in violation of public policy. However, the appellate court held that when an employee chooses to disclose information to his employer that serves only the employer's private interest and not the public interest at-large, the public policy exception does not apply. Foley, 47 Cal. 3d at 662. On appeal, the California Supreme Court affirmed this portion of the appellate court's holding, which dismissed Foley's causes of action alleging a discharge in breach of public policy and a tortious breach of the implied covenant of good faith and fair dealing. Id. at 670-671.

However, more importantly, the court reversed the portion of the lower court's judgment that dismissed Foley's cause of action alleging an implied-in-fact agreement to discharge only for cause. In response to Foley's implied-in-fact contract argument, the court determined, as in Pugh, that Foley had plead facts which, if proven, could lead a jury to find that he and his employer formed an implied-in-fact contract that limited his employer's ability to arbitrarily discharge him. Id. at 681-682. The court identified several factors that may prove the existence of an implied agreement to only terminate for cause. Those factors include personnel policies, employer practices, industry practices, employee's length of service, and assurances by the employer of continued employment. Id. at 679-680. In identifying these factors, the court reasoned that in employment cases, the fact finder needs to determine the parties' actual intent, and in order to do so, can examine the parties' conduct to see if they created an implied contract. Id.

C. Scott v. Pacific Gas & Electric Co.: "Demotions Protected"

Following Foley, the California Supreme Court in Scott v. Pacific Gas & Electric Co., 11 Cal. 4th 454 (Cal. 1995), significantly expanded the implied-in-fact contract exception to cover wrongful demotions as well. In Scott, the plaintiff employees were demoted from senior managerial engineering positions, and sued, claiming, among other things, that their employer breached an implied-in-fact contract term to demote employees only for good cause. Scott, 11 Cal. 4th at 458.

On appeal, the California Supreme Court reinstated the trial court's decision to award the employees damages arising from the employer's breach of an implied-in-fact contract term to only

demote employees for good cause. Id. at 474. In analyzing the plaintiffs' claim, the Scott court referred to Foley and pointed out the modern trend in contract law to reverse the presumption that the writing provides the definitive terms of the agreement, and stated that evidence from experience and practice can create new terms to an agreement. Id. at 463. The court quoted the Foley court language that "implied contractual terms 'ordinarily stand on equal footing with express terms.'" Scott, 11 Ca. 4th at 463 (quoting Foley, 47 Cal. 3d at 677-78).

The court concluded that the employees' claims based on an implied-in-fact contract term to demote only for cause should stand. The court noted "ample evidence" from the employer's personnel policy manual and testimony of one of the employer's managers to support the view that the employees had a reasonable expectation that the employer would follow its own human resources policy, which stated that disciplining of employees would only occur for good cause. Id. at 465.

III. What's the Problem with the Implied-In-Fact Exception?

Pugh, Foley, and Scott each advocated a "totality of the circumstances" approach, and set out a seemingly straightforward standard for determining the existence of an implied-in-fact contract. California courts, however, struggle greatly in applying this guideline. In fact, California case law applying the standard is inconsistent: see Wayte v. Rollins International, Inc., 169 Cal. App. 3d 1, 18 (Cal. Ct. App. 1985) (in wrongful discharge action, evidence of employer's repeated assurances over six years that employee's work was satisfactory was sufficient to raise inference that employee was wrongfully terminated in violation of an implied-in-fact promise that he would only be discharged for cause); Harlan v. Sohio Petroleum Co., 677 F. Supp. 1021, 1030 (N.D.Cal. 1988) (in plaintiff's action for breach of contract and wrongful discharge, court denied defendant employer's summary judgment motion because evidence that defendant made oral assurances about job security to plaintiff during recruitment raised genuine issue of material fact of whether employer's discharge of plaintiff was wrongful breach of an implied promise not to terminate except for good cause); Miller v. Pepsi-Cola Bottling Co., 210 Cal. App. 3d 1554, 1559 (Cal. Ct. App. 1989) (court affirmed trial court's grant of summary judgment for employer in wrongful discharge action and held that mere promotions and salary increases during eleven years of service were natural occurrences of employment relationships insufficient to raise the inference of an implied-in-fact contract); and Tollefson v. Roman Catholic Bishop, 219 Cal. App. 3d 843, 856 (Cal. Ct. App. 1990) (summary judgment for employer in wrongful discharge action was proper where employer and employee had express one-year agreement with no obligation for renewal, holding terms of written agreement cannot be changed through evidence of long service, prior contract renewals, and absence of poor performance evaluations).

Courts appear uncertain as to whether at-will disclaimers in employment manuals and handbooks, oral assurances of job security and continued employment, performance appraisals, promotions, salary increases, and a combination of some or all of these factors are enough to transform an at-will relationship into one for cause. In fact, these contradictory outcomes even led one judge of the U.S. Court of Appeals for the Ninth Circuit to reflect that the once simple presumption of at-will employment has been replaced by burdensome trials and discovery, has created endless and insurmountable confusion among judges and juries, and has withered away to a "hollow legal fiction."

See Kern v. Levolor Lorentzen, Inc., 899 F.2d 772, 783 (9th Cir. 1990) (Kozinski, J., dissenting) (questioned on other grounds by Guz, 24 Cal. 4th 317).

Much of the problem stems from the fact that, despite the stated resolve to abide by traditional contract law, California courts are veering from this goal. For instance, although contract law requires that parties manifest an intent to be bound by an agreement, courts are confused as to what factors demonstrate intent, as highlighted in Foley. Deciphering what the parties intended is no easy task -- especially since the Foley court explained that the contractual understanding need not be overt, but can arise from the parties' conduct. Foley, 47 Cal. 3d at 679-680. However, a significant discrepancy results when some California courts find the requisite contractual intent solely based on employer praise and promotion in response to satisfactory employee performance, while other courts require these factors plus much more.

Consequently, employers haven't the slightest idea of how to protect themselves from impliedly entering into "for cause" employment relationships. Since California courts insist on examining the "totality of the circumstances" (see, e.g., Pugh, Foley, and Scott), at-will disclaimers in employment handbooks and manuals provide little protection. Likewise, though employers could have their employees sign written, express agreements that specifically indicate that the employees work at-will, these too are only one factor for consideration in the "totality" approach. However, a few recent California cases significantly eliminated past confusion by enunciating what steps an employer can take to ensure that at-will remains the rule in the workplace.

IV. Clarity for California Employers?

The Pugh line of cases analyzes the employment relationship based on the "totality of the circumstances." However, in Guz, the California Supreme Court stressed that the "totality of the circumstances" analysis should not imply "that every vague combination of Foley factors, shaken together in a bag, necessarily allows a finding that the employee had a right to be discharged only for good cause, as determined in court." Guz, 24 Cal. 4th at 337.

Even though employers may attempt to protect themselves by including at-will provisions in employment handbooks and personnel manuals, California courts still allow other evidence of contrary employment intent, especially when other provisions in the employer's employment materials suggest limits on the ability to terminate. Id. at 339. However, at-will language in a handbook and personnel manuals cannot be ignored, and must be weighed along with other evidence of employer intent. Id. at 340. In fact, "most cases applying California law, both pre-and post-Foley, have held that an at-will provision in an express written agreement signed by the employee, cannot be overcome by proof of an implied contrary understanding." Id. at 340 n.10.

One bright spot for employers is that many of the post-Foley cases have not allowed for a finding of termination only for cause based solely on evidence of duration of service, regular promotions, favorable performance reviews, praise from supervisors, and salary increases. See e.g. Guz, 24 Cal. 4th 317, 341 (citing Horn v. Cushman & Wakefield Western, Inc., 72 Cal. App. 4th 798,

817-19 (Cal. Ct. App. 1999), Davis v. Consolidated Freightways, 29 Cal. App. 4th 354, 368-369 (Cal. Ct. App. 1994), Tollefson v. Roman Catholic Bishop, 219 Cal. App. 3d 843, 856 (Cal. Ct. App. 1990), and Miller v. Pepsi-Cola Bottling Co., 210 Cal. App. 3d 1554, 1558-1559 (Cal. Ct. App. 1989)). Rather, California courts acknowledge that these events are merely "natural consequences" of a properly functioning work environment. Guz, 24 Cal. 4th at 341. Further, the Guz court observed that transforming at-will relationships into ones terminable only for cause based solely on successful longevity would hinder the retention and promotion of employees. Id. at 342.

In order to create a "for cause" employment relationship, the employer must specifically communicate that seniority and longevity create rights against termination at-will. Id. at 342. For instance, though length of employment was a significant factor in Foley, repeated assurances of job security was the prominent conduct that led the court to find for the employee. This is good news for California employers, in that it appears they can protect themselves by minding what they say to their employees.

As an additional protection for employers, the court in Salsgiver v. America Online Inc., 147 F. Supp. 2d 1022 (D.C. Cal. 2000), noted that "an implied-in-fact contract requiring cause for termination is fundamentally inconsistent with an express at-will contract, and the terms of the express contract cannot be rewritten by implications arising from later conduct." Salsgiver, 147 F. Supp. 2d at 1029. Thus, there cannot be both an express contract and implied contract where each requires different results. The express term is controlling even if not part of an integrated employment contract. See Starzynski v. Capital Public Radio, Inc., 105 Cal. Rptr. 2d 525, 529 (Cal. Ct. App. 2001).

Likewise, in Agosta v. Astor, 120 Cal. App. 4th 596 (Cal. Ct. App. 2004), the California Court of Appeals followed up on these cases. The court said that "[w]hen the employment contract contains an 'at-will' provision, an employee's reliance on . . . oral promises of continuing employment is simply not justifiable." Agosta, 120 Cal. App. 4th at 604.

V. Current Status of the At-Will Employment Doctrine in California - Viable Statute or "Hollow Legal Fiction?"

Given the developments in California case law (e.g. Guz, Salsgiver, Starzynski and Agosta), California employers need to be more mindful of what they say and write in the workplace. California courts are still being asked to determine when at-will employment is not really at-will employment (see, e.g., Dore v. Arnold Worldwide, 2005 Cal. LEXIS 2518 (presently before the California Supreme Court)). Since courts will examine the "totality of the circumstances," termination for cause may be found in a particular case where the evidence of an implied contract outweighs the presumption of at-will employment. However, in accordance with the courts' much more careful recent application of the implied-in-fact contract exception, an express contract that articulates the at-will policy will not be trumped by evidence of an implied agreement.

Employers of course can still preserve at-will employment relationships by forming express agreements with their employees. However, this may lead one to question whether California really

has an at-will doctrine since employers need to take affirmative precautions to preserve the rule. It no longer enjoys a status as a "default" position that favors management. Additionally, will employees enthusiastically agree to enter into express contracts that give their employers unbridled power to terminate them on a whim? California case law makes this task easier said than done for employers.

At present, employers can expect surprises -- especially in the case of longer term employees. Take for example, a talented and hard-driving employee who is hired as a California clerical worker in 2001 and rises through the ranks to an executive managerial position. In 2006, she finds herself terminated as an "at-will" employee. If entry-level managers and executives entered into written agreements with for cause-type termination provisions during her employ, that employee has a plausible argument that a similar implied oral agreement between her and the firm arose when she became a managerial employee. Add to this scenario that she as a manager received favorable performance appraisals, stock options and/or bonuses on a merit basis like her peers, and her argument that her at-will status was over the years impliedly extinguished becomes even stronger.

Is California an "at-will" state any longer? The answer is probably not. Given the long history of judicial uncertainty and apparent indecision, it's unclear whether the courts will ultimately opt for a limited application of the implied-in-fact contract exception in the future, or will continue to even further erode the at-will employment doctrine. In the meantime, California employers can only hope that the courts will grant them at least some protection by applying the implied-in-fact contract exception under only the rarest of circumstances.

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