American Bar Association
Section on Labor and Employment Law
Employment Rights and Responsibilities Basics Program
Rancho Mirage, California
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EMPLOYMENT CONTRACTS, BASICALLY

Employment is presumed to be at will. Though the employment relationship is still considered to be contractual, the "at will" relationship may be terminated at any time by either party. Parties may restrict the right to terminate either by providing that the employment is for a "definite term" or by limiting the circumstances under which the employer may terminate the employee (e.g. for "cause").

I. Did the Parties Make an Agreement for a Definite Term?

There are many cases everywhere in which terminated employees have attempted to assert breach of contract claims, arguing that an employer was prohibited from terminating at will due to either the employment agreement, other writings including company policies as articulated in employee handbooks, oral representations, or a totality of facts and circumstances based on all of these.

A. Terms in the Written Agreement. Language in an employment agreement describing permanent or lifetime employment will probably not be interpreted by courts as establishing a relationship that may not be terminated at will. Agreements providing for annual compensation or other benefits that purport to extend over a period of time will not establish a contractual commitment for a specific period of time.

B. A Contract "Implied in Fact" from the Employer's Writings, Representations, Rules and Practices.

1. Other Written Commitments. Written policies distributed to employees that provide for termination and suggest that employment will not be terminated without cause may be found to be express contracts. *Campbell v. Leaseway Customized Transp., Inc.* 484 N.W. 2d 41 (Minn. Ct. App. 1992); *Thompson v. St. Regis Paper Co.,* 685 P. 2d 1081, 1087-88 (Wash. 1984); *Bobbitt v. Orchard, Ltd.* 603 So. 2d 356 (Miss. 1992).

2. Oral Representations of job security may provide a basis for a finding of an agreement limiting the right to terminate employment. *Hamersky v. Nicholson Supply Co.,* 517 N.W. 2d 382 (Neb. 1994). Claims based on oral representations can also be based on the totality of the employer's conduct - writings, oral representations, company policies and procedures. The existence of a written agreement which is contradictory greatly inhibits this claim. *Haggard v. Kimberly Quality Care., Inc.* 39 Cal. App. 4th 508, 46 Cal Rptr. 2d 16 (1995).

Most states reject attempts to interpret expressions by the employer of "lifetime" or "permanent" employment as contractual commitments, on the rationale that they fail to state a definite term of employment. *Hamersky v. Nicholson Supply Co., supra; Hunnewell v. Manufacturers Hanover Trust Co.,* 628 F. Supp. 759 (S.D.N.Y. 1986); *McKenny v. John V. Carr & Son, Inc. 922* F. Supp. 967 (D. Vt. 1996).

But don't be so sure. There are cases in which written at-will provisions in handbooks and elsewhere are deemed modified or eliminated by subsequent representations, assurances, etc. to the employee that she will be terminated only for cause. *Thomka v. Financial Corp.* 15 Cal. App 411 877, 19 Cal Rptr. 2d 382 (1993); *Wilson v. General Motors Corp.,* 454 N.W. 2d 405 (Mich Ct. App. 1990). Many courts may require that such assurances be in exchange for additional consideration by the employee, such as a decision to turn down a competing offer of employment, geographic relocation, etc.

3. Employment Handbooks as a Source of Rights Against Termination at Will. A principal area of litigation has been employment handbooks. Courts have found implied contracts prohibiting termination at will based on provisions in handbooks. As with implied contract theories generally, courts will look to whether the employee justifiably relied on the handbook provisions, and whether such provisions express an intent by the parties to create binding obligations. *See Burnside v. Simpson Paper Co.,* 864 P. 2d 937 (Wash. 1994). Because of these implied contract cases, employment handbooks now typically include disclaimer language, making it clear that the terms of the handbook do not constitute contractual commitments, that employment is "at will", and that the handbook may be modified by the employer.

The handbook can also contain procedural limitations on the employer, i.e. progressive discipline, right to receive warnings of the alleged terminable conduct prior to discharge, etc. Disclaimer language has also been applied by courts in ruling that the employee could not reasonably have relied on the procedural provisions as contractual terms of her employment. *Burnside v. Simpson Paper Co., supra,* at *447.*

Courts will evaluate the handbook provisions by how clear they are and by how prominently the disclaimer language is placed in the book. Some courts have found that where there was a doubt about the disclaimer language, it was up to the jury to determine whether " the handbook constitutes a promise of continued employment terminable only for cause in accordance with its provisions." *U.S.* ***ex rel*** *Yesudian,* 14 IER Cases (BNA) 545 (D.C.Cir. 1998). The disclaimer provisions should be conspicuous. In *Kapossy v. McGraw-Hill, Inc.,* 921 F. Supp. 234 (D.N.J. 1996), the court found the disclaimers insufficient where they appeared in "regular Roman type". Under New Jersey law, a disclaimer must be "conspicuous" as a matter of law in order to overcome the "implication" that the handbook constitutes "an enforceable contract of employment." *Nicosia v. Wakefern Food Corp.,* 136 N.J. 401, 643 A. 2d 554 (N.J. 1994).

May an employer modify its handbook and thereby change the terms of the contractual relationship with employees who commenced their employment under the terms of the former handbook? Some courts take the hornbook contract position that the modification of any agreement requires offer, acceptance and new consideration, and reject the notion that the opportunity for continued employment after the modification constitutes sufficient consideration. *Robinson v. Ada S. McKinley Community Services,* 19 F. 3d 359 (7 Cir. 1994). Other courts find the continued employment to be sufficient consideration for the modification. *See Ryan v. Dan's Food Stores,* 972 P. 2d 395, 401, (Utah 1998) (continued work with knowledge of the changed terms of employment renders the old handbook provisions no longer applicable); *U.S. ex rel. Yesudian v. Howard University, supra.*

4. Is the Statute of Frauds a Defense to a Claim of an Implied in Fact Agreement? The majority position is that the statute of frauds applies to oral employment agreements. The statute of frauds may be sufficient to defeat a claim of an oral agreement of employment for a period of years. But if the court finds that the terms of the contract are such that the contract *could have been performed* in one year, the statutory requirement has been satisfied. *McKenny v. John V. Carr & Son, Inc.,* 922 F. Supp. 967 (D. Vt. 1996). In *Hodge v. Evans Financial Corp., 778* F. 2d 794 (D.C. Cir. 1985), the court found that a promise of "lifetime employment' 'was void under the statute of frauds, because the agreement could not have been performed in one year. The court suggested that had the promise been for employment "until retirement," it would have ruled differently, as the employee could have retired within one year. The court rejected plaintiffs claim that he could have died within one year and therefore the statute of frauds was satisfied. On rehearing, however, the court changed its view, ruling that the contract would have been fully performed had plaintiff either died or retired within one year, and therefore was not invalidated by the statute of frauds. *Hodge v. Evans Fin. Corp.,* 823 F. 2d 559 (D.C. Cir 1987).

Also, where the implied in fact contract claim includes both oral statements and writings, the writings may be sufficient to overcome the statute of frauds.

C. Promissory Estoppel has been used by employees and courts as an alternative theory. Employees must show an unambiguous promise by the employer, reasonable and foreseeable reliance, and detriment as a result of that reliance. *Herbst v. System One Information Management, L.L.C.,* 31 F. Supp. 2d 1025 (N.D. Ohio 1998). The reliance may include relocation, sale/purchase of a home, relinquishing another job, etc. Some courts have held, however, that these actions, especially the relinquishment of the former job, are ordinary in connection with changing employment and are insufficient to establish an estoppel. These claims are strongest where an at will employment is terminated very shortly after its inception, and where the detriment is extreme, i.e. the long distance relocation to take a position that is immediately terminated.

The employee who moves her family hundreds of miles to take a new "at will" position may reasonably believe that her employment will be for a "reasonable period", but what should the

measure of her damages be in connection with a claim of promissory estoppel? In *Goff-Hamel v. Obstetricians & Gynecologists, P. C.,* 588 N.W. 2d 798 (Neb. 1999), the court found a promissory estoppel where plaintiff quit her job of eleven years in reliance on an offer of new employment, which offer was rescinded one day before she was to report to work because the wife of an owner of the company objected to her hiring. She was unemployed for many months thereafter. Summary judgment was granted in favor of the employee on a promissory estoppel claim. In remanding the case, the court stated, significantly, that the damages on an promissory estoppel claim ought not be based on lost wages but rather "as justice requires."

II. Obligations Implied in Law: The Covenant of Good Faith and Fair Dealing

Courts in many states have ruled that the implied covenant of good faith and fair dealing implied in every contract does not inhibit the right of termination at will under an employment at will agreement. *Murphy v. American Home Products Corp.,* 58 N.Y. 2d 293 (N.Y. 1983). The cause of action may be limited to cases where the employer's conduct is extreme, such as termination for reporting of unlawful activity, or termination for the sole purpose of denying the employee commission to which he would be entitled under the terms of his employment but for the termination. *See Reed v. Anchorage,* 782 P. 2d 1155 (Alaska 1989), *Mitford v. LaSala, 666 P.* 2d 1000 (Alaska 1983). Other states treat this cause of action as a tort cause of action, permitting the employee asserting such claim to seek tort damages including punitive damages.

III. The Employee's Rights Against Termination under a Written Agreement for Definite Term.

An agreement for a definite term does not insulate the employee from discharge. The employee must still perform her obligations under the agreement. This, the employer may terminate the employee if it has "cause" or "just cause" to do so. The problem for the employer subject to a "cause" standard is that the court or arbitrator becomes the ultimate decision maker as to the employee's right to continued employment. On the other hand, while the "cause" standard may protect the employee from an arbitrary discharge, it does not provide absolute protection in the event that the employer is not fully satisfied with her performance. Accordingly, the cause standard has greater value to the employee to the

extent that the contract defines it more restrictively, making it more a matter of intentional misconduct (violation of law, fraud or theft, refusal to work, etc.) and less a matter of subjective issues related to performance.

An employment agreement may be breached by failure to comply with its terms, or it may be terminated by repudiation or material breach, which permits the other party to cease performing under the agreement. *Lovink v. Guilford Mills, Inc.,* 878 F. 2d 584 (2d cir. 1989). A material breach by the employer might be failure to make the payments required or a reduction of position or job responsibilities below that required by the agreement. *See Schenider v. Dumbarton Developers, Inc., 767 F. 2d 1007, 1014 (D. C. Cir. 1985); ARP Rudman v. Cowles Communications, Inc.,* 30 N.Y. 2d 1, 330 N.Y.S. 2d 33 (N.Y. 1972).

Where an employee claims that she was terminated without cause in violation of the agreement (or resigned after a material breach of the agreement by the employer), her remedy is damages consisting of any compensation owed under the agreement (in whatever form) for the remainder of the contract term. However, the duty to mitigate applies, and the employee must diligently seek new employment, and her claim will be reduced by the compensation earned from such employment. *See Cornell v. T. F. Dev. Corp.,* 17 N.Y. 2d 69, 268 N.Y.S. 2d 29 (N.Y. 1966). If the contract provides for liquidated damages in an amount that is not unconscionable, no further inquiry into damages, including mitigation, is necessary. *Musman v. Modern Deb. Inc.,* 377 N.Y.S. *17, aff'd* 48 N.Y. 2d 941, 425 N.Y.S. 2d 95 (N.Y. 1979).

IV. Employee Rights Under the At Will Agreement.

The substantive terms of the employment relationship (e.g. compensation and benefits) are enforceable as to their terms notwithstanding that the employment may be terminated at will. The employee may recover compensation earned for the period of the relationship prior to its termination. Where the agreement provides for bonuses, commissions and other non-wage forms of compensation, there may be disputes about what is owed as of the date of termination, which depend on the precise terms

of the agreement. Note that state statutes also require the timely payment of wages and benefits, and may provide the additional remedies of penalties, interest, and attorneys fees on such claims.

V. The Employee's Obligations under the Agreement for a Definite Term.

Even though as a practical matter the commitment for a definite term is generally made by the employer as an inducement to the employee to accept employment, depending on how the agreement is worded, the employee is making a commitment to perform her service for a definite term as well, and is subject to a claim by the employer for breach of the agreement should she leave before the end of the term. (Such a claim might get asserted where the employee leaves to join a competitor) While the employer can not obtain specific performance requiring her to return to work, it does have a claim for damages. Accordingly, the right to resign prior to the end of the term is a subject that ought to be negotiated in the agreement for a definite term.

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Appendix

Worldwide Mud Products, Inc.

Mr. John Doe
New York, New York 10001

Dear Mr. Doe:

On behalf of Worldwide Mud Products, Inc. ("the Company"), I am delighted to offer you a position as Vice President, Business Development. This is an offer for permanent employment. The terms offered are set forth below.

1. You will receive annual salary of $300,000 for the first year of employment, $350,000 for the second year, and $400,000 for the third year. You will also receive an annual bonus based on your performance, which will in no event be less than 20% of your base salary for the applicable year.

2. In addition, on your first day of employment you will receive stock options for 100,000 shares of the Company's common stock, and on each of your first three anniversary dates you will receive an additional 100,000 shares, under the terms of the Company's employee stock option plan.

3. You will perform duties consistent with a very important senior executive position in the business development field, or such other duties as the Company may assign to you.

4. This agreement constitutes the entire agreement between the parties, and may be modified only by a writing signed by you and the Company. No other representations written or oral constitute a part of your employment agreement. This is an agreement for at-will employment. You will be issued our employee handbook, and will be expected to abide by its terms.

5. If you resign or if your employment is terminated for any reason, you will not engage in competition with the Company for a period of six months. "Competition" is defined as any work in the business development field in an industry in which the Company is involved or may be considering becoming involved in.

Please accept this agreement by signing in the space provided for your signature.

Very truly yours,
A.T. Will, President and CEO

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