In Defense of the Contract at Will

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The persistent tension between private ordering and government regulation exists in virtually every area known to the law, and in none has that tension been more pronounced than in the law of employer and employee relations. During the last fifty years, the balance of power has shifted heavily in favor of direct public regulation, which has been thought strictly necessary to redress the perceived imbalance between the individual and the firm. In particular the employment relationship has been the subject of at least two major statutory revolutions. The first, which culminated in the passage of the National Labor Relations Act in 1935,[1] set the basic structure for collective bargaining that persists to the current time. The second, which is embodied in Title VII of the Civil Rights Act of 1964,[2] offers extensive protection to all individuals against discrimination on the basis of race, sex, religion, or national origin. The effect of these two statutes is so pervasive that it is easy to forget that, even after their passage, large portions of the employment relation remain subject to the traditional common law rules, which when all was said and done set their face in support of freedom of contract and the system of voluntary exchange. One manifestation of that position was the prominent place that the common law, especially as it developed in the nineteenth century, gave to the contract at will. The basic position was well set out in an oft-quoted passage from *Payne v. Western & Atlantic Railroad:*

> [M]en must be left, without interference to buy and sell where they please, and to discharge or retain employees at will for good cause or for no cause, or even for bad cause without thereby being guilty of an unlawful act *per se*. It is a right which an employe may exercise in the same way, to the same

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[1] Act of July 5, 1935, ch. 372, 49 Stat. 449 (codified as amended at 29 U.S.C. §§ 151-169 (1982)).

[2] Pub. L. No. 88-352, 78 Stat. 253 (codified as amended at 42 U.S.C. §§ 2000e to 2000e-17 (1982)).

extent, for the same cause or want of cause as the employer.[3]

The survival of the contract at will, and the frequency of its use in private markets, might well be taken as a sign of its suitability for employment relations. But the contract at will has been in retreat even at common law, as the movement for public control of labor markets has now spilled over into the judicial arena. The judicial erosion of the older position has been spurred on by academic commentators, who have been almost unanimous in their condemnation of the at-will relationship, often treating it as an archaic relic that should be jettisoned along with other vestiges of nineteenth-century laissez-faire.[4] Thus it is commonly asserted

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[3] Payne v. Western & Atl. R.R., 81 Tenn. 507, 518-19 (1884), *overruled on other grounds*, Hutton v. Watters, 132 Tenn. 527, 544, 179 S.W. 134, 138 (1915). The passage continues as follows:

> He may refuse to work for a man or company, that trades with any obnoxious person, or does other things which he dislikes. He may persuade his fellows and the employer may lose all his hands and be compelled to close his doors; or he may yield to the demand and withdraw his custom or cease his dealings, and the obnoxious person be thus injured or wrecked in business.

81 Tenn. at 519. It should be noted that *Payne* did not itself involve the discharge of an employee for a bad reason or no reason at all. As the last two quoted sentences indicate, the question of the status of the contract arose obliquely, in a defamation suit by a merchant against a railroad. The railroad's yard master had posted a sign that read: "Any employe of this company on Chattanooga pay-roll who trades with L. Payne from this date will be discharged. Notify all in your department." *Payne*, 81 Tenn. at 510.

The plaintiff Payne claimed that his business, which had been heavily dependent upon the trade of railroad workers, had thereby been ruined. The court held for the defendant on the grounds that (a) there was no defamation implicit in the announcement and (b) the employer's notice to its employees was within its rights because all the contracts with its workers were terminable at will. *Hutton* overruled *Payne*, not on the ground that contracts at will were against public policy, but on an abuse-of-rights theory according to which an employer cannot use his right to discharge employees for the sole purpose of harming third-party interests. The propriety of the *Hutton* theory is a difficult question, but my views tend toward those of the *Payne* court. *See* Epstein, *A Common Law for Labor Relations: A Critique of the New Deal Labor Legislation*, 92 YALE L.J. 1357, 1367-69, 1381 (1983).

[4] *E.g.*, Blackburn, *Restricted Employer Discharge Rights: A Changing Concept of Employment at Will*, 17 AM. BUS. L.J. 467, 491-92 (1980); Blades, *Employment at Will v. Individual Freedom: On Limiting the Abusive Exercise of Employer Power*, 67 COLUM. L. REV. 1404, 1405-06, 1413-14, 1435 (1967); Blumrosen, *Employer Discipline: United States Report*, 18 RUTGERS L. REV. 428, 428-34 (1964); Feinman, *The Development of the Employment at Will Rule*, 20 AM. J. LEGAL HIST. 118, 131-35 (1976); Murg & Scharman, *Employment at Will: Do the Exceptions Overwhelm the Rule?*, 23 B.C.L. REV. 329, 338-40, 383-84 (1982); Peck, *Unjust Discharges from Employment: A Necessary Change in the Law*, 40 OHIO ST. L.J. 1, 1-10 (1979); Summers, *Individual Protection Against Unjust Dismissal: Time for a Statute*, 62 VA. L. REV. 481, 484 (1976); Weynard, *Present Status of Individual Employee Rights*, PROC. N.Y.U. 22D ANN. CONF. ON LAB. 171, 214-16 (1970); Note, *Guidelines for a Public Policy Exception to the Employment at Will Rule*, 13 CONN. L. REV. 617, 641-42 (1980); Note, *Protecting Employees at Will Against Wrongful Discharge: The Public Policy Exception*, 96 HARV. L. REV. 1931, 1931-35 (1983); Note, *Protecting At Will Employees Against Wrongful Discharge: The Duty to Terminate Only in Good Faith*, 93

that, however congenial the contract at will might have been to the conditions of earlier times, major transformations in firm organization and industrial production have rendered it anachronistic today. One early and influential attack on the contract at will shows the importance of the issues that it raises:

> It is a widely accepted proposition that large corporations now pose a threat to individual freedom comparable to that which would be posed if governmental power were unchecked. The proposition need not, however, be limited to the mammoth business corporation, for the freedom of the individual is threatened whenever he becomes dependent upon a private entity possessing greater power than himself. Foremost among the relationships of which this generality is true is that of employer and employee.[5]

The contract at will is thus thought to be particularly unwise because it invites the exercise of arbitrary power by persons with a dominant economic position against individuals whose mobility is said to be limited by the structure of labor markets. The absence of viable alternative employment opportunities is thought to leave employees vulnerable to coercion and exploitation. In the extreme situation, employers (or their managers) are said to fire workers out of personal animosity; the animosity may stem from the worker's refusal to grant personal or sexual favors or from a simple and irrational dislike of the personal characteristics or habits of the employee.[6] Once the outcomes of these market imperfections are identified, the conclusion is said to follow swiftly: where discharges from employment are not made for sound economic reasons, or to advance the financial interest of the firm, the power of the law must be used to redress the perceived imbalance.

The courts have been heavily influenced by these arguments,

HARV. L. REV. 1816, 1824-28 (1980) [hereinafter cited as Note, *Wrongful Discharge*]; Note, *A Common Law Action for the Abusively Discharged Employee*, 26 HASTINGS L.J. 1435, 1443-46 (1975); Note, *Implied Contract Rights to Job Security*, 26 STAN. L. REV. 335, 337-40 (1974); Note, *California's Controls on Employer Abuse of Employee Political Rights*, 22 STAN. L. REV. 1015, 1015-20 (1970).

5 Blades, *supra* note 4, at 1404 (footnotes omitted). Examples of the subsequent literature on the point are cited *supra* note 4.

6 Such allegations were made in Alcorn v. Anbro Eng'g, Inc., 2 Cal. 3d 493, 496-97, 468 P.2d 216, 217, 86 Cal. Rptr. 88, 89 (1970) (employee dismissed due to employer's animosity toward employee on the basis of his race and his union activities); Monge v. Beebe Rubber Co., 114 N.H. 130, 131-32, 316 A.2d 549, 550-51 (1974) (employee dismissed due to refusal to date her foreman); Hutton v. Watters, 132 Tenn. 527, 529-30, 179 S.W. 134, 134-35 (1915) (employees dismissed for patronizing a boarding house whose owner was personally disliked by employer).

and the tempo of their intervention into market processes has increased rapidly in recent years.[7] The underlying rationale for the intervention is well captured by the conclusion of the New Hampshire Supreme Court in *Monge v. Beebe Rubber Co.*: "We hold that a termination by the employer of a contract of employment at will which is motivated by bad faith or malice or based on retaliation is not in the best interest of the economic system or the public good and constitutes a breach of the employment contract."[8] Once the wrongful discharge is established, damages can be awarded or reinstatement can be ordered. More recently, legislatures have begun to consider proposals that replace the contract at will with an action for wrongful discharge, so that all private contracts of employment would be terminable by the employer only upon a showing of

[7] There appear to be three theories under which courts have recognized a cause of action for wrongful discharge: (1) discharge violates public policy; (2) discharge violates an implied term of contract; and (3) discharge constitutes a tort of emotional harm.

The public-policy approach is the most widely accepted. *See, e.g.*, Tameny v. Atlantic Richfield Co., 27 Cal. 3d 167, 176-77, 610 P.2d 1330, 1336, 164 Cal. Rptr. 839, 844-45 (1980) (dismissal for refusal to participate in price-fixing scheme); Glenn v. Clearman's Golden Cock Inn, Inc., 192 Cal. App. 2d 793, 796-97, 13 Cal. Rptr. 769, 771 (1961) (employee dismissed for joining a union); Petermann v. Teamsters Local 396, 174 Cal. App. 2d 184, 188-89, 344 P.2d 25, 27-28 (1959) (employee dismissed for refusing to commit perjury); Kelsay v. Motorola, Inc., 74 Ill. 2d 172, 181-83, 384 N.E.2d 353, 358-59 (1978) (employee dismissed for filing workers' compensation claim); Frampton v. Central Ind. Gas Co., 260 Ind. 249, 252-53, 297 N.E.2d 425, 428 (1973) (same); Sventko v. Kroger Co., 69 Mich. App. 644, 648, 245 N.W.2d 151, 153 (1976) (same); O'Sullivan v. Mallon, 160 N.J. Super. 416, 417-18, 390 A.2d 149, 150 (Law Div. 1978) (medical technician fired for refusal to perform operation for which she was not licensed); Nees v. Hocks, 272 Or. 210, 218-19, 536 P.2d 512, 515-16 (1975) (employee dismissed for serving on a jury); Reuther v. Fowler & Williams, Inc., 255 Pa. Super. 28, 32, 386 A.2d 119, 120 (1978) (dismissal for serving on jury) (dictum); Harless v. First Nat'l Bank, 246 S.E.2d 270, 275-76 (W. Va. 1978) (employee dismissed for calling attention to employer's violation of law).

The contract theory has also been used by a number of courts. *See, e.g.*, McKinney v. National Dairy Council, 491 F. Supp. 1108, 1122 (D. Mass. 1980) (dismissal due to age); Cleary v. American Airlines, 111 Cal. App. 3d 443, 456, 168 Cal. Rptr. 722, 729 (1980) (dismissal without the investigation or hearing that was normally part of employer's procedure); Maddaloni v. Western Mass. Bus Lines, 386 Mass. 877, 878-80, 438 N.E.2d 351, 354-56 (1982) (discharge to avoid paying commissions due); Fortune v. National Cash Register Co., 373 Mass. 96, 101, 364 N.E.2d 1251, 1255-56 (1977) (same); Toussaint v. Blue Cross & Blue Shield, 408 Mich. 579, 598, 292 N.W.2d 880, 885 (1980) (implied term forbidding dismissal except for cause); Weiner v. McGraw-Hill, Inc., 57 N.Y.2d 458, 465-66, 443 N.E.2d 441, 445, 457 N.Y.S.2d 193, 197 (1982) (same).

Finally, courts have occasionally treated discharge as a tortious infliction of emotional harm. *See, e.g.*, Alcorn v. Anbro Eng'g, Inc., 2 Cal. 3d 493, 498, 468 P.2d 216, 218, 86 Cal. Rptr. 88, 90-91 (1970); Agis v. Howard Johnson Co., 371 Mass. 140, 144-45, 355 N.E.2d 315, 318-19 (1976).

[8] 114 N.H. 130, 133, 316 A.2d 549, 551 (1974). Note, however, that the New Hampshire Supreme Court has since retreated from this broad view. *See* Howard v. Dorr Woolen Co., 120 N.H. 295, 297, 414 A.2d 1273, 1274 (1980) (limiting the *Monge* approach to cases involving violations of specific public policies).

"just cause," which would often be determined by an elaborate structure of mediation, arbitration, and administrative action.[9]

There is thus today a widely held view that the contract at will has outlived its usefulness. But this view is mistaken. The contract at will is not ideal for every employment relation. No court or legislature should ever command its use. Nonetheless, there are two ways in which the contract at will should be respected: one deals with entitlements against regulation and the other with presumptions in the event of contractual silence.

First, the parties should be permitted as of right to adopt this form of contract if they so desire. The principle behind this conclusion is that freedom of contract tends both to advance individual autonomy and to promote the efficient operation of labor markets.

Second, the contract at will should be respected as a rule of construction in response to the perennial question of gaps in contract language: what term should be implied in the absence of explicit agreement on the question of duration or grounds for termination? The applicable standard asks two familiar questions: what rule tends to lend predictability to litigation and to advance the joint interests of the parties?[10] On both these points I hope to show that the contract at will represents in most contexts the efficient solution to the employment relation. To be sure, the stakes are lower where the outright prohibition is no longer in the offing. No rule of construction ever has the power of a rule of regulation, since the parties by negotiation can reverse what the law otherwise commands. Nonetheless, bad rules of contract construction have costs that should not be understated, here or elsewhere. The rule of construction is normally chosen because it reflects the dominant practice in a given class of cases and because that practice is itself regarded as making good sense for the standard transactions it governs. It is of course freely waivable by a joint expression of contrary intention. When the law introduces a just-cause requirement,

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[9] Bills have been introduced in Michigan, California, Wisconsin, Ohio, Pennsylvania, and Massachusetts. Chicago Sun-Times, June 10, 1984, at 32, col. 1 (2-star ed.).

[10] The traditional rule has been codified under current California law: "An employment, having no specified term, may be terminated at the will of either party on notice to the other." CAL. LAB. CODE § 2922 (West 1971). Indeed, this should mean, as it now does, that where a contract speaks of "permanent" employment, the presumption should again be that the contract is terminable at will, for all that "permanent" connotes is the absence of any definite termination date. It does not imply one in which there is a lifetime engagement by either employer or employee, especially where none of the subsidiary terms for such a long-term relationship is identified by the parties. The proper rule of construction should be that the contract is terminable at will by either side.

it flies in the face of ordinary understandings and thus rests upon an assumption that just-cause arrangements are in the broad run of cases either more frequent or desirable than the contract at will, though neither is the case. Where this rule of construction is used, therefore, contracting-out will have to take place in the very large number of cases where the parties desire to conform to the norm by entering into a contract at will. Furthermore, it may be difficult to waive the for-cause requirement in fact, even if waiver is formally allowable as a matter of law, because of high standards for "informed" waiver that cannot be met after the fact. By degrees, the original presumption against the contract at will could so gain in strength that a requirement that is waivable in theory could easily become conclusive in fact.

These complications should all be avoided. The critics of the contract at will all point out imperfections in the current institutional arrangements, but they do not take into account the nonlegal means of preserving long-term employment relationships, and they ignore the greater imperfections that are created under alternative legal rules. Contracts at will are consistent with public policy and should be welcomed by it, not because they are perfect, but because in many contexts they respond to the manifold perils of employment contracts better than any rivals that courts or legislatures can devise.

In this area of private-contracting autonomy, there are some exceptions, arising out of the infrequent cases in which discharge of the contract at will is inconsistent with the performance of some public duty or with the protection of some public right. Just as a contract to commit murder should not be enforceable, neither should one to pollute illegally or to commit perjury.[11] But these

[11] This problem has arisen where employees at will have refused to perjure themselves on behalf of the employer, *e.g.*, Petermann v. Teamsters Local 396, 174 Cal. App. 2d 184, 188-89, 344 P.2d 25, 27-28 (1959) (discharge for refusal to commit perjury held wrongful), or where workers have been dismissed because they have filed workers' compensation claims, *e.g.*, Frampton v. Central Ind. Gas Co., 260 Ind. 249, 252-53, 297 N.E. 2d 425, 428 (1973) (discharge for filing claim held wrongful). It seems clear that any contract to commit perjury should simply be treated as illegal. The workers' compensation case is more difficult both because there is less justification for the coercive character of compensation, since no third-party interests are at stake, and because in all events the worker is entitled to file his claim and will do so if its value exceeds the gains he expects from the employment contract. A common law court cannot, however, attack the soundness of a statutory compensation system, so that this restraint on freedom of contract should be as valid as one imposed for the protection of strangers. At this point the central question concerns the proper remedy. Typically, reinstatement of the plaintiff is ordered, which has the disadvantage of requiring the court to supervise an ongoing relationship. It may well be that the employer should be able to fire the worker, but nonetheless be required to pay damages, preferably fixed by statute,

cases, however difficult in their own right, in no way require abandoning the basic common law presumption in favor of contracts at will. The recent efforts to undermine or abolish the contract at will should be evaluated not in terms of what they *hope* to achieve, whether stated in terms of worker participation, industrial harmony, fundamental fairness, or enlightened employment relations. Instead they should be evaluated for the generally harsh results that they actually produce. They introduce an enormous amount of undesirable complexity into the law of employment relations; they increase the frequency of civil litigation; and over the broad run of cases they work to the disadvantage of both the employers and the employees whose conduct they govern.

In the remainder of this paper, I examine the arguments that can be made for and against the contract at will. I hope to show that it is adopted not because it allows the employer to exploit the employee, but rather because over a very broad range of circumstances it works to the mutual benefit of both parties, where the benefits are measured, as ever, at the time of the contract's formation and not at the time of dispute. To justify this result, I examine the contract in light of the three dominant standards that have emerged as the test of the soundness of any legal doctrine: intrinsic fairness, effects upon utility or wealth, and distributional consequences. I conclude that the first two tests point strongly to the maintenance of the at-will rule, while the third, if it offers any guidance at all, points in the same direction.

I. The Fairness of the Contract at Will

The first way to argue for the contract at will is to insist upon the importance of freedom of contract as an end in itself. Freedom of contract is an aspect of individual liberty, every bit as much as freedom of speech, or freedom in the selection of marriage partners or in the adoption of religious beliefs or affiliations. Just as it is regarded as prima facie unjust to abridge these liberties, so too is it presumptively unjust to abridge the economic liberties of individuals. The desire to make one's own choices about employment may be as strong as it is with respect to marriage or participation in religious activities, and it is doubtless more pervasive than the desire to participate in political activity. Indeed for most people, their own health and comfort, and that of their families, depend

to the worker. On the clear public-policy exception to the validity of contracts at will, see generally Murg & Scharman, *supra* note 4, at 343-55.

critically upon their ability to earn a living by entering the employment market. If government regulation is inappropriate for personal, religious, or political activities, then what makes it intrinsically desirable for employment relations?

It is one thing to set aside the occasional transaction that reflects only the momentary aberrations of particular parties who are overwhelmed by major personal and social dislocations. It is quite another to announce that a rule to which vast numbers of individuals adhere is so fundamentally corrupt that it does not deserve the minimum respect of the law. With employment contracts we are not dealing with the widow who has sold her inheritance for a song to a man with a thin mustache. Instead we are dealing with the routine stuff of ordinary life; people who are competent enough to marry, vote, and pray are not unable to protect themselves in their day-to-day business transactions.

Courts and legislatures have intervened so often in private contractual relations that it may seem almost quixotic to insist that they bear a heavy burden of justification every time they wish to substitute their own judgment for that of the immediate parties to the transactions. Yet it is hardly likely that remote public bodies have better information about individual preferences than the parties who hold them. This basic principle of autonomy, moreover, is not limited to some areas of individual conduct and wholly inapplicable to others. It covers all these activities as a piece and admits no ad hoc exceptions, but only principled limitations.

This general proposition applies to the particular contract term in question. Any attack on the contract at will in the name of individual freedom is fundamentally misguided. As the Tennessee Supreme Court rightly stressed in *Payne*, the contract at will is sought by both persons.[12] Any limitation upon the freedom to enter into such contracts limits the power of workers as well as employers and must therefore be justified before it can be accepted. In this context the appeal is often to an image of employer coercion.[13] To be sure, freedom of contract is not an absolute in the employment context, any more than it is elsewhere. Thus the principle must be understood against a backdrop that prohibits the use of private contracts to trench upon third-party rights, including uses that interfere with some clear mandate of public policy, as

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[12] Payne v. Western & Atl. R.R., 81 Tenn. 507, 518-19 (1884). *See supra* note 3 and accompanying text.

[13] *See supra* note 5 and accompanying text.

in cases of contracts to commit murder or perjury.[14]

In addition, the principle of freedom of contract also rules out the use of force or fraud in obtaining advantages during contractual negotiations; and it limits taking advantage of the young, the feeble-minded, and the insane.[15] But the recent wrongful discharge cases do not purport to deal with the delicate situations where contracts have been formed by improper means or where individual defects of capacity or will are involved. Fraud is not a frequent occurrence in employment contracts, especially where workers and employers engage in repeat transactions. Nor is there any reason to believe that such contracts are marred by misapprehensions, since employers and employees know the footing on which they have contracted: the phrase "at will" is two words long and has the convenient virtue of meaning just what it says, no more and no less.[16]

An employee who knows that he can quit at will understands what it means to be fired at will, even though he may not like it after the fact. So long as it is accepted that the employer is the full owner of his capital and the employee is the full owner of his labor, the two are free to exchange on whatever terms and conditions they see fit, within the limited constraints just noted. If the arrangement turns out to be disastrous to one side, that is his problem; and once cautioned, he probably will not make the same mistake a second time. More to the point, employers and employees are unlikely to make the same mistake once. It is hardly plausible that contracts at will could be so pervasive in all businesses and at all levels if they did not serve the interests of employees as well as employers. The argument from fairness then is very simple, but not for that reason unpersuasive.

II. The Utility of the Contract at Will

The strong fairness argument in favor of freedom of contract makes short work of the various for-cause and good-faith restrictions upon private contracts. Yet the argument is incomplete in several respects. In particular, it does not explain why the presumption in the case of silence should be in favor of the contract at

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[14] *See supra* note 11.

[15] For my elaboration of this general point, see Epstein, *Unconscionability: A Critical Reappraisal,* 18 J.L. & Econ. 293 (1975).

[16] In the absence of force or fraud, any disclosure law would be regarded as only a nuisance by employers and employees alike, whatever the case for such laws in other contexts. *See, e.g.,* Kronman, *Mistake, Disclosure, Information, and the Law of Contracts,* 7 J. Legal Stud. 1, 11-18 (1978).

will. Nor does it give a descriptive account of *why* the contract at will is so commonly found in all trades and professions. Nor does the argument meet on their own terms the concerns voiced most frequently by the critics of the contract at will. Thus, the commonplace belief today (at least outside the actual world of business) is that the contract at will is so unfair and one-sided that it cannot be the outcome of a rational set of bargaining processes any more than, to take the extreme case, a contract for total slavery. While we may not, the criticism continues, be able to observe them, defects in capacity at contract formation nonetheless must be present: the ban upon the contract at will is an effective way to reach abuses that are pervasive but difficult to detect, so that modest government interference only strengthens the operation of market forces.[17]

In order to rebut this charge, it is necessary to do more than insist that individuals as a general matter know how to govern their own lives. It is also necessary to display the structural strengths of the contract at will that explain why rational people would enter into such a contract, if not all the time, then at least most of it. The implicit assumption in this argument is that contracts are typically for the mutual benefit of both parties. Yet it is hard to see what other assumption makes any sense in analyzing institutional arrangements (arguably in contradistinction to idiosyncratic, nonrepetitive transactions). To be sure, there are occasional cases of regret after the fact, especially after an infrequent, but costly, contingency comes to pass. There will be cases in which parties are naive, befuddled, or worse. Yet in framing either a rule of policy or a rule of construction, the focus cannot be on that biased set of cases in which the contract aborts and litigation ensues. Instead, attention must be directed to standard repetitive transactions, where the centralizing tendency powerfully promotes expected mutual gain. It is simply incredible to postulate that either employers or employees, motivated as they are by self-interest,

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[17] Kronman, *Paternalism and the Law of Contracts*, 92 YALE L.J. 763, 777 (1983). The point is especially important in connection with the law of undue influence, where there is a long historical dispute over the relationship between the adequacy of consideration received and the procedural soundness of the underlying transaction. *See* Simpson, *The Horwitz Thesis and the History of Contracts*, 46 U. CHI. L. REV. 533, 561-80 (1979). Nonetheless, paternalistic explanations, whatever their force elsewhere, have little power in connection with employment relations. Indeed, if one thought it appropriate to restrict the powers of workers to make their own decisions during negotiations over the terms of employment, it might follow that restrictions on their right to participate in unions could be justified as well, for in both instances workers have proven that they often need to be protected against their own folly.

would enter routinely into a transaction that leaves them worse off than they were before, or even worse off than their next best alternative.

From this perspective, then, the task is to explain how and why the at-will contracting arrangement (in sharp contrast to slavery) typically works to the mutual advantage of the parties. Here, as is common in economic matters, it does not matter that the parties themselves often cannot articulate the reasons that render their judgment sound and breathe life into legal arrangements that are fragile in form but durable in practice.[18] The inquiry into mutual benefit in turn requires an examination of the full range of costs and benefits that arise from collaborative ventures. It is just at this point that the nineteenth-century view is superior to the emerging modern conception. The modern view tends to lay heavy emphasis on the need to control employer abuse. Yet, as the passage from *Payne* indicates,[19] the rights under the contract at will are fully bilateral, so that the employee can use the contract as a means to control the firm, just as the firm uses it to control the worker.

The issue for the parties, properly framed, is not how to minimize employer abuse, but rather how to maximize the gain from the relationship, which in part depends upon minimizing the sum of employer and employee abuse. Viewed in this way the private-contracting problem is far more complex. How does each party create incentives for the proper behavior of the other? How does each side insure against certain risks? How do both sides minimize the administrative costs of their contracting practices?

In order to show the interaction of all relevant factors, it is useful to analyze a case in which the problem of bilateral control exists, but where the overtones of inequality of bargaining power are absent. The treatment of partnership relations is therefore very instructive because partners are generally social and economic

[18] One striking example of the durability of at-will arrangements in other markets comes from an issue frequently litigated in the law of eminent domain: whether a tenant in possession under a lease is entitled to compensation for the simple expectation of renewal of the lease when the government condemns the fee or the leasehold itself. The legal conclusion is that the tenant should receive compensation equal to the market value of the leasehold that he could have received from a willing buyer, taking into account the expectation of renewal. *See* Almota Farmers Elevator & Warehouse Co. v. United States, 409 U.S. 470, 473-74 (1973). But the problem only arises because the value of the expectation to the tenant is high, which in turn suggests that the probability of renewal is great, and indeed often approaches one hundred percent.

[19] Payne v. Western & Atl. R.R., 81 Tenn. 507, 518-19 (1884). *See supra* note 3 and accompanying text.

equals between whom considerations of inequality of bargaining power, so evident in the debate over the contract at will, have no relevance. To be sure, the structural differences between partnership and employment contracts must be identified, but these will in the end explain why the at-will contract may make even greater sense in the employment context.

A. At-Will Arrangements in Partnerships

The economic motivation to form partnerships is easy enough to understand. Partnerships allow individuals to pool the capital necessary to undertake larger ventures, and they allow the parties to obtain the benefits of a division of labor within a single firm, where each partner retains some equity claim in the final output of the firm. By combining their separate resources and talents in a cooperative venture, the parties can produce more of value than they could by acting separately and then exchanging their outputs in discrete market transactions, such as sale or barter.

Nonetheless, the organization of the simplest firm, i.e., one with only two people, creates a set of problems that does not exist for the sole entrepreneur: the question of management. The efforts of the two individuals must be coordinated, and each person must be sure that some steps are taken to prevent the other party to the contract from acting to nullify or reduce the advantages that are promised at formation.

The first business question that confronts the partnership is the division of the proceeds. If these are to be evenly divided, then some steps, some costly steps, must be taken to ensure equal contributions. Thus, for example, the two parties may have different types of skills with different market values. Should some difference in the time allocated to the partnership be required? Should the less productive partner be required to commit some additional cash or property to the joint venture? Or should the equal division of partnership gains be abandoned in favor of some complex formula, with partners resorting to intricate capital structures complete with loans, preferred interests, and options to purchase? The matter is, moreover, not simply one of fairness when disputes occur, but also of the incentives created upon contract formation. The less effective the mechanics for controlling the contribution of resources and the distribution of gains, the less likely it will be that the venture will be formed, and the smaller will be the expected gains, both private and social.

A critical variable in partnership formation is the level of effort the parties will bring to the joint venture. One naive assumption is that the cooperative nature of the enterprise will not influence the effort and performance levels of the partners. Yet, as the economic literature on agency costs so tellingly demonstrates,[20] hidden conflicts of interest pervade all business organizations at birth, during life, and upon death. The obvious conflict of interest arises when the gains of one partner are the losses of the other, as with simple theft of partnership assets by a partner. A second form of conflict, less dramatic but more persistent, arises because each partner bears the full costs of his own individual action, while obtaining only some fraction of the partnership gain that that action produces. The wedge necessarily driven between private and social (i.e., firm) costs creates an incentive for each partner to produce only to the point where, at the margin, the total amount of private gain is some multiple (greater than one) of the additional unit of private cost.[21] That tendency can manifest itself in any number of ways. Each partner may not work as hard as he would were he in business alone. Each partner may divert firm business to his own private account, all at a sporting discount, if only the customer remains quiet about the special arrangement. If both partners engage in this opportunistic behavior, then the firm output will fall below the levels it would achieve if they both continued to labor until, at the margin, *partnership* gains matched *partnership* costs.

These potential conflicts of interest will not materialize in each and every case, but they do pose a persistent threat to the stability of the firm. Within this framework, therefore, the managerial task is to determine what devices increase the likelihood that both partners will produce to the ideal point. In part there are legal prohibitions. The diversion of partnership assets can be met

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[20] *See* Jensen & Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure,* 3 J. Fin. Econ. 305, 308-10, 312-13, 333-34 (1976). For a recent collection of materials on the subject, see The Agency Relationship (J. Pratt & R. Zeckhauser eds. forthcoming), which contains a paper I wrote dealing with many of the same issues discussed here: Epstein, *Agency Cost, Employment Contracts, and Labor Unions.*

[21] The conflict can be stated formally as follows: let C represent costs to the individual, and G represent gains to the firm. Then assume any division of gain, p, for each partner that is strictly less than one. The conflict then arises whenever the following condition is established: $pG < C < G$. This inequality says that it is in the interest of the firm that the activity with cost C be undertaken, but that the individual actor will not undertake it because he is left worse off by the difference between C and pG. Good management rests in part upon the ability to narrow the gap between pG and G, or in the alternative to reduce the private costs to below pG. The challenge is to devise institutional arrangements that can overcome this fundamental conflict in discrete instances, and the problem in a sense is quite unending. If costs are reduced, then activities that were once unthinkable now become plausible, and with respect to some fraction of this new class, C will lie between pG and G.

with an action that recovers the proceeds for the benefit of the firm.[22] Yet litigation is always expensive and unpleasant. As a common sense matter an ounce of protection may be worth a pound of cure. With small partnerships one effective sanction is simply for each partner to watch the others: who comes to the office first, who leaves last; who does nonfirm work on firm time or with firm equipment; who receives the larger number of phone calls from customers; who generates the larger number of customer billings; whose services are in greater demand by outsiders.

The basic problem becomes only more complex as the size of the partnership increases—consider, for example, the division of profits in a large law firm, with its separate tiers of partners and, increasingly, permanent associates. A rough generalization is that as the size of the enterprise increases the demand for some internal organizational structure increases, perhaps exponentially, as well. Now the conflicts of interest become ever more acute as the gains from diversion increase because each partner receives a smaller fraction of firm profits.[23] Similarly, the informal social sanctions and affective ties among partners are attenuated by the sheer force of numbers. More formal procedures are required to control abuse, to protect, as it were, the well-intentioned partners from their fellows: personnel committees, formal audits, and managerial specialization quickly become standard parts of firm practice.

Partnership arrangements are difficult to police for yet another reason: all the partners are required to place all their eggs in

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[22] The problem here is one of the misappropriation of either partnership or corporate opportunity, and has been recognized as an issue as early as Roman times:

> A partnership lasts as long as the parties remain of the same mind, but when one of them renounces the partnership, it is dissolved. But of course if one of the partners renounces for the purpose of profiting alone by some coming gain, for example, if my partner in a universal partnership [one embracing all assets, however acquired], having been left heir by somone, renounces the partnership in order to gain the inheritance for himself alone, he will be compelled to share this gain. If, however, he makes other gain which he has not sought for, this belongs to him alone. I, on the other hand, have the sole right to anything whatever that I acquire after his renunciation of the partnership.

GAIUS, INSTITUTES, III, 151 (F. De Zulueta trans. 1946). Note the at-will presumption coupled with rules to prevent diversions of opportunity from the partnership; these rules are skewed so that the party in breach is left worse off, since he must share his own private gains but has no share in the gains of the innocent party. The Roman rule is carefully crafted and in essence represents the modern law, though it is unlikely that the Romans had any understanding of the formal economic theory of agency.

[23] A more formal statement, using the symbols set out *supra* note 21, would begin by noting that as the size of the firm increases, p (the fraction of the gain that goes to each partner) decreases. Then, returning to the basic inequality ($pG < C < G$), we can see that as p decreases, the interval between pG and G increases, and with it the likelihood and severity of conflicts of interest.

a single basket. The principal contribution to most partnerships is the partner's labor. Labor, unlike money, is not easily divisible among multiple investment opportunities. Therefore, while partners obtain the many advantages of firm specialization, they must sacrifice the advantage of risk diversification that is normally available in capital markets.[24] Not only is it possible to diversify risk at low cost in capital markets, but it is also easy to redeploy assets across firms. The threat of such redeployment, in turn, may be the investor's most powerful means of protecting himself from abuse at the hands of the firm's managers, who are always wary of hostile tender offers.[25]

Labor markets differ from capital markets in both of these particulars. Labor cannot be diversified in the normal service partnership because a person cannot be in more than one or two separate ventures at any given time and hope to maintain productive activities. A mutual fund for jobs is quite unthinkable. In addition, entrance and exit in labor markets is highly complex, as is often stressed in the literature critical of the contract at will.[26] Thus, a party may be legally entitled to withdraw from a joint venture at will, but he cannot substitute someone else in his place without the consent of the remaining partners, given the delicate personal chemistry behind any joint venture.

The consequences of low diversification and impaired practical alienability are clear. Labor ventures are inherently more risky. The choice of partners is critical at the outset, as is the need to monitor their activities continually. Yet attending to these needs raises a powerful tension that pervades partnership relations. Long-term cooperative ventures require some permanent internal structure, while effective control against abuse often depends upon the ability to withdraw from the venture at any time, and without

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[24] I have discussed some of these points in a similar vein in Epstein, *supra* note 20. For a convenient explanation of the principles of portfolio diversification, see Langbein & Posner, *Market Funds and Trust-Investment Law* (pt. 1), 1976 AM. B. FOUND. RESEARCH J. 1; *see also* Langbein & Posner, *Market Funds and Trust-Investment Law* (pt. 2), 1977 AM. B. FOUND. RESEARCH J. 1.

[25] Because the costs to shareholders of monitoring managerial decisions are high, they find it in their self-interest to remain passive and to avoid losses by simply selling their shares. *See* Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer,* 94 HARV. L. REV. 1161, 1170-71 (1981).

[26] *See, e.g.,* Blades, *supra* note 4, at 1405 ("Obviously, if every employee could go from job to job with complete ease, there would be little need to provide other means of escape from the improper exertion of employer pressure."). The effect of impaired mobility upon the desirability of the contract at will is discussed *infra* notes 45-46 and accompanying text.

cause, as most partnership agreements provide.[27]

The logic behind the right of withdrawal depends upon a delicate balance of advantage. In the simplest case, assume that the partnership originally calls for an even division of the gains between two partners. If partner *A* knows (or even has reason to believe) that partner *B* has misappropriated assets or opportunities belonging to the firm, his threat to withdraw will become instantly more credible because his losses from withdrawal must be measured against a (revised) baseline of less than half the partnership gains. *B*'s expected losses from dissolution will be correspondingly greater because he will lose the expected illicit gains obtained from improper behavior. *A*'s threat tends therefore to be made under those circumstances where it is most called for.

The at-will provision in partnership agreements by no means controls all abuse—nothing does that—because both sides will have to bear the costs of dissolution (including a costly partnership accounting) in the event that a break-up occurs. It is quite possible, for example, for *B* to engage in activities that net him more than his agreed-upon share of the assets if he knows that *A*'s costs of breaking up exceed his expected gains from dissolution. Nonetheless, the greater the wrongdoing by *B*, the more likely it is that dissolution will cost *A* less than continued abuse by *B*. The sanction of withdrawal remains imperfect, but it tends to become more credible as the abuses become greater. The provision for at-will dissolution of the partnership helps stabilize the arrangement after formation and thus tends to be in the interest of both parties at formation. To be sure, explicit legal remedies may be desired in cases of waste, but direct legal action always costs more than the simple act of separation, and any lawsuit is costly to bring and uncertain in its outcome. Thus, while resort to legal remedies is to be expected, it will not be frequent. Self-help by withdrawal may have a lower payoff, but its lower cost and greater predictability make it an effective sanction against misbehavior.

B. Employment at Will

When we move from partnerships to employment relations, we must determine how the differences in the relationships between

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[27] *See* Hillman, *Misconduct as a Basis for Excluding or Expelling a Partner: Effecting Commercial Divorce and Securing Custody of the Business*, 78 Nw. U.L. Rev. 527, 531 (1983); Hillman, *The Dissatisfied Participant in the Solvent Business Venture: A Consideration of the Relative Permanence of Partnerships and Close Corporations*, 67 Minn. L. Rev. 1, 4 (1983).

the parties influence the mix of the formal and informal control devices available to the parties. The starting point of the analysis is the difference in the ways in which profit and loss are divided. The central feature of a partnership is that the residual gains and losses are shared by the partners under an internal formula that makes both parties equity claimants. In the employment-contracting situation, the employer is the sole residual claimant upon the earnings of the firm, while the employee receives a fixed wage.[28] But this important difference does not mean that the advantages of the at-will arrangement are of no importance to the employment relationship. On the contrary, it is possible to identify a number of reasons why the at-will contract usually works for the benefit of both sides in employment as well as partnership contexts.

1. *Monitoring Behavior.* The shift in the internal structure of the firm from a partnership to an employment relation eliminates neither bilateral opportunism nor the conflicts of interest between employer and employee. Begin for the moment with the fears of the firm, for it is the firm's right to maintain at-will power that is now being called into question. In all too many cases, the firm must contend with the recurrent problem of employee theft and with the related problems of unauthorized use of firm equipment and employee kickback arrangements.[29] As the analysis of partnerships shows, however, the proper concerns of the firm are not limited to obvious forms of criminal misconduct. The employee on a fixed wage can, at the margin, capture only a portion of the gain from his labor, and therefore has a tendency to reduce output.[30] The employee who receives a commission equal to half the

[28] Sometimes the employee's wage will be fixed, not in dollar terms, but as a function of his own productivity (for example, sales personnel who work on commission). But even if the employee's claim is a function of the firm's profit from particular transactions, he is in a different position than is an owner. An individual salesman can make a fortune while the firm loses money; a pure equity partner cannot.

[29] For example, in Perks v. Firestone Tire & Rubber Co., 611 F.2d 1363, 1364 (3d Cir. 1979), the plaintiff, a discharged employee, had allowed the representative of a supplier to procure prostitutes for him.

[30] By way of comparison, his position is like that of a lienholder who is quite happy so long as the value of the security remains above the level of the lien, even if the venture itself does not prosper. This is one reason why there is an enormous reluctance to allow the mortgagee to enter into possession before default, especially when the equity in the property is large. The risks, of course, change radically upon default, at which point a mortgagee will generally want to keep up the property because its value is less than that of his lien. Note too that the conflict of interest is of great importance to an equity investor in a limited partnership who, having relied upon the valuation of property prepared for the mortgage lender, discovers that the lender's assessor was less sensitive than he is to the positive po-

firm's profit attributable to his labor may work hard, but probably not quite as hard as he would if he received the entire profit from the completed sale, an arrangement that would solve the agency-cost problem only by undoing the firm.

The mismatch between benefits received and capital or labor contributed, then, can and does exist between employer and employee just as it does between partner and partner. The different ways in which firm proceeds are divided only determines where and how the conflicts will arise, not whether they will arise. Indeed, since the roles of employer and employee are radically asymmetrical, the potential source of conflict is, if anything, larger than it is in relations between copartners. The conflicts between employer and employee may sometimes call for the severance of the relationship, just as they do in the partnership context. But the rational response is to counteract the tendency for employee abuse only to the point where private gain equals private cost.[31] Agency costs are like other costs that must be minimized in order for production to proceed, and the persistence of firms shows that this can be done.

The problem of management then is to identify the forms of social control that are best able to minimize these agency costs. Here the choices are the same as they were in the partnership situation. One obvious form of control is the force of law. The state can be brought in to punish cases of embezzlement or fraud. But this mode of control requires extensive cooperation with public officials and may well be frustrated by the need to prove the criminal offense (including mens rea) beyond a reasonable doubt, so that vast amounts of abuse will go unchecked. Private litigation instituted by the firm may well be used in cases of major grievances, either to recover the property that has been misappropriated or to prevent the individual employee from further diverting firm busi-

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tential of the project.

[31] There are analogies with corporate financial structures. Thus there is always a partial conflict of interest when a firm contains both debt and equity in its capital structure. The holders of the equity are, by virtue of the existence of the debt, induced to engage in riskier ventures than they would undertake without the debt. The explanation is clear enough. With the debt, the equity holders still obtain all the profits from the firm. But now the risk of bankruptcy is shared by others, thereby allowing the partial externalization of the costs of failure. *See* De Alessi, *Private Property and Dispersion of Ownership in Large Corporations,* 28 J. Fin. 839 (1973). The point does not condemn such debt structures, but it does invite the use of other control measures, such as limitations, contained in the original loan agreement, on the types of activities that the borrower may undertake. *See generally* Smith & Warner, *On Financial Contracting: An Analysis of Bond Covenants,* 7 J. Fin. Econ. 117 (1979).

ness to his own account. But private litigation, like public prosecution, is too blunt an instrument to counter employee shirking or the minor but persistent use of firm assets for private business.

As with the partnership, some alternative forms of control are needed. Internal auditors may help control some forms of abuse, and simple observation by coworkers may well monitor employee activities. (There are some very subtle tradeoffs to be considered when the firm decides whether to use partitions or separate offices for its employees.) Promotions, bonuses, and wages are also critical in shaping the level of employee performance.[32] But the carrot cannot be used to the exclusion of the stick. In order to maintain internal discipline, the firm may have to resort to sanctions against individual employees. It is far easier to use those powers that can be unilaterally exercised: to fire, to demote, to withhold wages, or to reprimand. These devices can visit very powerful losses upon individual employees without the need to resort to legal action, and they permit the firm to monitor employee performance continually in order to identify both strong and weak workers and to compensate them accordingly. The principles here are constant, whether we speak of senior officials or lowly subordinates, and it is for just this reason that the contract at will is found at all levels in private markets.

The parallels to the partnership situation are instructive, for the at-will arrangement is, if anything, even more effective between employers and employees. As with partnerships, the threat, be it of discharge or resignation, becomes more effective the greater the level of employee or employer abuse; it is thus an effective if informal means of encouraging self-restraint. In addition, within the employment context firing does not require a disruption of firm operations, much less an expensive division of its assets. It is instead a clean break with consequences that are immediately clear to both sides. The lower cost of both firing and quitting, therefore, helps account for the very widespread popularity of employment-at-will contracts. There is no need to resort to any theory of economic domination or inequality of bargaining power to explain at-will contracting, which appears with the same tenacity in relations

[32] *See, e.g.*, Malcomson, *Work Incentives, Hierarchy, and Internal Labor Markets*, 92 J. Pol. Econ. 486 (1984), for one effort to model the effectiveness of using internal promotions to improve workers' performance when monitoring is costly and hence imperfect. Malcomson's model does not address the question of whether the workers are under term contracts or contracts at will, but the structure of his argument is consistent with the at-will model of legal relations.

between economic equals and subordinates and is found in many complex commercial arrangements, including franchise agreements, except where limited by statutes.[33]

Thus far, the analysis generally has focused on the position of the employer. Yet for the contract at will to be adopted ex ante, it must work for the benefit of workers as well. And indeed it does, for the contract at will also contains powerful limitations on employers' abuses of power. To see the importance of the contract at will to the employee, it is useful to distinguish between two cases. In the first, the employer pays a fixed sum of money to the worker and is then free to demand of the employee whatever services he wants for some fixed period of time. In the second case, there is no fixed period of employment. The employer is free to demand whatever he wants of the employee, who in turn is free to withdraw for good reason, bad reason, or no reason at all.

The first arrangement invites abuse by the employer, who can now make enormous demands upon the worker without having to take into account either the worker's disutility during the period of service or the value of the worker's labor at contract termination. A fixed-period contract that leaves the worker's obligations unspecified thereby creates a sharp tension between the parties, since the employer receives all the marginal benefits and the employee bears all the marginal costs.[34]

Matters are very different where the employer makes increased demands under a contract at will. Now the worker can quit whenever the net value of the employment contract turns negative. As with the employer's power to fire or demote, the threat to quit

[33] As an example of a restriction upon the power of termination, automobile dealers may recover damages resulting from a manufacturer's failure to act in good faith in not renewing the dealer's franchise. 15 U.S.C. §§ 1221-1225 (1982). These provisions were conceived of as a supplement to the antitrust laws. Act of Aug. 8, 1956, Pub. L. No. 1026, 70 Stat. 1125 (codified at 15 U.S.C. §§ 1221-1225 (1982)) (statement of purpose).

[34] This makes it difficult to accept the argument that "[e]mployment at will is the ultimate guarantor of the capitalist's authority over the worker." Feinman, *supra* note 4, at 132-33. Yet, as Feinman notes, historically the employees who brought actions were generally those who earned high salaries. *Id.* at 118, 131-33. This is simply enough explained by noting that those would have been the only cases in which the amount in controversy exceeded the plaintiff's expected costs of suit. But the fact that employees could also quit at will makes it difficult to see in the at-will device the exploitation of the working class, especially since real wages were continually rising throughout the eighteenth and nineteenth centuries. *See* D. DIAMOND & J. GUILJOIL, UNITED STATES ECONOMIC HISTORY 277, 468 (1973); HERMAN E. KROOSS, AMERICAN ECONOMIC DEVELOPMENT 395-98 (2d ed. 1966); S. RATNER, J. SOLTOW & R. SYLLA, THE EVOLUTION OF THE AMERICAN ECONOMY 247, 308-09 (1979). Nor does a theory focusing on the employer's authority account for the right of the employee to *quit* at will.

(or at a lower level to come late or leave early) is one that can be exercised without resort to litigation. Furthermore, that threat turns out to be most effective when the employer's opportunistic behavior is the greatest because the situation is one in which the worker has least to lose. To be sure, the worker will not necessarily make a threat whenever the employer insists that the worker accept a less favorable set of contractual terms, for sometimes the changes may be accepted as an uneventful adjustment in the total compensation level attributable to a change in the market price of labor. This point counts, however, only as an additional strength of the contract at will, which allows for small adjustments *in both directions* in ongoing contractual arrangements with a minimum of bother and confusion.

The case for the contract at will is further strengthened by another feature common to contracts of this sort. The employer is often required either to give notice or to pay damages in lieu of notice; damages are traditionally equal to the wages that the employee would have earned during the notice period. These provisions for "severance pay" provide the worker with some protection against casual or hasty discharges, but they do not interfere with the powerful efficiency characteristics of the contract at will. First, lump-sum transfers do not require the introduction of any "for cause" requirement, which could be the source of expensive litigation. Second, because the sums are definite, they can be easily computed, so that administrative costs are minimized. Third, because the payments are unconditional, they do not create perverse incentives for the employee or heavy monitoring costs for the employer: the terminated employee will not be tempted to avoid gainful employment in order to run up his damages for wrongful discharge; the employer, for his part, will not have to monitor the post-termination behavior of the employee in order to guard against that very risk. Thus, provisions for severance pay can be used to give employees added protection against arbitrary discharge without sacrificing the advantages of a clean break between the parties.

2. *Reputational Losses.* Another reason why employees are often willing to enter into at-will employment contracts stems from the asymmetry of reputational losses. Any party who cheats may well obtain a bad reputation that will induce others to avoid dealing with him. The size of these losses tends to differ systematically between employers and employees—to the advantage of the employee. Thus in the usual situation there are many workers and a single employer. The disparity in number is apt to be greatest in

large industrial concerns, where the at-will contract is commonly, if mistakenly, thought to be most unsatisfactory because of the supposed inequality of bargaining power.[35] The employer who decides to act for bad reason or no reason at all may not face any legal liability under the classical common law rule. But he faces very powerful adverse economic consequences. If coworkers perceive the dismissal as arbitrary, they will take fresh stock of their own prospects, for they can no longer be certain that their faithful performance will ensure their security and advancement. The uncertain prospects created by arbitrary employer behavior is functionally indistinguishable from a reduction in wages unilaterally imposed by the employer. At the margin some workers will look elsewhere, and typically the best workers will have the greatest opportunities.[36] By the same token the large employer has more to gain if he dismisses undesirable employees, for this ordinarily acts as an implicit increase in wages to the other employees, who are no longer burdened with uncooperative or obtuse coworkers.

The existence of both positive and negative reputational effects is thus brought back to bear on the employer. The law may tolerate arbitrary behavior, but private pressures effectively limit its scope. Inferior employers will be at a perpetual competitive disadvantage with enlightened ones and will continue to lose in market share and hence in relative social importance. The lack of legal protection to the employees is therefore in part explained by the increased informal protections that they obtain by working in large concerns.[37]

3. *Risk Diversification and Imperfect Information.* The

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[35] *See supra* note 5 and accompanying text. The possibility of the poor exploiting the rich is discussed in the context of the free-rider problem by Mancur Olson, who notes that it is often easy for a small property owner, for example, to free-ride off his larger neighbor's provision of certain common goods. MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION 27-29 (1965).

[36] To illustrate the problem, consider the firm that wants to reduce the size of its work force. If it makes a general promise of ample severance pay to whoever leaves the firm, it runs the very high risk that it will lose its most desirable employees, for it is just these workers who will find it easiest to recoup their income elsewhere. There are complications, however, since the skills of able employees may not be transferable, or at least may not be easily marketable. But the tendency is nonetheless clearly present.

[37] The point has a close analogue in the law of landlord and tenant. Landlords of large apartment complexes are often able to extract more favorable terms from tenants than the owner of a downstairs duplex can. But the large landlord has more to lose by capricious behavior, for he suffers from the same asymmetric reputational vulnerability as does the large employer. The greater legal power conferred on him by contract thus works to the benefit of both sides, as any tenant who has been relieved by the eviction of a noisy neighbor can easily attest.

contract at will also helps workers deal with the problem of risk diversification. In this regard the employee is in the same position as the partner. Ordinarily, employees cannot work more than one, or perhaps two, jobs at the same time. Thereafter the level of performance falls dramatically, so that diversification brings in its wake a low return on labor. The contract at will is designed in part to offset the concentration of individual investment in a single job by allowing diversification among employers *over time*. The employee is not locked into an unfortunate contract if he finds better opportunities elsewhere or if he detects some weakness in the internal structure of the firm. A similar analysis applies on the employer's side where he is a sole proprietor, though ordinary diversification is possible when ownership of the firm is widely held in publicly traded shares.

The contract at will is also a sensible private adaptation to the problem of imperfect information over time. In sharp contrast to the purchase of standard goods, an inspection of the job before acceptance is far less likely to guarantee its quality thereafter. The future is not clearly known. More important, employees, like employers, *know what they do not know*. They are not faced with a bolt from the blue, with an "unknown unknown." Rather they face a known unknown for which they can plan. The at-will contract is an essential part of that planning because it allows both sides to take a wait-and-see attitude to their relationship so that new and more accurate choices can be made on the strength of improved information. ("You can start Tuesday and we'll see how the job works out" is a highly intelligent response to uncertainty.) To be sure, employment relationships are more personal and hence often stormier than those that exist in financial markets, but that is no warrant for replacing the contract at will with a for-cause contract provision. The proper question is: will the shift in methods of control work a change for the benefit of both parties, or will it only make a difficult situation worse?[38]

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[38] We should greet with skepticism any claim that takes the following form:

> The at will doctrine should be altered not because of "unequal bargaining power," but rather because it is inefficient. Courts must intervene, according to this view, in order to bring about the substantive outcome that the parties would have reached had transaction and information costs not precluded informed negotiation. When high costs of bargaining prevent negotiation between individual employees and employers, and inadequate access to information prevents parties from properly valuing the benefits of job security, judicial intervention is justified to ensure a more efficient result.

Note, *Wrongful Discharge*, *supra* note 4, at 1830. The author is right to dismiss inequality of bargaining power as a makeweight argument. But the discussion of imperfect information is nothing short of mystifying, for it simply assumes that universal arrangements are univer-

4. *Administrative Costs.* There is one last way in which the contract at will has an enormous advantage over its rivals. It is very cheap to administer. Any effort to use a for-cause rule will in principle allow all, or at least a substantial fraction of, dismissals to generate litigation. Because motive will be a critical element in these cases, the chances of either side obtaining summary judgment will be negligible. Similarly, the broad modern rules of discovery will allow exploration into every aspect of the employment relation. Indeed, a little imagination will allow the plaintiff's lawyer to delve into the general employment policies of the firm, the treatment of similar cases, and a review of the individual file. The employer for his part will be able to examine every aspect of the employee's performance and personal life in order to bolster the case for dismissal.

Nonetheless, it may be said that this inquiry is worth conducting because employers err in making decisions to fire and injustices will be done unless legal sanctions are imposed. But this analysis entirely ignores the fact that error costs always run in both directions. It has already been shown that there are powerful correctives against capricious discharge even under an at-will rule.[39] The chances of finding an innocent employee wronged by a firm vendetta are quite remote. By the same token, jury sympathy with aggrieved plaintiffs may result in a very large number of erroneous verdicts for employees. In principle it might be proper to tolerate the high error rate if the consequences of erroneous dismissal to the innocent employee were more severe than the consequences of erroneous reinstatement to the innocent employer. But quite the opposite is apt to be the case. Able employees are the very persons who have the greatest opportunity of obtaining alternate employment in the marketplace and who can therefore best mitigate their losses. Although their search for new work may be complicated because of the previous dismissal, the dismissed employee usually can get other persons, e.g., representatives of other companies with whom he has dealt, to help overcome the negative inference from the dismissal. Indeed there is less trouble in explaining away the dismissal if it is generally understood that contracts are terminable at will, since termination no longer implies employee misconduct.[40]

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sally unsound, without recognizing any of their strengths or noting any of the defects in the alternative rules.

[39] *See supra* notes 36-37 and accompanying text.

[40] Other (imperfect) legal protections are available to the employee as well. If, for ex-

The results of this analysis are not upset in any way by the procession of cases that now reach the appellate courts.[41] First, these cases are never a random sample of all dismissals, but rather are selected because they promise the greatest chance of success under the applicable law. Yet the doctrines of wrongful discharge apply to all cases, including those in which superior results are reached by a simple application of the at-will rule. In addition, these cases frequently arise on a motion to dismiss, so that their assertions of improper motive may well be left unsubstantiated at trial. Finally, there is good reason for skepticism about the power of juries to divine motive and purpose from the evidence that is presented to them. A single case easily can be regarded either as employer oppression or employer benevolence, and there is every reason to expect that very different interpretations of similar fact patterns will proliferate under any version of the for-cause standard.[42]

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ample, the previous employer deliberately gives false information in response to inquiries from prospective employers, his conduct may be actionable under the law of defamation, since the employer's bad faith would overcome any qualified privilege the employer might enjoy. If the employer volunteers the false information, the standard of liability may well be even stricter. *See, e.g.,* Clark v. Molyneux, 3 Q.B.D. 237, 243-44 (1877); R. EPSTEIN, C. GREGORY & H. KALVEN, CASES AND MATERIALS ON TORTS 1154-57 (4th ed. 1984); *see also* W. PAGE KEETON, PROSSER AND KEETON ON THE LAW OF TORTS § 115, at 832-34 (5th ed. 1984).

[41] *See* cases cited *supra* notes 6-8.

[42] Thus Monge v. Beebe Rubber Co., 114 N.H. 130, 316 A.2d 549 (1974), lends grist to the skeptic's mill. The facts of the case were summarized by another court as follows: "[f]emale employee wrongfully discharged for refusing to date foreman; court rejected employment-at-will defense as 'based on ancient feudal system.' " Novosel v. Nationwide Ins. Co., 721 F.2d 894, 897 n.5 (3d Cir. 1983). The reference to the feudal system is amusing since the contract at will by all accounts came to the fore in the last half of the nineteenth century, in part as a response to industrialization. *See* Feinman, *supra* note 4, at 125-29.

The summary of the facts found in the dissent to *Monge* itself, however, throws a very different light on the case:

> In my view, reasonable men could not find for the plaintiff on the evidence in this case even under the new rule of law which the court has fashioned today. The substance of the plaintiff's claim is that she was discharged because she did not accept an invitation of her foreman to go out with him. Although it was denied by the foreman, the jury could find on plaintiff's testimony alone that the invitation was extended. It was a single instance, however, and there is no claim that it was repeated or further pursued. It is not findable that this single refusal was the reason for the termination of plaintiff's employment. There was evidence, and none to the contrary, that it was a shortage of work and her lowest seniority that caused her press machine to be shut down and her loss of overtime. When her machine was shut down, she was given work on a degreasing machine at a higher rate of pay than when she started. When she told the foreman she "needed the money" from the overtime, he offered what from the uncontradicted evidence was the only work available to help her out until her overtime was restored. The only so-called harassment and ridicule claimed amounts to no more than once saying "How do you like my floor boy?" and "My wife wouldn't do that." It is uncontradicted that when she was having trouble with annoying phone calls and needed help, the per-

The difficulties are even greater once it becomes established that dismissals cannot be made at will. Now the employer will have to reconsider every aspect of personnel relations. If it is improper to dismiss at will, then it becomes improper to demote or to transfer at will, for an employee will be able to assert with perfect propriety that the employer had made work so unattractive to him that his conduct should amount to a "constructive dismissal" for which either damages or reinstatement is appropriate. Thus a rule that starts with modest ambitions will in the end regulate each and every aspect of the employment relationship. Professor Clyde Summers, for example, in his own proposal for the creation of a statutory cause of action for unjust dismissal recognizes that "[t]he statute [on unjust dismissal] must reach all forms of disciplinary action related to an employee's job, including demotion, reduction in pay, reduction in seniority, assignment to undesirable work, and forced resignation."[43] But he does not explain why the necessity for fashioning comprehensive regulation counts as a virtue instead of a vice, in light of the deleterious effects of increased regulation upon expected hiring patterns of employers. Where an employer might have been more willing to take risky employees under an at-will rule, he will now be less willing to do so under the for-cause rule because any subsequent demotion or dismissal will be an open invitation to a lawsuit by an aggrieved employee. Furthermore, in most at-will situations the dismissed employee is replaced by another, so it is hard to see how employees *as a class* benefit from a rule that can only hamper general mobility in labor markets.

These difficulties arise, moreover, no matter what the form of the rule. Thus, the rule could be stated as one that prohibits dismissals (or transfers) without cause, or it could be phrased only to prohibit a dismissal that is made in bad faith or with malice. The differences in formal expression will undoubtedly be significant in

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> sonnel manager personally went to the police and then to her home to talk with her and her husband; that when she could not pick up her Christmas turkey, the foreman personally delivered two instead of one to her home; and that he also at her request gave her husband, a mechanic, work on his automobile.
>
> Her final termination was in accordance with established company rules and she neither contested the termination nor pursued the grievance procedures under the union contract. She was denied unemployment compensation on the ground that she was a "voluntary quit" and did not appeal that finding.
>
> A finding that this company discharged the plaintiff because she refused her foreman a date eight months before could not reasonably be made and should not be permitted to stand.

Monge, 114 N.H. at 134-35, 316 A.2d at 552-53 (dissenting opinion).

[43] Summers, *supra* note 4, at 526-27.

the litigation of individual cases, as the for-cause standard should impose more stringent restrictions on employer freedom than the bad-faith standard. But from the institutional point of view the differences between the types of regulatory schemes would have only minor impact because *all* of them place costly and inconvenient restraints upon contractual freedom. So long as the cases align themselves in any continuous array, a large number of dismissals will be fair game for litigation no matter what the applicable legal standard. The administrative and error-cost considerations therefore reinforce the basic conclusion: there is no warrant for legal interference with the contract at will.

5. *Bilateral Monopoly and Inequality of Bargaining Power.* The account thus far given of the contract at will in no way depends upon any notion of an inherent inequality of bargaining power that pervades all employment contracts. Indeed if such an inequality did govern the employment relationship, we should expect to see conditions that exist in no labor market. Wages should be driven to zero, for no matter what their previous level, the employer could use his (inexhaustible) bargaining power to reduce them further, until the zero level was reached.[44] Similarly, inequality of bargaining power implies that the employee will be bound for a term while the employer (who can pay the peppercorn consideration) retains the power to terminate at will. Yet in practice we observe both positive wages and employees with the right to quit at will.

The reason why these contracts at will are effective is precisely that the employer must always pay an implicit price when he exercises his right to fire. He no longer has the right to compel the employee's service, as the employee can enter the market to find another job. The costs of the employer's decision therefore are borne in large measure by the employer himself, creating an implicit system of coinsurance between employer and employee against employer abuse. Nor, it must be stressed, are the costs to the employer light. It is true that employees who work within a firm acquire specific knowledge about its operation and upon dismissal can transfer only a portion of that knowledge to the new

[44] Note that the same arguments could be made in the consumer market as well, leading to the prediction that these same workers with a zero wage will pay infinite prices for the necessities of life. The only coherent models are those that assume that total wages and other income supply a budget constraint for purchases, so that both markets are in equilibrium simultaneously. Abstracting one market from another is a ploy that makes inequality of bargaining power seem more plausible than it is.

job.[45] Nonetheless, the problem is roughly symmetrical, as the employer must find, select, and train a replacement worker who may not turn out to be better than the first employee. Workers are not fungible, and sorting them out may be difficult: resumes can be misleading, if not fraudulent; references may be only too eager to unload an unsuitable employee; training is expensive; and the new worker may not like the job or may be forced to move out of town. In any case, firms must bear the costs of voluntary turnover by workers who quit, which gives them a frequent reminder of the need to avoid self-inflicted losses. The institutional stability of employment contracts at will can now be explained in part by their legal fragility. The right to fire is exercised only infrequently because the threat of firing is effective.

Thus far the account of inequality of bargaining power has been wholly negative. But the description of the employment relationship does suggest one way in which inequality can arise, even within the framework of generally competitive markets. In the course of an ongoing relationship between employee and employer, each side gains from the contract more than it could obtain by returning to the open market. The surplus that is created must be divided between the parties. In principle, either the worker or the employer could receive the entire surplus without inducing the other party, who still receives a competitive return, to sever the relationship. A fortiori any solution that divides the surplus between the parties should be stable as well. The contract at will thus creates a bilateral monopoly, but only to the extent of the surplus.

The question of inequality of bargaining power can now be helpfully restated: which side will appropriate most of the surplus in any negotiations between them? Unlike the typical formulations of the problem, this leaves the set of possible solutions strictly bounded because the employee cannot be driven below the competitive wage and the employer cannot be driven to a wage above the sum of the competitive wage plus the full amount of the surplus. An employer can therefore be said to possess an inequality of bargaining power when he is able to appropriate more than half the surplus, while the employee can be said to possess inequality of bargaining power if *he* can appropriate more than half the surplus.

[45] In some cases it is all too transferable, as with customer lists or trade secrets. When such information is transferred, an employer may look for redress to the elaborate body of law that regulates the transmission of trade secrets. *See* Kitch, *The Law and Economics of Rights in Valuable Information*, 9 J. LEGAL STUD. 683, 689-701 (1980).

To take an example, assume the employer is prepared to pay 20, while the worker is willing to work for 10. The agreed wage therefore could fall anywhere between those two numbers. If the employer is systematically able to appropriate more than 5 of this surplus, by keeping the wage level below 15, then he has unequal bargaining power, though still within the framework of overall competitive markets.

The existence of some surplus should be pervasive in all labor markets, given that labor is not perfectly fungible. In practice, the size of the surplus on average should be relatively small at the time of contract formation. Because the parties have not built up much specific capital in the relationship, quitting or firing will cause relatively small dislocations. As time passes, however, the gains to both sides from continuing the employment relationship are apt to increase, so that both sides have more to lose from separation. The bilateral monopoly problem now assumes greater significance. The increased size of the surplus can easily make wages somewhat indeterminate (which is why workers are commonly nervous about asking for a raise, and employers are nervous about refusing it). As the stakes become larger, the amount of resources spent in obtaining a larger portion of the surplus should increase. A contractual breakdown should nonetheless be an infrequent occurrence, as both sides have strong incentives to keep the relationship viable. The costs of negotiation tend to be reduced because each side is familiar with the other. The scope for bluffing is somewhat limited by each party's knowledge of the preferences of the other side. Finally, there are strong reasons for each side to avoid squeezing the last drop out of a relationship: miscalculation of the reserve price of the other party (i.e., the minimum he will accept or the maximum he will pay) could lead to a severance of the relationship and thus to a loss of the entire surplus.

It still remains to be determined which side is likely to appropriate most of this contract-specific surplus. One might guess that the employer will be able to achieve this objective, perhaps because his experience in repeat transactions with many workers fosters greater skills in negotiation. In addition, the employer may know in general the market wages available to beginning workers, as these typically will be public knowledge. Yet a number of considerations suggest the opposite conclusion. First, the employer often bargains through subordinate managers and thus faces an agency-cost problem avoided by the worker who bargains on his own account. Second, the worker's opportunity cost for his time will often be lower than the employer's, so that the increased time he can spend on the transaction may offset the employer's greater skill, if any, per unit of time. Third, the worker may be able to learn something about the employer's reservation price (i.e., the maximum wage he would be willing to pay) because the employer must reveal some information about his willingness to pay in negotiations with other long-term workers. Finally, it is not clear that the employer gains any real advantage because of his greater relative wealth, if any. To be sure, the wealthy employer can hold out for a larger share of the surplus because he has less, proportionally, to lose. Yet by the same token the employer's resolve may be weaker because he has less to gain by holding out.

This modest catalogue of considerations shows how difficult it is to determine the exact division of the surplus, although my suspicion is that in the broad run of cases it will tend to be evenly divided. But even if this guess is wrong, there is no reason for the law to interfere in the bargaining process. The whole question of inequality of bargaining power arises in the bounded context of how much of a *supra*competitive wage the worker will obtain. At the very worst, the worker will get the amount that is offered in some alternate employment where he has built up no specific capital. To try to formulate and administer a set of legal rules that will allow some trier of fact to measure the size of the surplus embedded in the ongoing transaction, and to allocate half (or more) of it to the worker, cannot be done at any social cost that is less than the expected size of the surplus itself, if it can be done at all. The entire exercise is fraught with the possibility of real error, as real resources would have to be expended solely to make transfer payments that can in no way enhance productive efforts. The existence of this transactional surplus does not negate the fact that markets are still competitive before prospective employers and employees enter into any transaction at all.

The size of the surplus, and thus the scope of any inequality problem, can be reduced more effectively by adopting legal rules that remove or minimize legal impediments to labor mobility. The contract at will, by allowing either side to sever relationships without legal impediment, tends to reduce rigidities in markets and thus to act as a counterweight to the bilateral monopoly problem that emerges even in voluntary markets. The complex rules that give workers "property" rights in their jobs tend to increase the size of any possible surplus and exacerbate the basic problem. The identification of a transaction-specific surplus, then, adds to our understanding of long-term employment relationships, but it affords no warrant for upsetting the contract at will on supposed grounds of public policy.

III. Distributional Concerns

Enough has been said to show that there is no principled reason of fairness or utility to disturb the common law's longstanding presumption in favor of the contract at will. It remains to be asked whether there are some hitherto unmentioned distributional consequences sufficient to throw that conclusion into doubt. One clear sign that there are not is that the advocates of the wrongful-discharge action themselves have not cast the argument in this form. Professor Lawrence Blades, for example, makes clear from the title of his own paper—*Employment at Will v. Individual Freedom*[46]—that he thinks abrogation of the contract at will helps advance the cause of individual liberty. While I believe that he is wrong in that conclusion, I think that he chose the correct ground on which to fight, for a moment's reflection makes it clear that distributional considerations enter at best only obliquely into the employment context.

The proposed reforms in the at-will doctrine cannot hope to transfer wealth systematically from rich to poor on the model of comprehensive systems of taxation or welfare benefits.[47] Indeed it is very difficult to identify in advance any deserving group of recipients that stands to gain unambiguously from the universal abrogation of the at-will contract. The proposed rules cover the whole range from senior executives to manual labor. At every wage level, there is presumably some differential in workers' output. Those who tend to slack off seem on balance to be most vulnerable to dismissal under the at-will rule; yet it is very hard to imagine why some special concession should be made in their favor at the expense of their more diligent fellow workers.

The distributional issues, moreover, become further clouded once it is recognized that any individual employee will have interests on both sides of the employment relation. Individual workers participate heavily in pension plans, where the value of the holdings depends in part upon the efficiency of the legal rules that govern the companies in which they own shares. If the regulation of the contract at will diminishes the overall level of wealth, the losses are apt to be spread far and wide, which makes it doubtful that there are any gains to the worst off in society that justify

[46] Blades, *supra* note 4.
[47] I have addressed these issues in detail in Epstein, *supra* note 3.

somewhat greater losses to those who are better off. The usual concern with maldistribution gives us situations in which one person has one hundred while each of one hundred has one and asks us to compare that distribution with an even distribution of, say, two per person. But the stark form of the numerical example does not explain how the skewed distribution is tied to the concrete choice between different rules governing employment relations. Set in this concrete context, the choices about the proposed new regulation of the employment contract do not set the one against the many but set the many against each other, all in the context of a shrinking overall pie. The possible gains from redistribution, even on the most favorable of assumptions about the diminishing marginal utility of money, are simply not present.

If this is the case, one puzzle still remains: who should be in favor of the proposed legislation? One possibility is that support for the change in common law rules rests largely on ideological and political grounds, so that the legislation has the public support of persons who may well be hurt by it in their private capacities.[48] Another possible explanation could identify the hand of interest-group politics in some subtle form. For example, the lawyers and government officials called upon to administer the new legislation may expect to obtain increased income and power, although this explanation seems insufficient to account for the current pressure. A more uncertain line of inquiry could ask whether labor unions stand to benefit from the creation of a cause of action for wrongful discharge. Unions, after all, have some skill in working with for-cause contracts under the labor statutes that prohibit firing for union activities, and they might be able to promote their own growth by selling their services to the presently nonunionized sector. In addition, the for-cause rule might give employers one less reason to resist unionization, since they would be unable to retain the absolute power to hire and fire in any event. Yet, by the same token, it is possible that workers would be less inclined to pay the costs of union membership if they received some purported benefit by the force of law without unionization. The ultimate weight of these considerations is an empirical question to which no easy answers appear.[49] What is clear, however, is that even if one could show that the shift in the rule either benefits or hurts unions and

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[48] That this may be irrational does not imply that it is impossible. *See* Stigler, *Wealth, and Possibly Liberty,* 7 J. LEGAL STUD. 213 (1978).

[49] It has been reported that union leaders do not favor these reforms. Chicago Sun-Times, June 10, 1984, at 32, col. 1 (2-star ed.).

their members, the answer would not justify the rule, for it would not explain why the legal system should try to skew the balance one way or the other. The bottom line therefore remains unchanged. The case for a legal requirement that renders employment contracts terminable only for cause is as weak after distributional considerations are taken into account as before.

IV. Exceptions to the Contract at Will

An examination of the contracting objectives of parties explains why contracts at will are common. The same set of considerations, however, also helps explain why contracts at will are *not* found in all employment contexts, but are instead sometimes displaced by more elaborate contractual mechanisms. The central point is that the contract at will works only where performance on both sides takes place in lockstep progression. This condition will be satisfied where neither side has performed or where the worker's past performance has been matched by appropriate payment from the employer. In these cases the contract at will provides both employer and employee with a simple, informal "bond" against the future misfeasance of the other side: fire or quit. Where the sequence of performance requires one side to perform in full before the other side begins performance, this bonding mechanism will break down because there are no longer two unperformed promises of roughly equal value to stand as security for each other. That is why an employee will have to resort to legal action if the employer simply refuses to pay wages for work that has already been done. It is also why a contract at will cannot handle the question of compensation for job-related personal injuries, for after injury the value of the right to quit no longer balances off the right to fire.[50]

The same problem of imperfect bonding under the contract at will also arises where the nature of the employment requires work for extended periods of time. Thus, in the traditional apprenticeship contracts explicit provision had to be made to ensure that the indentured servant would not go elsewhere and likewise that the master would not abuse him during the period of service.[51] Simi-

[50] For an account of the elaborate consensual arrangements that grew up to handle this problem, see Epstein, *The Historical Origins and Economic Structure of Workers' Compensation Law*, 16 Ga. L. Rev. 775, 789-94, 798-803 (1982).

[51] The power of the common law's presumption in favor of at-will contracts is shown, however, by the courts' refusal to infer such terms. *See* 6 C.B. Labatt, Commentaries on the Law of Master and Servant § 2198 (2d ed. 1913). At various times, legislatures regu-

larly in earlier times, contracts for agricultural workers were understood to be for the year or for the growing season.[52] These arrangements accordingly contained extensive risk-sharing features. The worker received some interim compensation, typically in the form of room and board, that functioned as progress payments for services already rendered. Yet the contract often called for the payment of a large cash sum at the end of the harvest because the power of the employer to withhold some of the wages until that time was necessary to counteract the possibility that a worker, who had pocketed wages in advance, might abandon the employer in order to obtain high wages for day-work at harvest time when labor was at a premium.[53]

The same problems can exist with modern employment contracts. Suppose that a worker has put in the effort to obtain for the firm a large contract on which he is to be paid a commission. If the firm dismisses him under an at-will contract before the sale is consummated and the commission is formally due, most courts will (rightly) imply a term of good faith that gives the employee the commission for the work done, unless the agreement explicitly provides otherwise. Thus in *Coleman v. Graybar Electric Co.*,[54] the plaintiff's claim for compensation rested in part upon commissions that were paid annually based upon the sales record in the previous period. The court construed the contract to preclude the at-will norm: "We conclude that in this case the contract did not authorize the forfeiture of additional compensation provided in the plan of compensation if the services of the employee were terminated arbitrarily and without just cause."[55]

As the size of possible commissions increases, moreover, the

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lated the duration of indentures. *See id.* § 2113.

[52] *See* Feinman, *supra* note 4, at 120. There is, however, no need to presume exploitation to account for this form of contract. *See infra* text following note 52.

[53] Usually the courts refused to allow the worker to recover on a quantum meruit count for the value of the services rendered when he quit before term. *See, e.g.*, Britton v. Turner, 6 N.H. 481, 486 (1834) (allowing the action but recognizing its deviation from the clear weight of authority); *see also* F. KESSLER & G. GILMORE, CONTRACTS, CASES AND MATERIALS 878 (2d ed. 1970). The majority result tends to be sound even though it requires the worker to continue the work in order to claim the deferred benefits and thus could result in some windfall to the employer. Where the worker quits before the end of the term, he can often obtain higher short-term wages in the market to offset the loss of the final payment. A rule that awarded some fraction of the deferred payment could give the worker both, which would provide him with the wrong incentives. Moreover, even when the employee loses on the wage claim, he has still obtained board and lodging, the value of which the employer would never recover by suit against the worker in breach, be it for legal or practical reasons.

[54] 195 F.2d 374 (5th Cir. 1952).

[55] *Id.* at 378.

potential gains from post-contractual exploitation will increase as well. But it does not follow that the parties are helpless to protect themselves against exploitation. Rather, when the stakes are high, it becomes worthwhile for the parties to fashion explicit allocations of the commission in the event of an employee dismissal.[56] Thus in *Fortune v. National Cash Register Co.*,[57] the commission contract in question was for the sale of a large cash register system. Under this contract, a salesman received seventy-five percent of the commission derived from a sale if the sales territory had been assigned to him at the date of the order; he received twenty-five percent of the commission if the territory had been assigned to him at the date of delivery; and he got the full commission if the territory had been assigned to him at both times.[58] The plaintiff in the action was a salesman who had been fired after the original deal had been struck but before it had been completed.[59] The seventy-five percent commission earned under the agreement had been paid, while the remaining twenty-five percent commission was paid by the firm to another employee, according to the express terms of the contract.[60] The court held that these express provisions were not dispositive and read into the agreement a covenant of good faith and fair dealing, on which it held that the plaintiff was entitled to a jury trial.[61]

The decision seems wrong in principle. The contractual provisions concerning commissions represent a rough effort to match payment with performance where the labor of more than one individual was necessary to close the sale. The case is not simply one where a strategically timed firing allowed the company to deprive a dismissed employee of the benefits due him upon completion of performance. Indeed, the firm kept none of the commission at all, so that when the case went to the jury, the only issue was whether the company should be called upon to pay the same commission twice. The court in *Fortune* did not try to understand the commis-

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[56] The same problem commonly arises in brokerage cases where the owner tries to dismiss the broker after the buyer is located but before the agreement is concluded. A covenant of good faith is normally appropriate here to prevent the expropriation of labor by the owner-seller, and these provisions are now commonplace in brokerage agreements, which also typically provide that the brokers obtain no commission for buyers whom the seller independently locates after the brokerage period. For a collection of cases, see F. KESSLER & G. GILMORE, *supra* note 53, at 337.

[57] 373 Mass. 96, 364 N.E.2d 1251 (1977).

[58] *Id.* at 97-98, 364 N.E.2d at 1253.

[59] *Id.* at 100, 364 N.E.2d at 1254.

[60] *Id.* at 99, 364 N.E.2d at 1254.

[61] *Id.* at 101-04, 364 N.E.2d at 1255-57.

sion structure that it was prepared to condemn; instead, it made the chronic mistake of thinking that what it intuited to be an unfortunate business outcome invalidated the entire contractual structure. In its enthusiastic meddling in private contracts, the court nowhere suggested an alternative commission structure that would have better served the joint interests of the parties at the time of contract formation. Here, as in so many cases, an unquestioning adherence to the principle of freedom of contract would have yielded results both simpler and superior to those generated after an extensive but flawed judicial examination of the basic terms.

Conclusion

The recent trend toward expanding the legal remedies for wrongful discharge has been greeted with wide approval in judicial, academic, and popular circles. In this paper, I have argued that the modern trend rests in large measure upon a misunderstanding of the contractual processes and the ends served by the contract at will. No system of regulation can hope to match the benefits that the contract at will affords in employment relations. The flexibility afforded by the contract at will permits the ceaseless marginal adjustments that are necessary in any ongoing productive activity conducted, as all activities are, in conditions of technological and business change. The strength of the contract at will should not be judged by the occasional cases in which it is said to produce unfortunate results, but rather by the vast run of cases where it provides a sensible private response to the many and varied problems in labor contracting. All too often the case for a wrongful discharge doctrine rests upon the identification of possible employer abuses, as if they were all that mattered. But the proper goal is to find the set of comprehensive arrangements that will minimize the frequency and severity of abuses by employers and employees alike. Any effort to drive employer abuses to zero can only increase the difficulties inherent in the employment relation. Here, a full analysis of the relevant costs and benefits shows why the constant minor imperfections of the market, far from being a reason to oust private agreements, offer the most powerful reason for respecting them. The doctrine of wrongful discharge is the problem and not the solution. This is one of the many situations in which courts and legislatures should leave well enough alone.