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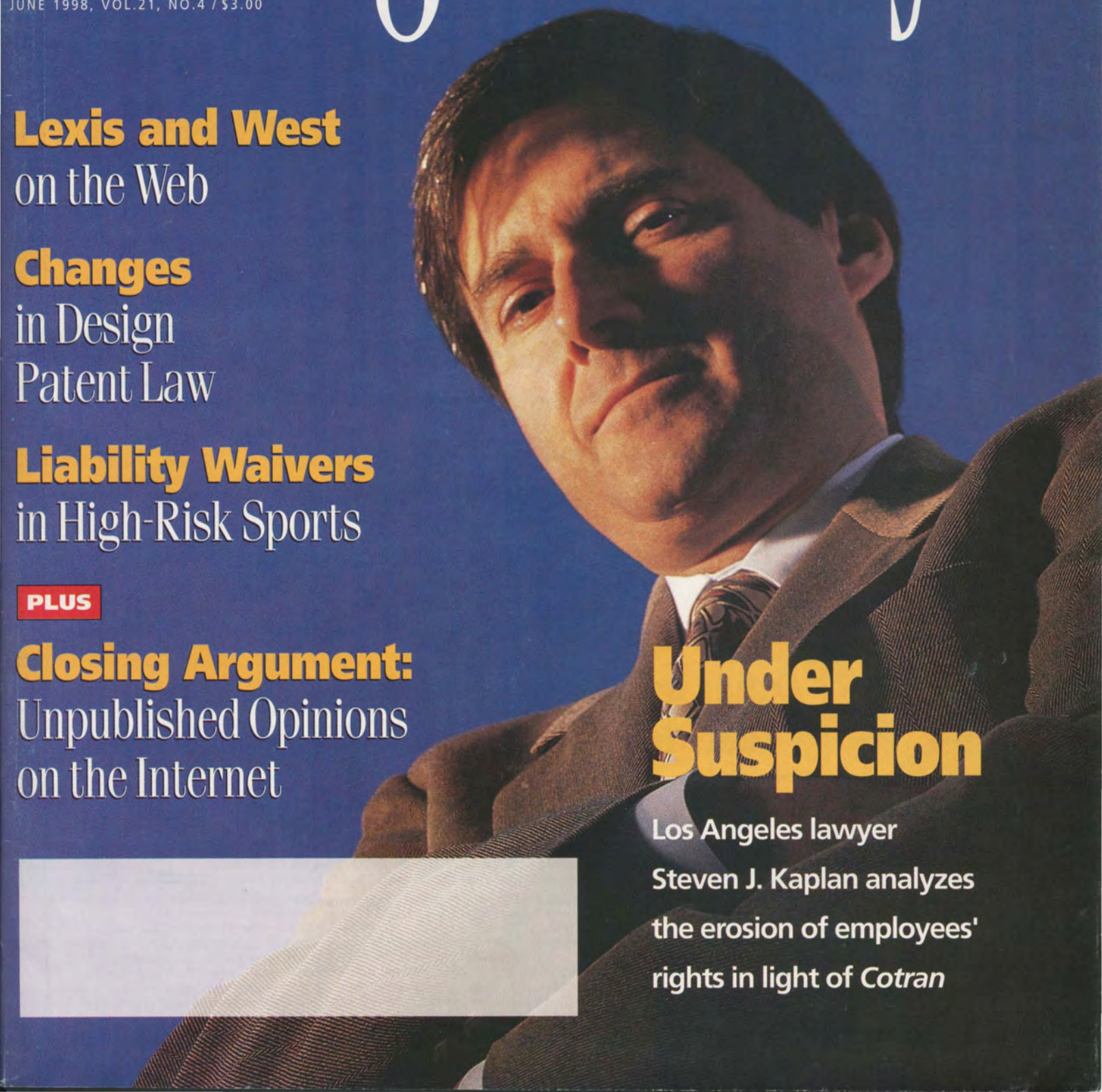

Under Suspicion

Los Angeles lawyer Steven J. Kaplan analyzes the erosion of employees' rights in light of *Cotran*

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Steven J. Kaplan is a partner with the Century City law firm of Krakow & Kaplan, where he represents employees and labor unions in employment and civil rights matters. In "Under Suspicion" he examines the additional burdens placed on wrongful termination plaintiffs in the aftermath of the California Supreme Court's *Cotran* decision. The article begins on page 32.

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By Steven J. Kaplan

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Rather than limiting wrongful termination lawsuits, the California Supreme Court's decision in Cotran may only serve to increase their complexity

The California Supreme Court's recent decision in *Cotran* v. *Rollins Hudig Hall International, Inc.*[1] signals a major retrenchment from the promise of *Foley* v. *Interactive Data Corporation*,[2] in which the supreme court held that an employee could use general principles of contract law to establish an implied-in-fact guarantee of job security from his employer. In *Cotran* the court held that to establish good cause for termination under an implied employment contract, an employer needs to have no more than a good faith belief, based on its own investigation, that the employee is guilty of wrongdoing. With this decision, truth has become the latest casualty in the continuing clash over employee rights.

This new decision is being hailed by employers and their lawyers as an antidote to contract claims for wrongful termination, and not without good reason. *Cotran* will make it easier for employers to defend against wrongful discharge claims brought by nonunion employees, especially in termination cases involving allegations of serious transgressions such as embezzlement or sexual harassment. Under *Cotran*, judges and juries will have to focus their attention not on whether an employee actually committed the alleged misconduct but on whether the employer conducted an adequate investigation into the accusation and acted in good faith. Wrongful discharge cases will become battles over procedural due process. Counsels for plaintiffs will no doubt agree with Yale Law School Professor Grant Gilmore, who once said, "Hell is a place with no justice, but where due process is strictly observed."

As happens with most major decisions, the case gives rise to more questions than answers. Most of these questions will come in the form of evidentiary disputes. For example, will facts probative of actual innocence that the employer could have, but failed to, uncover, necessarily create a question of fact as to the adequacy of the investigation? Ironically, will an employer's after-acquired evidence of actual guilt be excluded because it did not contribute to the employer's good faith determination?

The case will also complicate the presentation of evidence at trial. Lawyers will shift their focus to the question of whether the employer reasonably thought that the misconduct happened, but they will also have to account for the fact that the typical jury still will want to know if the misconduct actually did happen.

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From a plaintiff's perspective, *Cotran* is obviously an unfortunate decision, but it is not a panacea for management or a complete disaster for employees. Although the decision is based on faulty legal premises and questionable policy, it leaves enough room for a practitioner to mount viable breach of contract claims on behalf of wrongfully fired workers.

In *Cotran*, the plaintiff alleged that he had an implied-in-fact contract providing that his employer could not fire him except for good cause. Two female employees reported to the company that Ralph Cotran had masturbated in their presence and had harassed them with obscene phone calls. The company suspended Cotran pending investigation, then interviewed 21 people. In the end, the company chose to believe the complainants. Among its stated reasons was that "no one...interviewed had said it was 'impossible' to believe that [the] plaintiff had committed the alleged sexual harassment."

At trial, Cotran denied the accusations. He testified, however, that he had had romantic relationships with both women simultaneously without, at first, their knowledge. Cotran argued that the complainants were motivated by jealousy and by one woman's desire for a pay raise. The company defended on the ground that it had reached its decision honestly and in good faith following a thorough investigation. The trial court ruled that, in determining whether the company had good cause to terminate Cotran, the jury was to decide not whether the company acted in good faith but "whether the acts are in fact true." The jury sided with the plaintiff and awarded him $1.78 million in damages.

The court of appeals reversed the jury verdict, and the California Supreme Court, in a decision penned by Justice Janice Brown, affirmed. The supreme court held that at trial, the employer does not have to prove that the alleged misconduct actually occurred. Instead, to prevail on a claim for breach of an implied good cause contract, the employer need only prove that it had a reasonable and good faith belief that the wrongful conduct had happened.

The court adopted a standard it characterized as the "objective reasonableness of the employer's factual determination of misconduct." Under this standard, an employer acquits itself of its good cause obligation so long as its decision is based on:

> [F]air and honest reasons, regulated by good faith on the part of the employer, that are not trivial, arbitrary or capricious, unrelated to business needs or goals, or pretextual. A reasoned conclusion, in short, supported by substantial evidence gathered through an adequate investigation that includes notice of the claimed misconduct and a chance for the employee to respond.[3]

The court remanded for retrial under the new standard and stated, without explanation, that the objective reasonableness standard did not necessarily apply to written for-cause employment contracts.

In reaching its conclusion, the majority rejected the only prior California decision to face this issue directly. In *Wilkerson* v. *Wells Fargo Bank*,[4] the court of appeal held that in a wrongful discharge implied contract case, the employer was required to prove that the misconduct leading to dismissal had actually occurred. Breach of contract, held *Wilkerson*, is not a matter of belief but a matter of fact. By way of comparison, the court observed that "a defaulting borrower's good faith belief he or she has repaid a loan is not a defense to a lender's claim for payment."[5]

The *Cotran* case marks an unsettling departure from general principles of contract law. As dissenting Justice Joyce Kennard emphasized, the court substituted a rule of law for a determination that, until now, was made by the jury. Before *Cotran*, it was the jury's responsibility to determine what sort of implied contract, if any, was established by the employer's conduct. If a good cause obligation was found, it was also up to the jury to decide exactly how such cause was to be demonstrated by the employer.

Under *Cotran*, if a jury should find that an implied good cause provision exists in the parties' employment contract, jurors are precluded from making any finding as to what sort of cause was contemplated by the agreement. Instead, they are bound to apply the objective reasonableness standard imposed by the court even if, had they considered the question, they would have found that the contractual provision says something quite different.

The court primarily relied on non-California authorities. One of the most influential was an Oregon case, *Simpson* v. *Western Graphics Corporation*.[6] *Simpson* held that in an implied good cause context, it would be unreasonable to infer that the employer would have "intended to surrender its power to determine whether facts constituting cause for termination exist."[7]

In relying on this proposition, the court seemed to confuse subjective intent with the objective manifestations of intent, which are the proper subject of an implied contract analysis. Employers rarely admit that they intend for their actions to give rise to an implied for-cause contract, and the supreme court was right to assume that employers are equally unlikely to admit a subjective intent to surrender their decision-making authority. The point of the implied contract analysis, however, is that an employer's objective conduct, if it reasonably gives rise to a good cause expectation, may supersede the employer's subjective or even stated intent.[8]

The objective test for implied contract formation requires the fact finder to determine whether the conduct of the parties demonstrates that an implied agreement exists and, if so, the extent of its terms.[9] Far from seeking to ascertain the parties' subjective intentions, the implied contract consists of the expectations reasonably inferred from the promisor's objective conduct.[10] As noted in *Foley*, "'[I]t must be determined, as a question of fact, whether the parties acted in such a manner as to provide the necessary foundation for [an implied contract]....'"[11] The *Foley* decision instructed that to determine the existence of such an implied contract, one must look to the totality of the circumstances of the employment relationship.[12]

While the employer's stated intent is certainly one relevant factor in this analysis, it is not determinative and may be overcome by conduct suggesting a contrary contractual arrangement. *Walker* v. *Blue Cross of California*[13] is a case in point. It held that the employer's personnel handbook, which announced to employees that their employment was at will, could be contradicted by other conduct on the employer's part giving rise to a good cause obligation.[14]

What this all means is that the employee's reasonable expectation, based on the employer's objective conduct, controls the answer to the implied contract question. By focusing on the employer's assumed intention, *Cotran* turned the analysis on its head, both by trying to ascertain a hypothetical employer's subjective intent and by disregarding the reasonableness of the employee's expectation, which is the proper fulcrum of the analysis.

The court acknowledged that certain policy considerations, or what it called "practical considerations," prompted its conclusion. None of these considerations, however, holds up well to scrutiny. Referring to the Nevada case of *Southwest Gas* v. *Vargas*,[15] Justice Brown observed that a jury is not a suitable fact finder to oversee an employer's decision-making processes because jurors are "unexposed to the entrepreneurial risks that form a significant basis of every state's economy." The justice also criticized the "jury's relative remoteness from the everyday reality of the workplace." These are improper reasons to withdraw a factual question from a jury. It is

counsel's obligation to expose jurors to relevant facts that may be missing from their experience, but jurors do not need any particular expertise to serve. In any event, the "remoteness" idea rings hollow. Cloistered supreme court justices perhaps, but not jurors, are remote from the "everyday reality of the workplace." It is precisely because typical jurors do understand the consequences of unjust job loss and do not have an interest in protecting the prerogatives of capital that employers distrust the jury system and are increasingly imposing mandatory arbitration clauses in their employees' contracts.

Justice Brown also wrote that a standard of review allowing the jury to decide whether an employee in fact committed the act leading to dismissal would "dampen an employer's willingness to act." No statistical authority was cited to support this proposition. While the assertion has some surface appeal, it is a rather speculative basis on which to establish an important rule of law. If *Wilkerson* inhibited employers from firing employees without persuasive evidence of guilt, that is how it should be. All that will happen, now that the reins have been loosened, is that employers will not feel the same compulsion for certainty. This may make things easier for employers, but it will wreak havoc on the lives of many individuals who will have to seek new employment after being scarred with a termination for a moral or criminal offense of which they are innocent.

Labor and employment law practitioners know from their experience with wrongful discharge in the unionized workplace that employers are capable of operating their businesses efficiently even if a more demanding standard of review is imposed on them to support a job termination. For 50 years now, unionized employers have lived under a standard of review more stringent even than *Wilkerson*'s. Labor arbitrators require that when an employee is fired for stigmatizing misconduct, such as dishonesty, sexual harassment, or violence, employers must show, either with proof beyond a reasonable doubt or by clear and convincing evidence, that the misconduct actually occurred.[16] Volumes of published labor arbitration reports attest to the fact that unionized employers can successfully defend for-cause terminations under labor arbitration's tougher standard of review. Certainly, if unionized employers can survive and prosper under their more rigorous standard, the businesses of nonunionized employers would not suffer terribly from imposition of an easier standard such as *Wilkerson*'s.

The new standard not only makes it easier for employers to fire employees but also encourages biased investigations. Employers will now be more likely to side with the accuser against the accused, because there is little if any cost associated with an incorrect, proaccuser determination. On the other hand, there will often be a greater cost to a proaccused determination. If the charge is sexual harassment, for example, a finding for the accused may result in a sexual harassment lawsuit brought by the complainant. Finding against the accused avoids this risk, because under *Cotran* the wrongfully fired employee has the new, good faith standard to overcome. All the employer incentives now work against the wrongfully accused. Outcome-determinative investigations are likely to become the norm.

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There was a viable middle ground position that the court could have adopted that would have protected the interest of employers to make reasonable personnel decisions without subjecting them to unreasonable second guessing, while at the same time furnishing a meaningful avenue of relief for employees who are fired for misconduct that they did not commit.

The court could have distinguished between the two fundamentally different types of reasons that employers generally invoke as a justification for termination of an employee for cause: 1) poor job performance, and 2) affirmative wrongdoing, as was the case in *Cotran*. It could then have imposed an objective reasonableness or good faith test for terminations due to an employee's work performance, while preserving a "did it actually happen" standard for those occasions when, as happened in *Cotran*, an employee is fired for stigmatizing misconduct. This dual standard would adjust the definition of "good cause" to make it fit the context to which it is applied, using a good faith standard when the termination requires the exercise of some amount of subjectivity and discretion while imposing a tougher standard when the cause involves objective wrongdoing.

Walker perhaps said it best: "Whether good cause exists is dependent upon the particular circumstances of each case.... [C]are must be taken so as not to interfere with the employer's legitimate exercise of managerial discretion."[17] Requiring good faith in judging whether an employee is performing well is certainly legitimate, but deferring to an employer's discretion when deciding if someone committed a criminal offense is not.

This distinction is consistent with the lead appellate decisions that preceded *Cotran*. In *Pugh* v. *See's Candies, Inc.*[18] (known as *Pugh I*), in which the good faith standard was first adopted by then-Associate Justice Joseph Grodin, the employee was not accused of affirmative wrongdoing but rather of failing to be a team player. Likewise, in *Wood* v.

Loyola Marymount University,[19] the issue was whether the plaintiff, a college baseball coach, was losing too many games.[20]

Wilkerson, on the other hand, involved a bank employee's dishonesty, which the employer characterized as a nonperformance issue. In those circumstances where the employee denies the charge of dishonesty, the employer should be put to the task of proving that it actually happened.[21]

There may be occasions where the line between misconduct and poor performance is difficult to draw. But a distinction similar to this has been applied in the labor arbitration setting for more than 50 years, and it has not created any noticeable inconvenience for arbitrators. It is unlikely that judges would have any greater difficulty with it.

Now that *Cotran* has been decided, employment lawyers will have to adjust their approaches to litigating good cause cases. Whenever an employer reasonably fears that an employee may have implied good cause rights, it will feel compelled to launch a pretermination investigation. Employers that do not conduct an investigation could conceivably find themselves without a defense when sued for wrongful termination.

Investigation will become a business unto itself, and many lawyers and private investigators will begin to make a cottage industry of it. While the *Cotran* majority did not specify the contours of an adequate investigation, employers with good cause obligations will no doubt develop elaborate investigation systems to protect themselves.[22] They may also claim safe harbors by relying on the advice of independent investigators.[23]

Plaintiffs are certain to go to great lengths to challenge the adequacy of employer investigations. While *Cotran* cautioned that full constitutional due process rights are not applicable to a good cause investigation, the court emphasized that the essentials of an adequate investigation will be articulated through the "common law's incremental, case-by-case jurisprudence."[24] One area of law plaintiffs will try to coopt for use under *Cotran* is that of due process enjoyed by public sector employees. For example, public sector employees accused of wrongdoing or misconduct must be furnished with the names of their accusers and all evidence on which the employer based its decision.[25] They must also be given a fair opportunity to try to demonstrate their innocence.[26]

A second source for defining fair procedures comes from the body of law protecting criminal defendants. Did the employer thoroughly investigate possible credibility problems with the complainant and supporting witnesses, check the accuser's personnel

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files, and investigate possible improper motives behind the accusations?[27] Did the employer advise the accused of exculpatory evidence, such as a prosecutor must furnish to a criminal defendant?[28]

The court explicitly gave plaintiffs permission to cite the common law right to fair procedure that now protects certain professionals from arbitrary exclusion or expulsion from private organizations that control important economic interests.[29] Doctors, for example, cannot be denied hospital privileges without notice of the charges against them and an opportunity to inspect documents.[30] Fair procedure under this common law includes the right to impartial adjudicators and a practical method for testing impartiality.[31]

Some advantage may also be gained by consulting the body of good cause jurisprudence developed under collective bargaining agreements—what the U.S. Supreme Court has called the common law of the workplace.[32] Labor arbitrators have long insisted that, when investigating employee wrongdoing, employers must respect certain fundamental employee rights, such as the right to be heard, to confront one's accusers, to a prompt investigation, and to union representation.[33] One arbitrator, Carroll R. Daugherty, emphasized that fairness requires that the final decision maker be sufficiently detached so as not to have a compelling stake in the decision.[34]

Some large corporations have already incorporated procedures similar to these into their internal grievance procedures, allowing accused employees to have coworker representation and having uninvolved managers make final decisions.

A plaintiff's attack on the adequacy of an investigation will include a dissection of the employer's purported good faith. Among the questions a plaintiff will ask are whether the employer interviewed witnesses favorable to the accused and whether the investigator belied a result-oriented approach by using leading questions and failing to examine any possible improper motive on the part of the accuser. A critical issue will be the logical or reasoned basis used by the employer to make credibility decisions. The elusive question of how and why an employer reached a particular conclusion will become grist for a complicated cross-examination mill.

A related question is the consequence of an employer's reliance on circumstantial or hearsay evidence. In *Cotran*, the employer was swayed, in part, because none of the witnesses thought it was "impossible to believe" that Cotran had committed the offense. This is a rather dubious reason to destroy some-

one's career, for it allows prejudice and rumor to infect the decision-making process.

A plaintiff will also seek to determine whether an employer's investigation belies unlawful motive. For example, in sexual harassment cases, does the employer seem to routinely find that the accused male is guilty? A policy of knee-jerk acceptance of harassment accusations could be evidence of sex discrimination. A failure to investigate similar conduct by employees in a different protected class (such as taking male sexual horseplay more seriously than female sexual horseplay) could be an indication of unlawful discrimination. Also, an unremedied false accusation of sexual harassment in itself may qualify as sexual harassment if it can be shown that the accuser was motivated by a hostility to the gender of the accused.[35]

The admissibility of certain types of evidence will become particularly critical in the post-*Cotran* world. For example, in order to demonstrate that the investigation was deficient, a plaintiff should be permitted to introduce evidence of actual innocence that the employer could have but failed to uncover.[36] Evidence that an employer was faced with the possibility of a sexual harassment suit if it sided with the accused should be admissible to challenge the employer's good faith.

No doubt the issue of employee privacy will be raised as plaintiffs seek to discover information about their accusers. For example, employers are likely to resist disclosure of the personnel files of other employees on the ground that those files are privileged under the privacy clause of the California Constitution.[37] In 1987, the court of appeal held that employees do have a privacy interest in their personnel files.[38] Since then, employee privacy rights have been rolled back.[39] Given the overall lack of clarity in the law, frequent discovery battles can be expected over the degree to which employers whose investigations have been placed at issue by *Cotran* can withhold relevant documentation from plaintiffs seeking to prove the inadequacy of those investigations.

Plaintiffs also will place independent investigators under the microscope. There is little question that an investigation file is subject to discovery.[40] It is not clear whether an independent investigator's own track record with other investigations will be open to discovery in the same way that an expert witness's past experience is a proper subject of inquiry.

Perhaps the most important question left unresolved in *Cotran* is whether a plaintiff may avoid the objective reasonableness test by demonstrating that his or her particular implied-in-fact contract imposes a heightened standard of review, i.e., one requiring that the employer prove that the misconduct actually

occurred. In a concurring opinion, Justice Mosk wrote: "[T]here is nothing, of course, in the majority's standard that precludes an employer and an employee from negotiating or impliedly forming a contract with a 'good cause' clause that defines that term more explicitly, in which case the jury's good cause determination would be shaped by this contractual definition."[41] While the majority did not expressly agree with Justice Mosk, it relied heavily on *Simpson*,[42] the Oregon decision, which shared Justice Mosk's opinion. *Simpson* adopted a *Cotran* standard only "[i]n the absence of any evidence of express or implied agreement whereby the employer contracted away its fact-finding prerogative...."

It is too early to say what type of evidence might help to qualify for this more exacting standard. It behooves plaintiffs to revisit the independent consideration doctrine discussed in *Pugh I* and *Foley*. In *Pugh I*, the court held that independent consideration—that is, consideration given by the employee beyond the rendition of services to the employer—serves an evidentiary function of supporting an implied limitation on an employer's termination authority.[43] In *Foley*, the plaintiff had signed a separate no-competition and proprietary agreement with his employer. The court held that this "valuable and separate consideration" might be probative evidence of a contractual limitation on the employer's dismissal authority.[44] In the future, plaintiffs will likely argue that independent consideration in their employment relationship imposes on the employer not only a good cause obligation but also a more rigorous proof standard requiring the employer to demonstrate that the employee actually committed the alleged misconduct. Certainly an employee can argue that his or her surrender to a cram-down arbitration agreement imposes on the employer an obligation to be actually correct before it can sustain a termination.

Because the best defense can be a strong offense, an upswing can be expected in defamation claims against employers and the individuals who accuse employees of wrongdoing. The courts of appeal have long allowed defamation suits for nonprivileged internal corporate communications.[45] In *Gould* v. *Maryland Sound Industries, Inc.*,[46] the court of appeals allowed a defamation claim against an employer in a case in which a manager had accused the employee of making a $100,000 mistake in a bid estimate. The court found that this was a "statement of fact susceptible to proof" which, if untrue, could injure the plaintiff's reputation. California also recognizes the compelled self-publication doctrine, which allows an employee to sue a former employer for defamation if the employee was under a strong compulsion to tell a prospective

employer "what is in his personnel file in order to explain away a negative job reference."[47]

As recently as 1995, the California Supreme Court admonished against judicial overinvolvement in the employment relationship.[48] It also observed that employers have plenty of unilateral power in the way that they control the employment relationship to avoid unwanted contractual obligations. Employers exercise this power by requiring employees to sign cram-down arbitration clauses, unfavorable choice-of-law provisions, and so-called integrated at-will agreements as a condition of employment. *Cotran* extends a helping hand to these employers by giving them the power to decide, unilaterally, a material factual question concerning breach of the employment agreement. This is truly unnecessary.

While *Cotran* tips the scales further in favor of employers, it does not signal the death of wrongful discharge law. The new focus on fair and adequate investigations gives employees a fighting chance, although it will unduly complicate future wrongful termination litigation. So much so, in fact, that employers as well as employees may soon find themselves longing for the simpler days of *Wilkerson*. ■

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[1] Cotran v. Rollins Hudig Hall Int'l, Inc., 17 Cal. 4th 93, 69 Cal. Rptr. 900 (1998).
[2] Foley v. Interactive Data Corp., 47 Cal. 3d 654 (1988).
[3] Cotran, 17 Cal. 4th 93, 108.
[4] Wilkerson v. Wells Fargo Bank, 212 Cal. App. 3d 1217 (1989).
[5] *Id.* at 1230.
[6] Simpson v. Western Graphics Corp., 643 P. 2d 1276 (Or. 1982).
[7] *Id.* at 1279.
[8] Foley v. Interactive Data Corp., 47 Cal. 3d 654, 677 (1988).
[9] *See* Marvin v. Marvin, 18 Cal. 3d 660 (1976).
[10] Foley, 47 Cal. 3d at 677; Hillsman v. Sutter Community Hosp., 153 Cal. App. 3d 743 (1984).
[11] Foley, 47 Cal. 3d at 677 (quoting Silva v. Providence Hospital of Oakland, 14 Cal. 2d 762, 774 (1939)).
[12] Foley, 47 Cal. 3d at 680.
[13] Walker v. Blue Cross of California, 4 Cal. App. 4th 985 (1992).
[14] *Id.* at 993-94.
[15] Southwest Gas v. Vargas, 901 P. 2d 693 (Nev. 1995).
[16] *See generally* M. HILL & A. SINICROPOI, EVIDENCE IN ARBITRATION 32-36 (2d ed. 1990).
[17] Walker, 4 Cal. App. 4th at 994.
[18] Pugh v. See's Candies, Inc. (Pugh I), 116 Cal. App. 3d 311, 330 (1981).
[19] Wood v. Loyola Marymount University, 218 Cal. App. 3d 661 (1990).
[20] The exercise of good faith in this context has some similarity to the good faith required in a satisfaction contract.
[21] Wilkerson v. Wells Fargo Bank, 212 Cal. App. 3d 1217, 1230 (1989).
[22] L. M. Edwards & C. L. Kopitzke, *Ensuring a Fair and Proper Sexual Harassment Investigation*, LOS ANGELES