AN EMPIRICAL PERSPECTIVE ON INDEFINITE TERM EMPLOYMENT CONTRACTS: RESOLVING THE JUST CAUSE DEBATE

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The central question in modern employment contract law is whether nonunion employees should be legally protected against unjust discharge. New data on actual contract practices impose some much-needed empirical discipline on what thus far has been a speculative theoretical debate. These data strongly support a uniformly applicable default rule of employment at will and demonstrate the central role that the law of employee handbooks plays in determining when parties have opted out of that default. Courts should, therefore, reaffirm the at will default and design interpretive standards to facilitate the efforts of employers and employees to signal their contractual intent.

For nearly a century, the presumption that a hiring for an indefinite period was terminable “for good cause, for no cause or even for cause morally wrong” held unquestioned sway. But, in the last two decades,

1. As Harold Laswell remarked, “[j]nquiry does not abolish debate; it sharpens the realism of the perspectives of all who discipline conviction by data.” THE GREAT DEBATES: BACKGROUND, PERSPECTIVE, EFFECTS 24 (Sidney Kraus ed., 1962).

judges, legislators, and legal commentators have actively debated whether this presumption should be maintained, modified, or eliminated altogether. Despite a series of doctrinal innovations that has left the at will rule significantly eroded, courts in virtually every American jurisdiction continue to presume that an indefinite term employment contract is terminable at will by either party. And despite diligent and creative advocacy on behalf of the Model Employment Termination Act, only one state legislature has chosen to abrogate the common law rules governing such contracts and replace them with a statutory "good cause" standard for all terminations. Indeed, despite confident predictions of the doctrine's imminent demise, courts have steadfastly refused to jettison the at will presumption.

One plausible explanation for the simultaneous erosion and persistence of employment at will is that the existing debate has been inconclusive. A majority of scholars contends that legal protection against


4. For a thorough introduction to the diverse doctrinal theories by which courts have eroded the at will rule, see STEVEN L. WILLBORN ET AL., EMPLOYMENT LAW: CASES AND MATERIALS 29-256 (1993). In Montana and Puerto Rico, courts now must apply legislatively adopted good cause standards in place of the common law employment at will default. See MONT. CODE ANN. §§ 39-2-901 to -914 (1987); P.R. LAWS ANN. tit. 29, § 185a (1985 & Supp. 1990).


6. One commentator has asserted: So strong are the forces for . . . change that it may be only the details of an inevitable development that remain undisclosed. The prediction is that American courts will abandon the principle that, absent some consideration other than the services to be performed, a contract for an indefinite term is to be considered a contract terminable at will by either party. Cornelius J. Peck, Unjust Discharges from Employment: A Necessary Change in the Law, 40 Ohio St. L.J. 1, 1 (1979) (arguing that the Equal Protection Clause of the Constitution compels courts to provide to nonunion private sector employees the same protection against unjust discharge already afforded to many other employees by statute and common law). However, even courts in those jurisdictions that have eroded the at will presumption most significantly, such as California and Michigan, continue to assert that indefinite term employment contracts are terminable at will unless express or implied contractual commitments take the case outside the default rule.
unjust discharge is necessary to make the nonunion employment relationship productive, efficient, and fair. These advocates of reform would replace the doctrine of employment at will with a mandatory term requiring just cause for discharge. Nevertheless, a determined minority lauds the at will contract as an ideal legal regime for most workers and employers. For these defenders of the at will presumption, legally mandated just cause provisions are an unwarranted interference in voluntary contractual relations. Courts and legislatures are perhaps uncertain about the extent to which reformers have made the case for abandoning the traditional presumption. As a result, judicial decisions have produced an unsystematic, piecemeal erosion of the at will default.

In a recent and important article, however, Stewart Schwab presents a daring revisionist account of the simultaneous erosion and persistence of employment at will in contemporary employment contract doctrine. He argues that courts have adopted what he calls a “life-cycle just cause” default. Courts following this intermediate approach provide protection against unjust discharge for employees at the beginning and end of their careers while preserving the at will default for midcareer workers. Schwab also argues on theoretical grounds that the life-cycle just cause default is a normatively attractive rule. Relying on the economic theory of efficiency wages and implicit lifetime employment contracts, he maintains that the courts’ current approach optimally deters both opportunistic firings by employers and shirking by employees with job security.

Schwab’s analysis sets a new standard for analytical sophistication. It shares with the rest of the existing literature, however, a heavy reliance on theoretical speculation. Although it would be wrong to say that participants in the just cause debate never have relied on empirical data

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7. See, e.g., id.; Theodore J. St. Antoine, A Seed Germinates: Unjust Discharge Reform Heads Toward Full Flower, 67 NEB. L. REV. 56 (1988); Clyde Summers, Individual Protection Against Unjust Discharge: Time for a Statute, 62 VA. L. REV. 481, 484 (1976); see also WEILER, supra note 3, at 99-104 (proposing mandatory severance pay awarded by an administrative tribunal).


10. Id. at 11, 38-51; see infra part II.C.

11. See Schwab, supra note 3, at 11, 20-28; infra part IV.C.
to bolster their arguments, such appeals to empiricism have been, with two important exceptions, decidedly secondary and unsystematic.\textsuperscript{12}

This Article challenges the standard theoretical approach to the just cause debate with rigorous empirical analysis. My principal goal is to choose the socially optimal legal rule governing discharge from among the theoretically plausible candidates — mandatory just cause, default just cause, a life-cycle just cause default, and the traditional at will default.

I assume at the outset that employers and employees wish to maximize the joint value of their employment contract at the time of its formation. So long as appropriate legal rules regulate the external effects of employment contracting behavior, the law of contracts can focus on maximizing the private benefits of employment.\textsuperscript{13} The remaining question, therefore, is

\begin{itemize}
  \item \textsuperscript{12} See, e.g., Epstein, supra note 8, at 948 (asserting that most employment is at will); Mayer G. Freed & Daniel D. Polsby, \textit{Just Cause for Termination Rules and Economic Efficiency}, 38 Emory L.J. 1097 (1989) (same). In finding existing empirical information inconclusive, Stewart Schwab characterizes Freed & Polsby's article as an "extensive inquiry" into actual practices. See Schwab, supra note 3, at 28 n.71. Their article, however, presents no data on the contract practices of nonunion employers. James Dertouzos and several coauthors have conducted systematic studies of the litigation costs and potential employment losses associated with unjust discharge litigation. See JAMES N. DERTOUZOS, \textit{The End of Employment-At-Will: Legal and Economic Costs} (1988); JAMES N. DERTOUZOS ET AL., \textit{The Legal and Economic Consequences of Wrongful Termination} (1988); JAMES N. DERTOUZOS & LYNN A. KAROLY, \textit{Labor-Market Responses to Employer Liability} (1992). None of these studies presents data on contract practices.
  \item \textsuperscript{13} The two important exceptions involve arguments based on comparisons to the just cause protection commonly provided in union contracts, see Weiler, supra note 3, and to the legal protections against unjust discharge enjoyed by workers in other industrialized countries, see id. at 83. On the analogy to foreign laws, see Ronald G. Ehrenberg, \textit{Workers' Rights: Rethinking Protective Labor Legislation}, in \textit{Research in Labor Economics} 285 (Ronald G. Ehrenberg ed., 1986); Samuel Estreicher, \textit{Unjust Dismissal Laws: Some Cautionary Notes}, 33 Am. J. Comp. L. 310, 311 (1985); Jack Stieber, \textit{Protection Against Unfair Dismissal: A Comparative View}, 3 Comp. Lab. L. 229 (1980).
  \end{itemize}
how to maximize these joint benefits at the lowest total social cost. I argue, based largely though not exclusively on empirical data, that courts and legislatures should reject mandatory rules and reaffirm the at will default. At the same time, the data show that parties opt out of that default almost exclusively by means of employee handbook provisions. The theory of "information-forcing" default rules suggests that courts should both liberally construe employee handbooks that appear to signal an intent to provide just cause protection and readily enforce clear and prominent disclaimers of contractual effect contained in those handbooks.

I begin by clarifying the current state of the law and presenting new survey data on contemporary employment contract practices. I then use the results of these analyses to evaluate the theoretically plausible discharge rules. The first and most direct application of the data I have collected is to inform the choice of a socially optimal default term. According to majoritarian default theory, the state maximizes the joint returns from contracting by providing parties with the term that they would choose for themselves if there were no transaction costs. My data about actual contract terms are valuable evidence concerning the terms that employers and employees prefer, and they demonstrate that a large majority of employment contracts include an express confirmation of employment at will status. The revealed preferences of market participants thus strongly support an at will default. I also develop a novel empirical technique for determining the optimal scope of application for such a majoritarian default rule. The available data suggest that courts correctly apply the at will default uniformly to all indefinite term employment relationships because there is no cheaply observable and verifiable characteristic of employers or employees on which they could condition a rule of narrower scope.

Information about contract choices also sheds light on theoretical arguments for nonmajoritarian defaults. Contrary to an empirical

14. Naturally, employers and employees are not indifferent to the distribution of these joint benefits. At infra part V.B.3, I consider and reject an argument that mandatory just cause protection should be used to redistribute the gains from the employment relationship.

implication of the argument for a life-cycle just cause default, employers in comparatively liberal jurisdictions are more likely to contract expressly for employment at will and show no greater tendency to choose the prevailing default in those jurisdictions. Furthermore, contrary to the theoretical argument for an information-forcing just cause default, the firms that do not contract expressly for terms governing discharge are comparatively small. They are, therefore, not likely to be as well-informed about legal rules as the theory requires them to be. The data do, however, suggest that courts should adopt an information-forcing default rule of liberal construction for employment manuals.

Finally, empirical evidence can help us to assess the plausibility of some of the theoretical arguments for a mandatory just cause term. The common structure of such arguments is the claim that because of a market failure certain types of employers or employees are unable to contract freely for just cause, even though they prefer that term. Data on current contract practices can show whether these groups opt out of the prevailing at will default at a rate significantly lower than other groups. The available data, though more suggestive than conclusive at this point, are inconsistent with these theories in several ways.

Contrary to the claim that workers misperceive the value of just cause protection, the data reveal no tendency for employers to offer just cause protection to employees in occupations or industries where employees are more aware of the potential for unjust discharge. Contrary to the argument that employers misperceive the cost of extending just cause protection, legally well-informed employers show no greater tendency to contract for just cause. Despite the theoretical possibility that bargaining for just cause protection sends a signal that an applicant will be a bad worker, there are a large number of reported cases in which employees individually negotiated for enhanced job security, and a nontrivial proportion of employers contract expressly for just cause with all of their employees. Finally, contrary to the claim that unequal bargaining power prevents employees from obtaining just cause protection, there is no evidence that employees with many alternative opportunities contract expressly for just cause at a greater rate than less fortunate employees. Each of these observations requires at least some qualification of the corresponding theoretical argument for mandatory just cause protection.

The Article is organized as follows: Part II clarifies the existing law of employment contracts and critically evaluates Schwab’s claim that contemporary judicial decisions are consistent with the life-cycle just cause theory. Part III presents my data on nonunion employment contract practices. Part IV uses the survey data to determine both the content and scope of application for a majoritarian default term governing discharge. It then analyzes whether informational asymmetries between employers
and employees could justify adopting a nonmajoritarian just-cause default. Finally, it considers and rejects claims that just cause provisions in collective bargaining agreements and statutory protection against unjust discharge in other countries provide empirical support for extending just cause protection to nonunion workers in the United States. Part V provides a critical theoretical and empirical perspective on arguments for mandatory, as opposed to default, just cause protection. Part VI concludes the Article by synthesizing the analysis of prior parts and outlining a program for further empirical investigation. A technical Appendix provides detailed information about the survey and supplemental statistical tables.

II. EXPLAINING EXISTING LAW

The empirical method I use in this Article infers parties' preferences from their decisions about contract terms. Because they make these decisions in the shadow of current legal rules, statistical inferences are impossible without an accurate description of existing law. This Part thus begins by presenting a brief general account of prevailing employment contract law. I then describe and refute the hypothesis that the pattern of judicial decisions is consistent with the life-cycle theory.

A. Jurisdictional Variation

The central feature of existing law is dramatic jurisdictional variation in the strength of the at will presumption. States vary substantially in the extent to which they recognize the various doctrinal theories under which employees may attempt to challenge a discharge. As a result, cases that would reach the jury in one jurisdiction are dismissed on summary judgment in another. This striking inconsistency spans cases involving the covenant of good faith and fair dealing, oral assurances of job security, and the enforcement of employee handbooks.

The duty of good faith, for example, is an amorphous restriction on the right of employers to discharge at will. A few states appear to have recognized an expansive version of the covenant that approaches a general good cause requirement. A number of other states apply a far narrower duty of "economic good faith." Under this approach, courts


scrutinize discharges only when plaintiffs allege that they were fired to prevent them from receiving compensation for already completed services. A decided majority of jurisdictions, however, have refused to apply the covenant to employment contracts under any circumstances. These courts often explain that a duty of good faith is fundamentally inconsistent with an employer's right to discharge at will. The judicial reaction to good faith claims thus ranges from substantial sympathy to outright rejection.

Courts also differ significantly in their willingness to entertain claims based on oral assurances of job security. In some jurisdictions, the statute of frauds essentially bars all attempts to prove an oral just cause contract. Other states apply the statute far less rigorously and even permit plaintiffs to evade the statute altogether. Still others enforce oral promises more selectively, requiring plaintiffs to allege substantial reliance, part performance, or other facts sufficient to support equitable estoppel.

The law of employee handbooks follows a similar pattern. A few states, such as Florida and Missouri, have unequivocally rejected the argument that an employee handbook can ever form an indefinite term just cause contract. In other jurisdictions, handbooks are construed quite liberally in favor of employees to extend contractual protection whenever the language could possibly be read to restrict the right to

“economic good faith” to distinguish this particular form of protection from more expansive versions of good faith doctrine. The universe of unjust discharges includes firings for economically opportunistic reasons, firings for bad reasons that violate our moral intuitions about fair treatment, and purely arbitrary firings. A duty of economic good faith prohibits only the first category of discharges. A duty of “ethical good faith” would also prohibit discharges in the second category, but permits arbitrary discharges so long as they do not involve a wrongful motive. A “good cause” standard prohibits all three forms of unjust discharge because it requires an employer to have an affirmatively good reason for discharging all employees. For further discussion of the economic good faith standard, see infra part IV.C. See generally Individual Empl. Rights Manual (BNA) ¶ 505:51-52 (1994) [hereinafter BNA Manual]; LIONEL J. POSTIC, WRONGFUL TERMINATION: A STATE-BY-STATE SURVEY (1994); Monique C. Lillard, Fifty Jurisdictions in Search of a Standard: The Covenant of Good Faith and Fair Dealing in the Employment Context, 57 MO. L. REV. 1233 (1992).

18. See BNA Manual, supra note 17; POSTIC, supra note 17; Lillard, supra note 17.


discharge. Nevertheless, most courts now appear to be willing to enforce handbook promises, determining whether such claims will survive summary judgment by examining the character of the alleged assurances.

Commentators are thus justified in asserting that contemporary employment contract law is somewhat chaotic and unsettled. It remains unquestionably true, however, that the employment at will presumption has survived these doctrinal inroads and remains, in one form or another, the prevailing default rule in every state except Montana.

B. Definiteness and Specificity

As we have seen, some jurisdictions only permit parties to opt out of the at will presumption by means of a formal, signed writing that unequivocally commits the employer to more restrictive discharge terms. Courts in a few other jurisdictions have seemed close to abandoning employment at will in favor of a generally applicable good cause standard. But the overwhelming majority of states fall somewhere between these two extremes. In these more moderate jurisdictions, there exists a strong tendency to decide cases according to whether employment documents and alleged oral assurances are sufficiently definite and specific to contract around the default. Courts ruling against discharged employees almost always explain that the alleged assurances were too vague and generalized to be construed as a promise. In contrast, the same courts, in upholding other discharge claims, emphasize that a reasonable employee would understand the employer's definite and specific language as a legally enforceable commitment.

23. See, e.g., Kern v. Levolor Lorentzen, 899 F.2d 772, 775-76 (9th Cir. 1990) (applying California law); Foley v. Interactive Data Corp., 765 P.2d 373, 384-85 (Cal. 1988); Woolley v. Hoffmann-La Roche, 491 A.2d 1257, modified on other grounds, 499 A.2d 515 (N.J. 1985).


25. See Postic, supra note 17 (collecting cases in 49 states and the District of Columbia that affirm the at will presumption).


Handbook cases in states as diverse as Massachusetts, Michigan, California, and New York follow this basic pattern. But they differ substantially in the degree of definiteness and specificity required to cross the threshold of enforceability. In California, for example, the courts do not appear to have seen an employee handbook provision discussing discharge that they were not willing to enforce. New York courts, however, demand considerably more precise and specific assurances. In Sabetay v. Sterling Drug, Inc., for example, the court of appeals held that the employer’s handbook did not expressly limit its right to terminate employees at will. In fact, the New York courts have rarely seen a handbook provision that they were willing to enforce. Working between these interpretive extremes, courts in the majority of jurisdictions examine all the surrounding circumstances to determine whether the particular handbook provisions should be construed as a promise not to discharge without just cause.

Courts undertake a similar inquiry when plaintiffs allege that they have received oral assurances of job security. The statute of frauds sometimes bars enforcement of such oral assurances because many courts hold that an indefinite term just cause contract cannot be performed within one year. But most of these courts also permit plaintiffs to plead facts in avoidance of the statute. Through the doctrinal filter of statute of frauds analysis, judges thus engage in the traditional interpretive task of determining whether there is sufficient evidence of definite and specific efforts to contract out of the at will default. Other courts ignore the statute altogether by finding that the contract would be performable within one year. Even these courts screen oral assurance cases on summary judgment motions, and once again the specificity of the alleged oral assurances is a good predictor of which cases eventually reach a jury.

To summarize the pattern these decisions reveal, a chaotic main theme of jurisdictional variation overlays a unifying subtheme of judicial
attention to the traditional task of determining the parties' contractual intent. The strength of the at will presumption varies substantially across jurisdictions, but a large majority of jurisdictions have adopted an intermediate approach to employment contracts. These moderate jurisdictions analyze, more or less stringently, the definiteness and specificity of alleged oral and written assurances to determine whether the parties intended to opt out of the at will default.

C. The Life-Cycle Hypothesis

Stewart Schwab offers a completely different response to those who see "chaos" in contemporary employment law. He maintains that the decisions eroding and preserving the at will presumption establish a pattern of life-cycle just cause protection. According to Schwab,

[a] career-employment relationship faces two types of opportunism: opportunistic firings by an unfettered employer and shirking by employees with job security.

To curb opportunism adequately, courts must engage in difficult, case-by-case assessments or create more flexible presumptions. . . . [C]ourts have responded by adopting presumptions that vary with an employee's life cycle.

The danger of employer opportunism is greatest for late-career workers, and it is also a problem for some beginning-career employees. By contrast, the greater problem at midcareer is shirking. In response, the courts have begun to offer contract protection for workers at the beginning and end of the life cycle, while maintaining a presumption of at-will employment for midcareer employees.

36. He contends that "[r]eacting to the cases they see, courts have attempted to create a coherent doctrine. . . . [O]ne should appreciate the balance they are trying to achieve. Until now, no one has attempted to find the method behind the current madness." Schwab, supra note 3, at 12.

37. Id. at 10.

38. Id. at 21.

39. Id. at 11. The quotation could be read to suggest that courts are only just beginning to apply a life-cycle just cause presumption. But one who reads the entire article cannot help but conclude that Schwab means to describe a process of common law
Although the meaning of “shirking” may be intuitively obvious, the concept of “opportunistic firings” requires a brief explanation. In essence, the term refers to a firing that breaches the employer’s commitment to retain long-term employees until they retire. The economic model of “efficiency wages” suggests that employers implicitly promise to pay late career employees wages that exceed their productivity in order to induce greater effort during the midcareer when the same employees will produce more than they receive in wages. A significant problem with this implicit agreement, however, is that it is not self-enforcing. Employers have no incentive — other than the fear of developing a bad reputation — to keep this promise to retain employees until retirement. Indeed, the fact that late career employees are earning more than they are producing gives employers an affirmative incentive to dismiss them. But because a late career firing breaches the implicit promise to retain, it is opportunistic.

There are three basic implications of Schwab’s positive theory: (1) courts will protect early career employees who have recently moved to a new job after incurring substantial relocation costs or giving up another valuable position, (2) courts will not protect midcareer employees unless they see “an obvious case of particular opportunism, such as a firing before a pension vests or a sales commission is due,”

40. Strictly speaking, an efficiency wage model does not require this life-cycle pattern of compensation. Employers might simply pay higher wages in order to induce employees to work harder to avoid losing the more valuable job. See, e.g., Carl Shapiro & Joseph E. Stiglitz, Equilibrium Unemployment as a Worker Discipline Device, 74 AM. ECON. REV. 433 (1984). Most modern efficiency wage models, however, incorporate delayed compensation and a life-cycle pattern of compensation in which late career wages exceed late career productivity. See, e.g., Robert M. Hutchens, A Test of Lazear’s Theory of Delayed Payment Contracts, 5 J. LAB. ECON. S153 (1987).


42. For a detailed analysis of the relationship between employment contract default rules and this economic model of the labor market, see infra part V.C.

43. See Schwab, supra note 3, at 39-43.

44. Id. at 39. Schwab later reiterates this claim while acknowledging some uncertainty about his method of proof:

Of course, it is hard to demonstrate convincingly a negative statement like “cases of this type rarely occur,” especially when the methodology is to examine “leading” cases rather than systematically to examine all reported cases. Counterexamples do exist. In the text I discuss Foley v. Interactive Data as the most prominent counterexample. Still, I remain convinced as a
and (3) courts will protect late career employees against breach of the implicit lifetime employment contract.\(^4\)

What evidence then supports the life-cycle hypothesis? Schwab’s method is “to use ‘leading’ cases — those that may indicate trends in the law — and argue how these leading cases might fit together in a coherent structure.”\(^5\) In the subsections that follow, I refute the life-cycle hypothesis with two types of evidence. A close examination of the reasoning in employment contract decisions from many jurisdictions demonstrates that life-cycle considerations are not the conscious basis for deciding such cases. Moreover, the pattern of case results, when considered independent of their reasoning, contradicts the possible alternative claim that life-cycle concerns exert a powerful unconscious or concealed influence on courts’ decisions.

1. EARLY CAREER PROTECTION?

In support of the first proposition, Schwab cites cases such as *Grouse v. Group Health Plan, Inc.*\(^6\), in which a pharmacist accepted the defendant’s offer to work in one of its clinics. Relying on the offer and on specific instructions from the defendant’s agent, Grouse quit his current position and declined another job offer. The Supreme Court of Minnesota held that these facts established liability under a theory of promissory estoppel and remanded the case for trial on the issue of damages.\(^7\) Considering similar cases, some other courts have suggested that such “additional consideration” may give rise to an implied just cause contract for a reasonable time,\(^8\) and still others have used the hardship

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\(^4\) See *id.* at 43-47. Schwab defines early career workers as those who have five or fewer years tenure with their current employer. Midcareer employees are those with six to fifteen years of service, and late career employees have fifteen or more years tenure. *Id.* at 48.

\(^5\) *Id.* at 11.

\(^6\) *Id.* at 116.

of quitting a good job or moving a long distance to buttress evidence of a contract for a definite term.\textsuperscript{50} But as Schwab himself acknowledges, "[m]any or even most courts refuse to find that reliance on an at-will job offer is reasonable."\textsuperscript{51} Thus, contrary to the life-cycle hypothesis, the clearest pattern in the case law is a distinction between the majority of jurisdictions that simply refuse to entertain this sort of claim at all and the comparatively small number that are significantly more willing to do so.

There is also evidence that some early career employees receive discharge protection despite the fact that they have not incurred substantial moving expenses or given up a valuable position at another employer. In \textit{Toussaint v. Blue Cross & Blue Shield},\textsuperscript{52} the leading Michigan decision on the enforceability of oral assurances and employee handbooks, the successful plaintiffs, Charles Toussaint and Walter Ebling, were employed in middle management positions for five years and two years, respectively, before being discharged by their employers. The court describes no evidence to suggest that either employee should be characterized as a recent mover. Instead, Justice Levin explains:

\begin{quote}
Both Toussaint and Ebling inquired regarding job security when they were hired. Toussaint testified that he was told he would be with the company "as long as I did my job." Ebling testified that he was told that if he was "doing the job" he would not be discharged. Toussaint's testimony, like Ebling's, made submissible to the jury whether there was an agreement for a contract of employment terminable only for cause. . . . Toussaint's case is, if anything, stronger because he was handed a manual of Blue Cross personnel policies which reinforced the oral assurance of job security. It stated that the disciplinary procedures applied to all Blue Cross employees who had completed their probationary period and that it was the "policy" of the company to release employees "for just cause only."\textsuperscript{53}
\end{quote}


\textsuperscript{51} Schwab, \textit{supra} note 3, at 41.

\textsuperscript{52} 292 N.W.2d 880 (Mich. 1980).

\textsuperscript{53} \textit{id.} at 884. Justice Ryan, joined by Justices Coleman and Fitzgerald, would have permitted only Ebling to recover on the theory that he had been fired to prevent him from exercising a valuable stock option. \textit{id.} at 897-902 (Ryan, J., dissenting). Those same justices would have held that the assurances given to Toussaint were insufficiently definite to warrant enforcement. \textit{id.} at 902-09.
The court’s ruling in favor of both plaintiffs thus depends exclusively on a careful analysis of the nature of the assurances the plaintiffs received and on the context in which they received those assurances.

Similarly, in *Renny v. Port Huron Hospital*, the same court relied on a careful reading of the hospital’s employee handbook to conclude that a nurse with five years of service had an enforceable just cause contract. In particular, the court observed that the handbook contained a precise list of disciplinary violations and penalties for each type of violation, and there was no express statement within the handbook that employees were terminable at will. Again, as in *Toussaint*, there are no facts mentioned in the court’s opinion that would suggest that Renny was a recent mover. Massachusetts courts also appear willing to enforce handbook provisions on behalf of early career employees without requiring evidence of significant detrimental reliance.

Indeed, both the recent mover cases and these other early career cases confirm the centrality of written and oral assurances of job security in most employment contract cases. The majority of courts that find some protection for recent movers relies heavily on the existence of documents that could be interpreted to guarantee employment for a definite term. Thus, systematic jurisdictional variation, combined with careful judicial attention to the problem of interpreting arguably contractual writings, explains the legal protections afforded to recent movers better than the life-cycle theory.

2. ECONOMIC GOOD FAITH STANDARD IN MIDCAREER?

The second element of the life-cycle hypothesis is the prediction that courts will only protect midcareer employees against “particular opportunism.” Here Schwab relies on the line of authority imposing what I have called a duty of economic good faith. A frequently cited Massachusetts case, *Fortune v. National Cash Register Co.*, illustrates

55. *Id.* at 335-36.
57. *See* cases cited *supra* note 13.
58. Recall that the term “economic good faith” distinguishes these claims for opportunistically avoided compensation from “ethical good faith” claims that rely instead on moral intuition about whether a particular firing is wrongful. Protection against arbitrary, as opposed to economically or morally wrongful, firings can only be described as congruent with imposing a duty to establish just cause for all discharges. *See supra* note 17.
a common fact pattern. Fortune was a salesman for NCR working under an express at will contract which also provided that he would receive commissions for sales made in his territory. NCR fired him one business day after he signed a five million dollar order. As a result of the firing, Fortune lost about half of the $90,000 commission to which he would have been entitled had he remained employed at NCR until all of the machines were delivered. The court upheld a jury verdict awarding Fortune the full commission on the grounds that NCR acted in bad faith when it fired him. The objective of this doctrine is to "deny to [the employer] any readily definable, financial windfall resulting from the denial to [the employee] of compensation for past services." Thus, in Massachusetts at least, courts read a duty of economic good faith into at will employment contracts.

But once again, jurisdictional variation defies any attempt to generalize about the direction of the common law on this issue. The

60. Richard Epstein claims that NCR did not behave opportunistically because the company paid the commission to someone else. See Epstein, supra note 8, at 981-82. Although the court's opinion says that a portion of the commission was paid to a "systems and installations person" after Fortune's firing, Fortune, 364 N.E.2d at 1254, the company still appears to have avoided paying any commission at all on machines that were delivered more than eighteen months after the sale. In fact, after initially terminating his employment, NCR retained Fortune for eighteen months in a nonsales position before again discharging him. Id. By this clever device, NCR seems to have expected to have its cake and eat it too. Thus, contrary to Epstein's assertion, Fortune serviced the First National account during the entire period leading up to his second discharge, yet NCR avoided paying him the contractually specified commission.

61. Schwab also cites McClendon v. Ingersoll-Rand Co., 779 S.W.2d 69 (Tex. 1989), rev'd, 498 U.S. 133 (1990), a Texas Supreme Court case that used similar reasoning to protect an employee who was fired a mere four months before his pension would have vested; the U.S. Supreme Court ultimately overturned that decision on the ground that the wrongful discharge cause of action based on a motive to avoid pension obligations was preempted by ERISA. Finally, Schwab cites the spirited debate between Seventh Circuit judges Easterbrook and Posner over a case in which an at will employee of a close corporation resigned and sold his stock back to the corporation at book value on the eve of a merger that would increase his shares' value from $23,000 to more than $600,000. See Jordan v. Duff & Phelps, Inc., 815 F.2d 429 (7th Cir. 1987). The employee subsequently filed a 10b-5 action alleging that by failing to disclose the impending merger, the company's chairman committed fraud in the purchase of corporate securities. The majority opinion by Judge Easterbrook condemned the failure to disclose as "avowedly opportunistic" conduct, and reversed a summary judgment for the employer. Id. at 438. In dissent, Judge Posner asserted that "the possibility that corporations will exploit their junior executives . . . may well be the least urgent problem facing our nation." Id. at 449. Although fascinating for revealing uncharacteristic disagreement between these two prominent economically oriented judges, it is considerably less clear what Jordan teaches us about the common law of contracts.

Bureau of National Affairs reports that only fourteen states recognize the implied covenant of good faith and fair dealing on which this cause of action is based. Monique Lillard's detailed survey of state law reveals, by my count, at least twenty-eight states that have unequivocally rejected a version of the covenant that would provide such protection. In addition, a comprehensive survey of wrongful termination law by Lionel Postic reports, even more pessimistically, that thirty-six states have rejected the covenant. Although it is possible that another doctrine, such as restitution in quantum meruit, might enable some employees to recover even in these inhospitable jurisdictions, the inescapable conclusion is that protection against economic bad faith is far less certain than Schwab suggests.

Moreover, midcareer workers often are able to enforce employee handbook promises even though they are not victims of economic bad faith. According to Schwab, Rowe v. Montgomery Ward & Co. illustrates "the courts' reluctance to protect midcareer employees." In Rowe, the Michigan Supreme Court rejected an eight-year saleswoman's claim that oral assurances, the company’s Rules of Personal Conduct, and disciplinary guidelines contained in an employee handbook protected her against discharge for other than specifically enumerated reasons. Schwab suggests that "[o]ne can only speculate that the court would have viewed Rowe's claim more sympathetically if she had thirty-years tenure rather than eight."

An alternative to such speculation, however, is to consider how the court in Rowe reached this result. The court rejected Rowe's claim after carefully comparing the nature and circumstances of the alleged assurances of job security to those in Toussaint. Unlike Toussaint and Ebling, Rowe did not "engage in preemployment negotiations regarding

63. See BNA Manual, supra note 17, ¶ 505:51-52. According to BNA, 16 states have rejected the covenant outright, and 20 other states have issued no definitive ruling on the question. Id.
64. See Lillard, supra note 17, at 1262-1300.
65. See POSTIC, supra note 17, at xxiv-xxxvi.
66. Schwab initially disavows any intent to consider "the fascinating contract issues involved in employee handbooks and other arguably express agreements about the standard of discharge." Schwab, supra note 3, at 11. But as the text following this footnote reveals, he later relies heavily on handbook cases to bolster the life-cycle hypothesis. Schwab's reliance on these cases is unsurprising. The dominant judicial approach to modern employment contract law virtually requires plaintiffs to allege that their employers gave them express oral or written assurances of job security. See supra part II.B.
68. Schwab, supra note 3, at 48.
69. Id. at 49.
job security." Unlike the unequivocal statements made to Toussaint and Ebling, Rowe alleged statements that were comparatively "vague" and "couched in general terms." The court concluded that these oral statements were insufficiently "clear and unequivocal to overcome the presumption of employment at will." Similarly, the court's analysis of the company's Rules of Personal Conduct emphasized that "nothing in the rules suggested that the enumerated conduct was the only basis for dismissal, and the rules were consistent with a termination-at-will policy." Finally, the court refused to enforce the disciplinary guidelines "because the last handbook which plaintiff received clearly set forth an employment-at-will policy." Thus, a careful inquiry into definiteness and specificity, rather than life-cycle considerations, determined the result in Rowe.

A complementary approach is to examine other cases to discover whether similar factors appear to influence the results. In Rood v. General Dynamics Corp., for example, the Michigan Supreme Court recently addressed two cases that potentially involved the issue of life-cycle protection. Richard Rood had worked thirteen years as a plant physician for Chrysler and then two and one-half years until his discharge for General Dynamics, after General Dynamics purchased the plant at which Rood worked. Joseph Schippers, a truck driver, worked twelve and one-half years for SPX Corporation's Sealed Power Division before accepting a transfer to the same company's Hy-Lift Division where he worked for one and one-half years until he was discharged. Under the life-cycle theory, both of these employees are at the margin between midcareer and late career status. These cases are thus a good test of the life-cycle theory. If distinguishing midcareer employees from workers vulnerable to late career "opportunism" is important, then we would expect to see the court explicitly analyze that issue to determine whether either or both of these employees deserves just cause protection. If for some reason the court feels constrained not to base its decision on these
grounds, then its opinion should at least recite facts sufficient to distinguish the two cases on the life-cycle theory.

Despite the similarity in their job tenure, the court held for Rood and against Schippers. Admittedly, the results in these two cases are formally consistent with the life-cycle theory, but it is instructive to consider the court's analysis of their claims. Both employees relied on a combination of alleged oral assurances and employee handbook provisions. What distinguished the two cases, however, was the clarity and specificity of the employer's policy statements. As the court framed the issue, "[t]he common thread running through our decisions in 

Toussaint

and 

Renny is the presence of clear and specific employer policy statements, regarding employee discharge."77 Applying this clear statement rule, the court found Schippers had no legitimate expectation of just-cause protection. He had alleged oral assurances and a handbook provision committing his employer to "overall policies of employment and standards of conduct which are fair to all employees and in the best interest of the company."78 In contrast, Rood offered evidence of numerous specific standards and procedures, including a definition of "involuntary termination" as "discharge for reasons of misconduct or unacceptable performance,"79 that his employer had committed itself to follow. The court found that "these statements are sufficiently clear to warrant a reasonable employee to expect that the company had elected, at least temporarily, to limit its involuntary termination discretion . . . to misconduct or unacceptable performance."80

Significantly, longevity of service played no role in the discussion of either case. In dissent, the author of 

Toussaint

argued that both Rood and Schippers presented sufficient evidence to reach the jury, but at no time did he suggest that length of service played any role in his reasoning.81 Moreover, there is nothing in the recited factual circumstances of either plaintiff to suggest that the court was trying to protect Rood from late career opportunism while it saw Schippers as a midcareer shirker. The life-cycle hypothesis is thus incapable of predicting the outcome in cases such as these.

3. LATE CAREER PROTECTION?

The third and last prediction of the life-cycle hypothesis is that workers nearing the end of their career will receive protection against

77. Rood, 507 N.W.2d at 607.
78. The documents at issue also included a confirmation of at will status to which the court referred but on which it chose not to rely. Id. at 599, 608.
79. Id. at 608.
80. Id.
81. Id. at 609-11 (Levin, J., concurring in part and dissenting in part).
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unjust discharge. Here Schwab's leading cases are decisions from California, Montana, and New Hampshire. In each of the cited cases, the court relies expressly on the length of the plaintiff-employee's job tenure to determine that he should be protected against unjust discharge. Although it is beyond the scope of this Article to demonstrate by means of a comprehensive survey of cases that these decisions are atypical, a brief discussion of decisions from several other jurisdictions can establish that long tenure does not often imply just cause protection.

First, some jurisdictions are plainly hostile to all claims of contractual protection against discharge. In Florida, New York, and Virginia, for example, courts have unequivocally rejected the implied contract and good faith theories under which late career employees may receive protection elsewhere. In fact, Florida courts refuse to recognize even the theory that an employee handbook can form a just cause employment contract, and the Virginia Supreme Court has imposed a signed writing requirement that often will prevent the enforcement of otherwise definite promises of job security, including most long-term employment contracts.

82. Schwab, supra note 3, at 45-47. Schwab also cites Peter Linzer's discussion of job protection implied from longevity of service. See Peter Linzer, The Decline of Assent: At-Will Employment as a Case Study of the Breakdown of Private Law Theory, 20 GA. L. REV. 323, 353-68, 383-86 (1986). In text, Linzer contends that, consistent with the life-cycle hypothesis, "[c]ourts may continue to strive to force cases into traditional tort and contract molds, but in reality it will be the relationship, itself, and especially though not exclusively its length, that will be the source from which increasing entitlements in the job are to be created." Id. at 368 (emphasis added). In contrast, an extensive footnote acknowledges candidly that "many courts have not gone along" with the wholesale erosion of employment at will. Id. at 368 n.217. Both Linzer and Schwab focus far more on the isolated cases eroding employment at will than on the large number of jurisdictions in which courts have created only comparatively limited exceptions to that doctrine.


85. See, e.g., Lurton v. Muldon Motor Co., 523 So. 2d 706, 708-09 (Fla. Dist. Ct. App. 1988) (rejecting claim based on employee handbook that specifically stated employees would be terminated only if just cause exists); see also Heideck v. Kent Gen. Hosp., 446 A.2d 1095 (Del. 1982) (requiring extremely precise handbook language in order to create just cause contract).
promises contained in employee handbooks. In these jurisdictions, late career workers are thus no better off, and no worse off, than employees at other stages of the life-cycle.

Nor is the pattern of decisions declining to extend protection to late career employees limited to comparatively conservative jurisdictions. Consider the fate of late career workers in Massachusetts. The Supreme Judicial Court of Massachusetts was one of the first courts to impose a duty of good faith and fair dealing in the employment context. And, unlike New York and Florida, Massachusetts courts entertain tort claims for wrongful discharge in violation of public policy. But one will search in vain for any suggestion in Massachusetts case law that late career employees receive greater protection against discharge than other workers. As we have seen, under the implied covenant of good faith

89. My survey of relevant reported decisions by appellate courts in the state revealed the following results:


and fair dealing, employees may recover only if they are able to show that their employer has attempted to deprive them of "compensation for past services." Furthermore, the court sharply distinguishes cases involving the loss of "future compensation for future services," which fail to state a claim. Employment manual cases in Massachusetts similarly show no pattern related to the age or job tenure of the plaintiff. Instead, employees succeed when their employer's handbook and the circumstances of its distribution satisfy a number of formal criteria. These formal requirements for enforceability appear to be a filter designed to identify definite and seriously intended promises of job security.

Important cases from other jurisdictions also demonstrate the irrelevance of job tenure. In In re Certified Question (Bankey v. Storer Broadcasting Co.), the Michigan Supreme Court held that a thirteen-year employee was not protected against unilateral modification of an employer's written policy statements without suggesting even the possibility that late career employees might be protected from such arguably "opportunistic" conduct. Indeed, few employer actions could be more disruptive to the settled expectations of long term employees than an abrupt change in policies governing discipline and discharge.

The most consistent pattern in these decisions is that more definite and specific assurances of job security, particularly in writing, give plaintiffs a better chance of prevailing.

61-year-old employee with 11 years of service who sought to enforce oral assurances he received at the time of hiring; court holds that personnel director had no actual or apparent authority to enter into "lifetime employment contract"); O'Brien v. Analog Devices, Inc., 606 N.E.2d 937 (Mass. App. Ct. 1993) (rejecting claim brought by woman of unspecified age or job tenure for enforcement of handbook policies on grounds that policies were too indefinite); Mullen v. Ludlow Hosp. Soc'y, 592 N.E.2d 1342 (Mass. App. Ct. 1992) (upholding summary judgment against six-year employee who sought to enforce an employment manual that included a disclaimer of contractual intent); Gregory v. Raytheon Serv. Co., 540 N.E.2d 694 (Mass. App. Ct. 1989) (upholding summary judgment against 55-year-old recent mover who sought to rely on vague oral assurances by start-up company and who signed documents including an at will disclaimer).

The most consistent pattern in these decisions is that more definite and specific assurances of job security, particularly in writing, give plaintiffs a better chance of prevailing.

90. Gram, 461 N.E.2d at 797. Although one could frame a life-cycle claim for late career protection in these terms, the case law leaves no doubt that such a case would be dismissed for failure to state a claim. See id.

91. Id. at 798.

92. See Jackson, 525 N.E.2d at 415-16 (considering employer right to modify personnel manual terms, the degree of commitment the language expresses, evidence of negotiation concerning manual terms, evidence that the employer has called "special attention" to the manual, evidence that the employee has assented to the terms of the manual, and whether the manual identifies a term of employment); see also Pearson, 979 F.2d at 256 (applying Jackson factors to deny 21-year employee's attempt to enforce employee handbook); Rood v. General Dynamics Corp., 507 N.W.2d 591 (Mich. 1993) (illustrating analogous tendency in Michigan law).

Nevertheless, even Justice Levin, the author of *Toussaint* and a vigorous dissenter in *Rowe*, concurred in the view that an “employee could not legitimately expect that there will be no change in policy statements.”

The inescapable conclusion from these decisions is that, under Michigan law, just cause protection depends not on longevity of service, but rather on the definiteness and specificity of any oral assurances or employee handbook statements on which the plaintiff relies. Moreover, Michigan is one of many jurisdictions that has rejected the amorphous covenant of good faith and fair dealing under which late-career employees might otherwise seek protection.

Even in cases from the very jurisdictions Schwab cites in support of the life-cycle hypothesis, there is little, if any, basis for concluding that length of service is an important consideration. In New Hampshire, for example, few cases address the relevant questions of law, and the decision on which Schwab relies, *Foley v. Community Oil Co.*, was rendered by a federal district court. The only New Hampshire authority *Foley* cites is *Monge v. Beebe Rubber Co.*, a case ostensibly imposing an expansive duty of good faith and fair dealing. But the state’s supreme court has since retreated from this broad interpretation of *Monge*. In fact, that court has turned the good faith theory into little more than an expansive version of the public policy exception. Moreover, no

94. *Id.* at 121. In fact, the court held that employers do not even have to reserve the right to modify policies at any time with adequate notice to all affected employees. As the court put the issue of notice, “[f]airness suggests that a discharge-for-cause policy announced with flourishes and fanfare at noonday should not be revoked by a pennywhistle trill at midnight.” *Id.* at 120. Cf. *Sprague v. General Motors Corp.*, 768 F. Supp. 605 (E.D. Mich. 1991) (discussing modification of retiree benefits and ERISA cases requiring employer to reserve the right to modify benefits).

95. Consistent with this standard is the other firmly established principle that there is no just cause protection when the employment documents contain a clear and prominent disclaimer. *See, e.g.*, *Reid v. Sears, Roebuck & Co.*, 790 F.2d 453 (6th Cir. 1986) (applying Michigan law); *Toussaint v. Blue Cross & Blue Shield of Michigan*, 292 N.W.2d 880 (Mich. 1980).

96. *See, e.g.*, *Hammond v. United of Oakland, Inc.*, 483 N.W.2d 652, 655 (Mich. Ct. App. 1992). The Michigan Supreme Court briefly alluded to, but did not reach, the question of a duty of good faith in *Prussing v. General Motors Corp.*, 269 N.W.2d 181, 182-83 (1978). Dissenting in *Toussaint*, Justice Ryan mentions *Prussing* and the duty of good faith, but observes that “this is not the proper occasion to consider whether we wish to jurisprudentially align this state with [states such as New Hampshire that have recognized the covenant].” 292 N.W.2d at 909.

97. 64 F.R.D. 561 (D. N.H. 1974).

98. 316 A.2d 549 (N.H. 1974).

99. *See Howard v. Dorr Woolen Co.*, 414 A.2d 1273 (N.H. 1980) (restricting good faith to case in which “an employee is discharged because he performed an act that public policy would encourage, or refused to do that which public policy would
subsequent decision by the state's own courts has endorsed or relied on Foley. Although it is probably fair to say that New Hampshire recognizes quite a broad public policy exception, there is no case law whatsoever to suggest that it has adopted a life-cycle just cause default.

Nor can the law in Montana or California fairly be described as consistent with the life-cycle theory. Barely a year after the Montana Supreme Court's decision in Flanigan v. Prudential Federal Savings & Loan Ass' n, the sole Montana case that Schwab cites, a generally applicable statutory good cause standard superseded that ruling as well as other similar cases that had imposed tort liability for breach of the covenant of good faith and fair dealing. In response to those decisions, Montana businesses lobbied the state legislature to obtain statutory preemption of this developing employment contract jurisprudence. Employers apparently found the prospect of limited liability and a universal good cause requirement more attractive than increasingly uncertain liability exposure under the common law. Although Schwab suggests that length of service is a decisive variable in California cases, there is substantial evidence that written employer policies and oral assurances play an equal or greater role in determining which employees will be protected from unjust discharge.

4. THE FINAL WORD

In a final effort "[t]o clarify the distinction... between scrutinizing opportunistic late-career terminations and scrutinizing all employment decisions under a just-cause standard," Schwab examines the facts of Murphy v. American Home Products. Murphy was a fifty-nine year old accountant and auditor with twenty-three years of service who was fired after he reported to top management that his immediate superiors

condemn"); Cloutier v. Great Atl. & Pac. Tea Co., 436 A.2d 1140 (N.H. 1981) (reading Howard to condemn a discharge contrary to a general public policy to protect employees from dangerous working conditions and to the policy expressed in a more specific state statutory provision guaranteeing a day of rest each week).


102. See Krueger, supra note 101, at 653, 658-59.

103. See POSTIC, supra note 17, at 72-82 (collecting cases).

104. Schwab, supra note 3, at 50.

were engaging in "illegal account manipulations of secret pension reserves." These facts seem to suggest that Murphy would be a prime candidate for the late career protection afforded under the life-cycle theory. Surprisingly, Schwab explains that Murphy should not receive protection because "[i]nternal whistleblowing resembles too closely legitimate, but practically unverifiable, concerns that an employee is not a team player or that an employee creates difficulty in the office. Legal limning of these situations is probably not worth the costs." Schwab suggests, however, that he

would have greater sympathy for Murphy if he claimed that he was fired after twenty-three years of service because he was no longer pulling his weight or earning his salary. Unless the parties have clearly agreed to at-will dismissals throughout the life cycle, such a firing smacks of an employer opportunistically firing an employee who has committed the best years of his life and should reap, based on norms of seniority, the benefits of a career commitment to the employer.

Although one must admire Schwab's subtle analysis of the facts, the distinction he draws is completely lost on the court that decided *Murphy*. In point of fact, *Murphy* illustrates nothing more than the oft-repeated position of the New York Court of Appeals that employees must look to the legislature rather than the courts to effect any change in the doctrine of employment at will. Even a plaintiff such as Fortune, alleging economic bad faith in termination to avoid paying sales commissions, unquestionably loses in New York.

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106. *Id.* at 87.
108. *Id.* Schwab claims that *Murphy* is consistent with his "asymmetric-investment rationale for policing terminations . . . Because the dangers of contract opportunism and third-party effects are absent, courts do not need to police the situation." *Id.* at 37. He criticizes what he calls an "ad hoc opportunism test," on the ground that courts "may have difficulty identifying opportunism when they see it." *Id.* at 38. Even if courts can identify opportunism after the fact, an ad hoc test gives limited prospective guidance to employers and employees. Finally, the amorphous nature of an ad hoc opportunism test may mean that it becomes applied so broadly that it is "indistinguishable from a just-cause requirement for all terminations." *Id.* at 39. It is hard to fathom what late career just cause protection might involve other than an ad hoc factual inquiry into opportunism.
109. See *Murphy*, 448 N.E.2d at 91-92 (rejecting unequivocally both duty of good faith and the far more conventional public policy exception to employment at will).
110. See *Sabetay v. Sterling Drug, Inc.*, 506 N.E.2d 919 (N.Y. 1987). The New York Court of Appeals has recently established an extremely narrow exception to the at will doctrine in a case involving an attorney discharged for insisting that his firm report
Moreover, the distinction Schwab seeks to draw between prohibiting opportunism and requiring just cause surely cannot depend exclusively on the employer's proffered reason for discharge. Imagine a rule under which a court would grant summary judgment to employers that allege facts like those in Murphy while denying summary judgment to employers that give reasons like "not earning his salary" and "no longer pulling his weight." Such a rule would create tremendous incentives to fabricate acceptable reasons for discharge. Thus, in order to implement effectively the life-cycle just cause standard, courts would have to develop a burden-shifting framework, analogous to the rules that govern employment discrimination cases. There is no evidence that courts currently approach contract claims brought by late career employees in this way.

In summary, the life-cycle just cause hypothesis is far less consistent with the pattern of employment contract decisions than an alternative hypothesis of systematic jurisdictional variation. Although the strength of the presumption varies considerably, employment at will remains the default rule for indefinite term employment contracts. In deciding cases at every stage of the career, many courts also appear to attach tremendous significance to the role of contractual writings and to the definiteness and specificity of alleged assurances of job security.

III. EMPIRICAL EVIDENCE OF EMPLOYMENT CONTRACT PRACTICES

Now that I have established the content of existing law, my method also requires information about employment contract practices. Participants in the just cause debate have relied thus far almost exclusively on speculative assertions about the nature of existing practices. The new data presented in this Part make it possible to impose some empirical discipline on this theoretical debate.

Currently available sources provide surprisingly little information about the contractual relations between employers and their nonunion...
employees, who now comprise nearly 85% of the workforce. There is a growing sociological literature documenting the extensive use of formal and informal grievance mechanisms and the provision of procedural protections for nonunion workers. In 1986-87, for example, John Delaney, David Lewin, and Casey Ichniowski conducted an exhaustive survey of human resource management practices at 495 large companies.

Although the data from this survey are sometimes cited as evidence concerning contractual protections against discharge, they cannot, in fact, support that interpretation. The authors report the percentage of firms with "grievance procedures and complaint systems" that include "arbitration as the terminal step" of the procedure. Between 17% and 24% of firms responded that they had such procedures in place at the time of the survey. There are, however, several difficulties associated with interpreting these data. Most significantly, arbitration clauses for nonunion employees typically confer no protection against unjust discharge. Instead, employers use such clauses to foreclose litigation of statutory actions, such as employment discrimination complaints or ERISA claims. Whereas union arbitrators construe and enforce just cause provisions in collective bargaining agreements, nonunion employers may well require their employees to sign both an arbitration agreement and a confirmation of at will status. The Delaney...

113. See U.S. DEPT. OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 439 (1994) (reporting that 15.8% of employed wage and salary workers were union members in 1993).


115. JOHN T. DELANEY ET AL., HUMAN RESOURCES POLICIES AND PRACTICES IN AMERICAN FIRMS (1989) (reporting the results of a study involving a 1000-item, five-hour survey instrument conducted under contract for the United States Department of Labor).

116. For example, Stewart Schwab cites these data as suggestive evidence that might call into question the "blanket statement that private nonunion employees are subject to dismissal at will." See Schwab, supra note 3, at 28 n.73; see also Freed & Polsby, supra note 12.

117. DELANEY ET AL., supra note 115, at 24, 60.

118. See, e.g., Gilmer v. Interstate/Johnson Lane Corp. 500 U.S. 20 (1991) (enforcing arbitration agreement signed pursuant to registration as a security dealer).
data thus should not be construed as evidence of nonunion just cause protection.\footnote{119}

There are only two reliable, though incomplete, sources of empirical data concerning the formal contractual practices of nonunion employers. A Bureau of National Affairs survey, conducted in 1984, reveals that nearly four out of five employers had taken some action designed to avoid contractual liability to discharged employees. In the BNA survey, a bare majority of employers said that they had added to their employment documents language confirming that employees may be terminated at will.\footnote{120} A more recent paper by sociologists John Sutton and Frank Dobbin provides valuable time-series data on the proportion of employers using confirmations of at will status.\footnote{121} Sutton and Dobbin report that the percentage of firms that use employment at will clauses increased from 0\% to 29\% between 1955 and 1985. The data in these studies provide suggestive evidence about one important aspect of contract practice. They are, however, insufficient for the task of selecting legal rules for indefinite term employment contracts.

In order to begin to fill what can only be described as a data gap in the literature on employment contracts, I have conducted an exploratory survey asking companies a variety of questions about their employment practices. During the summer of 1994 and the winter of 1994-95, I contacted employers in Virginia, California, Texas, Michigan, and New York.\footnote{122} The average response rate was approximately 25\%.\footnote{123} The total sample size was 221 employers. The mean employer size was 261

\footnote{119. In addition, the average size of companies responding to the survey (7,884 employees) indicates that these data apply only to relatively large firms. It would be a mistake to infer general labor market patterns from such a sample.}

\footnote{120. See \textit{Bureau of Nat’l Affairs, Employee Discipline and Discharge} 26-28 (1985) (PPF Survey No. 139). BNA’s findings included the following: Some 63\% of employers “removed or changed wording in company publications to avoid any suggestion of an employment contract;” 60\% of employers “alerted company spokespersons to avoid making oral promises of job security;” 53\% of firms “added wording to applications and handbooks specifying that employment may be terminated for any reason;” 49\% of companies “removed wording that suggested limits on management’s right to fire employees for any reason;” 23\% of employers reported using severance agreements including a release of all claims with at least one discharged employee. Overall, 78\% of employers had taken some action specifically intended to protect the company against liability to discharged employees.}


\footnote{122. The interviews were conducted in two waves. The first set of interviewers was composed of law students; the second set was composed of graduate students.}

\footnote{123. This rate is well within the normal range for surveys of organizations, although far higher rates often are obtained when surveying individuals.}
employees, with a minimum size of ten and a maximum size of 10,000 employees.\textsuperscript{124}

The objective of the survey was to discover what, if any, contractual terms governed discharge at each employer. Designing a survey instrument to achieve this goal was a substantial challenge. Contract terms may be either written or oral.\textsuperscript{125} There are a large number of documents — such as employee handbooks, application forms, offer letters, form contracts, individual contracts, and miscellaneous personnel forms — in which such terms might be contained. Different terms may apply to distinct groups of employees within one company. Finally, it is essential to distinguish carefully formal and informal employer policies that often may influence discharge decisions from legally enforceable contractual statements concerning discharge.

The results reported below incorporate several conventions that I have adopted to facilitate consistent interpretation of employers’ behavior. First, preliminary analysis revealed that, for essentially every firm in the sample, the terms governing discharge of all employees within each firm were identical.\textsuperscript{126} It thus was possible to make the unit of analysis correspond to the firm rather than to a firm/employee-group cell.

Second, the interviewers asked respondents to classify each contractual statement according to whether it provided for employment at will, enumerated specific reasons that were required for discharge, stated a general good cause requirement, or established a contract for a specific length of time. In order to simplify the analysis, I combined the enumerated reasons and good cause responses into a general just cause category and eliminated from the sample four educational institutions that reported using term contracts. The remaining categories represented in the final sample are (1) no contract language concerning discharge, (2) express at will, and (3) just cause.

Third, the survey focused on employers’ actual conduct, rather than their opinions about discipline and discharge. The interviewers asked whether a particular statement addressed discharge and then what specifically that statement said. Nevertheless, legal rules governing the

\textsuperscript{124} The Appendix provides further details concerning the sample, the survey instruments, and the administration of the survey.

\textsuperscript{125} Of course, a promise may also be inferred from conduct, see \textit{Restatement (Second) of Contracts} § 2 (1979), but it would be impossible by means of telephone interviewing to detect the subtle contextual signals that constitute such an implied promise. Moreover, in the employment context, courts generally do not enforce contracts inferred solely from conduct. Instead, they rely heavily on specific written and oral assurances of job security. \textit{See supra} part II.B.

\textsuperscript{126} The principal exceptions to this general rule were companies in which a few top executives had individually negotiated contracts, and educational institutions that had a tenure system for faculty and more conventional contract terms for nonfaculty positions.
enforceability of such statements differ widely by state.\textsuperscript{127} For the sake of analysis, I have assumed that if a respondent reported that a document required specifically enumerated reasons or established a general good cause requirement for discharge, then that employer intended to provide legally enforceable just cause protection.

Finally, although the survey collected data on employers' oral statements concerning discharge, I do not analyze those statements here. I doubt that the respondents were able to provide sufficiently complete and reliable information about oral statements to make such an analysis meaningful. With these assumptions in mind, we now can turn to the data.

Slightly more than one-half of all employers (52\%) contract explicitly for an at will relationship. About one-third (33\%) use no documents that specify the terms governing discharge. And more than one in seven (15\%) contract expressly for just cause protection.\textsuperscript{128}

The predominant method of contracting is the employee handbook (61\% of all employers). Just over one in ten companies (12\%) specify discharge terms on their employment applications. Very few employers communicate such terms in offer letters (5\%), and even fewer use form contracts (4\%).\textsuperscript{129}

Crosstabulations by state suggest that there is little apparent difference in the underlying rate of preference for just cause protection in liberal and conservative jurisdictions. In California, 13.1\% of respondents contract for just cause, almost identical to the rate for Virginia (14.9\%). This difference is not statistically significant at

\textsuperscript{127} For example, the Virginia Supreme Court requires a signed writing to enforce employee handbook promises. See Progress Printing Co. v. Nichols, 421 S.E.2d 428, 430 (Va. 1992). Of course, it is possible that some employers strategically offer just cause protection in unsigned writings in order to deceive employees into thinking that they have legally enforceable protection when in fact they do not. For what it is worth, the interview reports seem to suggest that employers offering just cause protection are no better informed about these highly technical aspects of the law than one might expect the average employee would be. In any event, the legal rules I propose would eliminate this uncertainty by enforcing any reasonably definite commitment to discharge only for just cause. See infra part IV.D.2.

\textsuperscript{128} Recall that in Virginia only those statements made in a signed writing will be enforceable. Progress Printing, 421 S.E.2d at 430. The survey instrument did not ask respondents to provide the facts that are necessary to determine whether an employer's handbook would satisfy this requirement.

\textsuperscript{129} So few employers reported using individually negotiated contracts and the data on the terms of those contracts was so incomplete that I eliminated them from the analysis. For a discussion of survey data on individually negotiated golden parachutes, see \textsc{Ward Howell International}, \textit{1983 Survey of Employment Contracts and "Golden Parachutes" Among the Fortune 1,000: An Update of the 1982 Survey} (1983).
ordinary confidence levels. Similarly, Michigan and Texas employers provide just cause at nearly identical rates of 15.8% and 16.7%, respectively. Aggregating the liberal jurisdictions of California and Michigan and comparing them to the totals for Virginia, Texas, and New York, again reveals virtually indistinguishable rates of 13.8% and 15.6%, respectively.\textsuperscript{130}

Analogous figures for the percentage of employers contracting explicitly for employment at will show a statistically significant difference between liberal jurisdictions (61.3%) and conservative ones (46.8%). Examining at will contracts by state, however, reveals that the percentage in liberal jurisdictions is higher, principally because Michigan employers are extremely likely to contract for employment at will (73.7%). There have been an unusual number of Michigan cases clearly inviting employers to include disclaimers in their written documents in order to avoid legal enforceability of policy statements.\textsuperscript{131} Perhaps these judicial suggestions have influenced Michigan employers’ contractual practices.

Crosstabulations by size suggest that employment contracting behavior varies systematically with the number of employees at a company. Small employers are somewhat more likely than midsize or large employers to contract for just cause (17.7%, compared to 12.9% and 12.5%, respectively).\textsuperscript{132} Furthermore, small employers are about twice as likely to have no documents providing terms governing discharge (45.8%, compared to 21.2% and 27.5%, respectively). Midsize and large employers have the highest propensity to contract expressly for employment at will (65.9% and 60.0%, respectively, compared to 36.5% for small employers). This last observation is roughly consistent with the exponential growth in the use of at will clauses that Sutton and Dobbin observed in their sample of firms with more than fifty employees.\textsuperscript{133} The figures for midsize and large employers also seem generally consistent with the BNA survey finding that 53% of their (relatively

\textsuperscript{130} None of these differences is statistically significant at standard confidence levels.

\textsuperscript{131} See Postic, supra note 17, at 369-77 (collecting cases).

\textsuperscript{132} I define small employers as those with fewer than 50 employees, midsize employers as those with 50 to 249 employees, and large employers as those with more than 250 employees. For the purposes of personnel policies, these size groupings distinguish small employers that often have no formalized personnel function, midsize employers that more often have personnel managers, and large employers that almost always have specialized managers and for which the cost of developing personnel policies can be spread over a larger number of employees. See also part V.B.2 (discussing economies of scale in providing just cause protection).

\textsuperscript{133} See Sutton & Dobbin, supra note 121 and accompanying text.
large) employer-respondents had added at will clauses to applications or employee handbooks.\textsuperscript{134}

Contractual behavior varies only slightly across three broad industry groups. The services group is somewhat less likely to have no documents concerning discharge, and slightly more likely to contract for just cause. The retail and wholesale trade group is more likely to have no documents and just slightly less likely to contract explicitly for employment at will. The mining, manufacturing, construction, and transportation group is about average in all respects.\textsuperscript{135} At finer levels of aggregation, the only systematic pattern by industry is that not one of the twenty-one law firms in the sample provides just cause protection.

Finally, contract choices do not seem to be influenced by whether the employer has any unionized employees. Employers with at least some union employees contract in roughly the same pattern (44.4\% at will, 44.4\% none, 11.1\% just cause) as those without unions present in the workplace (52.7\% at will, 32\% none, 15.3\% just cause). Moreover, because the sample includes only eighteen employers with union employees, these differences are not statistically significant.

\textbf{IV. Choosing a Default Rule}

This Part might well be called “Taking Default Rules Seriously” because its principal objective is to take seriously the problem of developing optimal default terms governing discharge for indefinite term employment contracts. As a matter of general principle, we should try to achieve our social policy objectives with default rules whenever possible. Default rules preserve the liberty of contracting parties to vary the state-provided terms if those terms do not suit their needs. Moreover, the parties’ ability to alter default terms strictly limits the potential social loss from choosing an inefficient default rule to the lesser of two amounts: (1) the cost to parties of contracting back to their desired rule and (2) the cost to parties of living with an undesirable default.\textsuperscript{136} Thus, choosing

\begin{itemize}
\item \textsuperscript{134} See \textit{BUREAU OF NAT’L AFFAIRS}, \textit{supra} note 120 and accompanying text.
\item \textsuperscript{135} Mining, Manufacturing, Construction, and Transport contracts 52.6\% for at will, 13.8\% for just cause, and 33.6\% none. Wholesale and Retail Trade contracts 46.7\% for at will, 13.3\% for just cause, and 40.0\% none. Services contracts 53.3\% for at will, 17.3\% for just cause, and 29.3\% none.
\item \textsuperscript{136} This limitation follows from the observation that whenever parties’ losses exceed the costs to contract out of the undesirable default rule rational parties will incur those costs and escape the cost of the undesirable default. Conversely, whenever contracting costs exceed the costs of the bad default, parties will live with the bad rule and avoid the contracting costs. For a similar observation, see Barry E. Adler, \textit{Finance’s Theoretical Divide and the Proper Role of Insolvency Rules}, 67 S. CAL. L. REV. 1107, 1148 (1994).
\end{itemize}
a default rule is a considerably less risky social decision than imposing a mandatory term.  

I begin this part of the analysis by applying the well-developed theoretical literature on majoritarian default rules. Next, I extend that literature by offering an empirical strategy for choosing a default rule and for determining the scope of application of a particular default term. I then critically examine Schwab's normative case for the life-cycle just cause default. Finally, I consider whether an information-forcing default rule would enhance the efficiency of employment contracting.

A. An Empirical Application of Majoritarian Default Theory

"Intention not otherwise revealed may be presumed to hold in contemplation the reasonable and probable. If something else is in view, it must not be left to implication." At least since Judge Cardozo penned this famous aphorism, the dominant judicial approach to contract defaults has rested on providing a set of rules that most parties would regard as reasonable in the circumstances. By stages, judges, and particularly legal scholars, have developed various theoretical elaborations on the meaning of reasonableness and also have attempted to provide a normative foundation for this approach to choosing default rules.  

137. I take up arguments for mandatory just cause at infra part V.  
139. Charles Fried, for example, grounds his "autonomy" or "will" theory of promissory enforcement on the principle that contract law enhances parties' individual freedom by giving them the power to create legally enforceable commitments to others. See CHARLES FRIED, CONTRACT AS PROMISE (1981). For a critical discussion of this theory, see David Charny, Hypothetical Bargains: The Normative Structure of Contract Interpretation, 89 Mich L. Rev. 1815, 1823 (1991). Ian MacNeil, Stewart Macaulay, Jay Feinman, and others champion a "relational" approach that demands, in MacNeil's words, a "rich classificatory apparatus" by means of which courts may discover the norms and practices immanent in the parties' relationship and in their relationship to society. See Ian R. MacNeil, Economic Analysis of Contractual Relations: Its Shortfalls and the Need for a "Rich Classificatory Apparatus," 75 NW. U. L. REV. 1018 (1981). For a careful critique of relational contract scholarship from an economic perspective, see Richard Craswell, The Relational Move: Some Questions from Law and Economics, 3 S. Cal. Interdisciplinary L.J. 91 (1993). Randy Barnett in turn promotes a "consent" theory of contract that counsels courts "to choose default rules that reflect the conventional or common sense understanding existing in the relevant community of discourse." See Randy E. Barnett, The Sound of Silence: Default Rules and Contractual Consent, 78 VA. L. REV. 821, 829, 906-11 (1992). For a comprehensive catalogue of Barnett's writings on the consent theory, see id. at 826 n.27. Whatever the merits of these diverse theories, I think it is fair to say that the central paradigm in contemporary contracts scholarship is the economic analysis of default rules. Indeed, even as he challenges the normative attractiveness of the economic approach to contract defaults, Barnett describes how "a new and powerful heuristic device," economic default rule theory, has "increasingly
The most successful of these efforts has been the economic theory of default rules — the central paradigm in contemporary contracts scholarship. In their 1977 article on liquidated damages, Charles Goetz and Robert Scott originated the default rule concept. Goetz and Scott observed that:

[flacing positive transactions costs . . . the legal system provides ready-made rules based on common assumptions about typical contracting behavior. These “off the rack” contract rules reduce the costs of exchange by specifying the legal consequences of typical bargains where the expected cost of explicit negotiation exceeds the utility derived from individualized exchange.]

The essence of this approach is its prescription to design default rules that “mimic the market” and thus to impute into contracts those terms that most parties in the relevant market would prefer. These generally applicable contract formulations not only save direct transaction costs, such as the time, effort, and expertise expended on negotiating and drafting agreements, but also reduce the risks associated with courts’


error-prone attempts to interpret individualized contractual expressions.142

The majoritarian default theory is, however, considerably simpler to state than it is to implement. A number of problems arise when a lawmaker attempts to determine what contract terms most parties would want. In high-stakes commercial litigation, it is common practice for the parties to call expert witnesses to testify concerning the relevant trade usages.143 But in more routine sales cases, it appears that courts often simply instruct the jury to determine, without the benefit of expert testimony, issues such as what constitutes a reasonable time for inspection or whether attempts to salvage goods were commercially reasonable.144 Both of these informal approaches to establishing prevailing practices rely on casual empiricism — in one case relying on the knowledge of industry experts and in the other on the intuitions of lay jurors — to provide reasonably inexpensive evidence of contractual norms.

In some circumstances, however, a more formal empirical strategy might be preferable. It could provide a firmer, more scientifically defensible foundation for establishing particularly important default rules, such as the terms governing discharge in indefinite term employment contracts.145 And rigorous statistical analysis of industry practices would reduce the risk that an expert's normative bias will unduly influence the ultimate outcome.146 Finally, a formal empirical approach can uncover patterns of contract practice that allow us to test theoretical arguments for particular default or mandatory rules.

In order to apply majoritarian default analysis to employment contracting, I first must clarify what sorts of norms should be eligible for incorporation into the law of contracts. The essential task is to discover

142. See Goetz & Scott, Expanded Choice, supra note 15, at 265 (elaborating broader view of transaction costs, including "error costs" that result when specifically negotiated contract terms impede mutually beneficial adjustment or those terms create opportunities for parties to exploit strategically any interpretive ambiguity). The cost of this greater interpretive certainty, however, is that courts often will fail to honor or may misinterpret parties' efforts to contract out of the default. An inevitable tension therefore exists between the benefits of generalized contractual formulations and the costs that those state-supplied formulations impose on parties with idiosyncratic needs. See id.


145. There is, of course, an important distinction between the statutory domain of commercial law and the common law of employment contracts. But normative arguments for majoritarian default rules do not depend in any way on the unique statutory framework that governs sales law.

146. See Craswell, supra note 139, at 102-04.
the terms that most parties would wish to have included in their contracts. A lawmaker thus must distinguish between what I shall call “informal norms” that the parties do not intend to be legally binding, and “formal norms” that the parties consider part of a binding contractual commitment. The terms “formal” and “informal” are linguistically imprecise, however, because parties, and particularly employers, may adopt highly formal policies and procedures while at the same time indicating clearly that they do not intend to create a legal right for employees to sue to enforce those formal policies. For example, it is common practice for employers to adopt bureaucratic and formalized disciplinary policies in order to constrain their supervisory agents, even as they contract expressly with employees for an at will relationship. Employers thus reasonably might argue that, even without a disclaimer of contractual effect, the existence of such formal policies concerning discharge is not a valid signal of an intent to be legally bound.

From the perspective of employees, however, formal policies and procedures surely must seem to establish a binding commitment unless they are accompanied by a clear and prominent disclaimer. We must not lose sight of the fact that employment is a mutual exchange of labor services for compensation. Labor economists model the terms of labor contracts as the product of a market interaction between firms’ demand for labor services and individuals’ supply of those services. In addition to the more commonly analyzed price (wage) and quantity (hours) terms, the typical labor contract also provides for benefits such as health insurance, pension rights, and vacation pay. Most employment contracts also include express terms governing discharge.

Employees’ demand for just cause protection, like their demand for higher wages and benefits, is seldom expressed directly in individual negotiations over contract terms. Instead, workers are likely to choose among potential employers in part on the basis of their policies concerning discharge. To assess the demand for legally enforceable just cause protection, we must adopt the employee’s perspective on these contract terms. An employer that perceived a demand for just cause

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147. This usage is becoming standard in the literature. See Jody S. Kraus, Legal Design and the Evolution of Commercial Norms 31 (University of Virginia Legal Studies Workshop draft, 1994) (unpublished manuscript, on file with the author). As I discuss in the text, it nonetheless may produce confusion in some contexts.


149. According to my survey results, about two-thirds of employers contract expressly for terms governing discharge. See supra text accompanying note 126.

150. See also infra part V.A.3 (discussing signaling problem that arises uniquely in individual negotiations for discharge protection).
protection might provide (supply) documents that seemed to guarantee such protection while at the same time knowing that peculiar legal doctrines would make those guarantees unenforceable.\textsuperscript{151} The market equilibrium thus would depend on asymmetric knowledge of relevant legal doctrines.\textsuperscript{152} If employees were fully informed, however, they might well be less likely to work for these employers, and the employers would be forced either to raise wages or to offer legally enforceable just cause protection. With symmetric information, some or perhaps all of the deceptive employers would have to contract for just cause. Thus, we can obtain an upper bound on the number of employers who would offer just cause protection in the symmetric information equilibrium by assuming that all employees receiving apparent, but unenforceable, protection would demand enforceable protection, and that all employers offering apparent protection would feel compelled to offer enforceable protection.\textsuperscript{153}

It is also essential to decide how to interpret the behavior of employers who choose not to contract expressly for terms governing discharge. These employers may have investigated the default rule in their jurisdiction and concluded that it was a desirable contract term. In that case, the failure to contract around the default rule should be counted as an expression of preference for the default. Alternatively, employers may find the expected cost of investigating the default rule and drafting appropriate contract language exceeds any expected benefit from acquiring the necessary information.\textsuperscript{154} In these circumstances, the absence of express terms governing discharge simply indicates that transaction costs, broadly defined, have made contracting expressly for a discharge term unprofitable. This behavior conveys no information about these employers' preferences concerning the default rule or any alternative rules governing discharge.\textsuperscript{155}

The survey data on employment contract practices permit me to determine the majoritarian default rule for indefinite term employment

\begin{itemize}
\item \textsuperscript{151} See, e.g., Progress Printing v. Nichols, 421 S.E.2d 428, 430 (Va. 1992) (requiring signed writing to enforce employee handbook).
\item \textsuperscript{152} See infra part IV.D (discussing arguments for information-forcing rules).
\item \textsuperscript{153} It is also quite possible that few employers know these technical rules either. Interview reports suggest that a nontrivial number of employers do not know the law. See supra note 127.
\item \textsuperscript{154} Such parties also face the significant risk that courts will disregard their individualized contract terms. See Goetz & Scott, Expanded Choice, supra note 15, at 290-93.
\item \textsuperscript{155} Strictly speaking, under the assumptions in the text, the decision not to contract reveals the employer's belief concerning the relevant expected values. But if the employer's belief rested on the general assumption that courts will adopt commercially reasonable rules, then it would be circular to infer that a particular rule was correct simply because employers believed that most default rules are efficient.
\end{itemize}
contracts. Assuming first that those who do not contract prefer the prevailing default rule, the revealed preference of market participants is overwhelmingly for the at will contract. A mere fifteen percent of employers contract expressly for just cause. Thus, by more than a five-to-one margin, employers either contract expressly for employment at will or choose to adopt the prevailing at will default. If we adopt the alternative assumption that noncontracting employers are expressing no preference about the existing default rule, then employment at will remains the preferred contract arrangement by roughly a three-to-one margin. The available empirical evidence thus appears to provide strong support for the prevailing default rule of employment at will.\textsuperscript{156}

\textbf{B. A Behavioral Model for Selecting Default Rules}

But the analysis should not begin and end with determining the single rule that a majority of all market participants prefer. Just as antitrust law requires courts to discover the extent of the relevant market before they can decide whether a particular practice or agreement has a tendency to monopolize that market,\textsuperscript{157} majoritarian default theory demands careful inquiry into the scope of application for each default rule. Conventional solutions to this problem in commercial law rely on the informal empirical knowledge of expert witnesses or lay jurors to identify relevant patterns of conduct.\textsuperscript{158} This approach is a reasonably inexpensive means to identify contractual norms in particular geographic regions, industries, or other subgroups of parties.

Such casual empiricism is well-suited for the task.\textsuperscript{159} Experienced market participants can rely on their existing knowledge to offer testimony about prevailing practices. Using such knowledge gained in normal commercial pursuits economizes significantly on the resources needed to establish industry norms. But the opinions of such experts undoubtedly are tainted to some extent by their own preferences concerning practices. According to the psychological theory of cognitive

\textsuperscript{156} In part II, I showed that the default rule is not life-cycle just cause and that there is significant jurisdictional variation in the strength of the at will presumption. The survey data reveal a strong preference for the least restrictive standard for indefinite term contracts—an express at will relationship.

\textsuperscript{157} Economic expert witnesses often testify concerning the issue of market definition as well as on the monopolization issue. Sometimes these experts use empirical studies to supplement their theoretical arguments.

\textsuperscript{158} See supra notes 143-45 and accompanying text.

\textsuperscript{159} For strong endorsements of casual empiricism, see Barnett, supra note 139, at 907-08; Ian R. Macneil, \textit{Efficient Breach of Contract: Circles in the Sky}, 68 VA. L. REV. 947, 953 n.25 (1982) ("'Casual empiricism' is not a pejorative in my vocabulary; indeed, when used by wise people its other name is wisdom.").
dissonance, one important cognitive distortion is the fact that we tend to remember most clearly evidence that confirms our own view of the world.\textsuperscript{160} Second, experts may not have access to a broad enough sample of contractual relationships to be able to identify patterns that span geographic or industrial boundaries. Finally, experts may fail to identify complex patterns that depend on the simultaneous interaction of several variables. The psychological prominence of particularly salient characteristics may mask the effects of other factors that play a greater causal role.

The survey data presented in this Article allow me to test whether any particular subgroup of contracting parties has revealed a distinctive preference for different terms governing discharge. This data set also makes it possible to estimate a formal statistical model of contractual choice.

Consider first the crosstabulations by size and industry. Again assuming that failing to contract for discharge terms conveys no information about parties' preferences, the express contractual choices of employers in all size classes and in all industry cells reveal a strong preference for an at will contract.\textsuperscript{161} By a two-to-one margin, small employers contract for at will, while midsize and large employers contract for at will by an even larger five-to-one margin.\textsuperscript{162} Within broad industrial groups, the margin of preference for at will contracts is never less than three-to-one.

An interesting pattern emerges in considering the data on contract choice by employers within one-digit standard industrial classification (SIC) sectors. In the mining and construction sector, the percentage of just cause contracts (26.7\%) approaches the percentage of at will contracts (33.3\%). For no other one-digit SIC industry is the ratio of at will to just cause contracts significantly less than two-to-one. One might be tempted to conclude from this evidence that the majoritarian default rule for mining and construction is a close call. There are, however, two reasons to be cautious about this conclusion. First, the sample size for this cell is quite small (only fifteen employers). As a result, a random variation

\begin{quote}
\textsuperscript{161} The assumption that noncontracting parties express no preference about the default maximizes the chance that the analysis will reveal a preference for just cause because the alternative assumption counts the failure to contract as a "vote" for the prevailing default rule of at will. See also infra notes 166-69 and accompanying text (discussing third alternative based on the assumption that prevailing default in some jurisdictions approximates life-cycle just cause).
\textsuperscript{162} For small employers the figures are 36.5\% (at will) to 17.7\% (just cause); midsize employers contract 65.9\% (at will) to 12.9\% (just cause); large employers contract 60.0\% (at will) to 12.5\% (just cause).
\end{quote}
in the choice of even one of these employers would make the ratio between at will and just cause equal to the two-to-one level found for other industries. Second, other characteristics of these mining and construction companies may influence simultaneously their contractual behavior. Simple cross-tabulations are incapable of distinguishing such effects.

There are, however, formal statistical methods available to determine simultaneously the influence of multiple factors on contractual choice. For situations in which the choice variable is a continuous variable such as price or quantity, multiple regression analysis is the appropriate technique. But contractual choice is a discrete variable that takes on only one of three values in this sample. Such a categorical dependent variable requires a nonlinear statistical model known as multinomial logit.

A multinomial logit model of contract choice shows that only size appears to influence significantly the probability of choosing an at will contract as opposed to no contract. Consistent with the cross-tabulation results, location in Michigan also significantly increases the probability of choosing an express at will contract. These results are presented in Table 1.
## Table 1

<table>
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<tr>
<th>Variable</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
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<td><strong>cause</strong></td>
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<td>(0.091)</td>
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Coefficients reported in columns labeled “will” compare the probability of choosing not to contract to the probability of choosing an at will contract; columns labeled “cause” compare the probability of choosing not to contract to the probability of choosing a just cause contract. Model 3 and Model 4 were estimated on data for the 175 employers in California and Virginia only. Two-tailed t-statistics are reported in parentheses below each coefficient.
An alternative model of contract choice focuses solely on those employers that contract expressly for discharge terms. For this dichotomous choice between at will and just cause contracts, a simpler logistic regression framework can be used. The results of estimating a logistic model on these data are quite similar to the results of the multinomial logit analysis. Only the midsize and large firm variables are consistently significant, and both groups of employers are more likely to contract expressly for at will than the reference category of small employers. In addition, one subgroup of manufacturing employers (SIC = 3xxx, primarily composed of machinery manufacturing companies) is significantly more likely to contract expressly for at will.

The logistic regression model also can be used to predict what type of discharge terms noncontracting parties would be most likely to prefer. The procedure begins by estimating the logistic model on the sample of employers that contract expressly for terms governing discharge. Because the survey data include identical information on the characteristics of noncontracting parties, I can use these values along with the estimated parameters of the model to compute a predicted contract choice. Such a procedure predicts that none of the noncontracting parties would choose a just cause contract.

The estimated equations, however, explain a fairly small proportion of the variance in contract choice. Thus, the observed incidence of just cause protection is essentially random with respect to the observable variables. Smaller firms have a slightly greater tendency to contract for just cause, but in no size class or industry cell does the observed or predicted incidence of just cause even approach a majority of firms.

As a matter of social policy, these results support the current uniformly applicable at will default. Careful statistical analysis of this sample does not reveal any observable variables on which lawmakers should condition the default terms governing discharge. This is not to say that no refinement of these results is possible. The survey was exploratory and is based on a fairly small sample size. A larger follow-up study might reveal patterns of preference that remain statistically indistinguishable in the present data.

C. Latent Demand for Life-Cycle Just Cause

The goal of the majoritarian default theory applied in the last two sections is to minimize the total transaction costs of contracting. But just as selecting the wrong default rule can increase transaction costs, high transaction costs also could prevent parties from contracting for an

163. See Appendix part C.
efficient term. In particular, Stewart Schwab argues that the life-cycle default is sufficiently complex that employers find it too expensive to devise the necessary contract terms. If this were so, then a life-cycle just cause default might be justified on the ground that it is cheaper to opt out of such a rule than to opt into it. And the fact that none of the survey respondents uses such contracts only proves that individual employers did not want to bear the cost of developing such complex terms. According to this complexity argument, there is a latent demand for life-cycle just cause that a state-provided default term could satisfy.

Recall that the life-cycle rule has three basic elements. Together they create a just cause regime that varies in stringency across the career. Although Schwab discusses the economic good faith standard solely as a constraint on discharging midcareer workers, this lowest level of scrutiny must logically apply to all workers regardless of their job tenure. For “recent movers” — those early career employees who have incurred substantial moving costs or quit a good position to take a new job — the life-cycle default would provide an extra measure of protection. Employers must give recent movers “a good faith opportunity to perform [their] duties to the satisfaction of [their employer].” A subset of early career employees thus receives what amounts to just cause protection. Finally, the rule protects late career employees against discharges that breach their respective employers’ implicit commitment to retain them until retirement. As I explain below, the life-cycle protection for late career employees imposes a somewhat more stringent requirement than conventional understandings of just or good cause for discharge.

My survey data reveal a pattern of contract choices that is inconsistent with the argument that there is a latent demand for life-cycle just cause. First, if a significant proportion of employers wished to offer life-cycle protection, we should expect some fraction of them to choose

164. See Schwab, supra note 3, at 53.

165. The economic good faith standard is far narrower than a general good cause requirement because it requires a plaintiff to offer evidence that the employer has failed to pay for specific past services. This demanding proof requirement dramatically limits the potential scope of the rule. In practice, the standard applies principally to situations in which the literal terms of a sales commission contract permit the employer to avoid paying a substantial amount of commissions by discharging the employee before those commissions are due. See, e.g., Fortune v. National Cash Register Co., 364 N.E.2d 1251 (Mass. 1977). Good faith cases involving discharge to prevent a pension from vesting are preempted and must be brought under ERISA § 510. See Ingersoll-Rand Co. v. McClendon, 498 U.S. 133 (1990).

a just cause contract.\textsuperscript{167} Offering express just cause protection increases the reliability of the employer's commitment to a long-term employment relationship.\textsuperscript{168} For some employers then, express just cause will be closer to their desired discharge term than the prevailing at will default or the alternative of an express at will contract. Second, recall Schwab's claim that life-cycle just cause is underprovided because of its complexity. Recall also that California law comes closer than any other jurisdiction to offering life-cycle just cause as a default rule. California courts are sensitive to the problems of recent movers; they have expressly relied on longevity of service to support implied just cause protection and seem willing to protect all employees with an economic good faith standard. In contrast, Virginia courts recognize none of these theories and adhere strictly to the traditional at will default.

Employers in California should, therefore, be inclined to contract out of the state's comparatively attractive default rule at a lower rate than will Virginia employers. Virginia firms that fail to contract receive that state's stringent, and thus comparatively unattractive, at will default. In contrast, California employers get a more relaxed version of the at will presumption that more closely approximates the life-cycle just cause default. The multinomial logit results, however, show no statistically significant relationship between state and contractual choice, other than the extraordinary propensity of Michigan employers to contract expressly for at will.\textsuperscript{169} Moreover, simple crosstabulations show that, although California employers are slightly less likely (by a statistically insignificant margin) to contract expressly for just cause (13.1\% to 14.9\% for Virginia), they are also substantially more likely to contract expressly for an at will relationship (57.4\% to 49.1\% for Virginia). This latter result directly contradicts the empirical implications of the argument for a life-cycle default.\textsuperscript{170}

\textsuperscript{167} Perhaps those employers with more easily verifiable monitoring techniques will be most likely to offer just cause contracts. See Robert M. Hutchens, \textit{Seniority, Wages and Productivity: A Turbulent Decade}, 3 J. ECON. PERSP. 49 (1989).

\textsuperscript{168} Employers might also consider offering a renewable contract for a specific term. A significant problem with this approach is that renewable term contracts expose employees to the risk of nonrenewal. Moreover, standards for discharge under term contracts often closely resemble the protection afforded by an indefinite term just cause contract. The survey data reveal that very few employers use term contracts of any kind. See supra text accompanying notes 126-28.

\textsuperscript{169} This empirical fact is also inconsistent with the life-cycle theory because Michigan law is also closer to the life-cycle model than is Virginia law. In essence, Virginia courts are hostile to employee claims while Michigan courts are at least willing to entertain arguments based on definite and specific assurances of job security.

\textsuperscript{170} Of course, if I am wrong about Schwab's positive theory, and courts currently apply a life-cycle just cause default, then Schwab could point to the 33\% of employers
The theoretical case for life-cycle protection also depends on characteristics of employment — the need for firm-specific human capital and the difficulty of monitoring employee performance — that differ systematically across occupations and industries. Thus, the revealed preference for just cause should also vary by occupation and industry. The data reveal a remarkable uniformity across occupations within individual employers and across industries, with no statistically significant pattern emerging. Thus, no support exists for this empirical implication of the life-cycle theory.

In addition to these empirical problems, the complexity argument for a life-cycle just cause default depends on several questionable theoretical conjectures. First, Schwab contends that it would be too costly for employers to draft contractual language extending life-cycle just cause protection. In considering the problem of drafting a life-cycle just cause term, however, it is important to ask not simply whether it would be costly for employers to draft such a clause. The case for judicial or legislative creation of a life-cycle default requires that we compare these private costs of individualized contracting to the public and private costs of formulating and applying such a contract default.

A critical variable in the life-cycle theory is the crossover point between midcareer and late career. The life-cycle rule conditions important employment rights on the transition from one stage of the career to the next. It seems extraordinarily unlikely that courts can obtain adequate information to determine, even roughly, when a long-term employee’s productivity dips below his or her current wage. If courts were to try to generalize about all employment relationships, the general rule they would devise would be either precise but ill-fitting for many employers or flexible but so uncertain that most employers would contract expressly for the more definite at will and just cause rules.171

that choose not to contract expressly for discharge terms as an endorsement of the life-cycle theory. For reasons discussed more fully in the text, I am skeptical that noncontracting employers are expressing a preference for life-cycle just cause. It seems far more likely that these disproportionately small employers simply have chosen not to become informed about the specifics of prevailing law and the legal requirements for varying the default. Moreover, the theoretical argument for the life-cycle rule applies poorly, if at all, to firms in the smallest size class (those with fewer than 50 employees). See infra notes 176-80 and accompanying text.

171. Schwab makes a virtue of this vice by arguing that an uncertain crossover point combats the problem of opportunistic firings just before the transition from midcareer to late career and therefore from at will to just cause. See Schwab, supra note 3, at 53-54. But his argument in favor of uncertainty presumes both that uncertainty can effectively deter such firings and that employers will tolerate uncertainty rather than contracting expressly for employment at will. I suspect that both assumptions are false. First, employers would surely be able to discover a point in workers’ careers at which
Second, as difficult as it is to identify the productivity crossover points, it is even more difficult to define what just cause would mean under a life-cycle default. The models on which Schwab relies all envision employers firing workers who are "shirking" in unverifiable ways at any stage of their careers.\textsuperscript{172} As Alan Schwartz has observed, however, parties prefer not to condition contractual rights and obligations on unverifiable information because third-party enforcement becomes impossible.\textsuperscript{173} To paraphrase Schwab's formulation, the life-cycle rule protects late career workers against being fired for "slowing down" or "failing to pull their weight" or "being paid more than they are worth."\textsuperscript{174} But each of these vague statements also could characterize a late career employee who has breached his or her side of the implicit contract by "shirking" under the cover of a life-cycle just cause standard for discharge. Thus, the life-cycle rule must incorporate some limit on the extent to which current compensation exceeds current productivity. It is difficult to imagine how a judge or jury could possibly determine how unproductive an employee must be to warrant firing in the late career period. In point of fact, the optimal implicit life-cycle contract also would condition the extent of late career protection on the productive surplus a given employee had generated during the midcareer.\textsuperscript{175} Judicial inquiry into such subtle and context-specific factors would probably be no better than an expensive method for generating random outcomes.

Third, the argument for life-cycle just cause is a story about the dangers of delayed compensation. It is therefore only applicable to the limited set of employment relationships in which delayed compensation is likely or desirable. The implicit life-cycle contract arises because of the need to invest in firm-specific human capital or because of difficulties

\textsuperscript{172} See, e.g., Hutchens, \textit{supra} note 167, at 55.
\textsuperscript{173} See Schwartz, \textit{supra} note 41, at 314; see also Morris, \textit{supra} note 2, at 682-83, 762-63 (making similar argument in defense of employment at will).
\textsuperscript{174} See Schwab, \textit{supra} note 3, at 51 (discussing \textit{Murphy v. American Home Prods.}).
\textsuperscript{175} See, for example, the models discussed in Hutchens, \textit{supra} note 167, at 54-59.
monitoring workers. My search of the labor economics literature concerning human capital produced surprisingly little concrete evidence that would permit one to identify those occupations or industries for which firm-specific human capital is particularly important or for which monitoring is unusually difficult. Despite this lack of evidence, most economists seem to agree that firm-specific human capital is only, or at least principally, important in comparatively large firms. It also seems likely that monitoring problems are greater for larger employers. Contrary to the implications of the life-cycle theory, the survey data show that large employers are significantly more likely to contract expressly for an at will relationship.

Finally, the usefulness of the implicit lifetime contract depends on the existence of a device by which the career can be ended. Before statutory prohibition, mandatory retirement at a specific age served this function. In large firms that offer employees defined benefit pension plans, an actuarially unfair pension can induce workers to leave the firm at normal retirement age. Few small employers offer defined benefit plans and they are unable, therefore, to provide the necessary incentive to induce late career employees to retire. Moreover, an implicit, or even an explicit, promise of lifetime employment from a small employer has far

176. The latter story is the efficiency wage model. The former is a human capital model. Labor economists have developed a class of models which predict that firms will offer their employees delayed compensation. Relying on this economic scholarship, Schwab argues that workers are particularly vulnerable to opportunistic discharges when this delayed compensation comes due. There are a variety of explanations for why employers might wish to offer delayed compensation. For a readable survey of this literature, see Hutchens, supra note 167; see also George A. Akerlof & Janet L. Yellen, Efficiency Wage Models of the Labor Market (1986).

177. One interesting strategy for identifying levels of firm-specific human capital would be to compare the wage loss of workers who lose their jobs at a particular age and job tenure across occupations and industries. The wage loss would provide an indirect measure of firm-specific human capital, or at least of the relative importance of firm-specific human capital in various occupations and industries. An important confounding effect would be the presence of industry-specific human capital that might become worthless in a declining industry. Thus, steelworkers might have had principally industry-specific rather than firm-specific human capital.


lower value to an employee because the expected probability of survival for firms varies directly with size. Thus, if we observe primarily small firms failing to contract around the supposed life-cycle default, then it is a fair presumption that they are not doing so in order to take advantage of that default, but rather because it is not worth the investment to become informed about the rule and to deliberate about the issue. The data show that the group of employers that have failed to contract expressly for discharge terms is disproportionately composed of small employers that are unlikely to find the life-cycle default an efficient contractual arrangement.

In Part II, I showed that the character of any oral or written assurances of job security coupled with the legal and political climate in the relevant jurisdiction predict the outcome of contemporary employment contract cases far more accurately than the life-cycle theory. On normative grounds, the best that can be said for the life-cycle default is that it may be worth adding it to a publicly provided menu of pre-defined terms available for parties to opt into. The life-cycle rule is, however, unlikely to be a majoritarian default rule in any identifiable segment of the labor market.

D. Information-Forcing Default Rules

For most parties and in most situations, a simple majoritarian default maximizes the private value of contractual relations at the lowest possible social cost. But parties sometimes benefit when the state supplies a term that induces them to share information. An “information-forcing” default is designed to overcome problems of asymmetric information by requiring the better informed party to share his or her private information. Intuitively, the court adopts a default rule that favors the uninformed party. In order to reach his or her desired contract terms, the informed party must eliminate the informational asymmetry, thus permitting a more efficient exchange.

This Section first develops and then rejects the argument for an information-forcing just cause default. It also analyzes how the

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181. Recent empirical research using panel data on individual establishments in the United States and Canada has confirmed the commonly held intuition that smaller firms are more likely to shut down than are larger firms. See John R. Baldwin, The Dynamics of Industrial Competition: A North American Perspective 28, 46 (1995) (finding that rate of “closedown exit” is 47% for smallest firms and 19% for largest ones; the rate for exit by “plant closing” is 37% for smallest firms and 4% for the largest ones).

182. See Goetz & Scott, Expanded Choice, supra note 15, at 286.

183. See sources cited supra note 15.
information-forcing argument applies to the law of employee handbooks. This argument supports a rule of liberal interpretation coupled with willing enforcement of clear and prominent disclaimers.

1. JUST CAUSE AS A DEFAULT

The information-forcing argument for a just cause default relies on the observation that at will employees may be unaware that they have no legally enforceable protection against unjust discharge. Perhaps pervasive state and federal regulation of the employment relationship leads unsuspecting workers to believe that they have such protection. Alternatively, workers might infer from their employers’ informal statements concerning the grounds for discharge, coworkers’ statements about job security, or personal observation of prior discharges, that employees are only discharged for just cause. Employees untutored in the nuances of implied contracts may not understand that these signals of protective practices generally do not give them legal protection against discharge.184

If workers incorrectly assume that discharge without cause is illegal, then they will fail to demand contractual assurances of job security or to seek out employers offering express just cause protection. A market equilibrium based on employees’ misperceiving their legal status is potentially inefficient. Employees may demand, and employers may pay, wages that are too low by an amount equal to the value that employees would derive from having a just cause term in their contract. And contract terms may exclude inefficiently a just cause term because employers have no incentive to provide such a term to uninformed workers.

The theory of information-forcing defaults prescribes a simple solution to this informational asymmetry. Courts should adopt a default rule of just cause. Employers then would need to contract expressly for a return to the at will regime. Consequently, employers would be forced to inform workers of their at will status through the device of an express at will contract.185 A default rule of just cause term could also impose adequate procedural requirements for opting out of the default, thereby ensuring that all workers become aware that they do not have legal protection against discharge.186

184. See supra part II.B (showing that definite and specific assurances are required).
186. Employee handbook cases show how courts have responded to these concerns. Some cases turn on the existence of a written confirmation of at will status. Others
It is fair to ask, however, whether many workers see matters this way. Employees might equally well underestimate the extent of legal protection they have against discharge. For example, an extremely small proportion of those employees who think they have suffered sex or race discrimination bring legal actions against their employers. One possible interpretation of this empirical fact is that employees typically choose not to rely on potentially available legal rights. They might doubt that litigation is an effective vehicle for redressing perceived harms. On the other hand, many nonunion workers will have experienced discharge themselves or have friends who have been discharged, giving them an opportunity to discover the actual extent of legal protections that are available.

Even if some workers remain uninformed in the face of these experiences, market pressure would tend to eliminate their ignorance. Employers must compete at the margins for the same workers. An employer that recognized these workers' lack of knowledge would have an incentive to publicize its own legally binding just cause policy. Most employers, however, do not pursue such a policy, from which one might infer that legally enforceable just cause protection is not worth its cost. Prospective employees do not perceive a value that equals or exceeds the cost to employers from having their discharge decisions subject to additional legal scrutiny.

Demand that this important term be prominent. Courts also could follow the model of the Uniform Commercial Code provisions concerning the disclaimer of the implied warranty of merchantability and require specific, standard linguistic formulations of the statement of at will status. Finally, a court concerned about the dangers of unread boilerplate could require that the employee separately initial the clause.

A direct test of these competing theories could be performed. Workers at nonunion firms whose employment contracts are unquestionably at will could be asked whether they thought they had legally enforceable protection against unjust discharge.


One possible response to this market pressure argument would be the claim that employers engage in a conspiracy of silence to keep workers uninformed about their legal status. Ignoring for the moment the serious antitrust implications such a conspiracy would have for firms, it is difficult to believe that employers would be able to enforce such a labor market cartel. The individual gains from defection could be quite high. Moreover, the cartel would have to be enforced across industry lines. The lack of industrial cohesiveness or effective enforcement devices seems likely to doom such a conspiracy to failure.

An alternative formulation of the argument is the claim that all employers benefit from workers' ignorance since workers think that they are protected while employers need
My survey of employment contract practices is not the most direct approach to empirically testing this theory of informational asymmetry. But the argument for a just cause default implies that when employees are well-informed, employment contracts will include the optimal discharge term. Thus, if just cause protection is underprovided because of an informational asymmetry, we should expect legally well-informed employees to contract for just cause at a higher rate than uninformed employees.191

The survey data provide no support for this empirical implication of the argument for a just cause default. First, it would be surprising if employees were equally uninformed across all industries. But there is no discernible tendency in these data for specific industries to be more or less likely to offer just cause protection. Second, one might expect employees in some occupations to have better information about their legal status than employees in other occupations. Again, however, one of the most striking features of the data is that contract terms are typically uniform for all employees at a given employer. Thus, middle managers and janitors, engineers and manufacturing operatives all work under identical

not bear the cost of that protection. No one makes legal protection an issue since the misperception benefits the informed parties. This is an exceedingly fragile equilibrium. If even a small proportion of workers are informed through experience or simply because they care more about the issue, then employers will have an incentive to fashion contract terms to appeal to these informed parties. See Alan Schwartz & Louis L. Wilde, Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis, 127 U. Pa. L. Rev. 630 (1979). The equilibrium thus will unravel. For a discussion of informational and strategic reasons that informed parties may not emerge in the labor market, see infra part V.A.3.

191. This would not be a good test if informed workers are always infra-marginal. But this claim seems inherently implausible. It also is directly contrary to the results derived in Schwartz & Wilde, supra note 190, concerning the effect a subset of active searchers has on a competitive market for contract terms. In that model, the few searchers operate at the margin to ensure that the equilibrium contract terms reflect the preferences of the fully informed consumers. But the claim that a few informed parties can drive the market equilibrium toward the full information equilibrium depends heavily on the assumption that sellers (or employers) cannot discriminate in making contract offers between informed and uninformed parties. If sellers (employers) can identify informed buyers (employees), then the market equilibrium will include two distinct contracts, one for the informed parties and another for the uninformed. Another possible equilibrium might involve informed workers seeking out companies with protective policies while uninformed workers distribute themselves randomly across all employers. There thus could be two types of firms, one offering favorable contract terms and attracting a disproportionate share of informed workers, the other offering an at will contract and attracting only uninformed workers. In theory, such an equilibrium could be sustained so long as all firms make enough to stay in business and no one gains by taking or offering the contract for the other type of worker or firm. Only currently unavailable empirical evidence can confirm or refute this hypothesis.
contractual terms governing discharge. Finally, despite the fact that law schools no longer require students to study agency law, beginning law firm associates must surely know that employment at will is the default. The data reveal that none of the law firms in the sample offers a just cause contract. Thus, employers contracting with these well-informed employees nevertheless exhibit a strong preference for the prevailing at will regime.

2. THE LAW OF EMPLOYEE HANDBOOKS

Although the information-forcing argument does not provide a convincing rationale for adopting a just cause default, it shows how courts should design rules for interpreting employee handbooks to reduce the chances that those handbooks will misinform employees about their legal status. The survey data reveal that handbooks are by far the most important method by which employers communicate the details of their discharge policies to employees. Courts, therefore, will often have to determine whether disciplinary procedures and standards of conduct contained in handbooks should be given legal effect.

An information-forcing rule for employee handbooks involves two complementary elements. First, because employers drafting handbooks are in a better position than employees to avoid misunderstandings, courts initially should construe handbook provisions liberally in favor of employees. Statements that a reasonable employee might read to impose limits on an employer's discretion to discharge without cause should be enforced as contractual commitments. Furthermore, courts should essentially ignore the formal requirements of offer and acceptance, concentrating instead on whether the employer has distributed the handbook to a group of employees of which the plaintiff is a member.

192. There is also no discernible connection between the ratio of skilled to unskilled workers and the likelihood of contracting for just cause.
193. See supra note 127 and accompanying text.
194. The employment contract case law supports this observation. The vast majority of contract claims challenging discharges rely, at least in part, on employee handbook provisions that allegedly require just cause for termination. See supra part II (citing and discussing many cases).
195. Courts in Michigan, for example, now analyze handbook cases first according to ordinary contractual principles and then under a "legitimate expectations" theory. See, e.g., Rood v. Gen. Dynamics, 507 N.W.2d 591, 598, 606 (Mich. 1993). This distinction seems to produce more confusion than insight. See id. at 605 ("although we find in part B(2)(b) that GDLS's written policies and procedures could reasonably give rise to legitimate expectation of just-cause employment, we do not find that these policies and procedures evidence a clear intention on the part of GDLS to create a contractual just-cause employment relationship"). It would be preferable to develop a unified law for
These pro-plaintiff rules impose the burden of clarifying the legal effect of an employee handbook on employers — the party best able both to investigate the law and to control the content of the relevant documents.

The second element of the optimal rule follows from the first. If employers must bear the burden of clarifying their contractual intent, then courts must be prepared to honor that intent when employers signal it with sufficient clarity. In the context of employee handbooks, these signals ordinarily take one of two forms. Such documents often include a disclaimer of contractual effect — a clause providing that the terms of the handbook do not form a contract. Many other handbooks include an express confirmation of at will status. Both types of clauses should be enforced. Courts should, however, require that such clauses are sufficiently clear and prominent to inform a reasonable employee that he or she has no contractual protection against discharge.

Existing case law in many jurisdictions reflects precisely this approach to employee handbooks.¹⁹⁶ Thus, the information-forcing theory is useful both as a positive explanation and a normative argument for current practice.

E. Two Imperfect Empirical Analogies

My majoritarian default analysis infers the optimal terms governing discharge from the revealed preferences of market participants. This Section examines two alternative strategies. The first shifts our attention from the nonunion sector to consider contract terms routinely included in union collective bargaining agreements. The second approach rests on the observation that other industrialized countries have legislation requiring just cause for discharge. Neither analogy provides an adequate empirical foundation for abandoning the majoritarian at will default.

I. THE UNION ANALOGY

One of the many distinguishing features of union employment is the fact that virtually all collective bargaining agreements include just cause protection. Many commentators have argued that this empirical fact about union contracts reveals the term governing discharge that most employees would prefer more accurately than does evidence of nonunion contract enforcing employee handbooks that incorporates a publication standard in lieu of offer and acceptance doctrine and that establishes the perspective of a reasonable employee as the interpretive benchmark for identifying enforceable handbook provisions.

¹⁹⁶. *See supra* part II (discussing cases).
terms such as my survey data. If this argument is well-founded, then courts should, at the very least, supply a default term of just cause.\textsuperscript{197}

Proponents of the union analogy base their argument on a comparison of the mechanisms by which union and nonunion contract terms are determined. Douglas Leslie, for example, contends that workers have a strong preference for just cause protection that they only are able to express when they have a collective mechanism for doing so.\textsuperscript{198} Unions thus play a critical role in aggregating the preferences of their members. Although nonunion employers set contract terms in a competitive labor market according to the preferences of the marginal supplier of labor services, unions use ostensibly democratic processes that instead privilege the preferences of the median voter. The collective bargaining process effectively empowers inframarginal workers whose preferences were not formerly taken into account in determining the equilibrium contract terms.\textsuperscript{199} If these inframarginal workers systematically value just cause protection more highly than do marginal employees — who may be younger, more transient workers — then the terms of collective bargaining agreements will more faithfully reflect the aggregate preferences of all workers than do nonunion employment contracts.

But precisely the institutional differences that make the union analogy persuasive for its proponents prove, on further analysis, fatal to the argument. The analogy requires us to assume that both union and nonunion employment and employees are similar. But if an individual union employee transported to a nonunion workplace would not prefer just cause, or if union and nonunion employees differ systematically in

\textsuperscript{197} Arguments in support of mandatory rules must be considerably weightier than arguments for defaults because the consequences of error are far greater for mandatory rules. Thus, if the union analogy fails as a justification for a default rule, then a fortiori it fails as an argument for a mandatory rule.


\textsuperscript{199} See RICHARD B. FREEMAN & JAMES L. MEDOFF, WHAT DO UNIONS DO? (1984); WEILER, supra note 3; Leslie, supra note 198. The term "inframarginal" refers to workers who would not respond to a slightly lower wage or less attractive contract terms by seeking employment elsewhere. The intuition behind the argument about inframarginal workers is that nonunion employers have no incentive to tailor contract terms to satisfy the preferences of employees who intend to work for the company whether or not the terms are tailored. Instead the firm will adjust its contract offer to suit the desires of those workers who would otherwise prefer to work elsewhere. The preferences of these "marginal" workers thus determine the contract terms in a competitive equilibrium.
their contract preferences, then we should not use information about collective bargaining agreements to determine nonunion contract terms.

Concerning the first of these possibilities, there are several reasons to believe that unique characteristics of union employment and contract negotiation make just cause desirable. Nonunion employees who wish to contest a discharge must either represent themselves, pay a substantial retainer, or find an attorney willing to take their case on a contingent fee basis. In contrast, union employees challenge discharges through contractual grievance arbitration procedures with the benefit of union representation at every stage of the proceedings. Such a precommitment to share among all union members the cost of representation undoubtedly increases the practical value union employees derive from just cause protection.\textsuperscript{200} The greater job security offered by a just cause term also stabilizes union membership and helps the union to retain majority support. Just cause protection supplements the protection labor law provides against firings for engaging in union activity.\textsuperscript{201} Finally, union leaders may especially prefer just cause terms because processing grievances concerning discipline and discharge gives them a highly visible role as advocates for their members.

Similarly, it seems unlikely that rank-and-file union members have the same contractual preferences as their nonunion counterparts.\textsuperscript{202} A much more plausible story is that people have a tendency to self-select into union employment in part because they value the same job characteristics that other union members prefer. This self-selection produces a union workforce that has comparatively homogeneous

\textsuperscript{200} As a repeat player, the union also stands to gain from developing a reputation for firmness in negotiation. Because the employer, of course, is also a repeat player, it is difficult to predict which party will gain the most from reputational investments. In contrast, nonunion employees have no opportunity to establish a reputation and thus are at a comparative disadvantage in disputes with their employer. Plaintiffs' attorneys, however, may be able to provide a market substitute for the case screening and reputational functions that unions perform. In any event, union representation makes a just cause term more valuable.

\textsuperscript{201} See Freed & Polsby, \textit{supra} note 12.

\textsuperscript{202} Both proponents and critics of the union analogy assume implicitly that the contractual preferences of union members and of nonunion employees are identically distributed. The proponents make this implicit assumption when they argue that union just cause terms demonstrate that most workers prefer just cause. Freed and Polsby make a similar assumption when they contend that union voting procedures do not guarantee that collective bargaining agreements will contain only those terms preferred by a majority of union members. See \textit{id}. at 1123-24. The self-selection argument developed in the text suggests that neither argument adequately considers labor market dynamics. Because of self-selection, union contract terms are a poor model for nonunion employment contracts, and, contrary to Freed and Polsby's arguments, a solid majority of union members probably prefer those terms to all relevant alternatives.
preferences concerning the central features that distinguish union from nonunion employment. Workers who find union employment uncongenial are free to migrate to the nonunion sector in which they can obtain a different mix of job attributes. Similarly, those who are entering the workforce or changing jobs surely weigh the presence or absence of a labor union in deciding which jobs to pursue and which offers to accept. Thus, in a continuous dynamic process, the unionized sector of the labor market simultaneously attracts and repels workers of opposing types. Although I would not go so far as to argue that unions promote efficiency, this theory of self-selection suggests that, by offering a distinctive working environment and contractual regime, union employment may increase the job satisfaction of workers who prefer those characteristics.

The theoretical implication of my self-selection argument is that unionism should not be understood as the static imposition of differing institutional arrangements on an otherwise identical employment relationship. The advent of union representation is not a natural experiment for comparing the effects of alternative institutional forms in the way that advocates of just cause for nonunion employment have sought to use it. Instead, labor market adjustments permit workers of varying types to seek out the type of employment that they find most satisfying and for which they have a comparative advantage. The existence of substantial sectors of the labor market in which employees receive just cause protection proves only that some segment of the workforce prefers that package of benefits to the readily available alternative of at will employment in the nonunion sector. The possibility of self-selection undermines the implicit assumption that union and nonunion workers are identical in their underlying preference for just cause protection. If union workers are comparatively less adaptable and more concerned with security and stability, they will have a stronger preference for the protection that a just cause term provides.

The empirical implication of this analysis is that observations of union contract practices provide no useful data for determining why just cause protection is comparatively uncommon in the nonunion sector. The theory of self-selection could be tested directly with data on the attitudes and psychological makeup of union as opposed to nonunion workers. A

203. Some may object that the union wage premium attracts workers who do not really care about just cause protection. It is quite possible that a substantial number of union members choose union employment solely because it offers higher wages than otherwise comparable nonunion employment.

204. For work in this vein, see Freeman & Medoff, supra note 199.

205. The distinctive aspects of union contract terms are thus somewhat analogous to the strategy of product differentiation so common in consumer markets.
more indirect test could examine the relationship between the union wage premium and the proportion of workers choosing union representations. If union employment share declines as the union wage premium declines, then one reasonably might conclude that those workers leaving union employment had chosen the union because of the wage premium rather than because of a preference for just cause protection. Such a finding would further undermine the claim that union contract terms provide a good model for nonunion employment.\textsuperscript{206}

The survey data provide no information about employee attitudes, and they do not include a measure of the union wage premium. Nevertheless, the data do reveal that the presence of a union in the workplace does not appear to influence the terms governing discharge for employees not covered by a collective bargaining agreement. This observation suggests, at the very least, that the effect of unions is not to demonstrate to the employer and to other employees that a just cause contract is clearly preferable to an at will relationship. The dramatic differences between the role of just cause in union and nonunion employment relationships makes me profoundly skeptical about the wisdom of extending union terms to nonunion workers.

2. THE FOREIGN LAW ANALOGY

A second argument from a comparative perspective begins with the observation that workers in virtually every industrialized country in the world have some form of protection against unjust discharge.\textsuperscript{207} This empirical fact suggests to many the question: Why not us? If European countries can successfully produce goods despite just cause protection, then certainly we could do the same. Jack Beermann and Joseph Singer put this point more colorfully:

People in our society have come to view the world through ideological lenses that make them disbelieve claims that workers

\textsuperscript{206} Susan Catler reaches a similar conclusion based on quite different reasoning. See Catler, supra note 8. She contends that just cause protection will be ineffective when employees are unable to call on their union for representation in grievance proceedings. In her view, unionism offers the only hope for meaningful protection against unjust discharge. I agree that union representation in grievance proceedings probably improves employees' odds of success. I also suspect, however, that just cause terms in nonunion employment and even just cause provisions subject to mandatory arbitration significantly constrain employers' freedom to discharge. The question that this Article addresses is whether workers themselves behave as though that constraint is worth more than it costs employers.

\textsuperscript{207} For a useful survey of major European countries and Japan, see Estreicher, supra note 12.
would be productive without the insecurity of the at-will rule. To paraphrase Mark Kelman, it is only through a miracle, or quirky cultural differences, that workers in the rest of the industrialized world, where at-will is not in force, work at all.208

An initial response to this evidence is that it is not really an empirical argument about the choices workers make in foreign labor markets. Instead it is evidence of a somewhat overrated correlation in political outcomes. In fact, there are substantial differences in the stringency of European discharge laws, and few laws provide more than limited severance pay upon termination.209

The analogy to foreign law may still be forceful, however, if it shows that labor markets in other countries perform as well as or better than ours despite having some form of mandatory just cause protection. For example, if German labor productivity exceeds American labor productivity, then one might infer that the threat of discharge at will in the United States does not enhance productivity. But caution about this inference is appropriate. Higher labor productivity is exactly what one would expect to find in economies that impose high implicit taxes on employment.210 Employers will tend to substitute capital for comparatively expensive labor, thus increasing the marginal productivity of the remaining labor that is employed. After all, you do not have to show just cause to scrap a machine.211

Even more telling is the fact that recent macroeconomic results for the countries in which just cause protection is most meaningful have been fairly dismal.212 The presence of just cause requirements certainly is not the sole, or perhaps even the principal cause, of this poor economic performance. But it seems at least possible that these mandatory protections have made it more difficult for companies to adjust to changed economic circumstances. Just cause requirements may impose comparatively minimal constraints in a growing economy characterized by highly stable employment. But just cause requirements make it more

209. See Ehrenberg, supra note 12, at 294; Estreicher, supra note 12, at 311-23.
210. See Freed & Polsby, supra note 12, at 1139.
211. But see Ypsilanti Township v. Gen. Motors Corp., 506 N.W.2d 556 (Mich. Ct. App. 1993) (arguing that GM promised to keep its Willow Run plant open in order to induce the township to grant tax abatements to the company).
difficult to restructure a firm's workforce when competitive pressures are greatest. Workers who no longer fit into the occupational hierarchy can only be terminated at some substantial cost.

Recent work by labor economist Steven Stern posits a model of employment in which worker productivity is a function of skill, effort and position on a job ladder, and workers attach positional utility to each job. The employer's problem is to match workers to jobs. The profit-maximizing solution to this problem puts the best workers in the jobs with the highest productivity and positional utility. Stern's model provides a reasonably accurate picture of an employer's internal labor market or job ladder.

A modest informal extension of this model can help to explain why just cause protection can be too costly to be worth providing. It is unrealistic to suppose that the relative rankings of worker quality and positional utility will remain stable over time. Instead employers expect jobs to change, with some becoming more productive and others becoming less productive. Similarly, some workers may be unusually able to adapt themselves to new positions and new economic circumstances while others resist change and prefer a stable work environment. When change occurs, employers will want to dismiss or reassign these less adaptable employees. But under the most commonly used misconduct standard for just cause, the employees will have done nothing to warrant discharge. In fact, although they will often be capable of continuing to perform their jobs, their employer would benefit substantially from being able to replace them with more adaptable workers. Just cause protection thus impedes this economically beneficial adjustment to changed circumstances.

The empirical implication of this theory of dynamic adjustment is that just cause should thrive where employment relationships are stable.


214. Such an adjustment does impose costs on discharged employees. Unfortunately, the available empirical evidence concerning the size of these losses focuses exclusively on so-called "displaced workers" who have lost their jobs through layoffs or plant closings. See, e.g., JOB DISPLACEMENT: CONSEQUENCES AND IMPLICATIONS FOR POLICY (John T. Addison ed., 1991) (collecting papers that analyze wage losses and unemployment spells suffered by displaced workers). The losses for discharged workers could be larger than those for displaced workers if the fact of discharge reduces their employment opportunities. Discharged workers, however, might suffer smaller losses. Prospective employers may never learn the true reason for their termination, and discharged workers often lose not only their jobs but also all realistic prospects of reemployment in the same industry or occupation. Thus, discharged employees might have brighter employment prospects than those who have been displaced.
The observed pattern of contract practice seems generally consistent with the theory. Just cause is found most often in the rigid world of unionized employment and the highly regulated and bureaucratic environment of public employment. Employees in both sectors seem determined to maintain the status quo at virtually any cost. Interestingly, just cause terms are far less common in the more unstable domain of union construction work. The theory also is consistent with the observation that Europe, and unionized American industries, have had a much more difficult time adjusting to the changing product and labor market conditions of the past three decades. Finally, the theory suggests that workers who value these protections will tend to be attracted in disproportionate numbers to the sectors that offer such stability. Casual empiricism confirms that both union and government workers have an unusually strong taste for stability. And the fact that union employment has become increasingly concentrated in the public sector further supports the idea that both the union and the public sector attract workers with similar preferences.

In conclusion, neither the analogy to union contracts nor the analogy to foreign unjust discharge laws provides a convincing reason to believe that the majoritarian default derived in this Part should give way to a default term of just cause. Substantial institutional differences and unresolved theoretical problems make these comparisons unreliable measures of optimal terms for nonunion employment contracts. The survey data thus are the best available evidence of parties' preferences. Those data strongly support the prevailing default rule of employment at will.

V. Mandatory Just Cause

Taking default rules seriously, however, does not exhaust the range of possible terms governing discharge. Several commonly invoked arguments for just cause protection require the adoption of a mandatory rule rather than a default and simultaneously question the relevance of current contractual practice to the problem of designing the optimal legal rule.

The arguments for mandatory rules all have a common structure. Each theorizes that a market failure of some kind explains why so few nonunion employers offer just cause contracts. Were it not for this impediment, workers would express their underlying preference for contractual protection against unjust discharge. Each theory thus depends on two related empirical claims: (1) the hypothesized market failure prevents workers from expressing their preference for just cause protection, and (2) enough workers value that protection to justify adopting just cause as a mandatory rule for employment contracts. The
former condition, the *market failure proposition*, simply restates each theory's explanation for the observed absence of just cause contracts in the nonunion sector. The normative claim that courts or legislatures should adopt a mandatory just cause standard implies the latter condition, the *underlying preference proposition.*

This Part presents both theoretical and empirical objections to these market failure theories. In some cases, the theoretical argument for market failure requires quite special and implausible assumptions about behavior. In others, the hypothesized market failure is quite plausible, but equally plausible alternative assumptions reverse the theory's prediction that just cause will be underprovided. Finally, the survey data consistently fail to support the limited empirical implications of these theories.

### A. Information and Market Failure

The three most important market failure arguments rest on assertions about inadequate or asymmetric information. Workers, for example, may misperceive the value of just cause protection, or firms may misperceive its cost. Either form of misperception would produce a market equilibrium in which employment contracts include just cause protection less often than is socially optimal. Alternatively, information may be distributed asymmetrically between employers and employees thus creating impediments to bargaining for just cause protection. This Section examines each of these arguments in turn.

#### I. WORKER MISPERCEPTION OF VALUE

A paternalistic rationale for mandatory just cause is that workers systematically misperceive the value of that protection. This argument rests on an appeal to two psychological theories about cognition. First, people prefer not to think about unpleasant possibilities. They thus will tend to ignore the very real danger that they may be discharged. Second, people may tend to underestimate the expected losses from

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215. The question of what quantitative level of employee preference is required to justify adoption of a just cause standard may be somewhat controversial. Recall that we should demand a particularly strong argument for a mandatory rule. The burden thus should be on the proponents of these theories to demonstrate that the hypothesized market failures actually prevent employers from offering just cause contracts.

relatively remote, low probability events.\textsuperscript{217} Since firing is a remote, low probability event at the time of hiring, workers may have excessive confidence in their prospects for continued employment. Workers who underestimate the chance of suffering an unjust discharge will be less likely to demand just cause protection than they would if they were fully informed. If this misperception prevents workers from contracting for what otherwise would be a desirable contract term, a legislature could, in theory, enhance labor market efficiency by mandating the efficient term of just cause for discharge.

Although these theoretical speculations are superficially plausible, other equally plausible speculations suggest the wisdom of more cautious policy prescriptions. Consider carefully the unpleasant event against which a just cause term provides a contractual remedy — a discharge without just cause. The expected value of just cause protection thus depends on two probabilities: (1) the probability of discharge and (2) the probability that there is just cause for discharge. If it is true that the likelihood of an unpleasant event is underestimated, then employees should underestimate both the probability of being discharged and the probability that a given discharge will be for just cause. It is surely unpleasant to be guilty of the sort of conduct that would justify a disciplinary discharge. The theory of cognitive dissonance thus suggests that workers will be overly optimistic about their own job performance.\textsuperscript{218} This optimism, however, leads workers to overvalue just cause protection. It is thus not possible to predict on theoretical grounds whether this tendency towards overvaluation will be greater or less than the tendency to undervalue protection because workers underestimate the probability of discharge.


\textsuperscript{218} More formally, let p(D) equal the true probability of discharge and p(J|D) equal the probability that there exists just cause for a given discharge. Assuming for simplicity that judicial processes are costless and perfectly accurate, the value of just cause protection will be a positive function $V(\cdot)$ of the quantity $p(D)(1-p(J|D))$. Underestimating $p(D)$ therefore reduces an employee’s estimate of the expected value of just cause protection, $E(V)$. But underestimating $p(J|D)$ has the opposite effect and creates an upward bias in the estimate of $E(V)$. Thus, the relationship between the employee’s estimate of $E(V)$ and its true value depends on the relative magnitude of the two misperceptions. There is no \textit{a priori} basis for concluding that one or the other misperception will dominate.
Even if the claim that workers underestimate the risk of unjust discharge is true, however, the case for mandating just cause protection is far from complete. The value of just cause protection depends on the ability to enforce that protection in the event of an unjust discharge. Workers may well overestimate the economic value of having a cause of action for unjust discharge because they radically underestimate enforcement costs. A discharged employee must pay a retainer or find a lawyer willing to take her case on a contingent fee. She must commit a substantial amount of time to depositions and other aspects of case preparation. Finally, her recovery on a contractual theory is limited to lost wages and incidental expenses. To the extent that workers underestimate the difficulty of enforcing their legal rights and overestimate the potential returns, they will tend to overestimate the expected value of having just cause protection.

Given the theoretical ambiguity of this argument for mandatory just cause, it is difficult to test empirically. Nevertheless, one implication of the theory is that workers who have experienced discharge or who better understand the risk of discharge should demand and receive just cause protection. The underlying preference proposition requires that at least a majority of this informed group should contract for just cause. Unfortunately, my survey data do not reveal the knowledge and beliefs of individual employees. There is, however, no evidence that just cause protection is more common in occupations or industries in which employees might be better informed. Courts and legislators thus should hesitate to impose a mandatory term without substantial evidence that workers often underestimate the value of just cause protection.

219. Let $p(R)$ equal the probability of obtaining representation, $C$ equal the total cost of litigation, and $A$ equal the potential damage award for a successful litigant. The expected value of just cause protection is $E(V) = p(D) \cdot p(R) \cdot (A - C)$. If employees underestimate $p(D)$ and $C$, but overestimate $p(R)$ and $A$, then again it is not possible to predict whether they will demand just cause protection too infrequently or too often.

Mandatory just cause protection also may be a poor remedy for such worker misperceptions. Market intervention does not change the conditions that make employees misperceive the value of just cause. If they undervalue that protection, as the misperception theory claims, employers will be unable to lower wages to compensate for the full cost of a mandatory just cause term. To the extent that employers bear increased labor costs, fewer employees will have jobs than before. There can be no guarantee that those who gain from just cause protection will gain enough to be able to compensate for the losses of those who no longer have jobs. It is therefore also uncertain whether such an intervention could satisfy the test for potential pareto-superiority.

220. There are no discernible patterns by industry. See supra note 135 and accompanying text. An informal review of information on employers offering just cause protection similarly revealed no apparent pattern.
2. EMPLOYER Misperception of Cost

Even if employees do not systematically underestimate the value of a just cause term, employers could misperceive the cost they incur to offer just cause protection. An irrational fear of high attorneys fees, runaway jury awards, and the business disruption resulting from litigation could lead employers to overestimate both the probability and ultimate cost of unjust discharge suits. Mandatory just cause protection would, this theory suggests, force employers to behave more rationally.

As my discussion of employee misperception has suggested, reformers tend to hypothesize convenient misperceptions and ignore equally plausible misperceptions that would undermine the case for just cause reform. The theory of misperceiving costs claims that employers who lack accurate information about legal risks will overestimate the resulting costs. However, it seems equally likely that employers who are ill-informed about the law and its consequences will dramatically underestimate the legal risks to which they expose themselves when they agree to offer just cause protection. Most employers have never read the BNA Labor Relations Reporter or consulted an employment law attorney. One reasonably might expect these employers to be quite naive about the current state of employment law. Accordingly, they might in their ignorance be more willing to offer just cause protection. Of course, one might also argue that these employers will obtain their information from hysterical news stories and gossip about ridiculous verdicts and outrageously high damage awards to discharged employees. They might respond to this distorted view of the law by being utterly unwilling to extend just cause protection. Once again, however, the most definitive conclusion that can be reached on purely theoretical grounds is: it depends.

The central empirical implication of this misperception-of-costs theory is that the pattern of just cause protection in the labor market should respond in some systematic way to employers’ knowledge about the law and its costs. Perhaps the strongest evidence against the theory of employer misperception is that none of the law firms in the sample contracts for just cause. These firms are surely among the employers with the lowest probability of misperceiving the law. In addition, large employers with sophisticated legal counsel and prior first-hand experience


222. Interview notes from the survey confirm that a significant proportion of employers are woefully ignorant about the legal consequences of their employment practices.

223. See supra note 135 and accompanying text.
with discharge litigation should be well-informed and thus willing to offer just-cause protection. Contrary to the implications of the theory, larger employers are somewhat less likely to contract for just cause and more likely to contract for at will. There is thus some limited empirical evidence against the argument that employers do not provide just cause protection because they misperceive its costs.

3. ADVERSE SELECTION AND BAD WORKER SIGNALING

The last of these informational arguments for mandatory just cause focuses attention on an important informational asymmetry that may exist between employers and employees. Employers generally cannot know, and an employee may often know, whether he or she is highly productive and motivated or instead less productive and more prone to shirk.

Two problems arise from this informational asymmetry between employees and employers. A firm offering just cause contracts might

224. But see Edelman et al., supra note 221, at 74 (contending that those who might inform employers of these costs have a professional stake in exaggerating the danger of litigation).

225. Another implication of the theory is that employers insured against the tangible costs of discharge litigation should be more willing to offer just cause protection. In addition to the traditional comprehensive general liability policies, which provide very little protection against unjust discharge liability, a wide variety of new insurance products now offer employers protection against both the prospect of paying damages and the costs of defending challenges to their employment practices. Of course, insurance coverage offers no reimbursement for the nonpecuniary but tangible cost of time spent defending such suits or for the less tangible but potentially costly disruption of business and reputational losses that may accompany employment contract litigation. Nevertheless, an insured firm should be more willing than an otherwise identical uninsured firm to expose itself to the uncertain risk of litigation over just cause. The currently available data cannot address this implication of the theory.

226. The analysis that follows depends heavily on the assumption that workers but not firms know whether the workers are productive or not. It is perhaps equally plausible to assume that for many jobs, particularly those involving cooperative or team production, firms but not workers will be able to observe accurately worker productivity. Employees may have a strong tendency to see themselves as hard workers and to blame any lack of productivity on others. In contrast, an employer ordinarily has a much weaker personal interest in which employees receive favorable or unfavorable evaluations. If all employees' self-evaluations are consistently biased in their own favor, a signaling or adverse selection problem might still arise since a uniform bias would simply reduce the mean valuation of just cause protection without altering any other characteristics of the distribution. For discussion of such a systematic misperception, see supra part V.A.1. But if the amount of bias is correlated in some way with productivity, the bias could either eliminate or exacerbate the signaling problem. If unproductive workers tend to be more optimistic about their abilities, then they will no longer value just cause protection more highly than do productive workers. In contrast, greater optimism on the part of productive workers would exacerbate the signaling and adverse selection problems.
find that it tends to attract less motivated and competent workers. Workers know that cause for discharge is imperfectly verifiable. Employers sometimes will be unable to convince a third-party adjudicator that an employee is shirking even when she is in fact doing so. As a result, a just-cause requirement provides a form of insurance against discharge. Insurance against discharge is most valuable to those comparatively unproductive employees who expect to be discharged. Thus, an adverse selection problem could explain the absence of just cause contracts.227

A second, and analytically related, theory is that employees will be reluctant to ask their employers to extend just cause protection for fear that such a request will signal to employers that they are low quality workers who expect to need insurance against discharge. As with the adverse selection argument, employers might infer that those workers who value discharge insurance enough to ask for it are among the least valuable prospective employees. Bad worker signaling thus could also explain why employees do not receive just cause protection. Both theories identify a market failure that arises from an informational asymmetry about worker quality.

A significant theoretical criticism of these arguments is that the signaling problems are symmetrical. Just as prospective employees send an adverse signal by demanding just cause, so an employer might signal, by demanding an at will relationship or refusing to agree to a just cause term, that it is unusually likely to discharge workers without cause. Without further empirical argument about the relative importance of these competing effects, the signaling theory provides an ambiguous prediction about the market equilibrium. We thus might observe either too many just cause contracts or an inefficiently high number of at will contracts. One might argue that employers have more effective devices by which to bond their commitment to a fair discharge policy, and therefore the signal about employers has less practical significance than the signal about workers. This argument, however, would also imply that just cause protection is less valuable for workers because, by hypothesis, employers have effective bonding devices.228

Without accurate empirical measurement of productivity and perceptual bias, it is impossible to determine which of these stories most closely represents the labor market.


228. It might also be worth considering cases in which employees have a verifiable and especially strong preference for protection from discharge (e.g., risk aversion or large firm-specific investments in human capital). For these employees, the signal may not be adverse so long as the reasons for their preference are cheaply verifiable. The available data do not permit me to identify employees for whom just cause protection is especially
An empirical implication of the adverse selection argument is that employers should be more willing to offer just cause protection when they have other reliable sources of information about worker quality. Since adverse selection depends on the inability of employers to distinguish good from bad workers, reliable information would tend to overcome this difficulty and diminish the importance of contractual choice as an indicator of worker quality. This argument also applies to the analogous claim that workers do not ask for just cause protection because it signals that they will be unproductive. If a worker knows that the employer already has an overwhelming quantity of high quality information about his or her abilities, then the worker who values just cause protection should be willing to bargain for it. Thus, we should observe contractual just cause terms in industries and occupations in which employers engage in extensive search before hiring or in which worker quality is a function of easily observable variables. After a trial period of employment, firms also should be willing to extend just cause protection. Such recontracting is always possible after a period during which employers learn about worker quality by observing their performance on the job.

Again, the survey data do not reveal a pattern of contracting that seems consistent with these implications. There is no pattern along industrial lines; terms are uniform across occupations within individual firms; and there is no evidence that many employers grant contractual protection against discharge after employees complete a probationary period. Employers’ failure to extend just cause protection to post-probationary employees can only be explained by something other than adverse selection or signaling.

A second empirical implication of these theories is that employers who do not have effective devices to bond their commitment to fair treatment should be more willing to offer just cause contracts. Most economic models of the employment relationship rely on reputation as a bonding device. It is therefore tempting to conclude that large firms, whose reputational investments have a longer expected life and a larger expected return, will be better able to bond their commitment to fair treatment. But this conclusion implicitly assumes that large and small firms are otherwise identical. Contrary to that assumption, it may be substantially more difficult for a large firm to signal its commitment not

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229. Academic tenure systems and professional partnership tracks are the closest approximations to the pattern this theory requires. A thorough analysis of these unusual contracting regimes, however, is beyond the scope of this Article.

to discharge without just cause. In small firms, one individual often hires and fires all employees. In larger firms, agents of the corporate employer have delegated authority to make personnel decisions. Employees in larger organizations are thus far less able to rely on a personal relationship with the decisionmaker to ensure fair treatment. Large firms tend to rely instead on formal policies and procedures to control their agents. But if agency problems are the source of most unjust discharges, then it is more important for large firms, and less crucial for small firms, to bond their commitment to fairness. Thus, either large or small firms might be more likely to contract for just cause protection.

As with the other informational arguments, the empirical implications of the bad worker signaling and adverse selection theories are ambiguous. The available data provide no support for their implications, nor do they directly contradict these theories. Nevertheless, the burden of proof should be borne by the proponent of a mandatory rule. A failure of proof is thus fatal to the case for mandatory just cause.

B. Other Alleged Market Failures

The competitive market model also requires that all contract terms be purely private goods, and that the provision of just cause not involve economies of scale in production. This section considers whether the failure to meet one of these conditions could explain the absence of just cause contracts in the nonunion sector. Either of these market flaws could provide a theoretical justification for regulatory intervention to correct the resulting inefficiencies. Finally, the section examines and rejects the claim that unequal bargaining power between employers and employees justifies a mandatory just cause term.

1. JUST CAUSE AS A LOCAL PUBLIC GOOD

Some have argued that just cause protection, like workplace safety, should be considered a local public good. A public good is one that is both nonexclusive and nonrivalrous in consumption. A local public

231. See sources cited supra note 114.
232. I have already analyzed the related argument that labor unions permit workers and firms to overcome the resulting collective action problems and thus provide just cause protection. See supra part IV.E.I.
233. See Leslie, supra note 198; see also Susan Rose-Ackerman, Progressive Law and Economics-And the New Administrative Law, 98 YALE L.J. 341, 355-57 (1988) (arguing that workplace safety and health is a local public good).
234. Thus, investments in national defense, for example, provide benefits that accrue to all residents and impose costs that do not increase as each new resident receives
good has identical characteristics for a smaller collective unit. Street lights or police protection, for example, provide nonexclusive benefits and are nonrivalrous in consumption for residents of the place in which they are located. Similarly, when an employer invests in improving the air quality or the safety of machinery in its plant, all employees benefit, and the marginal cost of providing those improvements to each additional employee is zero. Douglas Leslie, among others, argues that employers will tend to undersupply such local public goods because employees have an incentive to understate their willingness to accept lower wages in return for safety. Each employee will claim to have no interest in safety while privately hoping that others will agree to pay for safety improvements that will benefit all workers. A classic free-rider problem thus impedes the supply of socially desirable safety improvements. If just cause protection shares similar characteristics, then it too will be undersupplied.

The analogy between workplace safety and just cause protection is, however, less than perfect. A just cause term is not exactly nonrivalrous in consumption because the marginal cost of extending protection to each additional employee is positive. Such a provision exposes the employer to liability for both unjust discharges and discharges erroneously labeled unjust, and it constrains the employer’s ability to discharge for observable but unverifiable causes. Just cause protection is also not exactly nonexclusive because an employer could theoretically limit its offer of just cause to only those employees willing to pay for that protection. Nonetheless, employers may feel that individualized protections would have corrosive effects on the morale of those employees without protection. It is at least plausible, then, that just as employers often prefer to offer uniform pay and benefits to all workers within a particular classification, they also may be reluctant to permit the randomly distributed disparities in pay and contract terms that would result from individually negotiated just cause. Thus, the argument runs, just cause is an all-or-nothing proposition, and employees face a collective action problem in demanding just cause protection. A decision must be made on behalf of employees who have no mechanism by which they can express their collective preferences.

The first theoretical response to this argument is that the employer is a dictator who is able to coerce contributions and provide the local protection.

235. See Leslie, supra note 198, at 355.

236. Freed and Polsby provide a detailed analysis of the competing considerations that employers would face in trying to determine how individually negotiated just cause protection would influence the relations among employees. See Freed & Polsby, supra note 12, at 114.
public good. Except for individually negotiated contracts, to which the local public good argument does not apply, employers dictate the terms of employment. If they perceive that workers value just cause protection at more than its cost to the employer, they have every incentive to lower wages, offer just cause, and perhaps share the resulting surplus with employees.

An alternative version of the local public good argument claims that it is costly for employees to communicate their preference for just cause. Every employee tends to want to free-ride on the efforts of others to communicate this preference. As a result, employers will never learn that employees want just cause and thus, despite the available surplus, will not offer that protection. This revised version of the argument also founders. The labor market provides substantial incentives for employers to compete to offer the optimal package of local public goods. Although they lack a collective voice, employees have ample opportunities to express their preferences for just cause protection by exiting from at will employers and applying to work at just cause employers. In fact, all of the classic conditions for an efficient Tiebout equilibrium are present. Employers, like localities, compete to offer that package of wages, benefits, and other contract terms that will attract a productive workforce at the lowest cost.

The local public good argument rests on a flawed theory of the process by which nonunion employment contracts are formed. Consequently, there is no need to pursue the theory’s empirical implications. Nevertheless, the survey data refute the claim that employers will provide just cause protection only when a union is available to overcome the collective action problems the employees face. A substantial percentage of nonunion employers, of all types, offer just cause contracts.

2. ECONOMIES OF SCALE IN PROVIDING JUST CAUSE

Another fallback position for someone who claims that just cause is a local public good could be the argument that just cause is unavailable because there are economies of scale in providing it. Perhaps there

237. For discussion of the mechanisms by which employees might express their preferences, see ALBERT O. HIRSCHMAN, EXIT, VOICE, LOYALTY (1970).
239. I refer here to economics of scale principally in administering a just cause standard within a single employer. This characteristic of legal rules may potentially cause them to be undersupplied. I have already considered, under the rubric of transaction costs, possible problems resulting from the public good character of legal standards.
are large fixed costs associated with establishing the bureaucratic mechanisms to protect employees against unjust discharges.\textsuperscript{240} The average per capita cost of extending just cause protection thus might decline globally.

It is not immediately apparent how either a default or mandatory rule of just cause could improve the efficiency of such a market. By hypothesis, the impediment to offering just cause is a large fixed cost. Product markets with globally decreasing average costs are called natural monopolies. The economic problem in such markets is to regulate the seller's monopoly that inevitably arises. In contrast, an employer is always the exclusive provider of contract terms for its employees. The employer, moreover, has an important advantage over a natural monopolist in most other product markets. It has the opportunity to price discriminate among "consumers" of its employment contract terms. An employer may be able to "charge" employees wage "prices" for just cause protection that differ according to their intensity of preference for such protection. It is well known that a perfectly price discriminating natural monopolist produces the efficient level of output.\textsuperscript{241} Similarly, the wage-discriminating employer should be able to cover the fixed cost of offering just cause so long as such a contract term provides net benefits for employees.

Legally mandated just cause thus is likely to require many employers, for whom the fixed cost of providing just cause is too great, to incur inefficient costs to provide that protection. And a default rule of just cause would have no effect on informed employers' decisions. It would merely require those employers for whom the cost of just cause is too high to bear the additional cost of contracting back to the at will regime.

One empirical implication of the economies-of-scale theory is that just cause will not be provided by individually negotiated contract to selected employees. But many reported cases discuss individual negotiations over job security.\textsuperscript{242} Another implication is that large employers should have an advantage in providing just cause to their workers. The survey data suggest that larger employers are somewhat less likely to offer legally enforceable just cause protection and more

\textsuperscript{240} Freed and Polsby offer a provocative discussion of the role of economies of scale in providing just cause. See Freed & Polsby, supra note 12, at 1128.

\textsuperscript{241} See, \textit{e.g.}, WALTER NICHOLSON, MICROECONOMIC THEORY: BASIC PRINCIPLES AND EXTENSIONS 355-56 (2d ed. 1978).

likely to contract expressly for an at will relationship. These empirical facts are inconsistent with the claim that economies of scale prevent employers from offering just cause contracts.

3. BARGAINING POWER

Often the first and only argument reformers offer in support of a mandatory just cause regime is the claim that large corporate employers have a bargaining power advantage in their relationship with nonunion employees.\(^{243}\) According to this argument, unequal bargaining power explains the prevalence of at will employment. Its proponents seldom specify exactly what they mean by the term “bargaining power.” But, after excluding the analytically distinct arguments that I have already analyzed, three possible interpretations remain: (1) concern about nonnegotiable offers, (2) substantive inequality in bargaining position, and (3) monopsony power. In this subsection, I demonstrate that all three versions of the argument are theoretically flawed and show that the available data contradict their empirical implications.

Tales of economic domination through the device of the nonnegotiable job offer are a staple of bargaining power enthusiasts. They contend that nonnegotiable offers impair competition and enhance employers’ market power. In other economic markets, however, the use of nonnegotiable offers correlates quite poorly with the absence of effective competition.\(^{244}\) Moreover, the assumption that an employer can credibly commit not to negotiate is decidedly nontrivial.\(^{245}\)

\(^{243}\) See, e.g., Weiler, supra note 3, at 147-49 (discussing bargaining power argument).

\(^{244}\) Contrary to the arguments of these reformers, many unique goods, such as mansions and antiques, for which the claim of seller market power is most credible, are sold on individually negotiated terms. In contrast, nonnegotiable terms are common in comparatively competitive markets. Everything from breakfast cereal to automobiles and from haircuts to legal services are frequently offered on nonnegotiable terms. And although the price term is negotiable in many consumer transactions, most other contractual terms are typically nonnegotiable. Try, for example, to bargain with a stereo dealer over particular warranty terms, or ask the airline ticket agent to provide you with special contractual protection against flight delay (though you may specify your seat and meal preferences). As these examples suggest, sellers in competitive markets pick and choose the mix of negotiable and nonnegotiable terms in their contract offers. The resulting pattern of behavior contradicts the predictions of the bargaining power theory.

\(^{245}\) Some offerors may derive long-run gains from establishing a reputation for standing firm even when negotiation could produce a mutually beneficial agreement. It is also plausible to assume that employers would be in a good position to establish and benefit from such a reputation. Such a hard-nosed bargaining strategy thus might explain the apparent prevalence of nonnegotiable offers in the labor market. An equally plausible explanation for this practice, however, is that the costs of individual negotiation exceed
Suppose, however, that employers derive a significant bargaining advantage from making credible nonnegotiable offers. According to the bargaining power argument, employers exploit this advantage by refusing to provide just cause protection even though employees value that protection at more than it costs employers to provide it. This claim is economically incoherent. Employers have no conceivable incentive to impose contract terms that diminish the value of the employment relationship. Indeed, the profit-maximizing strategy for an employer with a bargaining power advantage is to provide precisely those contract terms that produce the largest possible gains from exchange.\textsuperscript{246} This strategy maximizes the amount of productive surplus that the employer can capture. When an employer includes an inefficient and undesirable term in its offer, it squanders a portion of the economic gains that accrue to the employer with a bargaining advantage.\textsuperscript{247}

the potential benefits from individually tailored employment contract terms. My own experiences suggest that wages are often subject to negotiation. In contrast, few people appear to negotiate over discharge terms. Nonetheless, it would be quite strange for an employer to try to develop a reputation for toughness about job security while simultaneously agreeing to bargain over wages. Such a strategy would seem to sacrifice the gains that normally accrue to making credible nonnegotiable offers. Unfortunately, I doubt that any currently available empirical data can arbitrate between these two plausible theoretical stories.

\textsuperscript{246} The optimal nonnegotiable offer is a contract consisting of the joint maximizing terms at a price equal to the offeree's reservation value for that contract. The phrase "joint maximizing terms" describes the set of contract terms that produces the greatest net benefit to the offeree after deducting the offeror's cost of performance. The offeree's "reservation value" is simply the contract price that makes the offeree indifferent between accepting and rejecting the offer. With such a strategy, the offeror will capture all of the possible gains from trade with the offeree. If the offeror deviates from the joint maximizing terms, she reduces the available gains and thus decreases her own potential returns from the nonnegotiable offer. In fact, for every dollar by which the undesirable terms diminish the value of the contract, she loses exactly one dollar in potential profit from the contract. Thus, unless employers, or workers, misperceive the optimal contract terms, employers have every incentive to make a nonnegotiable offer that includes the term governing discharge that maximizes the value of the employment relationship.

\textsuperscript{247} For substantially similar criticism of the bargaining power argument, see, e.g., Weiler, supra note 3, at 147-49; Duncan Kennedy, Distributive and Paternalistic Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power, 41 Md. L. Rev. 563 (1982). In theory, minimum wage laws could constrain employers' ability to shift the costs of just cause protection to employees. However, an overwhelming majority of employees are paid more than the minimum wage. See Wage Increase Would Have Little Impact on Jobs, 148 Lab. Rel. Rep. (BNA) 371, 372 (Mar. 27, 1995) (reporting that 6.2% of hourly wage workers are paid the minimum wage or less). Legal minimum wages thus could explain the lack of just cause protection for only a few low-paid employees. So long as wages remain above the minimum wage, employers maximize profits by offering the same contract terms that employers would offer in a perfectly competitive labor market.
Alternative interpretations of the bargaining power argument are similarly flawed. According to the substantive inequality theory, workers need jobs more than employers need workers. Because the resulting contract terms systematically favor employers over comparatively powerless employees, employers retain the right to discharge without cause. According to the monopsony theory, labor markets are not competitive. Employers exploit their market power by imposing at will contracts on employees. Both of these theories, like the theory of nonnegotiable offers, thus depend on the assertion that employers refuse to provide just cause protection even though employees would accept wages sufficiently lower than current levels to cover the cost of that protection. We should, of course, not presume uncritically that all employers behave rationally. But before accepting an argument that depends on the assertion that most employers act contrary to their economic self-interest, we should demand some evidence that such an assumption is warranted. Proponents of the bargaining power argument have yet to provide such evidence.

The empirical implications of these bargaining power theories are somewhat uncertain. In general, employees with substantial bargaining power should demand and receive just cause protection. Jobs for which employers have a hard time finding qualified candidates should offer just cause. Small employers without a bargaining power advantage may have to offer just cause protection in order to attract workers. If workers fail to contract for just cause protection in these situations, then the unequal bargaining power theory is empirically undermined. The survey data reveal no such patterns and therefore provide no support for the claim that an underlying preference for just cause is going unsatisfied.

If nonnegotiable offers are what prevents workers from contracting for just cause protection, then employers should offer just cause contracts when they bargain or when the parties could have bargained. According to the theory, it is the employer's explicit or implicit commitment not to negotiate that produces undesirable at will contracts. An empirical test

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248. Although the proponents of the monopsony theory do not make this argument, monopsony could alter the equilibrium contract terms if we assume that workers' preferences for those terms are not homogeneous. The lower level of employment under monopsony implies that different workers will be at the margin where contract terms are determined. Systematic differences in their preferences for job security could result in an equilibrium with different contract terms. Somewhat ironically, the claim is sometimes made that infra-marginal workers, who could become marginal workers in a monopsonistic equilibrium, have a stronger preference for job security. See Leslie, supra note 198, at 358 n.11. Contrary to the claims of the at will critics, monopsony thus could conceivably increase the likelihood that workers receive just cause protection. The comparative rarity of monopsonistic labor markets, however, makes this speculation relatively unimportant.
of the theory thus depends on distinguishing those employment offers in which such a commitment was made from those in which bargaining did occur or could have occurred. There should be no impediment to obtaining just cause in individually negotiated contracts. The available data cannot test this empirical implication because both the quality and quantity of data on individually negotiated contracts are inadequate.

Substantive inequality is essentially a theory about contract terms themselves and thus has no strong empirical implications. Nevertheless, the argument purports to be a virtually universal description of employment, applicable to all but the most sought-after employees such as baseball free agents, top executives, and academic superstars. According to the substantive inequality theory, ordinary employees should not be able to obtain just cause protection. The survey data strongly contradict this prediction. In fact, fifteen percent of employers offer just cause contracts, and no evidence indicates that the provision of just cause protection is correlated with differences in bargaining power.

The monopsony theory's central empirical implication is that employers in competitive labor markets will offer just cause protection. If the barrier to obtaining just cause protection is the employer's market power, we need only examine labor markets in which employers compete for workers. Most labor markets have this characteristic. The survey data confirm the widely held view that the majority of these employment contracts are at will. This empirical fact strongly suggests that monopsony power does not explain the failure of employers to offer just cause protection to their workers.249

VI. CONCLUSION

Courts have eroded the presumption that indefinite term employment contracts are terminable at will, but they have simultaneously preserved this basic doctrinal principle despite a scholarly chorus calling for its swift abandonment. Some jurisdictions have come perilously close to imposing a just cause requirement for all discharges. Others have enforced the at will presumption so strenuously that they have ignored evidence that suggests the parties intended to contract out of the default rule. Nevertheless, in the vast majority of jurisdictions, employment contracts, like other contracts, require courts to parse the parties' statements and conduct according to consistent interpretive rules. These courts typically

249. Employer market power might also vary between rural and urban labor markets. No evident pattern of different behavior for rural and urban employers exists. Although urban employers compete actively in the labor market, they do not seem to offer just cause protection at a higher rate than rural employers.
Indefinite Term Employment Contracts demand that oral or written assurances of job security be sufficiently definite and specific that a reasonable employee would regard them as a binding commitment. Within the general confines of this doctrinal test, however, courts vary considerably in their willingness to find that a particular type of assurance overcomes the at will presumption.

The empirical analysis presented in this Article strongly supports a reaffirmation of the at will default. The revealed preference of market participants resoundingly endorses an at will relationship. Moreover, no readily identifiable subgroup of parties has expressed a preference for more protective discharge terms. The at will rule is a majoritarian default that should apply uniformly to all indefinite term employment contracts. The information-forcing argument for a just cause default relies on an empirical assumption about legal knowledge, but that assumption is inconsistent with the observed pattern of contracting behavior. The law of employee handbooks, however, should incorporate an information-forcing rule of liberal construction.

A variety of market failures could theoretically justify a mandatory just cause rule. Several of these arguments rely on convenient assumptions about the particular ways in which parties misperceive market information. Equally plausible assumptions produce the opposite result, however, and the observed patterns of market behavior provide no support for the claim that misperceptions influence contract terms. Informational asymmetry between employers and employees could be a more significant problem. But again, special assumptions are needed to predict that employers will underprovide just cause, and the survey data reveal no pattern consistent with the bad worker signaling and adverse selection theories. Neither collective action problems, economies of scale, nor bargaining power arguments provide a sound basis for imposing a mandatory just cause term.

The exploratory study presented in this Article offers a powerful empirical foundation for reasoning about optimal employment contract terms. Its limited sample size and random sampling design, however, restrict the range of hypotheses to which the data are relevant. A larger sample and more refined sampling techniques could produce even sharper tests of the empirical implications of the various theoretical arguments. The success of this modest first step suggests the value of further empirical investigation of employment contract practices.

Despite these prospects for further insights, a formal empirical approach necessarily imposes demanding restrictions on the scope of the analysis. Observations must be readily quantifiable, and it must be possible to obtain the necessary data by means of standard survey techniques or from public sources. Many essential features of contractual relationships are quite difficult to observe by these methods. Indeed, some critical facts, such as the parties’ motivations, may be inherently
unobservable by any means. Legal scholars will often have no choice but to continue to rely on casual empiricism, and even pure theoretical speculation, to resolve many important questions. Formal empirical methods thus should play an important, but complementary, role in these policy debates.
APPENDIX — A SURVEY OF EMPLOYMENT CONTRACT PRACTICES

The data discussed in this Article are derived from a telephone survey conducted in the summer of 1994 and the winter of 1994-95. In the first wave, Law student assistants under my supervision conducted 136 interviews. In the second wave, graduate student interviewers at the University of Virginia Center for Survey Research conducted eighty-five interviews.

A. Sample

The sample for the first wave of interviews was drawn at random from an online database maintained by American Business Information of Omaha and available on Dialog. The American Business Directory (ABD) contains a listing of about 7.4 million private and public business establishments in all sectors of industry. A continuous telephone collection and verification process involving approximately one million phone calls per month updates the ABD. A companion database, which I used for this study, covers all companies with 20 or more total employees. The sampling universe for the first wave consisted of all private employers with 20 or more employees in each of five states: California, Michigan, New York, Texas, and Virginia.

The sample for the second wave of interviews was also drawn from the ABD. But in order to investigate whether contract practices varied systematically across different industries, I restricted the sampling universe to private employers in California and Virginia with 20 or more employees in one of the following industries: Chemical Manufacturing, Machinery Manufacturing, Textile Manufacturing, Trucking, and Legal Services. These industries are a parsimonious cross-section designed to represent both manufacturing and services, and to include manufacturing industries that vary substantially in their human capital requirements and in their typical internal labor market structure. To identify dissimilar industries, I relied in part on unpublished tabulations of internal labor market characteristics supplied by Sutton and Dobbin.

B. Survey Design

The survey instrument for the first wave of interviews began with background questions concerning the company and the respondent. The data available from these questions include line of business, headquarters and subsidiaries, total number of employees, number of union and nonunion employees, and the occupational distribution (managers, professionals, technical/ skilled workers, salespeople, laborers/ operatives, and others).
The next series of questions inquired about documents distributed to employees. These questions asked whether employee handbooks, pre-printed form contracts, individually negotiated contracts, or other documents discuss discharge. Respondents were then asked to classify such statements according to whether they specify employment at will (documents say employer may "discharge for any reason or no reason"), just or good cause (documents say "good or just cause is required"), enumerated reasons for discharge (documents list "specific causes that are required for discharge"), or other terms (e.g., documents give some specific reasons such as stealing or failing a drug test which are not a complete list of reasons for discharge). Follow-up questions ensured that respondents had not missed documents and had correctly classified the relevant statements.

Additional questions asked about oral statements concerning discharge, the use of term contracts, probationary periods, and seniority practices. Several more questions inquired about formal procedures for challenging termination decisions and the length of notice given to terminated employees.

The survey instrument for the second wave of interviews differed in several respects. First, it was developed for a computer-aided telephone interviewing system used at the University of Virginia Center for Survey Research. The instrument thus consisted of a computer program that generated on-screen prompts to interviewers and recorded responses typed at the keyboard. The computerized format made it possible to streamline the interview process by embedding conditional branching and flow control in the survey instrument itself.

This instrument also attempted to simplify the respondents' task by reducing the number of categories into which they were asked to classify employment documents. For each type of document, interviewers asked whether it specified employment at will ("you have the legal right to discharge employees for any reason or no reason at any time"), good cause ("you may discharge employees only for reasons of poor or faulty performance of their duties, or that employees may only be discharged for specific reasons listed in a document, such as an employment contract or employee handbook"), or employment for a specific length of time ("employees are hired on fixed term contracts and can be discharged at the end of that time for no reason or for any reason but only for good cause during the term"). Specific questions were added to discover whether employers required employees to sign a confirmation of at will status. Finally, this instrument included a series of questions designed to determine whether the employer used any of the personnel procedures that are characteristic of internal labor markets.
C. Additional Empirical Results

The following table provides results from the logistic regressions performed on data for firms contracting expressly for either an at will or a just cause contract. The coefficients measure the influence of each variable on the probability of choosing to offer a just cause contract. Thus, positive coefficients indicate that an employer is more likely to offer just cause and negative coefficients identify characteristics that make firms less likely to offer just cause.
Table 2

<table>
<thead>
<tr>
<th>Variable</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
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<td>(0.02)</td>
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<td>(0.79)</td>
<td>(0.81)</td>
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<td>(0.18)</td>
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<tr>
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<tr>
<td></td>
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<td>(0.98)</td>
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<tr>
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<td>(0.11)</td>
<td>(0.12)</td>
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<td>(0.11)</td>
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<td>(0.67)</td>
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<tr>
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<td>(0.19)</td>
<td>(0.20)</td>
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</table>

Model 3 and Model 4 were estimated on data for the 116 employers in California and Virginia who contracted expressly for terms governing discharge. P-values for the significance of the Wald statistic are reported in parentheses below each coefficient.