

## ARTICLE

# MARKET ORDERING VERSUS STATUTORY CONTROL OF TERMINATION DECISIONS: A CASE FOR THE INEFFICIENCY OF JUST CAUSE DISMISSAL REQUIREMENTS

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## I. INTRODUCTION

Since the start of the twentieth century, the majority of employment relationships in the United States have been governed by the common law employment-at-will presumption. This rule permits both employers and employees to terminate their relationship at any time with or without cause, in the absence of a contractual provision to the contrary.<sup>1</sup> Thus, employees whose contracts incorporate the at-will presumption have no legal recourse against their employers if they are terminated without cause.

Over the past three decades, academics and commentators have hotly debated the proper scope of an employer's power to terminate its employees and the efficacy of the common law's allocation of this authority. Early opponents of the at-will presumption seized on the rule's historical pedigree, arguing that it was premised on antiquated notions of economic individualism and contractual freedom.<sup>2</sup> Buoyed by increasing regulation of the workplace and the passage of federal legislation limiting the power of employers to terminate employees in some circumstances,<sup>3</sup> these early critics concluded that "the freedom of contract slogan no longer insulates a transaction from minimum demands of fairness, reasonable behavior, and consistency with important policies."<sup>4</sup> Ultimately, according to these commentators, the greater threat to freedom came not from government regulation, but from employers who, by virtue of their market power, threatened to deny their employees the ability to control any meaningful aspect of their working lives.<sup>5</sup>

Law and economics scholars responded strongly to these initial criticisms, mounting a defense of the at-will presumption based on its comparative efficiency over a just cause

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1. See Andrew P. Morriss, *Exploding Myths: An Empirical and Economic Reassessment of the Rise of Employment At-Will*, 59 MO. L. REV. 679, 688 (1994).

2. See Lawrence E. Blades, *Employment at Will vs. Individual Freedom: On Limiting the Abusive Exercise of Employer Power*, 67 COLUM. L. REV. 1404, 1416 (1967); Note, *Protecting At Will Employees Against Wrongful Discharge: The Duty to Terminate Only In Good Faith*, 93 HARV. L. REV. 1816, 1826 (1980) [hereinafter Note].

3. See, e.g., National Labor Relations Act, Act of July 5, 1935, ch. 372, 49 Stat. 449 (codified as amended at 29 U.S.C. §§ 151-169 (1988)); Civil Rights Act of 1964, Pub. L. No. 88-352, 78 Stat. 253 (codified as amended at 42 U.S.C. § 2000e to 2000e-17 (1988)).

4. Note, *supra* note 2, at 1826.

5. See Blades, *supra* note 2, at 1404.

requirement.<sup>6</sup> Critics of the at-will rule were forced to confront this defense, because by implication it suggested that reforms affording employees greater job security would affect them adversely as a class.<sup>7</sup> The result was a second wave of scholarship criticizing the at-will presumption on economic grounds, premised on the existence of structural and bargaining defects in the market for labor.<sup>8</sup>

These academic attacks on the at-will rule have had a profound influence on the development of employee discharge law. Spurred by reform-minded commentators, courts have developed a number of common-law exceptions to the at-will rule that curb employers' freedom to make termination decisions.<sup>9</sup> State legislatures have also enacted measures

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6. See, e.g., Charles A. Brake, Jr., *Limiting the Right to Terminate at Will—Have the Courts Forgotten the Employer?*, 35 VAND. L. REV. 201 (1982); Richard A. Epstein, *In Defense of the Contract at Will*, 51 U. CHI. L. REV. 947 (1984); Mayer G. Freed & Daniel D. Polsby, *Just Cause for Termination Rules and Economic Efficiency*, 38 EMORY L.J. 1097 (1989); Jeffrey L. Harrison, *The "New" Terminable-at-Will Employment Contract: An Interest and Cost Incidence Analysis*, 69 IOWA L. REV. 327 (1984).

7. See, e.g., Harrison, *supra* note 6, at 355; Epstein, *supra* note 6, at 972.

8. This chronology is simplified to some extent, as a few of the initial arguments levied against the at-will rule were economic. See Note, *supra* note 2, at 1830-36. However, supporters of the common law regime effectively countered these claims as part of their first-order defense. Ultimately, a second wave of criticism, almost entirely economic in nature, was levied against the at-will presumption. See, e.g., PAUL C. WEILER, *GOVERNING THE WORKPLACE: THE FUTURE OF LABOR AND EMPLOYMENT LAW* 48-104 (1990); Arthur S. Leonard, *A New Common Law of Employment Termination*, 66 N.C. L. REV. 631 (1988); Peter Stone Partee, *Reversing the Presumption of Employment at Will*, 44 VAND. L. REV. 689 (1991); Stewart J. Schwab, *Life-Cycle Justice: Accommodating Just Cause and Employment at Will*, 92 MICH. L. REV. 8 (1993).

9. Courts have developed three such exceptions to the at-will rule. The first is a public policy exception, which permits employees to recover against their employers in tort if they are terminated for a reason that contravenes an identified public policy interest of the state. See Michael J. Phillips, *Toward a Middle Way in the Polarized Debate Over Employment at Will*, 30 AM. BUS. L.J. 441, 446-47 (1992). The second exception allows employer liability for breaking either express or implied promises made concerning discharge policies. In essence, this exception reduces the quantum of proof necessary to prove that the parties contracted out of the at-will rule. Most commonly, cases decided under this rubric hold an employer liable for failing to follow standard discharge policies in a given case or failing to respect promises of job security made in employee handbooks. *Id.* at 448-49. The third exception to the at-will rule is based on the implied covenant of good faith and fair dealing, which has been read by a few courts to require that employment contracts be interpreted in light of community standards of fair treatment. *Id.* at 447-48. Courts employing this external approach have generally interpreted these community norms as requiring that employees not be terminated for "bad faith reasons" unrelated to their job performance. See, e.g., *Monge v. Beebe Rubber Company*, 316 A.2d 549 (N.H. 1974) (permitting recovery for a "bad faith" discharge predicated on a female employee's refusal to submit to a superior's sexual advances). The adoption of these exceptions varies from state to state. For a state-by-state breakdown of the exceptions' applicability, see LIONEL J. POSTIC, *WRONGFUL TERMINATION: A STATE-BY-STATE SURVEY* (1994).

designed to limit the range of legally permissible justifications for discharging employees.<sup>10</sup>

Academic commentators who favor a just cause requirement therefore appear to be winning the debate over the at-will presumption's relative efficiency. The purpose of this article is to challenge this trend by offering a comprehensive defense of the at-will presumption's economic superiority. Part II presents a preliminary case for the comparative efficiency of the at-will rule over a just cause requirement. With this baseline established, Part III addresses criticisms of the at-will rule premised on the existence of structural defects in the labor market. Included in this discussion are older claims premised on the existence of unequal bargaining power, and newer arguments concerning employers' incentives to exploit senior career employees. Finally, Part IV addresses criticisms of the at-will presumption based on possible defects in employer-employee bargaining. This section responds to recently proffered claims that non-unionized employees are unable to bargain effectively for job security, either because they lack accurate information about the risk of unjust termination, or because collective action problems hinder effective group bargaining. Ultimately, the paper concludes that retention of the at-will rule is justified by its comparative efficiency.

## II. THE COMPARATIVE EFFICIENCY OF THE AT-WILL PRESUMPTION VERSUS A JUST CAUSE REQUIREMENT

Where parties to a contract are able to bargain without impediment or cost, the law's default assignment of a property

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10. For example, the State of Montana has adopted a wrongful discharge statute that prohibits employers from terminating employees without just cause. *See* Mont. Code Ann. §§ 39-2-901 to -914 (1987). The statute provides for arbitration of termination disputes, but affords access to the courts where one party objects to arbitration. *See id.* §§ 39-2-914. Compensatory damages in the form of lost wages are available to aggrieved employees, and punitive damages are available where the employer's action is motivated by malice. *See id.* §§ 39-2-905.

Similarly, the Model Employment Termination Act, which has yet to be enacted by any state, prohibits employers from terminating employees without just cause so long as they have been employed by the firm for over one year. Model Employment Termination Act § 1(4) (1991). The Act permits an employer to opt out of the just cause regime by express written agreement, so long as the firm provides employees a minimum graduated schedule of severance payments. *See id.* § 4(c). Disputes under the Act are subject to binding mandatory arbitration, and damages available to discharged employees are limited to reinstatement, back pay and lost fringe benefits, attorney's fees, and a lump-sum severance payment if reinstatement is not awarded. *See id.* §§ 5-7.

right to either party does not prevent the parties from efficiently allocating that right by contract.<sup>11</sup> These ideal conditions do not exist in the market for labor,<sup>12</sup> but if bargaining costs or impediments are low enough, the flexibility afforded by permitting contractual allocation of job security rights will produce more efficient results than a legal rule fixing the outcome.<sup>13</sup> Thus, prior to examining possible defects in the labor market, it is necessary to determine whether, as a theoretical matter, the at-will presumption is the more efficient discharge rule. While this proposition may be difficult to prove with certainty, affirmative evidence of the rule's efficiency will provide a background against which allegations of market defect may be judged.

Each party to a contract has an independent incentive to maximize that party's gain from the transaction. As a result, each party is willing to make exchanges that allocate property rights under the contract efficiently.<sup>14</sup> By making such exchanges, the parties maximize the total gain created by the contract, and by sharing the gain, enhance their individual positions.<sup>15</sup> Employees bargaining over job security will therefore agree to work on an at-will basis if that regime's value to employers exceeds the costs it imposes on employees.<sup>16</sup> In exchange for agreeing to forgo the protection of a just cause rule, employees in a well-functioning market will demand additional compensation sufficient to cover the costs imposed by the at-will rule, plus some portion of the surplus generated by the agreement.<sup>17</sup> In order to determine whether this exchange

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11. See Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 10 (1960).

12. See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 51 (4th ed. 1992) (stating that the ideal conditions described by Coase do not exist in any market).

13. See Coase, *supra* note 11, at 18; Epstein, *supra* note 6, at 954 ("Courts and legislatures have intervened so often in private contractual relations that it may seem almost quixotic to insist that they bear a heavy burden of justification every time they wish to substitute their own judgment for that of the immediate parties to the transactions. Yet it is hardly likely that remote public bodies have better information about individual preferences than the parties who hold them."); Harrison, *supra* note 6, at 385.

14. See NICHOLAS MERCURO & TIMOTHY P. RYAN, *LAW, ECONOMICS AND PUBLIC POLICY* 44-47 (1984); A. MITCHELL POLINSKY, *AN INTRODUCTION TO LAW AND ECONOMICS* 27 (2nd ed. 1989); Coase, *supra* note 11, at 9.

15. See MERCURO & RYAN, *supra* note 14, at 44-47; POLINSKY, *supra* note 14, at 27; Coase, *supra* note 11, at 10.

16. See Phillips, *supra* note 9, at 471.

17. See *id.*

will be made, three factors must be considered: the costs borne by employers under a just cause regime, the benefits of that regime to employees, and whether the rule provides the parties with incentives to behave efficiently.

A. *Costs Borne by Employers Under a Just Cause Regime*

The differences between the at-will presumption and a legally enforceable just cause requirement are dramatic. A just cause regime would prevent employers from terminating employees who would otherwise have been discharged under the at-will rule when:

1. The employer has just cause to terminate the employee, but is unable to supply enough evidence to satisfy the fact-finder, either because the information has not yet been amassed or is impossible to acquire, or because securing the information would cost the employer more than would be gained by terminating the employee.<sup>18</sup>

2. The employer considers an act of misconduct or lack of competence serious enough to warrant termination, but the fact-finder does not agree with this assessment.<sup>19</sup>

3. The employee's job could be performed more efficiently by a replacement, despite the fact that the employee is neither incompetent nor has engaged in any misconduct.<sup>20</sup>

4. The employee is disliked by the employer for personal reasons, but the conflict is not sufficiently severe to establish a claim of insubordination or other misconduct.<sup>21</sup>

5. The employer mistakenly believes that the employee is incompetent or guilty of misconduct, and that error is corrected either by enhanced information-gathering procedures implemented in response to the just cause regime or through the dispute resolution process itself.

Despite the fact that a just cause regime would reduce the number of erroneous discharge decisions, prohibiting these types of discharges will impose costs on employers large enough

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18. See GRIEVANCE GUIDE 19 (BNA) (8th ed. 1992) (stating that the just cause rule as applied in the context of union collective bargaining agreements requires the employer affirmatively to prove employee wrongdoing).

19. See *id.*

20. See *id.*

21. See *id.* at 7 (stating that "personality factors" are not to be considered in making just cause determinations).

to offset corresponding gains. These costs stem from the implementation of additional information-gathering and record-keeping procedures, transaction costs generated by the litigation or arbitration of termination disputes, and a diminished ability to discharge inefficient employees. Small businesses would be disproportionately affected by each of these burdens, and given that small businesses constitute a large and growing portion of the United States economy,<sup>22</sup> the overall economic impact of a just cause requirement would be dramatic.

### 1. *Monitoring Costs*

Under a just cause regime, employers would place a high premium on detailed information and documentation of employee performance; without it, employers would be unable to justify their discharge decisions to courts or arbitrators, saddling them with inefficient employees.<sup>23</sup> Imposition of a just cause rule would thus prompt a number of costly changes in workplace procedures.

Employers will first be compelled to promulgate detailed personnel policies and standards of conduct, because discharge decisions will not be sustained under a just cause regime unless employees are adequately warned of the consequences of their actions.<sup>24</sup> In formulating personnel policies, employers will have to bear the cost of monitoring the decisions of judges or arbitrators responsible for passing on the validity of discharges;<sup>25</sup> if the judge or arbitrator rejects a workplace rule, employers will suffer the expense of revising it and notifying their employees of the change.<sup>26</sup> Employers will also lose a great

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22. See ANDREW D. HILL, "WRONGFUL DISCHARGE" AND THE DEROGATION OF THE AT-WILL EMPLOYMENT DOCTRINE 146 (Labor Relations and Public Policy Series No. 31, 1987) (stating that 93% of U.S. businesses are classified as small); James E. DeFranco, *Modification of the Employee At Will Doctrine—Balancing Judicial Development of the Common Law With the Legislative Prerogative to Declare Public Policy*, 30 ST. LOUIS U. L.J. 65, 70 (1985) (arguing that small businesses may account for an increasingly larger proportion of jobs as the economy shifts focus from production to services).

23. See DeFranco, *supra* note 22, at 78; Julius G. Getman, *Labor Arbitration and Dispute Resolution*, 88 YALE L.J. 916, 921 (1979).

24. See GRIEVANCE GUIDE, *supra* note 18, at 3.

25. See Getman, *supra* note 23, at 921.

26. Notification of employees may entail significant expense, because it is often not enough just to furnish employees with a copy of the rules. Some sort of follow-up procedure may be required in order to guarantee that the employees actually read and understand the rules. See, e.g., *In re Ethyl Corp.*, 74 Lab. Arb. Rep. (BNA) 953, 956

deal of flexibility in implementing workplace rules, because just cause regimes generally require that all employees be punished equally for the same offense.<sup>27</sup>

Once these policies are established, employers must create an information-gathering apparatus that reactively investigates identified instances of misconduct and proactively seeks out unidentified instances of shirking or incompetence. These needs are generally filled in the unionized sector by regular performance evaluations, the filing of reports by supervisors, and the use of progressive discipline.<sup>28</sup> These procedures allow employers to document instances of misconduct and thereby demonstrate to fact-finders that terminated employees have been afforded adequate warnings and opportunities to conform to company standards.<sup>29</sup> Once employers amass a body of evidence sufficient to justify termination, discharge decisions are generally reviewed by internal auditors to guarantee that factual findings are supported by the necessary quantum of evidence and that investigations were conducted in a fair and impartial matter.<sup>30</sup>

These internal investigation and auditing procedures are costly to implement and would impose a significant burden on employers.<sup>31</sup> While it is true that employers under the at-will rule must also monitor their employees' performance, the threat of litigation over termination decisions will spur employers to gather information and generate documentation more intensively.<sup>32</sup> These additional information-gathering costs will hit small businesses especially hard because these firms are unlikely to maintain written records of employee performance or conduct formal performance evaluations under the current

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(1980) (striking down the discharge of an employee caught in possession of marijuana on plant premises). The arbitrator stated, "it is a risky assumption for a firm to give rules to its workers in a written form and then expect them to read and understand them without some type of follow-up to confirm reading and clarity of understanding." *Id.*

27. See GRIEVANCE GUIDE, *supra* note 18, at 3; Getman, *supra* note 23, at 921.

28. See HILL, *supra* note 22, at 167-70.

29. See GRIEVANCE GUIDE, *supra* note 18, at 3.

30. See HILL, *supra* note 22, at 171.

31. See MICHAEL J. DUANE, THE GRIEVANCE PROCESS IN LABOR-MANAGEMENT COOPERATION 74 (1993); Defranco, *supra* note 22, at 78; Cheryl S. Massingale, *At-Will Employment: Going, Going...*, 24 U. RICH. L. REV. 187, 202 (1990).

32. See Defranco, *supra* note 22, at 78; Epstein, *supra* note 6, at 965; Getman, *supra* note 23, at 921.

at-will regime.<sup>33</sup>

## 2. *Transaction Costs*

A shift away from the at-will rule would also force employers to defend their termination decisions before neutral third parties. Depending on the nature of the proposed just cause regime, this neutral evaluation will be made either by a traditional court or, as in the unionized sphere, by an arbitrator.<sup>34</sup> The transaction costs imposed by the resolution of termination disputes will depend on which system is used.

Some proposed just cause regimes rely on judicial resolution of termination disputes.<sup>35</sup> The costs of using this forum would likely be so large as to outweigh any attendant gains to employees.<sup>36</sup> If discharged employees are permitted to collect only compensatory damages, all but the most highly compensated employees will find it exceedingly difficult to obtain representation, because the costs of successfully pursuing a claim will exceed available damages.<sup>37</sup> More employees could be afforded access to the courts if punitive damages were available, but this possibility will force employers to spend excessively in order to minimize liability.<sup>38</sup> For example, one study of California wrongful discharge litigation in which plaintiffs were permitted to recover punitive damages estimated that average attorney fees totaled \$164,000 per case between 1980 and 1986,<sup>39</sup> even though the average claimant received a

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33. This is so both because smaller firms can more easily monitor their employees and because there is less turnover in management. Thus, the employer's memory of employee performance can more effectively substitute for formal documentation. This claim is borne out by the direct relationship between firm size and the complexity of information-gathering procedures. See Robert J. Aalberts & Lorne H. Seidman, *Managing the Risk of Wrongful Discharge Litigation: The Small Business Firm and the Model Employment Termination Act*, J. SMALL BUS. MGMT., October 1993, at 75, 76.

34. See DUANE, *supra* note 31, at 63-6; Getman, *supra* note 23, at 935-36.

35. Montana's statute permits resort to the courts whenever one party does not wish the dispute submitted to arbitration. See MONT. CODE ANN. §39-2-914 (1987).

36. See WEILER, *supra* note 8, at 101; Massingale, *supra* note 31, at 202-04.

37. See Defranco, *supra* note 22, at 82.

38. See HILL, *supra* note 22, at 150-51. This problem will be magnified if decisions are made by juries rather than judges. Many commentators have noted that juries are systematically biased in favor of terminated employees. See *id.* at 149; Epstein, *supra* note 6, at 970; Defranco, *supra* note 22, at 82 (stating that commentators are in almost universal agreement that juries are unduly sympathetic to the employee and indifferent to the management considerations relevant to termination decisions).

39. See JAMES N. DERTOUZOS, *THE LEGAL AND ECONOMIC CONSEQUENCES OF WRONGFUL TERMINATION* 44 (1988).

payment of only \$125,000.<sup>40</sup> Even if such cases are settled before trial or are resolved at the summary judgment stage, employers would still bear the cost of answering the complaint, discovery, and preparing and arguing dispositive motions.<sup>41</sup> Ultimately, the costs of judicial resolution are even greater than these figures suggest, because they do not include the costs to the state of administering the judicial system nor the costs to employers of lost employee-hours spent preparing for litigation.<sup>42</sup>

Given the expense of litigation-based enforcement, proponents of just cause protection commonly suggest using union-style arbitration to resolve termination disputes.<sup>43</sup> In the unionized sphere, a number of internal procedures are used to facilitate the resolution of termination disputes before they are submitted to arbitration.<sup>44</sup> If employees believe that their contractual rights have been violated by their terminations, they can, with the assistance of a union shop steward or member of the grievance committee, file a grievance with an industrial relations representative, who is then required to pass on the validity of the grievance.<sup>45</sup> If the representative's resolution of the dispute does not satisfy either the employees or their employer, appeal is taken to a larger committee composed of higher level management and union officials.<sup>46</sup> Ultimately, if either side is unhappy with this second body's resolution, the dispute will be submitted to a neutral third party for arbitration.<sup>47</sup>

In the context of unionized employment, this grievance procedure permits most disputes to be resolved without resort to arbitration.<sup>48</sup> However, it is not clear that this model of internal dispute resolution can be successfully implemented by non-union firms. The success of these procedures in unionized

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40. See DERTOUZOS, *supra* note 39, at 47.

41. See Defranco, *supra* note 22, at 83-84; Epstein, *supra* note 6, at 970.

42. See Defranco, *supra* note 22, at 86.

43. See Massingale, *supra* note 31, at 209; Clyde W. Summers, *Individual Protection Against Unjust Dismissal: Time For A Statute*, 62 VA. L. REV. 481, 521 (1976). The Model Act requires disputes to be submitted to binding arbitration. See MODEL EMPLOYMENT TERMINATION ACT § 5 (1991).

44. See DUANE, *supra* note 31, at 63-67.

45. See *id.* at 65.

46. See *id.* at 66.

47. See *id.*; Getman, *supra* note 23, at 919.

48. See Getman, *supra* note 23, at 919-20.

workplaces is largely attributable to the process of repeat play in negotiations and dispute resolution between union officials and management.<sup>49</sup> Because each side has a stake in maintaining a reputation for reasonableness and cooperation, positions are moderated and settlement is encouraged.<sup>50</sup> In addition, terminated employees are represented throughout these internal procedures by union officials who stand on equal footing with management in deciding the outcomes of disputes.<sup>51</sup> Because these employee representatives do not exist in non-union workplaces, it is unlikely that terminated employees would be satisfied with outcomes produced by their employers' own self-imposed internal procedures.<sup>52</sup> Appeal to arbitration therefore seems much more likely in the non-unionized workplace.

These constraints on the use of internal grievance resolution procedures will make arbitration outside of the unionized sphere more closely resemble trial-type litigation than union-style arbitration. This is so for a number of reasons. First, non-union arbitrators will not be able to rely on the foundation laid by the firm's internal dispute resolution bodies. In the union context, these bodies are required to issue written opinions stating their findings and proposed outcomes.<sup>53</sup> Because these opinions will not be produced in the non-union sphere, the arbitrator will have to start from scratch, conducting much more extensive and costly proceedings before reaching a decision. Second, because a union is not present to represent employees before the arbitrator, workers will have to seek outside counsel or proceed pro se. If outside counsel are typically employed, the moderating influence that repeat play generates between firm and employee representatives will be lost, as any one attorney is not likely to represent many employees discharged from a particular firm.<sup>54</sup> Third, non-union arbitrators will likely have little experience with the operations of the myriad employers

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49. *See id.* at 933-36.

50. *See id.*

51. *See id.* at 919; DUANE, *supra* note 31, at 65-67.

52. *See* Getman, *supra* note 23, at 935-36. This is particularly so when the dispute is over a policy about which unrepresented employees typically have little information, such as the reasonableness of a given personnel policy or the consistency of punishments levied against past violators of a policy.

53. *See* DUANE, *supra* note 31, at 65-66.

54. *See* Defranco, *supra* note 22, at 86; Getman, *supra* note 23, at 936-38.

coming before them. This will force employers to make extensive and costly presentations of evidence concerning the efficacy of their personnel policies and their past record of punishing violators.<sup>55</sup> Given these differences, dispute resolution in the non-union sphere will undoubtedly cost more and risk a greater number of erroneous decisions than do the procedures currently used in the unionized sphere.<sup>56</sup>

Given that no procedure analogous to the type of non-union arbitration required by a just cause regime is currently in use, accurate estimates of per dispute transaction costs are not available. It seems likely, however, that arbitration of termination disputes will prove to be very costly indeed.

### 3. *Inability to Terminate Inefficient Employees*

In addition to these monitoring and transaction costs, a just cause regime will also hinder employers' ability to terminate inefficient employees. A just cause requirement by definition prohibits employers from terminating even inefficient employees when sufficient evidence has not yet been amassed to justify termination to an arbitrator, or when the nature of the offense prevents such evidence from ever being amassed.<sup>57</sup> It would also prohibit terminations based solely on the fact that another person could perform the employee's job more efficiently.<sup>58</sup>

In addition to categorically prohibiting these types of efficient discharges, third-party decisionmakers under a just cause regime will undoubtedly make mistakes when passing on the validity of discharges.<sup>59</sup> If such decisions are made by juries rather than

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55. See Getman, *supra* note 23, at 936-38.

56. See Defranco, *supra* note 22, at 86.

57. See *id.* at 78. This problem is made all the more acute by the frequent unpredictability of arbitrators' decisions. See, e.g., *In re Erie Mining Co.*, 65 Lab. Arb. Rep. (BNA) 880 (1975) (rejecting the termination of a brakeman who accidentally shot himself in an attempt to shoot a crow alongside the employer's railroad track); *In re Gamble Bros.*, 68 Lab. Arb. Rep. (BNA) 72 (1977) (declaring illegal the discharge of an employee who smoked marijuana during a lunch break, because the employer failed to promulgate a rule which clearly alerted employees that the act was forbidden and penalized by discharge); *In re Pepsi Cola Bottling Co.*, 76 Lab. Arb. Rep. (BNA) 54 (1980) (rejecting the discharge of an employee who by choice and not necessity urinated on the floor of his delivery vehicle, because there was nothing in the parties' contract subjecting an employee to discharge based on the offensiveness of his personal behavior).

58. See GRIEVANCE GUIDE, *supra* note 18, at 19.

59. See Defranco, *supra* note 22, at 82-83; Epstein, *supra* note 6, at 970.

judges or arbitrators, sympathy for discharged employees will systematically generate overcompensation.<sup>60</sup> The threat of significant litigation costs and damage awards premised on erroneous verdicts will deter firms from terminating marginal employees.<sup>61</sup> The extent of this problem depends, as above, both on the transaction costs attending the chosen method of dispute resolution and on the types of damages available to wrongfully discharged employees. Obviously, the use of a more costly enforcement mechanism or the availability of punitive damages will dull employers' incentives to terminate inefficient employees all the more.

Ultimately, the imposition of a just cause regime will have a significant impact on employers' ability to build an efficient workforce. The potential costs of discharge litigation will not only affect employers' willingness to terminate inefficient employees, but will also chill the use of other common disciplinary devices short of termination. Just cause protection typically extends to cover claims of constructive discharge that can readily be pressed by transferred or demoted employees.<sup>62</sup> The inability of employers to wield these measures against inefficient or shirking employees will indirectly occasion further productivity losses. If employers can no longer credibly threaten employees with tough disciplinary measures, employees will have little incentive to produce efficiently.<sup>63</sup> This problem will be particularly acute for those employees whose output is difficult to measure or monitor. A credible threat of termination, demotion, or a cut in pay may be the only way to deter employee shirking.<sup>64</sup>

The burden of maintaining inefficient employees will again fall disproportionately on small businesses. Given that such firms have relatively smaller operating budgets and are therefore more likely to be risk averse, the threat of high litigation costs will deter such firms from terminating inefficient

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60. See HILL, *supra* note 22, at 149; Defranco, *supra* note 22, at 82-83; Epstein, *supra* note 6, at 970.

61. See Richard A. Epstein, *Agency Costs, Employment Contracts, and Labor Unions*, in PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS 127, 140 (John W. Pratt & Richard J. Zeckhauser eds., 1985); HILL, *supra* note 22, at 151; Defranco, *supra* note 22, at 78.

62. See Epstein, *supra* note 6, at 972; Epstein, *supra* note 61, at 143.

63. See Epstein, *supra* note 6, at 965.

64. See *id.* at 965, 969, 972.

employees.<sup>65</sup> Personality factors are also likely to have a greater impact on office morale in small businesses due to the closer proximity and greater contact of employees.<sup>66</sup> Because personality conflicts are not generally sufficient to support a discharge under a just cause regime, small employers will lose a large measure of control over the tone of their workplaces.<sup>67</sup>

#### 4. *Error Costs Compared*

Under both the at-will rule and a just cause regime, mistakes will be made; the key question in comparing these error costs is whether employers or arbitrators are more prone to err.

Errors under the at-will rule include both the termination of employees erroneously believed to be inefficient or engaging in misconduct, and discharges motivated by personal rather than business concerns.<sup>68</sup> This second type of discharge will most often occur when termination decisions are made by unmonitored agents of a large firm who themselves will not be adversely affected by the discharge of efficient but unpersonable employees.<sup>69</sup> A just cause regime will help to eliminate these errors in two ways. First, the adoption of more effective information-gathering procedures will reduce the number of errors made by employers. Firms will also have a greater incentive to monitor the behavior of agents responsible for termination decisions, and through the use of screening and auditing devices, will be better able to prevent terminations based on personal animosity. Second, third-party decision-makers will overturn erroneous discharge decisions through the review process. This threat can be expected to deter a number of wrongful discharges that would otherwise have occurred.

While a just cause regime will therefore decrease the number of erroneous termination decisions made by employers, it is unlikely that these gains will outweigh the costs imposed on employers. Employers governed by the at-will presumption already have adequate incentives to minimize the number of erroneous discharges,<sup>70</sup> while no such constraint limits the error

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65. See Brake, *supra* note 6, at 230.

66. See *id.*

67. See *id.* at 229-30.

68. See Leonard, *supra* note 8, at 677-78.

69. See Freed & Polsby, *supra* note 6, at 1131; Schwab, *supra* note 8, at 26.

70. See Epstein, *supra* note 6, at 973-74; Freed & Polsby, *supra* note 6, at 1130-31;

costs imposed by a just cause rule.

The desire to maximize productivity and profits encourages employers operating under the at-will rule to take the optimal amount of care in reducing the incidence of erroneous termination decisions.<sup>71</sup> If employees are terminated despite their competence and efficiency, employers suffer a number of losses. First, the value of the surplus generated by the parties' employment contracts will be lost, including any expected returns generated by the employees' training.<sup>72</sup> Second, employers will have to bear the cost of locating and training replacements.<sup>73</sup> Third, the continuity of the workplace will be disrupted, reducing the productivity of terminated employees' coworkers until replacements are trained.<sup>74</sup> Fourth, employers will be required to pay terminated employees any severance benefits mandated by their contracts.<sup>75</sup>

In addition, terminations increase the rate the state charges employers for unemployment insurance coverage. All state unemployment insurance programs are funded through a system of experience rating.<sup>76</sup> As such, employers' contributions are based, at least in part, on the number of their terminated employees drawing on the system.<sup>77</sup> Although employers are not typically required to bear the full cost of unemployment payments made to terminated employees,<sup>78</sup> so that the operation of this system in itself does not give employers

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Schwab, *supra* note 8, at 26. The discussion in this section is limited to cases of actual employer error in making termination decisions. Employers' incentives to terminate efficient employees paid in part with deferred compensation will be discussed in Part III.

71. This claim is borne out by the fact that employers in different industries and of different sizes have adopted widely disparate discharge policies. A small number of the largest non-unionized employers in the United States operate under schemes almost identical to those used in the unionized sphere. These firms rely initially on structured internal dispute resolution procedures and ultimately permit appeal to binding arbitration. See DUANE, *supra* note 31, at 70-72; David Nye, *When the Fired Fight Back*, ACROSS THE BOARD, June 1995, at 31, 32-33.

72. See Epstein, *supra* note 6, at 973-74.

73. See WEILER, *supra* note 8, at 146; Schwab, *supra* note 8, at 42.

74. See WEILER, *supra* note 8, at 64; Note, *supra* note 2, at 1834-35.

75. See Epstein, *supra* note 6, at 967.

76. See Robert Topel, *Financing Unemployment Insurance: History, Incentives, and Reform*, in UNEMPLOYMENT INSURANCE: THE SECOND HALF-CENTURY 108, 108 (W. Lee Hansen & James F. Byers eds., 1990).

77. The formulas used to determine the extent of employer liability differ from state to state. *Id.* at 108-32 (discussing nuances of various systems). Each state has a maximum rate which employers can be charged, so employers already paying the maximum rate will not bear any further costs if they terminate more employees. *Id.* at 110-11.

78. *Id.* at 116.

adequate incentives to make efficient termination decisions,<sup>79</sup> this additional cost coupled with the others described above should be sufficient to induce employers to take optimal levels of care.

Apart from these direct costs incurred when employees are erroneously terminated, employers also suffer reputational losses that increase long-term labor costs.<sup>80</sup> If an employer develops a reputation as a wrongful discharger, its current employees will demand a risk premium to compensate them for the greater termination risk.<sup>81</sup> Similarly, new employees will demand higher wages, or elect to work for firms with better reputations for protecting job security.<sup>82</sup>

This check on employer behavior will not operate perfectly, however, because it may be difficult for current and potential employees to acquire information on a firm's termination record.<sup>83</sup> Current employees may also be unable to support their demands for a risk premium with a credible threat to quit if they have made a significant investment in firm-specific training or if personal reasons preclude their changing jobs.<sup>84</sup> While these limitations suggest that infrequent wrongful terminations will not occasion severe reputational losses, these losses will still discourage firms from systematically abusing their employees. Such a policy would alienate the best current and potential employees, who will generally be more mobile.<sup>85</sup> Thus, the need to satisfy top employees will encourage firms to adopt universally beneficial policies.<sup>86</sup>

Although employers operating under the at-will rule are encouraged by a number of cost factors to make efficient termination decisions, a just cause requirement operates in precisely the opposite fashion. A just cause regime gives employees an incentive to initiate suits for their nuisance

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79. See *id.*

80. See Epstein, *supra* note 6, at 967-68.

81. See *id.*

82. See *id.*; POSNER, *supra* note 12, at 329.

83. See WEILER, *supra* note 8, at 74; Schwab, *supra* note 8, at 27.

84. See WEILER, *supra* note 8, at 63-67; Martin H. Malin, *The Distributive and Corrective Justice Concerns in the Debate Over Employment At-Will: Some Preliminary Thoughts*, 68 CHIKENT L. REV. 117, 143 (1992).

85. See Epstein, *supra* note 6, at 967-68; Schwab, *supra* note 8, at 27.

86. See Epstein, *supra* note 6, at 968.

value,<sup>87</sup> and will therefore likely produce a tremendous volume of wrongful termination suits.<sup>88</sup> Terminated employees often harbor animosity toward past employers and wish to seek revenge or transfer the blame for their personal failures.<sup>89</sup> These desires, coupled with the transaction costs of adjudicating termination disputes, give discharged employees ample incentive to pursue strike suits.<sup>90</sup> Firms faced with such suits will be forced either to pay nuisance settlements in order to avoid the costs of resolution, or to litigate a sufficient number of cases to develop a reputation as a non-settler. In either case, the employer will be forced to bear losses from termination decisions that were undoubtedly correct.

Proponents of a just cause regime contend that the rule's error costs will be offset by productivity increases caused by the provision of job tenure to employees. These claims are premised on the notion that job security will increase employee morale and loyalty, facilitate greater continuity among the workforce, and reduce the amount of resources wasted in training employees who are then terminated.<sup>91</sup> However, as stated above, provision of job tenure may in fact reduce the productivity of those workers whose performance is difficult or costly to monitor, because such workers' performance can only be assured through ready resort to harsh discipline.<sup>92</sup> In any event, employers already have adequate incentives to implement cost-effective productivity-enhancing measures. If provision of job tenure did increase productivity enough to offset its costs, employers would provide it without legal compulsion.

The premise that job tenure will increase morale and loyalty may also be faulty, because the morale of a firm's better employees will be affected adversely if they are forced to continue working with incompetent or unpersonable colleagues.<sup>93</sup> Even if the relationship between loyalty and productivity is positive for some firms, there are several industries in which loyalty and workforce continuity do not

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87. See Defranco, *supra* note 22, at 82-83.

88. See *id.*; Epstein, *supra* note 6, at 970 (arguing that a just cause requirement will allow a substantial fraction of dismissals to generate litigation).

89. See Defranco, *supra* note 22, at 82-83.

90. See *id.*

91. See WEILER, *supra* note 8, at 64; Leonard, *supra* note 8, at 677.

92. See Epstein, *supra* note 6, at 965.

93. See Defranco, *supra* note 22, at 78.

enhance worker output.<sup>94</sup> Absent proof that the gains from extending just cause protection to the benefiting firms outweigh the losses imposed on adversely affected sectors, these blanket assertions do not justify burdening the entire economy with a just cause rule.

### B. *Benefits to Employees of a Just Cause Regime*

On the other side of the ledger are the burdens imposed on employees by the at-will rule. These costs are both economic and personal in nature, and the extent to which they are borne by discharged employees depends on their type of job and the length of time spent in the employers' service.

All wrongfully terminated employees suffer two types of losses: reputational losses that may hinder their efforts to find replacement jobs, and search and possible relocation costs associated with finding new employment.<sup>95</sup> Wrongfully terminated career employees suffer even more dramatic losses. In addition to forfeiting seniority rights and any deferred compensation or late vesting pension benefits,<sup>96</sup> discharged career employees are denied further access to a defining element of their personality. For most long-term workers, their employment is an important source of self-esteem, helps define their identity and status in the community, and affords them access to valued personal relationships with colleagues.<sup>97</sup> To the extent that terminated career employees are likely to be older and nearing retirement, such employees will also be at a disadvantage when competing against younger applicants for new positions, because younger employees afford employers a longer time to recover investments in firm-specific training.<sup>98</sup> Career employees' jobs therefore are not fungible, and the

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94. See *id.* at 76-77; Freed & Polsby, *supra* note 6, at 1135.

95. See Note, *supra* note 2, at 1833-34.

96. See WEILER, *supra* note 8, at 65-66; Leonard, *supra* note 8, at 678.

97. See WEILER, *supra* note 8, at 63-64 ("The type, place, and the responsibilities of one's job exert an important influence on one's home life, friendships, routines, and sense of identity."); Massingale, *supra* note 31, at 201 (arguing that loss of employment increases the risk of health problems, suicide, mental breakdowns, and family discord); Todd M. Smith, *Wrongful Discharge Reexamined: The Crisis Matures, Ohio Responds*, 41 CASE W. RES. L. REV. 1209, 1256 (1991) ("In today's industrial society, employment plays a central role in defining one's self-image.").

98. See Leonard, *supra* note 8, at 678.

losses occasioned by their wrongful termination cannot be fully mitigated by securing new employment.<sup>99</sup>

Despite the gravity of these losses, their incidence alone does not justify extending just cause protection to all employees. Virtually all of the burdens imposed by wrongful terminations fall on the terminated employees themselves.<sup>100</sup> Since there are few external costs these workers cannot consider when negotiating their employment contracts, in the absence of an information deficiency or other bargaining defect,<sup>101</sup> employees can be expected to negotiate for themselves the optimal amount of job security.

Moreover, any gains that might accrue to employees as a class from the imposition of a just cause requirement will also be undermined by employers' strategic responses. Employers can be expected to pass much of the total cost of tenure protection back to employees through wage reductions.<sup>102</sup> If employers are unable to pass these costs back to employees,<sup>103</sup> they will respond by hiring fewer workers.<sup>104</sup> This effect is significant because unemployed workers bear many of the burdens associated with wrongful termination, including search costs, familial disruption, and loss of self-esteem.<sup>105</sup> To the extent that a just cause regime would make it more difficult for the unemployed to find work, employees as a class will suffer.

A just cause rule will also discourage employers from hiring more risky employees, because the costs of correcting hiring

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99. See WEILER, *supra* note 8, at 66.

100. Losses from the disruption of income or depression also fall on a terminated employee's family, but parties can, as a general matter, be expected to consider costs borne by their families when bargaining for contractual protections.

101. This issue will be taken up in Parts III and IV.

102. See HILL, *supra* note 22, at 144; Harrison, *supra* note 6, at 336.

103. The minimum wage requirement may prohibit employers from passing these costs back to some employees. See Harrison, *supra* note 6, at 341.

104. See Gail L. Heriot, *The New Feudalism: The Unintended Destination of Contemporary Trends In Employment Law*, 28 GA. L. REV. 167, 201 (1993). If some types of workers, like independent contractors or part-time employees, are not covered by the just cause regime, employers may respond by substituting these types of workers for full-time employees. This substitution effect is observed in Japan, where employees are afforded just cause protection. See *id.* at 214. The effect of this development on employees as a class is unclear; the net result may be an equal number of man-hours purchased by employers. However, this substitution will itself produce inefficiencies, as employers do not choose to employ these substitutes under the current rule, despite incentives to minimize labor costs. See *id.* at 202.

105. See Massingale, *supra* note 31, at 201.

mistakes through termination may be prohibitive.<sup>106</sup> Employees who have once been terminated will therefore have a more difficult time finding work under a just cause regime.<sup>107</sup> Similarly, employers will be more reluctant to hire individuals who challenged the termination decisions of previous employers, particularly if their claims were unsuccessful.<sup>108</sup> Because the class of employees wrongfully discharged under the at-will rule is much smaller than that of employees terminated for valid reasons under either rule, a just cause requirement will have the perverse effect of disadvantaging the larger second group of employees in order to benefit the smaller first group. If the magnitude of the losses suffered by those who wrongfully lose their jobs are roughly equal to the costs incurred by those who cannot find work, a shift to a just cause rule will impose net losses on employees as a class.

Ultimately, it is not likely that employers will happily bear the costs of a just cause requirement. Instead, these costs will be passed back to employees either in the form of lower wages or lower overall demand for labor. If employees do in fact desire tenure protection enough that they are willing to purchase it despite these costs, a just cause rule would be efficient. Nevertheless, a legal rule mandating that outcome should not be necessary, since the optimal allocation of job security rights should be established through contract so long as no significant defect exists in the market for labor. The next section evaluates the possibility that such a defect taints the contractual choice of discharge rules.

### III. STRUCTURAL LABOR MARKET DEFECTS

Structural defects exist in those markets where the participants possess widely disparate levels of market power, enabling one party to extract extra-competitive rents from the

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106. See HILL, *supra* note 22, at 151; Epstein, *supra* note 6, at 972; Heriot, *supra* note 104, at 196. Evidence for this proposition can be found in the hiring practices of Japanese employers. Just cause protection is afforded to Japanese employees, and consequently, screening processes are considerably more intensive than those used in the United States. For example, applicants to one large Japanese firm must take written aptitude and personality tests and endure investigations into their family and personal background, including visits to the applicants' homes, interviews of neighbors and school-teachers, and inquiries into the applicants' health. See Heriot, *supra* note 104, at 209-11.

107. See Epstein, *supra* note 6, at 972; Epstein, *supra* note 61, at 140-41.

108. See Epstein, *supra* note 61, at 140-41.

other.<sup>109</sup> Two such defects in the market for labor have been posited by opponents of the at-will rule: the presence of unequal bargaining power between employers and employees, and the existence of a bilateral monopoly relationship between employers and senior career employees. At-will opponents argue that these defects prevent employees from contracting for efficient levels of job security, even when both parties have full information about the other side's preferences and are able to bargain without impediment.<sup>110</sup>

### A. *Unequal Bargaining Power*

Early opponents of the at-will rule rejected the notion that employees bargain over tenure protection on equal terms with their employers.<sup>111</sup> According to these commentators, employees suffer two related disadvantages that prevent them from negotiating guarantees of job security. First, employees cannot credibly support demands for greater job security by threatening to quit. This is because, at-will opponents argue, employers typically spend less obtaining replacement workers than do employees in locating new jobs.<sup>112</sup> Even where the absolute costs to the employer are greater, employers are typically much wealthier than individual employees, and as a result spend less in proportion to their total income.<sup>113</sup>

Second, employees are compelled to work by their need to purchase basic necessities. Because most people must earn at least some money in order to survive, opponents of the at-will rule argue, employees are often confronted with the choice of working for a below-market wage or not working at all.<sup>114</sup> Thus, individuals deciding whether to accept "take it or leave it" offers of employment are not generally in a position to refuse and seek better terms on the open market. Similarly, recently terminated employees who are living paycheck to paycheck may be pressured into accepting early below-market offers of

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109. See John Cirace, *A Synthesis of Law and Economics*, 44 Sw. L.J. 1139, 1170-74 (1990) (contrasting the features of competitive markets with those of bilaterally monopolized markets); Harrison, *supra* note 6, at 351-52.

110. See Harrison, *supra* note 6, at 351-52.

111. See Blades, *supra* note 2, at 1404-05; Frank J. Cavico, *Employment At Will and Public Policy*, 25 AKRON L. REV. 497, 501-02 (1992); Summers, *supra* note 43, at 519-20.

112. See Cavico, *supra* note 111, at 501-02.

113. See *id.*

114. See *id.*

employment in order to meet pending financial obligations.

These claims of unequal bargaining power are ultimately premised on the notion that employers possess a degree of monopoly power over their employees.<sup>115</sup> This becomes clear if the market for job security is understood as a product market, with employers offering levels of job tenure for sale to current and potential employees. Opponents of the at-will rule argue that disparities in bargaining power permit employers to overprice job security protections, and as a result supply an inefficiently small amount of that good to employees.<sup>116</sup>

Claims premised on the presence of monopoly power in the labor market suffer from both factual and theoretical deficiencies. As a preliminary matter, these arguments rely on the assumption that a just cause rule would be efficient. If, as suggested in Part II, the at-will rule is the more efficient discharge rule, just cause protection should not be offered even in a perfectly competitive market. No losses would therefore be suffered if tenure protection were similarly unavailable in markets monopolized by employers.<sup>117</sup>

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115. Cf. Freed & Polsby, *supra* note 6, at 1099-102. Harrison, *supra* note 6, at 351-52. This claim differs from an argument that employers are actually monopsonists, as where only one employer exists in a discrete geographical area. Monopsonistic employers would also have, although from a different source, a degree of market power that would allow them to expropriate monopoly rents from their employees. See Phillips, *supra* note 9, at 464-66. Instances of monopsony power in the market for labor are exceedingly infrequent, however, because employees are typically mobile enough to leave isolated geographic regions and seek other work. See *id.* In addition, even in small towns, employers are not often concentrated enough to afford them a significant degree of market power. See *id.*; Freed & Polsby, *supra* note 6, at 1101. Where employer monopsony power does in fact exist, its prevalence in a given State and the costs it imposes are unlikely to be great enough to justify the imposition of a just cause rule on every employer in the State.

116. At-will opponents cannot be arguing that employers will refuse to offer tenure protection at any price, but only that it will be undersupplied given existing market conditions. Rational monopolists use their market power to earn extra-competitive rents. See POSNER, *supra* note 12, at 273-75; Cirace, *supra* note 109, at 1173 (describing a monopoly market as one where the seller restricts the supply of a product in order to create an artificial shortage and raise the price). If workers were to offer an upper-limit price sufficient to cover the costs of a just cause regime plus some additional premium, no reason can be posited why monopolist employers would refuse the offer.

117. One may argue that just cause protection, although inefficient in a competitive market, would be optimal in a monopolized market. This "second best" argument depends on one of two erroneous assumptions. The first is that monopolist employers are more likely to abuse their discretion to discharge employees than firms operating in a competitive market. This claim is faulty, because monopolists are also profit maximizers, and therefore typically have no incentive to behave inefficiently. See RICHARD A. POSNER, *ANTITRUST LAW: AN ECONOMIC PERSPECTIVE* 16 (1976). The second assumption is that the promulgation of a just cause requirement would effectively redistribute income from employers to employees. This claim is also erroneous, because

Opponents of the at-will rule also overestimate the extent of the pressure placed on employees by the need to purchase basic necessities. While many employees require a steady stream of income to maintain their current lifestyles, a significant number of working people are not at risk of falling below subsistence levels.<sup>118</sup> Terminated employees seeking replacement work are also protected in part by unemployment insurance and severance pay.<sup>119</sup> These safety nets generally afford discharged employees a number of weeks in which to seek new employment, thereby reducing the likelihood that they will be forced to accept below-market compensation packages.<sup>120</sup>

Recently hired employees also retain the option to quit should they receive a more lucrative offer of employment.<sup>121</sup> While this possibility is undoubtedly impaired by the difficulty and risk of looking for new work while employed full-time, the fact that many people do change jobs without an intervening period of unemployment suggests that this threat can discipline employers. This check would operate even more effectively if employers possessed a significant degree of market power, because competing employers acting through headhunters or similar recruiting agents would find an ample supply of underpaid employees that they could lure to a firm paying a competitive wage.<sup>122</sup>

In addition, typical labor market conditions challenge the claim that employees are pressured into accepting below-market levels of compensation.<sup>123</sup> Employees sometimes bargain with

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a monopolist forced to provide just cause protection would remain perfectly able to pass on the costs to their employees in the form of lower wages, benefits, or fewer employment opportunities. See Harrison, *supra* note 6, at 355; Note, *supra* note 2, at 1829.

118. In 1993, approximately 39.3 million Americans, or 15.1% of the population, lived in poverty. See Sam Fulwood III & Melissa Healy, *1.3 Million More Drop Into Poverty*, L.A. TIMES, Oct. 7, 1994, at A22. While another significant percentage of the population lives near the margin, those who live near or below the poverty line do not constitute a majority of the population. See Denise M. Topolnocki, *The American Dream and Today's Reality*, MONEY, Oct. 1, 1992, at 98, 101 (stating that in 1990, approximately 40% of U.S. households earned less than \$25,000 per year).

119. See DeFranco, *supra* note 22, at 74-75; Epstein, *supra* note 6, at 964.

120. See Michael B. Rappaport, *The Private Provision of Unemployment Insurance*, 1992 WIS. L. REV. 61, 84.

121. Cf. *id.* at 84 n.84.

122. In essence, these competing employers would act like new entrants into a monopolized market, over time dissipating the monopoly power of other employers. See POSNER, *supra* note 12, at 283.

123. See Epstein, *supra* note 6, at 973.

potential employers over wages and compensation, and often interview with several employers before ultimately selecting one.<sup>124</sup> Even for those employees who visit only one employer,<sup>125</sup> compensation terms are still disciplined by those employees who do shop around for employment.<sup>126</sup> Because compensation packages are generally nearly uniform for similar work within a particular firm,<sup>127</sup> non-shopping employees benefit from the competitive effects of employers' efforts to hire selective workers.<sup>128</sup>

Further, it is difficult to contend that employers possess a sufficient degree of market power to withhold competitive wages from newly hired employees, given that the vast majority of workers are paid much more than a basic subsistence wage.<sup>129</sup> Employees could only have established this above-subsistence lifestyle if the competitive process successfully dissipated employers' market power to some extent. The fact that

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124. Even if the terms of employment are not expressly negotiated with individual employers, different employers nevertheless offer competing compensation packages. This competitive process takes the place of formal bargaining. See Freed & Polsby, *supra* note 6, at 1098-101; see also Schwab, *supra* note 8, at 29 (stating that the monopsony power of employees is limited, particularly over younger employees, by the fact that most have alternative job options).

125. This class of potential employees includes those who are compelled to accept their first job offer because they need money immediately, either to purchase basic necessities or meet current debt obligations.

126. See WEILER, *supra* note 8, at 73-74 ("It takes only a small critical mass of comparison shoppers to generate a satisfactory degree of market control over product sales by a business."); see also Epstein, *supra* note 6, at 968 (stating that employers' termination decisions are disciplined by the threat that the best workers will leave if decisions appear arbitrary); Michael H. Gottesman, *Wither Goest Labor Law: Law and Economics in the Workplace*, 100 YALE L.J. 2767, 2769 (1991) (reviewing WEILER, *supra* note 10) (arguing that the extension of favorable contract terms to 40% of the labor force is sufficient to place a "critical mass" of pressure on all employers to match those terms).

127. See Don Bellante & Philip K. Porter, *A Subjectivist Economic Analysis of Government-Mandated Employee Benefits*, 13 HARV. J.L. & PUB. POL'Y 657, 662 (1990); Freed & Polsby, *supra* note 6, at 1098-101.

128. Opponents of the at-will rule commonly contend that the best employees are not effective negotiating proxies for other workers because they do not value job security as highly. See WEILER, *supra* note 8, at 76; Partee, *supra* note 8, at 703. This argument is essentially one of informational deficiency and will be addressed in greater detail in Part IV.A. It is sufficient to note for the purposes of this discussion that employees who shop around for work are not necessarily the best workers. This class of shopping employees also includes those who have planned well enough for unemployment that they are not pressured into accepting early offers made at below-market rates, and those who have just been terminated from other employment. These workers may be exceptionally interested in tenure protection, having recently felt the sting of termination.

129. See Epstein, *supra* note 6, at 973 (arguing that in a labor market characterized by unequal bargaining power, "wages should be driven to zero, for no matter what their previous level, the employer could use his (inexhaustible) bargaining power to reduce them further, until the zero level was reached").

employees have been able to bid up the price of their labor proves that employees can bargain with some degree of effectiveness under adverse conditions.<sup>130</sup>

Claims of unequal bargaining power also are refuted by the actual distribution of job security rights under the at-will rule. As profit maximizers, monopolists use their market power to earn the highest possible extra-competitive returns.<sup>131</sup> In order to secure these returns, it is necessary for a monopolist to sell at least one unit of the product over which they possess market power.<sup>132</sup> The overwhelming majority of non-unionized firms do not offer tenure protection to their employees, however,<sup>133</sup> and this behavior is entirely inconsistent with that of a monopolist; without the sale of job security rights, market power is not translated into monopoly rents.

The absence of any objective indicia of monopoly power underscores an even broader point: job security is not a product that can effectively be monopolized. Given the high fixed costs associated with administering a system of tenure protection, employers typically cannot offer such protection in a cost-effective manner to some employees but not others.<sup>134</sup> Such exclusions would also create intolerable morale problems for employers, because employees would view the denial of "fair" treatment to uncovered workers as arbitrary. A monopolist employer is thus confronted with the choice of producing either zero or one units of tenure protection. Zero units would rarely be selected as a level of output because, as discussed above, this would afford the monopolist no return.<sup>135</sup> Thus, monopolists

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130. *Id.* Even though some employees are paid relatively little for their work, this fact does not suggest that employers possess any degree of monopoly power. Employees may earn low wages even in a competitive market if the value of their labor is low, or if there are many people willing to perform their jobs relative to the number of positions available. See Harrison, *supra* note 6, at 352 n.130.

131. See POSNER, *supra* note 117, at 9-10.

132. *Id.* Although employers may be more aptly described as monopoly sellers of jobs, rather than job security, each employer, monopolist or not, has an incentive to develop an optimum compensation package. Because each term in a compensation package is generally fungible, it is conceptually sound to imagine each term as its own individual product market. If employers are willing to trade more in wages than the cost of providing job security, even a monopolist would provide it. *Id.* For a monopolist to earn any return from its market power, however, it must sell at least one unit of the monopolized product.

133. See Morriss, *supra* note 1, at 688; Schwab, *supra* note 8, at 28.

134. See WEHLER, *supra* note 8, at 76.

135. A monopolistic employer may choose to sell zero units of job security at time one in order to increase its market power, thereby permitting it to sell the protection at

would almost always choose to provide that one unit of job security to their employees if it were efficient and therefore profitable to do so.<sup>136</sup> If employers did indeed possess significant levels of market power, they might charge an extra-competitive price for this one unit. However, even in a monopolized market the optimal level of tenure protection would not be undersupplied.<sup>137</sup>

### B. *Bilateral Monopoly—Incentives to Exploit Career Employees*

Recent critics of the at-will rule have emphasized the rule's effect on terminated career employees.<sup>138</sup> While these commentators concede that newly hired workers may enjoy the benefits of a competitive market, they argue that career employees typically make significant investments in their jobs

a higher price at time two. This strategy would only be effective, however, if the value placed on job security by the firm's workforce increased over time. This would be possible for a firm starting out with a young workforce if it expected to keep the same employees long enough for them to establish seniority and become invested in their jobs. For most established employers this circumstance is unlikely to arise, because their ratio of career employees to recent hires should remain constant over time.

136. It might be profitable for the largest firms to offer tenure protection to management or career employees while excluding laborers or recent hires. This would only be possible, however, if the pool of protected workers were large enough to bear the costs of administering the system, and if the perceived division between the classes of workers would not cause significant morale problems. Such an employer would confront the choice of selling one unit of job security or two. These employers could be induced to select an output level of one unit, given how much career employees value job security. Depending on the value non-career workers and laborers place on job security, this might result in a sub-optimal supply of the good. However, such employers would be able to maximize profits while still offering protection to both classes of workers by engaging in price discrimination. See PHILLIP AREEDA & LOUIS KAPLOW, *ANTITRUST ANALYSIS* 450-52 (4th ed. 1988) (defining price discrimination as the practice of charging different customers a different price for the same product, and noting its efficiency where it results in output increases). Price discrimination is possible in this context because employers typically negotiate with the two classes of employees separately, and because employees paying less for their protection cannot circumvent the pricing scheme by reselling their protection to members of the other class. See POSNER, *supra* note 16, at 281 (stating that a monopolist will likely be able to price discriminate if arbitrage can be prevented). Thus, even monopolistic employers confronted with highly complex supply decisions are unlikely to offer an inefficiently low amount of tenure protection.

137. This appropriation of monopoly rents cannot be addressed effectively by a just cause statute. As stated above, monopolists would provide such protection without compulsion were it efficient to do so. If a just cause duty imposed by statute proved to be inefficient, however, the costs of providing the protection would simply be passed in full back to employees in the form of lower wages, benefits, or fewer employment opportunities. See Harrison, *supra* note 6, at 355; Note, *supra* note 2, at 1829.

138. See WEILER, *supra* note 8, at 63-67; Samuel Issacharoff, *Reconstructing Employment*, 104 HARV. L. REV. 607, 621-23 (1990) (reviewing WEILER, *supra* note 8); Schwab, *supra* note 8, at 43-47.

that preclude them from seeking alternative employment.<sup>139</sup> In essence, these commentators argue that as the duration of job tenure grows, employers develop an increasing degree of market power over their employees.

In many cases employers' leverage is counterbalanced by a corresponding degree of market power held by senior employees.<sup>140</sup> As described in Part II, employers make significant investments in selecting and training employees, and also receive morale and productivity benefits from the maintenance of a stable workforce.<sup>141</sup> As a result, employers are not likely to offer most career employees compensation packages low enough to prompt their departure. Career employees and their employers are thus in the position of bilateral monopolists competing over the allocation of the surplus created by their relationship.<sup>142</sup> Generally, there are no efficiency consequences to the allocation of this surplus so long as the negotiations do not fail, forcing the parties to sever their relationship.<sup>143</sup>

In some circumstances, however, it is to the employer's advantage to terminate career employees. Often, employees will receive some portion of their compensation in a deferred form, like a late vesting pension.<sup>144</sup> In order to avoid making these deferred payments, employers may terminate career employees before the payments come due.<sup>145</sup> Employers are thus unfairly able to capture the value of their employees' services, in effect receiving the benefits of their labor without providing the full measure of promised compensation. As one commentator noted:

Late-career employees face the greatest danger of opportunistic firings. At the end of their life cycle, they often earn more than their current productivity. If they do, the employer has a financial incentive to terminate them, even if it violates an implicit promise to allow the employee to reap the rewards of hard work earlier in his career.<sup>146</sup>

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139. See WEILER, *supra* note 8, at 63-67.

140. See Gottesman, *supra* note 126, at 2782-83.

141. See *id.*; Epstein, *supra* note 6, at 973-74.

142. See Epstein, *supra* note 6, at 974; Gottesman, *supra* note 126, at 2782-83.

143. See Epstein, *supra* note 6, at 976; Gottesman, *supra* note 126, at 2784.

144. See WEILER, *supra* note 8, at 66-67; Schwab, *supra* note 8, at 43.

145. See WEILER, *supra* note 8, at 66-67; Schwab, *supra* note 8, at 43.

146. Schwab, *supra* note 8, at 43.

This potential for employer opportunism does not alone justify legal intervention on behalf of career employees, because the possibility still exists that such employees can secure protection through contract. Opponents of the at-will rule therefore typically couple their claims of employer opportunism with allegations of other market failures, the combination of which render contractual remedies ineffective.<sup>147</sup> One such formulation argues that new employees decline to negotiate for guarantees of job security because they lack accurate information about termination practices.<sup>148</sup> Over time, these employees gain the information necessary to make accurate judgments about the need for tenure protection, but are unable to negotiate for it because of their weak bargaining position.<sup>149</sup> Professor Paul Weiler, the most ardent proponent of this theory, stated:

Because any new job will be considerably less valuable to [the career] worker than his present position, even though longer service with his firm enhances the employee's knowledge of and interest in the subject of unjust discharge, the "equity" he would lose by changing jobs correspondingly reduces his bargaining power to do something about it.<sup>150</sup>

In order to evaluate claims of career employee exploitation, it is first necessary to understand why wages increase with seniority, and why employees sometimes accept remuneration in the form of deferred payments. Labor economists have proposed two complementary models to explain why wages increase with seniority: the human capital model and the efficiency-wage model.<sup>151</sup> Under the human capital model, employees become increasingly valuable to their employers as they acquire seniority.<sup>152</sup> These gains accrue to employers as a result of growing employee familiarity with the practices of the firm and long-term returns on investments in worker training.<sup>153</sup> Since senior employees are considerably more

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147. Cf. WEILER, *supra* note 8, at 76.

148. *Id.*

149. *Id.*

150. *Id.*

151. See H. Lorne Carmichael, *Self-Enforcing Contracts, Shirking, and Life Cycle Incentives*, 3 J. ECON. PERSP. 65 (1989); Robert M. Hutchens, *Seniority, Wages and Productivity: A Turbulent Decade*, 3 J. ECON. PERSP. 49 (1989); Schwab, *supra* note 8, at 13-19.

152. See Schwab, *supra* note 8, at 13-15.

153. See *id.*

valuable than new and untrained workers, continuation of the employment relationship generates a surplus which the parties may share.<sup>154</sup>

The essential feature of employment contracts under the human capital model is that they are self-enforcing.<sup>155</sup> In order to induce senior workers to stay on, employers are willing to offer a premium over the prevailing market wage. Similarly, because much of the workers' training is firm-specific, employees are discouraged from quitting by the threat of lower outside wages. Senior employees are paid less than the full measure of their productivity, leaving some part of the surplus for the employer, but earn more than they could receive from an outside firm.<sup>156</sup> Each receives a positive return over their next best option, and neither party has an incentive to terminate the relationship. As a result, employees whose contracts are based on the human capital model do not require legally imposed tenure protection, both because their employers already have optimal incentives to make efficient termination decisions, and because their bargaining position is such that employers would provide tenure protection to them through contract if it were efficient to do so.

While the human capital model accurately describes many career employment relationships, it fails to explain the prevalence of employer-imposed measures, like mandatory retirement and actuarially unfair pensions, designed to limit the duration of the employment relationship.<sup>157</sup> These measures are inconsistent with the human capital model because they suggest a point at which employers no longer find it profitable to maintain senior workers.

The efficiency-wage model was developed in response to this defect.<sup>158</sup> The efficiency-wage model posits that compensation increases with seniority because it is difficult for employers to measure and monitor effectively the performance of their employees. Employers confronted with this difficulty will structure compensation schemes to give employees incentives to

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154. *See id.*

155. *See id.* at 15.

156. *See id.*

157. *See id.* at 15-16; Hutchens, *supra* note 151, at 53.

158. *See* Schwab, *supra* note 8, at 15-18.

work hard throughout their careers.<sup>159</sup> Compensation packages designed to have this motivational effect require two elements: deferred wages and easy resort to termination.<sup>160</sup> Those employees who perform well throughout their careers are rewarded with large bonus payments at the end of their service, usually in the form of late-vesting pensions or high seniority-based wages. Those employees caught shirking are terminated, and thereby lose the right to receive these high-value deferred payments. This threat of loss deters employee shirking, while the hope of future payments keeps senior employees from seeking alternative employment.<sup>161</sup>

Unlike those contracts premised on the human capital model, efficiency-wage contracts are not self-enforcing.<sup>162</sup> Typically, once employees become eligible to receive their deferred compensation, the cost of making these promised payments exceeds the value of the employees' current production. Once this point is reached, employers have an incentive to terminate opportunistically even the most productive career employees in order to avoid having to make deferred payments.<sup>163</sup> Employers contracting with efficiency-wage employees would not necessarily be willing to sell efficient levels of job security protection, because in some circumstances, it would be more advantageous to forego the gains from its sale and instead, reap the rewards of cheating employees at the end of their careers.

Employees contracting under the efficiency-wage model are therefore subject to abuse. Despite this threat, three countervailing considerations recommend against protecting this limited class of employees with a legally mandated just cause requirement. First, easy resort to termination is an essential component of the efficiency-wage scheme, because employees will only be discouraged from shirking if employers can credibly threaten to deny them ultimate payment. A just cause regime would not likely afford employers the flexibility to implement efficiency-wage contracts because the level of monitoring necessary to satisfy the standard is too difficult or costly to implement. Thus, employers operating under a just cause

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159. See Hutchens, *supra* note 151, at 55-56; Schwab, *supra* note 8, at 15-18.

160. See Schwab, *supra* note 8, at 15-18.

161. See *id.*

162. See *id.* at 19.

163. See *id.*

system would be forced to choose between bearing the costs of unpoliced shirking and the implementation of second-best monitoring measures.

Second, despite the possibility of unfairness in individual cases, employer opportunism is not likely to have significant efficiency consequences. Opponents of the at-will rule identify two interrelated factors that prevent efficiency-wage employees from securing contractual guarantees of job security: lack of bargaining power and inadequate information at the time employees begin with a new employer.<sup>164</sup> In order to evaluate the impact of these market failures, it is necessary to identify the source of employers' market power.

It is extremely unlikely that employees would enter into efficiency-wage contracts unwittingly. The very nature of efficiency-wage contracts precludes the possibility that employees would sign on without knowledge of their terms. The primary means used by efficiency-wage contracts to motivate employee effort is the threat of termination prior to the deferred payment's commencement.<sup>165</sup> In order for this incentive to operate, employees must be made aware of this termination threat at the time they enter into the contract, and of the fact that a portion of their wages are being deferred. Given this necessity, efficiency-wage contracts will most always be negotiated at a point in time known to both parties, with both parties having full knowledge of the contract's implications.

Consequently, employer leverage cannot arise from hooking employees into deferred wage schemes without their knowledge. The vast majority of younger, and relatively uninformed employees frequently change jobs before settling on career positions.<sup>166</sup> It is unlikely therefore that junior employees would agree to deferred wage contracts before working at a firm for some length of time. Indeed, such a decision would be irrational, because employees who have not yet decided to remain with their current employers long enough to recoup the deferred wages would forfeit those wages if they chose to leave.

Because deferred wages are not themselves a source of employer bargaining power, any employer leverage held over

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164. See WEILER, *supra* note 8, at 76.

165. See Hutchens, *supra* note 151, at 55-56; Schwab, *supra* note 8, at 15-18.

166. See WEILER, *supra* note 8, at 64; Malin, *supra* note 84, at 136.

employees at the time of efficiency-wage contract formation must derive from another source. The most likely possibility is the sort of firm-specific training described by the human capital model. Recall that employment relationships defined by the human capital model create a surplus over other transactions available on the open market, and as a result both parties have adequate incentives to maintain their relationship.<sup>167</sup> Inefficiency only arises under this model when the parties terminate their relationship, thereby wasting the investments made in firm-specific training.<sup>168</sup> The relevant inquiry, then, is whether in the process of formulating efficiency-wage contracts, bilateral monopolists bound together by the potential for mutual gain will terminate their relationship rather than agree to a system of deferred wages.

The likelihood of such a breakdown depends in part on how much information employees have about their employer's termination record. Opponents of the at-will rule generally concede that employees who have worked at a firm for an extended period of time are familiar with the firm's termination policies.<sup>169</sup> As a result, such employees should be able to estimate with reasonable accuracy the possibility of being unfairly terminated, and thus deprived of their promised deferred compensation. Employees entering into efficiency-wage contracts will use this probability to discount the lifetime value of the compensation package offered by their employers. In order to assure that these trained employees do not leave, employers will be forced to set termination policies that maintain the expected value of this compensation package above those offered by outside firms. The higher the differential between the internal wage and the outside wage, the more often employers will be able to cheat their employees. In no case, however, would a rational employer opportunistically terminate so many employees as to alienate those workers deciding whether or not to sign on to a deferred wage plan.<sup>170</sup>

This analysis does not change significantly if assumptions

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167. See Schwab, *supra* note 8, at 13-15.

168. See Epstein, *supra* note 6, at 975-76; Gottesman, *supra* note 126, at 2784.

169. See WEILER, *supra* note 8, at 75-76.

170. This assumes that employers contract with a relatively consistent number of career employees each year. If, for example, an employer were to sign on all of its career employees at one time, it could cheat more readily because no new contracts would be made on the basis of its worsening termination record.

about the accuracy of employee information are relaxed. Employee underestimation of the risk of opportunistic termination would not generate significant inefficiencies, because such ill-informed employers would have no incentive to sever their relationships with current employers. Underestimation of the termination risk would only lead employees to overvalue the offered compensation package, making offers from outside employers relatively less attractive. Although underinformed employees are therefore more likely to be cheated,<sup>171</sup> they are less likely to make inefficient decisions about whether to change jobs.

Conversely, if employees were to overestimate the risk of opportunistic termination by their current employer, the possibility that employees would sever ties would increase. Given that the burden of this loss would fall in part on employers, the threat that employees might overestimate the termination risk will, however, deter opportunistic firings in the first instance.<sup>172</sup> In order to guarantee a reputation for loyalty among its employees, and thereby assure that investments in career employees are not lost at the stage of efficiency-wage contract formation, employers will refrain from cheating their career employees.<sup>173</sup> The primary goal of employers and employees negotiating efficiency-wage contracts is to maximize their individual share of the surplus created by the parties' continued relationship. Cheating career employees is one way for employers to appropriate part of this surplus, but it is not likely to be the best long-term method for doing so. The division of surplus between bilateral monopolists will depend on the relative bargaining power of the two parties.<sup>174</sup> If, as opponents

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171. While there are no efficiency consequences stemming from the severance of the parties' employment relationship, underestimates of the termination risk may generate inefficiency by falsely encouraging employees to rely on the deferred payments. If investments are made on the expectation that such payments will be made, any resources spent in preparation may be wasted. The possibility that workers will underestimate the risk of being cheated also raises significant distributional questions. Employers may be able to recover more than the total surplus created by the parties' cheating relationship, and actually recover part of the competitive wage cheated employees could have received on the open market. See WEILER, *supra* note 8, at 77-78. Despite the seriousness of these difficulties, they are more appropriately addressed in connection with issues of information deficiency. More detailed consideration is therefore deferred until Part IV.

172. See POSNER, *supra* note 12, at 329; Epstein, *supra* note 6, at 967-68.

173. See Epstein, *supra* note 6, at 967-68.

174. See Cirace, *supra* note 109, at 1175.

of the at-will rule contend, employers really do possess a higher degree of bargaining power, they should be able in the long run to appropriate most of the surplus created by employment relationships.<sup>175</sup> Given that cheating career employees is likely to tarnish a firm's reputation, thereby making it more difficult to recruit and retain the best employees, it seems likely that rational employers would rely on less risky measures to assure a favorable division of the surplus.

One final reason counsels strongly against the adoption of a just cause standard to protect career employees stripped of their deferred wages. Even if employers were to systematically abuse employees contracting under the efficiency-wage model, remedies more narrowly tailored than a blanket just cause standard can be developed to protect this relatively small class of workers. One option is to permit career employees unfairly denied deferred wages to bring breach of contract actions against their employers.<sup>176</sup> While the threat of such claims would force employers to bear many of the same costs associated with a just cause standard, this remedy has the virtue of not prohibiting employers from entering into efficient at-will contracts with other unaffected classes of employees. Ultimately, if efficiency-wage contracts are so prone to abuse as to justify their prohibition, it is best to accomplish that result through a means imposing as few collateral costs as possible.

#### IV. LABOR MARKET BARGAINING DEFECTS

Even in markets where the parties participate on a level playing field, it is possible that rights and responsibilities will not be allocated optimally through contract. Difficulties may arise when some impediment to bargaining prevents the parties from either identifying or consummating efficient exchanges. In the employment context, opponents of the at-will rule have identified two bargaining defects that may limit the ability of employers and employees to contract for optimal discharge protection. First, the parties may have inadequate information.

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175. See WEILER, *supra* note 8, at 76-77.

176. Such claims would likely be premised on an exception to the at-will rule prohibiting terminations that violate the implied covenant of good faith and fair dealing. See Harrison, *supra* note 6, at 346-49; Phillips, *supra* note 9, at 448-49. This "good faith exception" is currently recognized in some form by 7 states. See POSTIC, *supra* note 9, at xxiv-xxxv.

Employers may misunderstand employee preferences; and employees may systematically underestimate the risk of wrongful termination.<sup>177</sup> Consequently, both parties to employment agreements may undervalue protections against unjust termination and therefore fail to negotiate optimal discharge rules.

Second, opponents of the at-will rule argue that employees are unable to bargain for just cause protection because of a public goods or collective action problem. This claim builds on the observation that employers must make significant capital expenditures in order to administer a just cause regime successfully.<sup>178</sup> Because a just cause regime can only be administered profitably if a large number of employees participate, opponents of the at-will rule argue, no single employee can successfully bargain for tenure protection.<sup>179</sup> Some form of collective action on the part of employees is therefore required if tenure protections are to be instituted,<sup>180</sup> but in the absence of a union, employees have no means to register their collective preferences. This argument is commonly buttressed by the fact that just cause protection is near uniformly guaranteed in collectively bargained contracts.<sup>181</sup>

This section will respond to each of these arguments in turn. Before these individual claims are evaluated, however, it should be noted that they alone are not sufficient to establish the efficacy of mandating just cause protection. Even if the factual premises of both arguments are true, and employees are unable to bargain for tenure protection because of an informational deficiency or collective action problem, it does not necessarily follow that fully informed or unified employees would find it profitable to bargain for such protection. In order for that claim to be proven, opponents of the at-will rule must rebut the conclusions of Part II and demonstrate the comparative efficiency of a just cause regime.

### A. *Informational Defects*

Opponents of the at-will rule typically make two claims

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177. See WEILER, *supra* note 8, at 74-76.

178. See *id.* at 75; Cf. Gottesman, *supra* note 126, at 2789-90.

179. See WEILER, *supra* note 8, at 75; Gottesman, *supra* note 126, at 2789-90.

180. See WEILER, *supra* note 8, at 75; Gottesman, *supra* note 126, at 2789-90.

181. See WEILER, *supra* note 8, at 78.

concerning the adequacy of information held by parties to employment contracts. The first is that employers underestimate the extent to which employees value tenure protection. The second is that employees underestimate the risk of being terminated unjustly.

1. *Employers' Information on Employee Preferences*

Employers' knowledge of their employees' tenure-protection preferences is limited by the methods used to collect this information. Opponents of the at-will rule take a narrow view of the opportunities available to employers to receive feedback from employees, arguing that information about desired levels of job security is exchanged largely at the time of contract formation.<sup>182</sup> This conclusion is based on the observation that employers negotiate a disproportionate number of contracts with employees who frequently change jobs, and whose preferences do not therefore represent the views of mainstream career employees.<sup>183</sup> When coupled with their claim that employers maintain leverage over career employees, this view has led some commentators to conclude that employers will only offer compensation packages that appeal to marginal workers.<sup>184</sup>

In a generally fixed employment market (that is, one in which employees are primarily career-term), the bulk of transactions involve new-hires or top or bottom employees for whom cross-firm mobility is more likely as a result of promotion or discharge. Because exchanges guide a freely functioning market, the terms and conditions of employment (including job security) end up being driven by this non-representative segment of the workforce.<sup>185</sup>

This argument relies, however, on an inaccurately narrow perception of the sources of information available to employers. In addition to initial contract negotiations with these new employees, employers also renegotiate contracts with many senior employees.<sup>186</sup> This is particularly so when employees' compensation packages shift from human capital-based

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182. *See id.* at 75-76; Issacharoff, *supra* note 138, at 621.

183. *See* WEILER, *supra* note 8, at 75-76; Issacharoff, *supra* note 138, at 621.

184. *See* WEILER, *supra* note 8, at 75-76; Issacharoff, *supra* note 138, at 621.

185. Issacharoff, *supra* note 138, at 621.

186. *See* Part III.B *supra*.

contracts to efficiency wage contracts, as discussed above.<sup>187</sup> Many employers also have established institutional mechanisms designed to facilitate the collection of information,<sup>188</sup> including periodic meetings between management and employees, and personnel departments that act as clearinghouses for employee feedback.<sup>189</sup>

Opponents of the at-will rule also erroneously assume that "marginal" new employees will be less interested in job security than will typical career workers. While it is true that younger, more mobile workers are less likely to demand job security protections,<sup>190</sup> other "marginal" employees, such as workers who were recently terminated, are more likely to desire such protection. These employees, having experienced the losses associated with unemployment first-hand, are likely to have a deeper appreciation of the value of tenure protection and therefore demand it more frequently.

The class of "marginal" employees also includes the most productive workers, who because of higher market demand for their services are able to change jobs more readily.<sup>191</sup> Opponents of the at-will rule argue that these workers will desire job security guarantees less than average workers, both because they face a smaller chance of termination and because they suffer smaller losses if fired.<sup>192</sup> While this claim may accurately describe the preferences of some highly productive workers, it does not hold true for all. For those employees contracting under the efficiency-wage model, job security protection is one possible method of guaranteeing payment of deferred compensation.<sup>193</sup> To the extent that the most productive employees fall into this class, they are as likely as other senior employees to require such protection. Under the efficiency-wage model, wages eventually outstrip the productivity of every worker, no matter how qualified.<sup>194</sup>

Thus, employers are likely to receive accurate information

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187. *See id.*

188. *See* DUANE, *supra* note 31, at 70-72.

189. *See id.*

190. *See* WEILER, *supra* note 8, at 63-64.

191. *See* Epstein, *supra* note 6, at 968; Issacharoff, *supra* note 138, at 621.

192. *See* Issacharoff, *supra* note 138, at 621.

193. *See* Part III.B *supra*.

194. *See id.*

about employee preferences from initial contract negotiations, contract renegotiations, and more informal meetings and contacts with employees. Once armed with this information, employers have incentives to offer compensation packages that reflect the preferences of their workforce as a whole.<sup>195</sup> Employers seek to minimize total labor costs, and this can only be done by offering contract terms whose benefit to their entire workforce exceeds the cost of provision,<sup>196</sup> including the cost of productivity losses caused by the firms' impaired ability to recruit new workers. In deciding whether to offer just cause protection, for example, employers will evaluate how much their employees would be willing to give up in wages in exchange for the guarantee. If career employees were willing to surrender more than this cost, rational employers would offer the protection.<sup>197</sup> If employers decline to offer this protection because its value to career employees is exceeded by the desire of "marginal" workers to receive higher wages, this refusal stems from an accurate estimate of aggregate employee preferences, not a systematic failure to protect the interests of a weaker class of workers.<sup>198</sup>

If it were ultimately desirable for employers to provide tenure protection, employers would not be deterred from offering it even if a majority of "marginal" workers did not want it. Preferences can be expected to differ among groups of employees, and as a result certain terms will appeal to some groups and not others.<sup>199</sup> However, compensation packages generally include a number of terms, and employees decide which to accept based on the value of the package as a whole.<sup>200</sup> So long as other benefits offered by the employer make the contract worth accepting, new employees will still sign on to a contract that does not perfectly reflect their individual preferences.<sup>201</sup> This claim is borne out by the fact that

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195. See Freed & Polsby, *supra* note 6, at 1117.

196. See *id.* at 1098 n.1.

197. See *id.* at 1117.

198. See *id.* at 1120-24; cf. Epstein, *supra* note 61, at 147.

199. See WEHLER, *supra* note 8, at 75-76; Issacharoff, *supra* note 138, at 621.

200. See Freed & Polsby, *supra* note 6, at 1098 n.1.

201. See *id.* In a perfect market, all possible permutations of contract terms would be available: individual employees could select the employer whose package perfectly match their preferences. The labor market does not function perfectly, however, and so employees are forced to accept compensation packages that most closely reflect their preferences. It is therefore likely that an employee would accept an offer of employment

compensation packages often include guarantees that are more favorable to senior career employees than new and younger hires.<sup>202</sup> Examples include the extension of health care benefits to family members, the availability of pension and profit-sharing plans, provisions for paid maternity leave, and promises of severance pay and unemployment benefits.<sup>203</sup> Because employers have every reason to offer tenure protection if it is desired by their workforce as a whole, they can and do take steps to ensure that lack of employee information is not an impediment.

## 2. *Employee Underestimation of Termination Risk*

Opponents of the at-will rule also contend that employees fail to contract for efficient levels of tenure protection because they lack accurate information about employers' termination records.<sup>204</sup> Prospective employees negotiating with a new firm are unlikely to know the number of recently terminated employees, and will almost certainly not be able to determine whether those discharges were wrongful.<sup>205</sup> This is particularly likely if the firm employs many different types of workers, has operations spread over a large geographic area, or intentionally misrepresents the reasons for its termination decisions.<sup>206</sup> New employees will also be reluctant to solicit this information, both because it is sensitive and therefore closely held by employers, and because they do not want give the impression that they are concerned about being fired.<sup>207</sup> Even senior workers may misestimate the risk of wrongful termination if they are not privy to information about the circumstances of past discharges.<sup>208</sup>

Thus far, it has only been established that employees may misestimate the risk of being wrongfully terminated, not that they will underestimate it. If employees responded to this

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despite the fact that the employee would not independently choose every contract term. See WEILER, *supra* note 8, at 73-74.

202. See DeFranco, *supra* note 22, at 72.

203. See *id.*

204. See WEILER, *supra* note 8, at 74-75; Malin, *supra* note 84, at 143; Note, *supra* note 2, at 1831-32.

205. See WEILER, *supra* note 8, at 74-75; Malin, *supra* note 84, at 143; Note, *supra* note 2, at 1831-32.

206. See Malin, *supra* note 84, at 143; Note, *supra* note 2, at 1831-32.

207. See WEILER, *supra* note 8, at 74-75.

208. See Malin, *supra* note 84, at 143.

uncertainty by overestimating the risk, they would demand either efficient or inefficiently high levels of tenure protection.<sup>209</sup> Overestimation of this risk is likely because people commonly overestimate the risk of low probability-high cost events.<sup>210</sup> Given the magnitude of loss suffered by wrongfully terminated workers, it is also likely that employees will be risk averse, preferring a sure loss spread over their working lifetime to the chance of a large (but smaller in expected value) loss suffered all at once.<sup>211</sup> Opponents of the at-will rule contend, however, that the phenomenon of cognitive dissonance will push employees to underestimate rather than overestimate the wrongful termination risk:

[W]hat is special about dismissal (as compared, say, to a natural mishap) is that one's own behavior and job performance are likely to play a key role in the employer's decision. If people believe—as I assume most do—that they can and do perform acceptably in their jobs, the phenomenon of cognitive dissonance is likely to make workers discount rather than inflate the chance that they (rather than others) will be singled out for dismissal.<sup>212</sup>

At-will opponents also buoy this claim by reference to union-negotiated collective bargaining agreements, which almost universally include just cause dismissal requirements.<sup>213</sup> According to this view, the union acts as an information clearinghouse, with complete access to the institutional history of the firm, the details of past discharges, and information about firm policy and the temperament of people making termination decisions.<sup>214</sup> The union thereby eliminates the need for individual employees to gather information by assessing the desirability of tenure protection for the whole group. Because nearly every union contract includes a just cause guarantee, and

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209. If many different levels of tenure protection were available, overestimation of termination risk would lead to inefficient overpurchasing. However, job security guarantees beyond those offered by just cause protection are extremely rare. Thus, if employees overestimating the risk of wrongful discharge purchase the same protection they would have chosen if accurately informed, their overestimation will have no efficiency consequences.

210. Common examples include airline crashes and natural disasters. See WEILER, *supra* note 8, at 74 n.53.

211. See Freed & Polsby, *supra* note 6, at 1107.

212. WEILER, *supra* note 8, at 74 n.53.

213. See *id.* at 78; Note, *supra* note 2, at 1832.

214. See WEILER, *supra* note 8, at 78; Note, *supra* note 2, at 1832.

individually negotiated contracts most always do not, at-will opponents conclude that the latter group was compelled by their underestimation of termination risks to make an inefficient decision.<sup>215</sup>

This informational claim is very difficult to evaluate, because it depends on competing psychological rather than economic theories. This difficulty is magnified by the fact that people often respond differently to identical situations. Some employees likely have such a high estimation of their job performance that they never consider the possibility of being terminated. Others may lack self-confidence or may have been fired before. Still others may be highly risk averse, and would thus be likely to overestimate the chance of termination.

These competing theories aside, the actual risk of wrongful termination is quite low.<sup>216</sup> At-will opponents have estimated the number of wrongful discharges per year at 150,000.<sup>217</sup> Based on a nonunion workforce of 72 million, this figure yields a .21% chance that any one employee will be wrongfully terminated in a given year.<sup>218</sup> This figure must be discounted even further, because a just cause regime cannot be expected to resolve every case accurately. Given this low level of risk, it cannot be said with confidence that employees who choose not to contract for just cause protection are acting irrationally.<sup>219</sup>

The union example also fails to substantiate claims of informational deficiency. Put simply, the argument proves too much.<sup>220</sup> Just cause provisions are included in almost every union-negotiated collective bargaining agreement.<sup>221</sup> The exceptions to this near uniform pattern occur in industries like construction, where there is little long-term employment.<sup>222</sup> Thus, the actual termination record of an unionized employer does not appear to play any role in determining whether unions demand just cause protection. It is possible to respond that the

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215. See WEILER, *supra* note 8, at 78; Note, *supra* note 2, at 1832.

216. See WEILER, *supra* note 8, at 74; Freed & Polsby, *supra* note 6, at 1106-1107.

217. See Jerry Frug, *Why Courts Are Always Making Law*, FORTUNE, Sept. 25, 1989, at 248.

218. See Freed & Polsby, *supra* note 6, at 1106-07 (calculating this percentage based on Professor Frug's estimate).

219. *Id.*

220. More in-depth criticisms of the union example appear in Part IV.B.

221. See WEILER, *supra* note 8, at 72.

222. *Id.* at 72 n.48.

risk of error alone under the at-will rule is sufficient to justify seeking tenure protection, even from an employer with a perfect termination record. This is, however, less a claim of informational deficiency than a general assertion of the just cause rule's efficiency. If the at-will rule were uniformly undesirable, no matter what the employer's termination record, it seems likely that nonunionized employees would have eventually caught on and demanded just cause protection as well.

These factual disputes aside, the at-will opponent's informational claim suffers from a more basic theoretical difficulty. As discussed in Part III, the labor market is essentially a competitive one for new employees, and beyond the point of firm-specific surplus, for senior employees as well. Generally, informational deficiencies do not persist in competitive markets over the long-term.<sup>223</sup> This is because such deficiencies create profit-making opportunities for those firms willing to correct them.<sup>224</sup> By educating consumers about the value of a product, sellers can stimulate demand and thereby increase the number of mutually beneficial transactions available.

Information about the desirability of tenure guarantees can be given to employees by either their current employer, or by that employer's labor market competitors. These firms will disseminate information about termination records to the extent that the potential gains from the sale of just cause protection outweigh the costs of dissemination. These costs include expenditures on information collection and transmittal, and losses stemming from the foregone ability to terminate some employees unjustly.

Employers may be particularly unlikely to inform their own employees that they have underestimated the risk of unjust termination. This information deficit gives employers a degree of monopoly power, because it allows them unjustly to terminate a larger number of workers before they start losing employees to rivals.<sup>225</sup> If these firms employ a large number of efficiency-wage employees, the benefit to employers may be substantial. While unlikely, it is not impossible that employers would disseminate

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223. See Howard Beales, Richard Craswell, & Steven C. Salop, *The Efficient Regulation of Consumer Information*, 24 J. L. & ECON. 491, 502 (1981).

224. See *id.*

225. See *id.* at 507-08.

this information to their employees. If employers already capture the majority of the surplus created by their employment relationships, it may be to their advantage to increase the size of the shared surplus by selling job security as a new product. Ultimately, the results are inconclusive: some employers may find it desirable to cheat their employees, while others may earn greater rewards from offering just cause protection.

Even if some employers find it valuable to inform their employees about the true risks of wrongful termination, it may be difficult to imagine this information actually being conveyed. Firms generally do not disparage themselves to prospective applicants, nor seek to undermine the morale of their current employees by making them feel less secure in their jobs. However, in other markets sellers commonly disclose negative information about their primary products in order to increase sales of supplementary goods. For example, car and appliance manufacturers sell extensive warranties that insure buyers against breakage and malfunction. In order to generate demand for these warranties, it is necessary to inform customers about the risk that the product is defective, even though this information will obviously decrease the product's value in the eyes of consumers. Similarly, when car manufacturers market new safety features but offer them only on more expensive models, they may create the perception that less expensive models are unsafe.

Employers confronted with this problem may be able to disseminate the necessary information in a relatively inoffensive way. One possible method is to suggest that the error rate under the at-will rule is unacceptably high, while not affirmatively admitting any wrongdoing. Support for the sufficiency of this limited presentation can be found in the union example. There, employees agree to forego wages in exchange for job security even though no dramatic effort is made to convince them of its necessity. If, as opponents of the at-will rule contend, employees are aware of the magnitude of loss they will suffer if wrongfully terminated late in their career,<sup>226</sup> even this meager presentation should be enough to convince most employees to purchase just cause protection.

Should employers operating in a competitive market fail to

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226. See WEILER, *supra* note 8, at 75-76.

disclose this information to their employees, the disclosures would ultimately be made by competitors. This would enable these competing firms to attract better employees by making their compensation packages relatively more attractive. It is true that firms may find it difficult to collect accurate information about other employers' termination records, both because the information may be closely held, and because it may not be clear which firms they actually compete with for employees. However, employers that believed in the efficiency of just cause protection could easily finesse this difficulty. Without having any specific knowledge about other firms' discharge practices, such employers could assert, as above, that the error rate under the at-will rule is intolerably high, and that it gives employers the ability to cheat their senior workers. This disparagement of any firm not offering just cause protection would make these employers look better by comparison, and should enable them to attract better employees. If just cause protection actually proved to be efficient, every employer would eventually have to offer it in order to remain competitive.

Perhaps the most powerful objection to this discussion about information disclosure in a competitive market is that employers do not actually release any information about termination records, nor make any efforts to sell just cause protection to their employees. This does not necessarily suggest, however, that a defect in the labor market is at work. It may simply be that, as described in Part II, just cause protection is inefficient. If it is, employers have no reason to encourage its purchase. Even in a perfectly competitive market, it would not be provided.

### 3. *Collective Action Problems Among Employees*

Finally, opponents of the at-will rule argue that employees are unable to secure job security protection through contract because they suffer from a public good or collective action problem.<sup>227</sup> This argument is built on two premises. First, broad employee participation is required if employers are to generate a return on the capital expenditures they must make in order to administer a just cause regime.<sup>228</sup> These expenditures are inevitable because just cause regimes require employers to

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227. *See id.*

228. *See id.*

promulgate workplace rules, establish a progressive discipline system, and create a comprehensive record-keeping apparatus.<sup>229</sup> Second, non-union employees have no established procedures for collective bargaining and so generally negotiate their contracts individually.<sup>230</sup> In the absence of a procedure that permits employees to register their preferences as a group, at-will opponents argue, individual employees will refuse to pay their share of the just cause regime's costs, absent a guarantee that other individually contracting employees will also pay.<sup>231</sup>

Support for this collective action thesis is again drawn from union-negotiated collective bargaining agreements, which almost universally provide for just cause protection.<sup>232</sup> Because unionized workers are unlikely to value job security protection differently than nonunionized workers, opponents of the at-will rule attribute the dramatic difference in contracting results between the two sectors to a market defect.<sup>233</sup> In order to remedy this public goods problem, either the government must require employers to provide just cause protection, or employees must unionize and bargain collectively:

[T]here must be some means to impose the fair share of the costs of the benefit upon those employees who would *not* be willing to spend the necessary sum (or who would attempt to "free ride") but who would inevitably enjoy the benefit were it purchased. There are only two ways that these conditions for an efficient exchange can be met, and both require rejecting the traditional market approach: through governmental imposition of the benefit...or through the creation of a system of collective employee bargaining in which the collective decision can be imposed upon nonconsenting employees by requiring them to contribute their *pro rata* share of the purchase price....<sup>234</sup>

This analysis ignores, however, the critical role played by employers in facilitating the collective expression of employee preferences and in policing free riders. If it were efficient to offer just cause protection, employers themselves would have an incentive to provide it in order to capture part of the surplus

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229. *See id.*

230. *See* Gottesman, *supra* note 126, at 2789-90; *see also* WEILER, *supra* note 8, at 75;

231. *See* WEILER, *supra* note 8, at 75; *see also* Gottesman, *supra* note 126, at 2789-90.

232. *See* WEILER, *supra* note 8, at 72-73.

233. *See id.*

234. Gottesman, *supra* note 126, at 2789.

created by its sale.<sup>235</sup> Once it is recognized that employers have a stake in the outcome of this transaction, it becomes clear that they, rather than the government, are in the best position to guarantee that all employees pay their share of the costs of tenure protection.

Private firms could easily achieve this outcome. If employers are unsure about their employees' interest in just cause protection, the question of its provision could be subjected to a binding vote.<sup>236</sup> All employees would be asked, probably through a circulated memorandum, whether they would be willing to give up a certain amount of salary in exchange for tenure guarantees.<sup>237</sup> A vote structured in this simple way would avoid free rider problems, because employees voting "no" would not be absolved of their responsibility to pay a pro rata share of the costs if a majority voted "yes."<sup>238</sup> Employees would therefore have no reason to misrepresent their preferences strategically, because doing so would only contribute to the loss of a desired benefit.<sup>239</sup> If a majority of employees voted for just cause protection, employers could memorialize this result in all of their individually negotiated contracts.<sup>240</sup> By making the benefit non-waivable, employees could guarantee that all employees share the costs of maintaining the system.

Government regulation of termination guarantees is

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235. See Freed & Polsby, *supra* note 6, at 1117. The proposition that employers would offer just cause protection if doing so were economically efficient assumes, of course, that employers would not gain more from withholding the protection and maintaining their ability to cheat efficiency-wage employees out of deferred compensation. For a discussion of the validity of this assumption, see Part III.B *supra*.

236. If, as Part IV.A.1 indicates is likely, employers already have accurate information about employee preferences for just cause protection, this voting procedure would not be necessary. Employers could simply include the desired result in all individually negotiated contracts and make the benefit non-waivable.

237. This procedure will not yield perfect information, because a simple "yes or no" vote does not register the possibility that some "yes" voters would agree to pay more than a simple pro rata share for just cause protection. Thus, it is possible that a majority could vote against tenure protection despite its efficiency. While this is a difficulty, employers do have other methods of acquiring this information, as described *supra* in Part IV.A.1. It should also be noted that union collective bargaining agreements operate on the basis of a simple majority voting procedure, and thus also do not have any way of accounting for the intensity of employee preferences. See Epstein, *supra* note 61, at 147; Freed & Polsby, *supra* note 6, at 1120-21.

238. Cf. Lucian A. Bebchuk, *The Pressure to Tender: An Analysis and a Proposed Remedy*, 12 DEL. J. CORP. L. 911, 931-35 (1987) (suggesting the use of a similar voting scheme to solve collective action problems among corporate shareholders confronted with tender offers).

239. See *id.*

240. See WEILER, *supra* note 8, at 75.

therefore not required. This proposition is supported by the fact that some nonunionized employers provide union-style just cause protection, including resort to outside arbitration.<sup>241</sup> These employers are among the largest private-sector firms, and as a result, their employees should face almost insurmountable barriers to collective action.<sup>242</sup> The burden falls on at-will opponents to explain how the public good problem was surmounted in these difficult cases, despite the absence of a government mandate or collectively bargained contract determining the result.

In light of the fact that employers can themselves facilitate the collective expression of employee preferences and police free riders, yet do not generally offer just cause protection, other explanations must exist for the prevalence of just cause protection in union contracts. Three such explanations are possible. The first lies in the differing types of work done by union and nonunion workers. Unionization is particularly concentrated in certain sectors of the economy, such as manufacturing, mining, construction, and transportation.<sup>243</sup> Workers in these sectors typically perform more routine and repetitive tasks than nonunion employees, who are concentrated in the service industries.<sup>244</sup> As a result, firms operating in highly unionized industries may have less difficulty in creating and enforcing objective and readily verifiable performance standards, thereby reducing the costs of administering a just cause regime.<sup>245</sup> Thus, even if unionized and nonunionized employees place a near-equal value on just cause protection, that value is only one component of an efficiency calculation. If the costs of providing tenure guarantees were significantly higher in nonunionized industries, nonunion employers would be justified in refusing to offer the protection.

A second explanation, more fundamental to the nature of unions themselves, may also explain the prevalence of just cause

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241. See DUANE, *supra* note 31, at 71.

242. *Cf. id.*

243. See Michael A. Curme, Barry T. Hirsch, & David A. MacPherson, *Union Membership and Contract Coverage in the United States, 1983-1988*, 44 *INDUS. & LAB. REL. REV.* 5, 13 (1990) (using 1988 figures).

244. See Schwab, *supra* note 8, at 59.

245. *See id.*

protection in union contracts. Unionized employees generally use the market power created by their combination to secure an above-market wage.<sup>246</sup> Unionized employees can therefore be expected to value just cause protection more highly and demand it more frequently, because the losses they will suffer if terminated will typically exceed those of a similarly situated nonunion employee.

Just cause protection is also likely to be included in union-negotiated contracts because it facilitates union administration, provides union organizers with additional guarantees against retaliatory discharge, and generates additional work for union officials. By reducing worker turnover, just cause protection helps to maintain stability in the workforce.<sup>247</sup> This makes union representation easier by reducing the need to educate new employees about union operating procedures and deterring the termination of experienced employee representatives.<sup>248</sup> Just cause protection also reduces barriers to union organization and permits unions to employ more aggressive bargaining tactics by insulating outspoken union members against pretextual discharges.<sup>249</sup> Finally, the administration of a just cause regime creates employment opportunities for union officials, who represent employees in disciplinary proceedings and act as judges in deciding termination disputes.<sup>250</sup> Because these same officials often assist in the drafting of collectively bargained agreements,<sup>251</sup> it is possible that just cause protection may be included in union contracts even if it does not serve the interests of most employees.<sup>252</sup>

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246. See Dale Belman, *Unions, the Quality of Labor Relations, and Firm Performance*, in UNIONS AND ECONOMIC COMPETITIVENESS 41, 41-42 (Lawrence Mishel & Paula B. Voos eds., 1992); Epstein, *supra* note 61, at 147.

247. See Epstein, *supra* note 61, at 141-42.

248. See *id.*

249. See *id.*

250. See Freed & Polsby, *supra* note 6, at 1125.

251. See *id.*

252. See *id.* This possibility stems from a collective action problem similar to that posited by at-will opponents. If union organizers realize concentrated gains by including just cause protection in union contracts, but the costs of its inclusion are spread broadly across the population of workers, no one worker will have an adequate incentive to oppose the contract provision. Some form of collective action among employees would therefore be necessary in order to defeat it. Such group action would, however, be hindered by high information and transaction costs, and by the prospect of free riders. See MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS*, 46-48 (1965).

## V. CONCLUSION

During the past half-century, government has dramatically tightened its regulatory grip over the workplace. This change has been fostered by academics distrustful of the labor market's ability to guarantee the interests of employees fairly and efficiently. The at-will presumption has not been immune from these attacks, nor has it proven entirely resistant to the judicial inroads proposed by these commentators. Unsatisfied with this piecemeal dismantling of the common law regime, opponents of the at-will rule have intensified their efforts to justify the rule's complete abandonment in favor of a union-style just cause requirement.

These proposals have been supported in large measure by assertions of the just cause regime's superior efficiency, as well as allegations that defects in the labor market prevent employees from negotiating desired guarantees of tenure protection. This article has sought to demonstrate the factual and theoretical deficiencies of these claims. At bottom, opponents of the at-will rule fail to appreciate the value of the flexibility afforded by the free market. Given the extraordinary diversity of employment relationships in the United States, it is difficult to believe that any one discharge rule can produce optimal results in every case. Most often, parties to employment contracts are likely to have more accurate information about their preferences and better incentives to reach efficient results than legislators, judges, or arbitrators. The key question is whether a blunt legal rule should be used to correct the few errors that do occur. Given the staggering costs likely to be imposed by a just cause requirement, errors are better left to the corrective devices inherent in the functioning of a well-working market. Freedom of contract should be guaranteed, and the at-will rule maintained.

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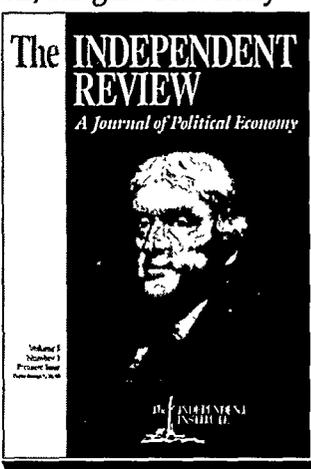
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