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Linda McPharlin

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RISK MANAGEMENT FOR EMPLOYERS:
TERMINATING POOR PERFORMERS
WITHOUT LEGAL LIABILITY

Linda Hendrix McPharlin*

I. INTRODUCTION

Few legal events have had as much impact on day-to-day business as the rulings of California courts in the 1980's regarding employment law. Most California employers, including those in the Silicon Valley, are now acutely aware that “wrongfully” discharged employees have gained access to a wide range of rights and remedies not previously available. The long assumed right of employers to run their businesses, hiring and firing employees as they choose, “whatever be [their] reason, good, bad, or indifferent,” has become virtually obsolete. It is the preservation of that right, modified in recognition of newly affirmed employee protections, that is the goal of this article.

Of primary concern to employers who are intent upon protecting their prerogatives is the drafting and negotiating of employment contract provisions that make risk-free termination possible. Second, employers can take advantage of the growing body of case law which discusses what constitutes good cause for termination. Employers can use that knowledge at the time of termination to assess whether the requirements for “good cause” have been met. Finally, employers can follow up the termination of an employee with a release agreement that closes the door on future litigation.

This article focuses on using the above methods to discourage claims entirely and, in the event of lawsuits, successfully defeat them at an early stage of litigation by demurrer or summary judgment, thus avoiding a jury trial. While the arsenal for employers to ward off employment claims remains limited, the employer is by no

* Hopkins & Carley, a law corporation. J.D. Santa Clara University 1976, (magna cum laude); B.A. U.C.L.A. 1968 (Phi Beta Kappa).

1. “Precisely as may the employee cease labor at his whim or pleasure, and, whatever be his reason, good, bad, or indifferent, leave no one a legal right to complain; so upon the other hand, may the employer discharge, and, whatever be his reason, good, bad, or indifferent, no one has suffered a legal wrong.” Union Labor Hosp. Ass'n v. Vance Redwood Lumber Co., 158 Cal. 551, 554, 112 P.2d 886 (1910). See also, Patterson v. Philco Corp., 252 Cal. App. 2d 63, 65-66, 60 Cal. Rptr. 110 (1967).

Rather than the author's final draft, a student-edited version of this article was inadvertently published by the printer. Copies of the author's final version may be obtained by writing the Computer and High-Technology Law Journal.
means defenseless. In fact, the employer may wish to consider its own cross-complaint against the non-performing employee to recover damages suffered by the company as a result of the poor performance. This last recourse is addressed here because an employer may often wish to take the offensive when faced with a claim from a sales representative who did not sell or from an executive who did not manage.

II. CURRENT CALIFORNIA EMPLOYMENT LAW: THE EMPLOYER'S PERSPECTIVE

California Labor Code § 2922 provides that employment which is not for a stated length of time can be terminated "at the will" of either party. But an employer's reliance on this doctrine at face value is ill-advised because of the many exceptions to the rule which have been recently recognized by the courts. Section 2922 has been said to create only a presumption of at-will employment. The presumption can now be overcome by discharged employees who are able to show the existence of an exception arising (1) from another statute, (2) from public policy, or (3) from contract. Where a discharge falls within any of these exceptions, the employer faces liability for wrongful termination.

The first exception limiting at-will discharge, that of statute, has long existed at federal, state, and local levels. This exception prohibits discriminatory, unsafe, or otherwise unsavory employer practices and discharges related to those practices. The second exception, which is becoming increasingly recognized in the courts, exists where an employee discharge violates an express statutory objective or undermines a firmly established principle of public policy; such discharges might be said to violate the spirit rather than the letter of the law. The "growth" area in employment law, and the third exception to at will discharges, has been that of contract. Recognition in the employment arena of implied contracts and covenants of good faith and fair dealing associated with them, has re-

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2. CAL. LAB. CODE § 2922 (Deering 1976).
3. For example, anti-discrimination laws found in Title VII, Civil Rights Act, 42 U.S.C. §§ 2000e-2000e-17 (1964); age discrimination statutes such as in CAL. GOV'T CODE §§ 12941-12942 (Deering 1988 Supp.); and local statutes such as those in San Francisco prohibiting discharge because of sexual orientation. SAN FRANCISCO, CAL. POLICE CODE, art. 33 (1981).
4. The public policy exception is described in Tameny v. Atlantic Richfield Co., 27 Cal. 3d 167, 172, 164 Cal. Rptr. 839, 610 P.2d 1330 (1980), where the plaintiff alleged his discharge resulted from his refusal to participate in an illegal price-fixing scheme. See also Garibaldi v. Lucky Food Stores, Inc., 726 F.2d 1367 (9th Cir. 1984), cert. denied, 471 U.S. 1099 (1985).
sulted in the most dramatic recent changes in employer-employee relations.

The expansion of employee rights has been matched by a similar expansion in the remedies available to employees. These remedies include not only contract-type damages for lost wages, but tort and punitive damages as well. Punitive damages are recoverable for discharges in violation of public policy, or in violation of the implied covenant of good faith and fair dealing (found to exist in employment relationships). They are also available for infliction of emotional distress in the discharge process when the employer's conduct is "extreme and outrageous, having a severe and traumatic effect upon plaintiff's emotional tranquility."

Various studies have quantified the risks employers face in discharges. One such study found that 62 wrongful discharge cases in 1987 proceeded to a jury trial in California. Of those, 61% resulted in favorable jury verdicts or trial settlements for plaintiffs, with awards averaging $482,697; the average excludes one $17.5 million decision. Of course, the number of cases which actually go to trial represents only a fraction of the hundreds of wrongful discharge cases filed but disposed of before trial. Some potential limitation of large damages awards may be obtained from recent legislation which has redefined the "oppression" necessary for an award of punitive damages. To show oppression, the plaintiff must now prove "despicable conduct," a harsher standard that may be difficult to meet. Nonetheless, the prospect of punitive damages, usually an unknown, and invariably in large amounts, is a serious consideration for an employer. An employer must weigh this consideration against the advisability of a discharge or of a settlement with a complaining employee.


7. Alcorn v. Anbro Engineering, Inc., 2 Cal. 3d 493, 498, 86 Cal. Rptr. 88, 468 P. 2d 216 (1970). While emotional distress claims broaden potential damages recovery and open the door to punitive damages, they are a type of personal injury claim and thus may introduce the possibility of insurance coverage, at least for defense costs (recently limited), by the employer's general liability carrier, a worker's compensation carrier, and/or a carrier of director and officer liability insurance.


9. Chapter 1498, of the California Statutes of 1987, effective September, 1987, which amends Civ. CODE § 3294. This amendment further strengthens the standard of proof for punitive damages by requiring that the defendant be found guilty of oppression, fraud, or malice "by clear and convincing evidence."
Within the three areas of exception to at-will employment (statute, public policy, and contract), employers can exercise varying levels of "risk control" to limit litigation. With respect to employee claims arising from a violation of statute or public policy, most employers can reduce the risk of litigation by engaging in good business practices.

The most serious challenges to risk control that an employer may face are allegations of breach of employment contracts. These are not written contracts in which the terms are spelled out, but rather are implied and oral employment contracts found by courts to exist in many employment relationships.

The now established theory of implied contract did not gain prominence in employment cases until the 1981 case of Pugh v. See's Candies, Inc. The court in this case found that numerous circumstances common in employer-employee relationships may create an implied contract obligating the employer not to terminate the employee without good cause. Factors giving rise to an implied contract include longevity of service, commendations and promotions, the existence of personnel practices and policies oriented to fairness, and assurances of continued employment. Such a contract then overcomes the statutory presumption that the employer may terminate for any reason, commonly referred to as termination "at will."

Pugh, involving an employee who had worked 32 years for the same company, and other cases suggest that lengthy employment may be essential to a wrongful discharge claim. Nonetheless, other cases have permitted such claims by employees of short duration.

10. 116 Cal. App. 3d 311, 327, 171 Cal. Rptr. 917 (1981). The court held that employees can establish an implied contract for continuing employment unless good cause for discharge exists: "there is no analytical reason why an employee's promise to render services, or his actual rendition of services over time, may not support an employer's promise . . . to refrain from arbitrary dismissal." 116 Cal. App. 3d at 325-26. See also Walker v. Northern San Diego County Hosp. District, 135 Cal. App. 3d 896, 905, 185 Cal. Rptr. 617 (1982).

11. Id.

12. "[T]he longevity of the employee's service [in this case 18 years], together with the expressed policy of the employer, operate as a form of estoppel, precluding any discharge of such an employee by the employer without good cause." Cleary v. American Airlines, Inc., 111 Cal. App. 3d 443, 456, 168 Cal. Rptr. 722 (1980). In Shapiro v. Wells Fargo Realty Advisors, 152 Cal. App. 3d 467, 478, 199 Cal. Rptr. 613 (1984), the court noted the failure of the plaintiff, with only three and a half years employment, to show the longevity factor.

Whatever the state of the matter in the appellate courts, employees in Silicon Valley with tenure of a few years or less have not been discouraged from filing claims. Indeed, given practices in the high-tech industry, two years of employment may well be viewed as long term by a local jury.

Bolstering employee claims of implied contracts are claims of oral contracts. These claims are based on employer statements that employment will continue as long as their work is satisfactory, or that future employment with the company is secure. The employee relying upon a breach of oral contract claim may need to withstand a legal challenge that such an oral contract is barred by the Statute of Frauds in view of the absence of a writing. This issue is currently being addressed by the California Supreme Court, and a ruling is expected shortly.

Oral contracts made by careless managers hoping to “sell” a recruit, are difficult to control. Contracts that imply that termination will be only for good cause are even more difficult to control because they arise from events that comprise the very nature of the employment relationship. Such contracts are easily alleged by employees and often serve as the “hook” on which the employee terminated for poor performance hangs a claim which has scant legal

[14] A sample review of the case roles in Santa Clara County for a period of nine court days in 1987, September 22 through October 2, revealed the filing of six cases (out of 158 total cases filed in that period) which were denominated complaints for wrongful termination. In these cases, minimal tenure of employment did not deter several complaining employees, whose "longevity" was 1-1/2 months, 9 months, 2-1/2 years, 3-1/2 years and 15-1/2 years. Whether these cases can withstand legal challenges before reaching a jury is of course unknown at this stage, but the employer is nonetheless forced to litigate once the complaint is filed.

[15] An oral employment agreement that by its terms cannot be performed within one year is barred by the Statute of Frauds, CAL. CIV. CODE § 1624(a) (Deering 1987 Supp.) In Newfield v. Insurance Co. of the West, 156 Cal. App. 3d 440, 446, 203 Cal. Rptr. 9 (1984), the court, finding "a reasonable expectation of employment for more than one year" held that the Statute of Frauds barred an oral agreement. A recent Ninth Circuit federal case, however, found that the Statute of Frauds does not bar wrongful discharge based on a partially oral and partially implied contract; the rule of Newfield is not representative of California law and accordingly holds that if an oral agreement is capable of being performed within a year, it is not within the confines of the statute of frauds. Eisenberg v. Ins. Co. of North America, 815 F.2d 1285, 1291 (9th Cir. 1987).

grounds. The employer is then forced to defend the grounds for termination, prove good cause, and possibly face second guessing by a jury of "employees."

Can an employer take charge of the inevitable scenario wherein an employee is fired from his job, files a lawsuit and wins a judgment over the employer? California's new and more conservative Supreme Court may assist employers in the future, but employers need not wait for judicial guidelines to adopt specific procedures to minimize risk of legal claims from employees discharged for poor performance.

III. IS A CROSS-COMPLAINT AGAINST THE EMPLOYEE A VIABLE PURSUIT FOR THE EMPLOYER FACED WITH A WRONGFUL TERMINATION LAWSUIT?

This question is frequently asked by employers sued for wrongful termination. The matter stems from the employer's mistaken belief that the poorly performing employee could possibly be entitled to damages without an offsetting award to the employer for losses caused by the employee. The employer stance is that employee misfeasance is the cause for numerous company problems.

The lack of California case law addressing cross-complaints by an employer when an employee has filed a wrongful termination suit indicates that this option has rarely been pursued, if at all. Apart from abundant tactical considerations, there appears to be no reason why an employer cannot sue an employee for failing to adequately perform the job, even though the employee's conduct does not amount to criminal or fraudulent wrongdoing.\(^\text{17}\) Statutes under which an employee can be held liable for inadequate job performance are found in the Labor Code:

An employee is bound to exercise a reasonable degree of skill, unless his employer has notice, before employing him, of his want of skill.\(^\text{18}\)

An employee is always bound to use such skills as he possesses, so far as the same is required, for the service specified.\(^\text{19}\)

An employee who is guilty of a culpable degree of negligence is

\(^{17}\) An employer may also, of course, sue an employee for indemnity when that employee has committed a particularly egregious act, such as an unauthorized tort against a third party. In Walsh v. Hooker and Fay, 212 Cal. App. 2d 450, 462, 28 Cal. Rptr. 16 (1963), the court stated: "[t]he law is well settled that when a judgment has been rendered against an employer or principal for damages occasioned by the unauthorized tortious act of his employee or agent, the former may recoup his loss in an action against the latter."

\(^{18}\) CAL. LAB. CODE § 2858 (Deering 1976).

\(^{19}\) CAL. LAB. CODE § 2859 (Deering 1976).
liable to his employer for the damage thereby caused to the employer. The employer is liable to the employee if the service is not gratuitous, for the value of the services only as are properly rendered.\textsuperscript{20}

These sections and the case law interpreting them provide little help in determining precisely what type of employee action or inaction would be necessary for that employee to be held liable to the employer. Courts have served notice to the lack of precedent on the issues as to whether simple negligence of an employee gives rise to a cause of action by the employer and what constitutes the "culpable degree of negligence" referred to in the Labor Code. They have nonetheless indicated that a cause of action for negligence against the employee is possible.\textsuperscript{21}

One court has interpreted the standard of the Labor Code to mean that an employee is guilty of a culpable degree of negligence when he is hired for pay and fails to use ordinary care; gross negligence is the standard only where the employee is a volunteer, a "gratuitous" employee.\textsuperscript{22} Another court followed the Restatement of Agency, § 380, and opined that it is implied in every contract of employment "that the employee will conduct himself with such decency and propriety as not to injure the employer in his business."\textsuperscript{23}

Ironically, a corporation which sues its employee may be required under the California Corporations Code to indemnify the employee for expenses incurred in the defense or settlement of the action against the employee if the employee is deemed to have acted in good faith.\textsuperscript{24} In other words, it appears that an employee could be found negligent, but nonetheless indemnified, if he or she meant well.

As the law now stands, it seems clear that an employer may file a cross claim against an employee for negligence. Certain assess-

\begin{footnotesize}
\item[20.] CAL. LAB. CODE § 2865 (Deering 1976).
\item[21.] See Division of Labor Law Enforcement v. Barnes, 205 Cal. App. 2d 337, 349, 23 Cal. Rptr. 55 (1962), and Dahl-Beck Elec. Co. v. Rogge, 275 Cal. App. 2d 893, 80 Cal. Rptr. 440 (1969). In Barnes, the employer hired Cobb to irrigate its alfalfa. Cobb maliciously and with intent to defraud insufficiently watered the crop. As a result, a cutting of alfalfa hay was lost and monetary damage resulted. The Division of Labor Law Enforcement sued the employer to recover Cobb’s wages. The court held that whether the employer was entitled to interpose a cross-action for culpable negligence would be a question of fact.\textsuperscript{22}
\item[23.] Twentieth Century-Fox Film Corp v. Lardner, 216 F.2d 844, 850 (9th Cir. 1954), \textit{cert. denied}, 348 U.S. 944 (1955). \textit{Accord}, Foley v. U.S. Paving Co., 262 Cal. App. 2d 499, 505, 68 Cal. Rptr. 780 (1968), where the court stated that "every employment contract includes a covenant of good faith and fair dealing between the parties."
\item[24.] CAL. CORP. CODE § 317(c) (Deering 1988 Supp.).
\end{footnotesize}
ments should be made first, however, most important of which is the impact the claim will have on a jury. A strong case of employee malfeasance will likely serve to defeat the employee's wrongful discharge claim before the jury. Is it worthwhile to risk loss of jurors' sympathy in the main action with an offensive claim which may antagonize them? Might not the employer be seen negligent as well, for failing to supervise the employee properly, or failing to hire with care, or failing to terminate the employee before damage was caused? The scope of inquiry may be broader than the employer is willing to face. For example, is it really the fault of the vice president of marketing that sales fell short of target? What about product bugs, late arrival to market, or the CEO's failure to authorize hiring of a sales manager? Blaming a single employee for a company's problems is a difficult proposition at best.

Thus, while a clear legal impediment may not exist, a claim against an employee, even one solvent enough to pay a judgment, should be considered only in unusual circumstances. The law will not bar the claim, but good sense might.

III. At Time of Employment, Controlling Subsequent Contract Claims

A. "At-will" Disclaimers

The placement of disclaimers in all written materials the employer presents to the employee specifying that employment is "at will," is frequently suggested to employers in order to avoid wrongful discharge litigation.\(^{25}\) The disclaimer can be placed in application forms, offer letters, confidentiality agreements, stock option plans, personnel handbooks, and any other materials relevant to the employment relationship, particularly those acknowledged and signed by the employee. The disclaimer can then serve to contradict claims by the employee that he or she believed that termination would only be for good cause.\(^{26}\)

\(^{25}\) A sample of such a disclaimer is:

Except for those employees who have written contracts with the company for employment for a specified period of time, employment is "at-will" employment, that is, the employment relationship may be terminated at any time with or without cause, and with or without notice, at the option of either the company or the employee.

\(^{26}\) In Shapiro v. Wells Fargo Realty Advisers, 152 Cal. App. 3d 467, 199 Cal. Rptr. 613 (1984), the plaintiff had signed a written stock option and employment agreement which reserved the company's right to discharge the employee with or without good cause. The court held that the express contractual provisions created "at will" employment and prevented plaintiff from alleging an implied contract for continued employment. The Shapiro
The problem with this approach lies in its variance with the actual practices of most employers who generally endeavor to treat employees fairly, and who do not normally terminate or discipline employees without cause. Moreover, a true policy of "no cause" termination may well be counterproductive in the competitive recruiting environment frequently found for high-tech industry technical personnel and executives.

High-tech employers, familiar with personnel practices, often have policies which contradict an assertion that employment is at will. Such a policy is incorporated by listing specific grounds for immediate termination or by providing procedures for disciplinary steps before termination. Moreover, the employer's course of dealing with employees may create similar obligations to treat employees fairly.

Nevertheless, the "at-will" disclaimer remains the simplest overall attack on claims of implied employment contracts. So long as the employer demonstrates consistency with the disclaimer in its practices, it can serve a useful purpose.

B. Employment Contracts with Termination Provisions

1. Contracts for a Specified Term

If the reported cases, and the experience of company counsel, are any indication, employers rarely enter formal, written employment contracts with their employees. To the extent terms of employment are in writing, they are found in brief offer letters. Employment contracts have been reserved, apparently, for those highly desirable executives with whom the employer is willing to commit to guaranteed employment for a specified period of time. Such contracts have long had their termination provisions governed by the strict definition of "cause" set forth in California Labor Code § 2924 which states:

An employment for a specified term may be terminated at any time by the employer in case of any willful breach of duty by the employee in the course of his employment, or in the case of his habitual neglect of his duty or continued incapacity to perform it.27

While this statute has not been interpreted in all cases to mean


27. CAL. LAB. CODE § 2924 (Deering 1976).
that an employer can only terminate a term contract for these three reasons, the standard is a stringent one, and poor performance without greater dereliction of duty will be insufficient to meet the standard. Indeed, were that not the case, the employee bargaining for a guaranteed term of employment would receive nothing more than employment without such a contract.

From the employer's perspective, term contracts offer little flexibility. Even when written to include descriptions of events triggering termination, such events necessarily must be of the caliber found in Labor Code § 2924 to avoid legal liability for the termination. Since the employee is much less likely to be bound to the term of employment than the employer, term contracts are rightfully reserved for instances where the employee clearly has superior bargaining power.

2. Employment Contracts with no Specified Term

Employment not for a specified term is deemed by the Labor Code to be at-will employment. Although subject to the judicial exceptions discussed above, at-will employment is not subject to the Labor Code definition of cause. Such employment may truly be at the will of both employer and employee when governed by a contract with specific conditions that the parties themselves have freely chosen and negotiated.

A valid, express contract addressing the circumstances under which termination will occur, such as only for good cause, will supersede any implied contract that covers the same subject but requires different results. Since opportunities for an employer to imply that the employee will be fairly treated abound in employment relationships, the courts will often find a contract to exist between the employer and employee. In the case of a written contract, the agreement between the parties is visible, and the issue of termination is addressed squarely rather than obliquely as in an implied contract. With a written contract, the employer can barr-


gain for an acceptable way to handle the termination situation, without having to meet standards of good cause. Moreover, the employer can spell out that the contract terms cannot be varied by anything other than the written agreement of both parties.

Written employment contracts for every employee may appear to be an overwhelming burden for high-tech employers more concerned with getting the product out the door. However, handling the termination situation in a negotiated writing before problems arise can avoid inevitable and time-consuming difficulties at the time of termination. At the very least, contracts with high-level employees should be considered. It is with these employees that the risk of large damage awards stemming from the loss of high wages, valuable rights such as appreciated stock, and the prestige associated with the position, are greatest. Moreover, the employer's demonstration of cause and fairness is likely to be more difficult in the termination of high-level employees. Careful personnel practices geared to fairness, such as written performance evaluations, disciplinary steps and warning periods, are infrequently used with management level employees. The Board of Directors or the CEO may wish to deal most swiftly with these employees in order to ensure the company's survival. However, speedy termination may appear unnecessarily harsh to outsiders.

Of course a contract with a management employee can serve many purposes, including spelling out the employee's bounds of authority, the expectations of the Board of Directors, the benefits and terms of employment, and even sales goals. However the two particular provisions discussed below, arbitration clauses and termination provisions, are aimed at diminishing the possibility of wrongful discharge litigation.

**a. Termination Provisions**

In employment termination cases in California, no courts have directly addressed the issue of whether an employer can provide for a determination of liquidated damages upon termination in an employment contract. However, other authority indicates that such a provision would be upheld. A statutory presumption of validity exists for liquidated damages provisions in most contracts, unless it can be shown that the provision was unreasonable under the circumstances existing at the time the contract was made.\(^31\)

A severance pay arrangement between employer and employee,

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one type of liquidated damages provision, was recently approved by a federal district court in California. In *Cox v. Resilient Flooring Division of Congolium Corp.*, the court found that the severance pay had been fixed at a level designed to make the employee whole should he be fired without cause. The court strictly construed the implied contract and implied covenant of good faith and fair dealing theories and held that the employee was not wrongfully terminated but was sufficiently compensated by the severance pay. This pay was not the “two weeks in lieu of notice” severance pay that is often seen in high-tech company policies, but rather a genuine assessment of the loss the employee might suffer upon termination.

Employers willing to pay for the unchallenged right to terminate an employee may wish to negotiate liquidated damages or “termination pay” along with employee salary and benefits at the time of employment in order to eliminate subsequent challenges. Such action can serve as a type of “wrongful discharge self-insurance” for employers. Furthermore, with a set price on termination, the employer is likely to both hire and fire with sensitivity to the employee’s right to compensation, and the employee is clearly warned that termination may occur without cause.

### b. Calculation of the Payment

The employee in the *Cox* case discussed above, after 27 years with the company, had accrued a right to severance pay for 27 weeks, a period which could be seen as a reasonable amount of time for finding new employment. The same employer’s policy might not have been determined to be reasonable for an employee of only a few years’ tenure. Predetermined severance policies are not as likely to address the equities of a particular employee’s situation as are termination pay provisions negotiated with each individual employee. In the latter situation, the employee is an active participant in the process and can choose other employment if the termination pay, like the salary, is unsatisfactory. In that case, a subsequent claim of unfairness by the employee is less viable.

One means of calculating a fair discharge payment is described in Professor Prince’s proposal for a statutory alternative to wrong-

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33. *Id.* at 738, n.12.
35. *Id.*
ful discharge. His proposed statute avoids the question of "just" versus "wrongful" discharge altogether by establishing a "no-cause" discharge option for employers and employees. This would allow the employer to terminate the employee without cause upon payment of a statutorily calculated discharge payment. The discharge payment increases as the age, tenure, and salary of the employee increases. The amount arrived at is then reduced by 20% if the employer has written documentation of the employee's poor performance and warnings related to that same performance.

A formulated amount, suggested in the above proposal, could be partially set at the time of employment based on age and level of position, with variables of tenure and employment record calculated at termination. Alternatively, the employer may choose to establish the exact termination amount at the time of employment, but retain the option of paying nothing where the employee is terminated for exceptionally good cause, such as that level of cause defined in Labor Code § 2924.

Determining the base amount of the payment, taking both parties' interests into account, might start with a realistic estimate of the time necessary for the employee to find new employment. Executive search firms, which often provide testimony on this subject in wrongful discharge litigation, could be a source of such information. Settlements from non-litigated employment claims in the high-tech arena might also be helpful. Such settlements are generally estimated to be in the range of six to twelve months salary for vice president's and chief executive officer's levels and two to six months for lower level employees.

c. Employee Claims Which May Still Survive

Employers' use of liquidated damages clauses in employment contracts may not resolve all potential employee claims. The aggrieved employee, depending upon the circumstances, might be able to make out a defamation action or a claim for intentional infliction of emotional distress. In addition, the terminated employee could argue that termination pay clauses are unconscionable, or attack the contract on the basis of adhesion due to the unequal bargaining position between the employer and potential employee. Further-

37. Id.
38. CAL. LAB. CODE § 2924 which requires a high level of cause. See supra note 27 and accompanying text.
more, the employee could argue that it is against public policy to limit the employee's right to bring an action for breach of the covenant of good faith and fair dealing. The employee may also argue that he bargained not simply for money when entering into an employment contract, but also for the opportunity to be employed, and the experience, prestige and good will associated with being an employee of the company. When considered in this light, termination pay may not be considered full compensation for the employee who suffers the mental distress of being fired and the stigma of unemployment.

The employer's rebuttal to such claims would focus on the employee's full participation in negotiating the termination pay and the employee's opportunity to anticipate an amount that would reasonably cover any of the number of predictable eventualities which follow discharge. The employer's position would be strengthened where the employer has encouraged the employee to seek legal consultation and recorded that fact in the contract. If an employer and employee have bargained for and agreed upon a fair and reasonable price for termination in the employment contract, the timely paying of such compensation at termination is at least presumptive of good faith and may protect the employer from any further liability.

d. Inclusion of a Mandatory Arbitration Clause in the Employment Contract

A written employment contract provides the employer with an opportunity to consider the inclusion of a provision for mandatory and binding arbitration of disputes relating to the employment relationship, thereby avoiding the "perils of jury assessment." Such an arbitration provision can require that disputes be decided by neutral arbitrators chosen by the parties themselves rather than by persons chosen from the jury pool. Arbitration may result in a speedier and more private means of resolving a dispute with the employee, without the protracted discovery employer defendants often face in litigation.

Courts tend to strictly enforce agreements to arbitrate in the absence of a showing "that arbitration would be contrary to the reasonable expectations of any party or that any loss or unfair im-

40. In Toussaint v. Blue Cross & Blue Shield of Michigan, 292 N.W. 2d 880, 897 (Mich. 1980), the Michigan Supreme Court noted that the employer can avoid the perils of jury assessment by providing for an alternative method of dispute resolution, such as binding arbitration, in a written agreement.
position would result." Section 1281.2 of the California Code of Civil Procedure states that a court must issue an order compelling arbitration of a controversy brought into court once it determines that an agreement to arbitrate the controversy exists.

The desirability of arbitration can be seen in its introduction into recent employment legislation. In Montana, for example, the state legislature, in drafting a comprehensive wrongful discharge statute, included mandatory arbitration along with other provisions in attempting to balance employer-employee interests.

Binding arbitration, though frequently desirable for employers, is not without its drawbacks. Arbitration may make it easier for employees to attack employer decisions and thus increase the number of complaints and challenges. Moreover, arbitration may result in the employer being assessed substantial damages without the fuller investigative discovery and hearing processes which accompany traditional court litigation. Finally, an arbitration decision is appealable only on limited grounds and appeal is a right more likely to be exercised by an employer than an employee with lesser resources. Nonetheless, these potential drawbacks aside, most employers will find arbitration more amenable to their interests than jury trial.

V. MEASURES THE EMPLOYER CAN ADOPT AT THE TIME OF TERMINATION

A. Handling the Termination Process

For many employers, wrongful discharge litigation will be no


42. The court of appeal underscored the mandatory nature of California's arbitration statute in its holding in Tas-T-Nut Co. v. Continental Nut Co., 125 Cal. App. 2d 351, 270 P.2d 43 (1954), wherein it stated:

Where parties have agreed to arbitrate their differences it is clear intent of the California arbitration statute that the courts should enforce the performance of that agreement and when, notwithstanding the agreement, suit has been filed, the statute specially enjoins the court, if the defendant seeks to claim the right to arbitrate, to stay the court action until arbitration has been accomplished. . . .

Id. at 358. See also Bos Material Handling, Inc. v. Crown Controls Corp., 137 Cal. App. 3d 99, 186 Cal. Rptr. 740 (1982).


44. CAL. CODE CIV. PROC. § 1286.2 (Deering 1981), provides that an arbitrator's award can be appealed only where it was obtained through corruption, fraud or other undue means, where there was corruption on the part of any of the arbitrators, where the rights of a party were substantially prejudiced by an arbitrator's misconduct, or where the arbitrators exceeded their powers or otherwise acted contrary to their statutory mandate.
more than a vague concern until the eve of a termination. The employer, initially convinced to a moral certainty of the necessity of the termination, will soon discover that the employee is well versed as to his ability to contest a discharge and will become concerned. What can an employer do when faced with an implied contract that the employee will be treated fairly and discharged only for good cause, when no prior risk avoidance measures have been taken, no written contract exists and when there is a dearth of objective evidence of fairness in the form of critical performance evaluations or warnings that termination was likely?

The advice likely to be given to the employer under these circumstances is that which the employer is loathe to hear: wait. Wait to allow the employee a genuine opportunity to improve his performance after being notified specifically of the deficiencies and the improvement expected. Wait until he has written documentation that could be shown to a jury, in the event of a wrongful discharge action, evidencing fairness in giving the employee an opportunity to improve his performance before a termination came “out of the blue.” Check the personnel file to see if there are glowing reviews or promises of promotions or salary increases. All of these are viewed as reasonable bases for an employee’s expectation of continued employment. Wait to assess, with the standards utilized by the courts, whether there exists demonstratable good cause for the termination, or whether other factors tend to make the stated cause appear pretextual. And wait until tempers have cooled and the termination can be conducted in a calm and civil manner. This will help reduce the occurrence of claims of infliction of emotional distress, defamation, and breach of the implied covenant of good faith and fair dealing.

Most important to the termination process is the assessment of good cause: whether it exists and whether it can be proven when viewed by third parties more sympathetic to the employee. “Good cause” can be defined in the employer’s own policies, but care must be taken that the policies are followed and applied evenhandedly. If so, the employer adhering to its own express policies in the termination has a better chance of being seen as fair. Most terminations, though, will not fit neatly into a predefined category. The categories themselves, such as “poor performance,” might be too broad to be of real use.

45. See Rulon-Miller v. International Business Machines Corp., 162 Cal. App. 3d 241, 248, 208 Cal. Rptr. 524 (1984), wherein the employer was found to have specifically treated its male and female employees differently in the application of the policy.
Even though cause may be defined in company policies or in the employment contract, the employer should also look for guidance to the definitions of "good cause" used recently by the courts. One such example is "a fair and honest cause or reason, regulated by good faith on the part of the party exercising the power." Another articulation of "good cause" is balancing the employer's interest in operating the business efficiently and profitably, the employee's interest in maintaining his employment, and the public's interest in maintaining a proper balance between the two. Both definitions, because of the references to good faith and the balancing of interests, indicate the employer's loss of sole control in the termination process.

Although courts have recognized that they should not interfere with the legitimate exercise of managerial discretion and subjective judgment, especially where the employee occupies a sensitive managerial position, employers may find that their subjective judgment will be tested severely by a jury with less understanding of the need for managerial discretion than management itself. Nonetheless, executives, managers, supervisors, and creative employees will usually be evaluated by considerations, such as maturity, leadership ability, tact, confidence, style, and loyalty, that defy definition or comparison, particularly in a small company.

Judicial recognition of the need for managerial discretion is found most predictably in cases where such discretion is used to effect layoffs based on bona fide economic concerns. Layoffs are given much protection by the courts and as long as the employer can show a genuine economic need for the layoff, their terminations will likely be upheld and no duty found requiring the employer to protect the employee's economic interests over those of the company. Employers would weaken their position, however, by filling the spot once occupied by the undesirable employee or by claiming

48. Pugh v. See's Candies Inc., 116 Cal. App. 3d at 330, accord, Percivel v. General Motors Corp., 539 F.2d 1126, 1130 (8th Cir. 1976). But see, Crosier v. United Parcel, 150 Cal. App. 3d 1132, 1140, 198 Cal. Rptr. 361 (1983), where the court rejected the employer's request to preclude review of its business judgment that violation of the employer's rule against fraternization among employees constituted cause, although the court did defer to the employer's judgment about when the rule should be applied.
49. Gianaculas v. Trans World Airlines, Inc., 761 F.2d 1391, 1395 (9th Cir. 1985); Clutterham v. Coachmen Industry, Inc., 169 Cal. App. 3d 1223, 1227, 215 Cal. Rptr. 795 (1985). In the latter case the employee's argument that the employer "had a duty to consider the employee's economic interests and to try to preserve his job if possible" was rejected. Id. at 1228. See also, Sorosky v. Burroughs Corp., 826 F.2d 794 (9th Cir. 1985).
economic necessity as a justification for removing an employee that
the company had wished to terminate for other reasons. Arguing
economic necessity will not assist the employer where a discrimina-
tory pattern is found in the layoffs, such as where all persons termi-
nated are of a particular sex, race, or age, or where discriminatory
reasons motivated the choice of one employee over another.

If no layoff results from an assessment of whether an em-
ployee's poor performance constitutes adequate cause to justify ter-
mination, employers might look to proven methods employed in the
labor context. Arbitrators involved in union wrongful discharge ac-
tions against management have dealt with the problem of the deter-
mination of the existence of just cause for a long time. Arbitrator
Carroll R. Daugherty has reduced the basic elements of the just
cause determination to seven factors.\textsuperscript{50} A "no" answer to one or
more of the following seven questions indicates that just cause was
not satisfied by the employer or that a discriminatory or arbitrary
element was present.

1. \textit{Notice}: Did the employer give the employee forewarn-
ing of the possible or probable consequences of the employee's
conduct?

2. \textit{Reasonable rule or order}: Were the employer's rules or
orders reasonably related to the operation of the business and to
the performance that the employer might properly expect of the
employee?\textsuperscript{51}

3. \textit{Investigation}: Did the employer before terminating the
employee make an effort to discover whether the employee did in
fact violate a rule or order of management?

4. \textit{Fair investigation}: Was the employer's investigation
conducted fairly and objectively?

5. \textit{Proof}: At the investigation, did the employer obtain
substantial evidence that the employee was "guilty" as charged?

6. \textit{Equal treatment}: Has the employer applied its rules,
orders and penalties evenhandedly and without discrimination to
all employees?

7. \textit{Penalty}: Was the degree of discipline administered by
the employer reasonably related to the seriousness of the em-
ployee's proven offense and the record of the employee?\textsuperscript{52}

Another perspective on the cause issue is the situation where
the employer is acting for an honest and legitimate business reason,

\textsuperscript{50} \textit{Koven \& Smith, Just Cause: The Seven Tests} (1985).

\textsuperscript{51} See Toussaint v. Blue Cross and Blue Shield of Michigan, 292 N.W. 2d 880 (Mich.
1980).

\textsuperscript{52} \textit{Koven \& Smith}, at 10.
but the belief in such is found to be mistaken. The courts have generally found for the employer in these situations, holding that if there is (1) a legitimate business interest for the employee’s termination and (2) good faith reliance thereon, a mistake in the determination will not be actionable against the employer.\(^\text{53}\)

On their face the above standards appear to grant wide latitude to employers. The difficulty with poorly performing employees is that the judgment call is often wholly subjective and thus subject to varying interpretations. The most objective good cause determination will still be suspect if an unfair motive is found to be at the heart of the decision. Is the employee in a minority group or over age 40? Is the employee on the eve of vesting valuable stock rights? Has the employee recently returned from lengthy jury duty, or maternity, disability or sick leave? Has the employee complained about an unfair or illegal business practice?\(^\text{54}\) An affirmative answer to any of these questions may make the employer’s decision regarding the quality of the discharged employee’s performance, no matter how well founded in cause, appear pretextual.

Finally, after the analysis is complete and the employer remains convinced that the employee’s poor performance will be judged accordingly, the employer should consider whether an alternative, short of termination, can be offered to the employee. This might include another position in the company or continued employment until a replacement is found or the employee locates another position. This practice, at little cost to the employer, may significantly reduce the employee’s chances of a successful claim for damages and place the employer in a favorable light.

**B. Entering into a Release with the Employee**

Employers often ask whether it is advisable to have employees sign written releases at the time of termination, especially where severance pay or some other type of consideration beyond that which the employer is required to give under its policies is offered. At one time employers were reluctant to present a release to the employee for fear it would encourage the employee to consider his legal rights. Recently, however, in light of considerable publicity about employee rights, most employees, particularly upper-level

\(^{53}\) LaGoe v. Duber Indus. Sec., Inc., 194 Cal. App. 3d 349, 354, 239 Cal. Rptr. 445 (1987). Summary judgment for employer was upheld on grounds that employer’s investigation of theft allegations and subsequent discharge of employee were reasonable.

\(^{54}\) See e.g., CAL. LAB. CODE § 1102.5 (Deering 1984), barring employer action against an employee who discloses statutory violations to a government agency.
employees with whom the employer has negotiated a severance package, are likely to consider their legal rights regardless of whether the employer protects itself with a written release.

A well-drafted release is the employer's best tool for avoiding subsequent litigation of the issues. Utilization of such a release ensures that the employer will not end up in the position of having made a severance payment to buy the discharged employee's good will and face a lawsuit for wrongful discharge as well.

Clearly the employee is under no obligation to sign a release. Where the release proffered by an employer provides the employee nothing beyond that which he is entitled by law, such as unused vacation pay, or non-defamatory references, the employee may rightfully refuse to sign it. It is unlikely that such a release, which is effectively without consideration, would be upheld.

Like all contracts, a release should be entered into by the parties knowingly and voluntarily. The employee should have the opportunity to negotiate regarding the terms, it should be written in plain English, and should clearly spell out the consequences. The employee should be advised to consult an attorney and must be given ample deliberation time. The courts have generally held that uncoerced releases will be upheld so long as they are sufficiently specific and obtained without harassment or misleading circumstances. Specificity is important, especially where release of statutory claims is expected—the obvious goal of an employer seeking to remove all potential of litigation. The statutes should be named and the release made applicable to lawsuits and actions filed with regulatory agencies.

A recitation that the employer is not admitting liability of any type by entering into the release is common to releases and has long been thought to protect the settling parties from later claims of admission. A recent federal court decision, however, calls that con-


56. Runyan v. National Cash Register Corp., 787 F.2d 1039, 1044 (6th Cir. 1986), cert. denied, 107 S. Ct. 178 (1986), involving Age Act rights, which upheld a non-court supervised release where there was a bona fide factual dispute and the release was a good faith compromise of that dispute.

57. In EEOC v. Cosmair, 821 F.2d 1085, 1089 (5th Cir. 1987), the employee signed a release of age claims in exchange for severance benefits, which was seen as insufficient, without specific language, to prevent the employee from filing EEOC charges. That is, the release only waived the individual's right to recover from the employer, not the bringing of agency charges.
clusion into question. In *Casino v. Reichhold Chemicals, Inc.*, an employee was offered $18,000 in severance pay to sign a release agreement. The employee rejected the offer and subsequently won $492,000 in an age discrimination lawsuit. The *Casino* court allowed admission of the proposed release as evidence that the employer knew it was acting illegally in firing the employee thereby distinguishing the release from a bona fide offer to settle made after a lawsuit is filed, which cannot be used against the party making the offer. The court further noted that such severance offers are inherently coercive because of the employer's superior bargaining position, especially in the context of termination.59

The *Casino* decision advises employers to use extreme care in the presentation of releases. Unless the employee has formally presented a claim through lawsuit or demand letter, or the employer is certain the employee will accept the offer presented in the release, the employer should postpone the offer. Instead, the employer should pay what is required under existing policies and save the settlement money until a settlement is necessary. The employer should then make sure the offer has negotiating room to permit employee participation and encourage the employee to obtain legal counsel. The written release itself should be broad and all-inclusive and used by the employer in all settlement situations so that a reference to particular statutes and laws will not be considered a specific admission that such a statute applies to the individual case at hand.

In addition to a release, the termination process should include a written memorandum to the employee outlining the reasons for discharge, offering assistance to the employee in reemployment efforts, and, where appropriate, a mutually agreed upon letter of recommendation. The goal is to leave the employee in the best frame of mind possible under the circumstances and to assist the employee in finding new employment to reduce the potential damages the employee may suffer.

VI. CONCLUSION

The employers' legal difficulties in the termination of poor performers stem from the imposition by courts of implied contract terms, which were probably never contemplated by employers accustomed to free rein in the management of their businesses. Using those court findings to their advantage, employers can take contract

58. 817 F.2d 1338 (9th Cir. 1987).
59. Id. at 1343.
matters into their own hands, consider the terms they want to see in their arrangements with employees, and then negotiate those terms openly and frankly. Both parties can then know what their relationship entails and act accordingly.