

# BARGAINING WITH IMPERFECT INFORMATION: A STUDY OF WORKER PERCEPTIONS OF LEGAL PROTECTION IN AN AT-WILL WORLD

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INTRODUCTION .....	105
I. THE DEBATE OVER THE EFFICIENCY OF THE AT-WILL RULE .....	111
II. THE INADEQUACY OF EXISTING EMPIRICAL EVIDENCE OF WORKERS' LEGAL KNOWLEDGE .....	120
III. THE SURVEY DESIGN: TESTING EMPLOYEES' LEGAL KNOWLEDGE AND INFORMATION GATHERING EXPERIENCES .	126
IV. THE RESULTS: CHALLENGING THE ASSUMPTION OF FULL INFORMATION .....	133
V. THEORETICAL IMPLICATIONS: THE CASE FOR A JUST-CAUSE DEFAULT .....	147
CONCLUSION .....	155
APPENDIX A .....	157
APPENDIX B .....	160

## INTRODUCTION

*[E]mployers 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.<sup>1</sup>*

The assumption that workers understand the legal basis on which they have contracted lies at the heart of the traditional economic defense of the at-will rule in employment.<sup>2</sup> As Richard Epstein and others have argued, employers and employees bargain with full infor-

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<sup>1</sup> Richard A. Epstein, *In Defense of the Contract at Will*, 51 U. CHI. L. REV. 947, 955 (1984).

<sup>2</sup> See, e.g., *id.*; Mayer G. Freed & Daniel D. Polsby, *Just Cause for Termination Rules and Economic Efficiency*, 38 EMORY L.J. 1097, 1098 (1989); Andrew P. Morriss, *Bad Data, Bad Economics, and Bad Policy: Time to Fire Wrongful Discharge Law*, 74 TEX. L. REV. 1901, 1929 (1996); J. Hoult Verkerke, *An Empirical Perspective on Indefinite Term Employment Contracts: Resolving the Just Cause Debate*, 1995 WIS. L. REV. 837, 874-75.

mation in their own best interests, and, therefore, the prevalence of at-will contracts in the real world represents an efficient outcome, reflecting the desires of the parties.<sup>3</sup> While many commentators have questioned the assumption that workers are legally informed,<sup>4</sup> the debate has been characterized by a remarkable dearth of empirical information.<sup>5</sup> This study, by directly testing workers' knowledge of the relevant legal rules, offers empirical evidence contradicting the assumption of full information commonly made by defenders<sup>6</sup> of the at-will rule. Far from understanding "the footing on which they have contracted,"<sup>7</sup> workers appear to systematically overestimate the protections afforded by law, believing that they have far greater rights against unjust or arbitrary discharges than they in fact have under an at-will contract.

As Epstein suggests, the at-will rule is easily stated: absent a contract of employment for a fixed term, an employer may discharge its employees at will "for good cause, for no cause or even for cause morally wrong, without being thereby guilty of legal wrong."<sup>8</sup> The doctrine merely states a default rule, providing a ready presumption when an employment contract is silent as to its duration. In theory, em-

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<sup>3</sup> See, e.g., Epstein, *supra* note 1, at 953-55.

<sup>4</sup> See, e.g., Joseph Grodin, *Toward a Wrongful Termination Statute for California*, 42 HASTINGS L.J. 135, 137 (1990); Arthur S. Leonard, *A New Common Law of Employment Termination*, 66 N.C. L. REV. 631, 674 (1988); Cass R. Sunstein, *Rights, Minimal Terms, and Solidarity: A Comment*, 51 U. CHI. L. REV. 1041, 1055 (1984); Steven L. Willborn, *Individual Employment Rights and the Standard Economic Objection: Theory and Empiricism*, 67 NEB. L. REV. 101, 128 (1988).

<sup>5</sup> Commentators on both sides of the debate have noted the lack of empirical evidence on the level of employee information regarding job security. See, e.g., Verkerke, *supra* note 2, at 886-88; Willborn, *supra* note 4, at 128 n.87.

<sup>6</sup> Throughout this Article, I refer to "defenders" and "critics" of the at-will rule. Although this terminology oversimplifies the debate, the labels are nevertheless useful for identifying broad positions. Thus, I include among the "critics" all those arguing for change in the at-will rule, whether they call for judicial action or statutory reform, and whether they advocate a mandatory just-cause requirement or merely a rebuttable presumption. The "defenders" similarly encompass a range of opinions as to the appropriateness of the at-will rule and exceptions to it, yet all share a belief in the basic soundness of the traditional rule. Not all commentators, however, are easily classified. For example, Dau-Schmidt shares the critics' skepticism about the efficiency of the individual bargaining process, but questions whether alternative institutions can better accommodate employer and employee preferences. Kenneth G. Dau-Schmidt, *Employment Security: A Comparative Institutional Debate*, 74 TEX. L. REV. 1645 (1996). Also difficult to classify is Schwab's life-cycle analysis, which "does not categorically condemn or celebrate employment at will," but sees coherence in the courts' willingness to find contract protections against discharge at the beginning and end of an employee's career, while applying the at-will rule at mid-career. Stewart J. Schwab, *Life-Cycle Justice: Accommodating Just Cause and Employment at Will*, 92 MICH. L. REV. 8, 61 (1993).

<sup>7</sup> Epstein, *supra* note 1, at 955.

<sup>8</sup> *Payne v. Westeru & Atl. R.R. Co.*, 81 Tenn. 507, 519-20 (1884), *overruled on other grounds*, *Hutton v. Watters*, 179 S.W. 134, 138 (Tenn. 1915). *Payne* is not an employment case, but provides the classic summary of the meaning of employment at will.

ployer and employee are free to contract around the at-will presumption, but, in fact, very few do so. Although collective bargaining agreements negotiated by unions typically include just-cause protections against discharge, in the world of individual employment agreements, fixed-term contracts are unusual and indefinite-term just-cause contracts are rarer still. Thus, the vast majority of nonunion, private sector workers are employed at will.<sup>9</sup>

In the early part of this century, the law governing termination was so well settled that discharges from employment generated very little litigation<sup>10</sup> and virtually no commentary.<sup>11</sup> Then, in a 1967 article, Blades argued that the traditional common-law rule rendered employees vulnerable to employer coercion,<sup>12</sup> kindling a debate over the at-will rule in employment. Since then, a growing chorus of academic commentators has condemned the rule, calling for its abandonment, either through judicial action or statutory reform.<sup>13</sup> Many critics fo-

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<sup>9</sup> Employment at will is the default rule in every American jurisdiction except Montana, Puerto Rico, and the Virgin Islands. See Montana Wrongful Discharge From Employment Act, MONT. CODE ANN. §§ 39-2-901 to -915 (1997); P.R. LAWS ANN. tit. 29, §§ 185a-185m (1995); V.I. CODE ANN. tit. 24, §§ 76-79 (1997).

Of course, the at-will employee is not wholly unprotected against discharge. A number of statutes prohibit discharges for certain illegal reasons. For example, Title VII of the Civil Rights Act of 1964, 42 U.S.C. §§ 2000e to 2000e-17 (1994), forbids discharge because of an employee's race, color, religion, sex, or natural origin, and the National Labor Relations Act outlaws retaliatory discharge of an employee for exercising rights under the Act. 29 U.S.C. § 158 (1994). Similarly, most states recognize an exception to the at-will rule when the employer's motive for discharge violates a clear public policy. See 9A Lab. Rel. Rep. (BNA) 505:51 to :52 (1997). Although numerous, the exceptions to the at-will rule are quite narrow and often difficult to prove. Because of these difficulties of proof, some commentators argue that the background presumption of employment at will undermines the effectiveness of antidiscrimination legislation and other wrongful discharge protections. See, e.g., Cynthia L. Estlund, *Wrongful Discharge Protections in an At-Will World*, 74 TEX. L. REV. 1655 (1996); Ann C. McGinley, *Rethinking Civil Rights and Employment at Will: Toward a Coherent National Discharge Policy*, 57 OHIO ST. L.J. 1443 (1996).

<sup>10</sup> See Andrew P. Morriss, *Exploding Myths: An Empirical and Economic Reassessment of the Rise of Employment At-Will*, 59 MO. L. REV. 679, 688 n.25 (1994).

<sup>11</sup> Today, however, the very origins of the at-will rule are the subject of controversy. See, e.g., Jay M. Feinman, *The Development of the Employment at Will Rule*, 20 AM. J. LEGAL HIST. 118 (1976); Sanford M. Jacoby, *The Duration of Indefinite Employment Contracts in the United States and England: An Historical Analysis*, 5 COMP. LAB. L. 85 (1982); see also Mayer G. Freed & Daniel D. Polsby, *The Doubtful Provenance of "Wood's Rule" Revisited*, 22 ARIZ. ST. L.J. 551 (1990) (asserting that the employment at will rule was well accepted in 1877 when Wood formally articulated it in his treatise, *The Law of Master and Servant*); Jay M. Feinman, *The Development of the Employment-at-Will Rule Revisited*, 23 ARIZ. ST. L.J. 733 (1991) (refuting Freed & Polsby's assertion that Wood's rule was generally accepted at the time and arguing that the rule was an innovation that led courts to view skeptically employees' contractual claims); J. Peter Shapiro & James F. Tune, Note, *Implied Contract Rights to Job Security*, 26 STAN. L. REV. 335, 341-43 (1974) (arguing that the at-will rule articulated in Wood's treatise was not supported by the cases or any analysis).

<sup>12</sup> Lawrence E. Blades, *Employment at Will vs. Individual Freedom: On Limiting the Abusive Exercise of Employer Power*, 67 COLUM. L. REV. 1404 (1967).

<sup>13</sup> Several commentators have suggested that courts should abandon the common-law presumption of employment at will and replace it with either a rebuttable presumption

cus on the perceived unfairness of the rule.<sup>14</sup> Pointing to the just-cause provisions found in most collective bargaining agreements and the civil service protections afforded public employees, they argue that no justification exists for denying private, nonunion employees comparable protections.<sup>15</sup> Those advocating change also invoke the experiences of other industrialized countries, which limit employers' power of discharge, to support arguments for giving employees greater tenure rights.<sup>16</sup> In short, the critics contend that the at-will rule is unsuited to modern conditions and out of sync with contemporary values of a humane workplace.

More recently, the battle over the at-will rule has been joined on grounds of economic efficiency. Epstein fired an early salvo, arguing that, far from being an unfair, one-sided bargain, the at-will employment relationship represents an efficient accommodation of both employer and employee interests.<sup>17</sup> The rule's critics counter that at-will arrangements are not so much the result of an efficient contracting process as the imposition by the party with superior bargaining power of its preferred terms.<sup>18</sup> Moreover, they argue, by curbing managerial abuse and increasing employee loyalty, just-cause protections might ultimately result in a net efficiency gain for the firm.<sup>19</sup>

At the center of this debate lies the simple fact that the vast majority of nonunion, private sector employees are employed at will. For

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that an employer may not terminate an employee without just cause, *see, e.g.*, Leonard, *supra* note 4, or a mandatory just cause standard, *see, e.g.*, Cornelius J. Peck, *Unjust Discharges From Employment: A Necessary Change in the Law*, 40 OHIO ST. L.J. 1 (1979). Others have argued for either state or federal legislation to establish just-cause protections for employees. *See, e.g.*, Janice R. Bellace, *A Right of Fair Dismissal: Enforcing a Statutory Guarantee*, 16 U. MICH. J.L. REFORM 207 (1983); William B. Gould IV, *The Idea of the Job as Property in Contemporary America: The Legal and Collective Bargaining Framework*, 1986 BYU L. REV. 885, 908-12; Grodin, *supra* note 4; Theodore J. St. Antoine, *A Seed Germinates: Unjust Discharge Reform Heads Toward Full Flower*, 67 NEB. L. REV. 56, 70-81 (1988); Jack Stieber & Michael Murray, *Protection Against Unjust Discharge: The Need for a Federal Statute*, 16 U. MICH. J.L. REFORM 319 (1983); Clyde W. Summers, *Individual Protection Against Unjust Dismissal: Time for a Statute*, 62 VA. L. REV. 481, 519-31 (1976).

<sup>14</sup> For example, St. Antoine invokes the "piercing hurt to individuals" who are unjustly fired to justify the call for reform. St. Antoine, *supra* note 13, at 67. In arguing for abandonment of the at-will rule, others rely on estimates of the large number of workers who are discharged without cause. *See* Peck, *supra* note 13, at 8-10; Stieber & Murray, *supra* note 13, at 322-24.

<sup>15</sup> *See, e.g.*, Summers, *supra* note 13, at 519-20.

<sup>16</sup> *See, e.g.*, William B. Gould IV, *Job Security in the United States: Some Reflections on Unfair Dismissal and Plant Closure Legislation from a Comparative Perspective*, 67 NEB. L. REV. 28, 50-54 (1988); Grodin, *supra* note 4, at 136-37; Jack Stieber, *Protection Against Unfair Dismissal: A Comparative View*, 3 COMP. LAB. L. 229 (1980); Summers, *supra* note 13, at 508-19.

<sup>17</sup> Epstein, *supra* note 1.

<sup>18</sup> *See, e.g.*, Blades, *supra* note 12, at 1411-12; Clyde W. Summers, *The Contract of Employment and the Rights of Individual Employees: Fair Representation and Employment at Will*, 52 FORDHAM L. REV. 1082, 1106-07 (1984).

<sup>19</sup> *See, e.g.*, Leonard, *supra* note 4, at 676-78.

defenders of the at-will rule, the predominance of at-will arrangements attests to their economic superiority.<sup>20</sup> For critics of the rule, it is symptomatic of the breakdown of the market.<sup>21</sup> Each side has spun out competing theories to explain the prevalence of at-will employment agreements, purporting to demonstrate either the robustness of the individual bargaining process or the various market failures that beset it. As this debate over the at-will rule has advanced, it has taken on an increasingly speculative air. Each side makes assumptions about real world conditions, which, if they held true, would inevitably lead to the intended normative conclusion. However, with only a few exceptions, little effort has been made to test these assumptions empirically.<sup>22</sup>

One critical assumption in the debate over the at-will rule concerns what employees know going into the hiring process. Defenders of the at-will rule generally assume that employees are fully informed of the background legal rules as well as the risks of discharge they face with particular employers.<sup>23</sup> For example, Epstein quickly dismisses the possibility that workers are confused about the law.<sup>24</sup> Morriss is likewise skeptical: "One obvious characteristic of the at-will rule is that the legal responsibilities of the employer are clear—it has none. How then are employees systematically fooled?"<sup>25</sup> Similarly, in arguing that workers "choose among potential employers in part on the basis of

<sup>20</sup> See, e.g., Epstein, *supra* note 1, at 955-57; Freed & Polsby, *supra* note 2, at 1097-98.

<sup>21</sup> See, e.g., PAUL C. WEILER, GOVERNING THE WORKPLACE: THE FUTURE OF LABOR AND EMPLOYMENT LAW 72-74 (1990); Samuel Issacharoff, *Contracting for Employment: The Limited Return of the Common Law*, 74 TEX. L. REV. 1783, 1794 (1996); Walter Kamiat, *Labor and Lemons: Efficient Norms in the Internal Labor Market and the Possible Failures of Individual Contracting*, 144 U. PA. L. REV. 1953, 1957 (1996).

<sup>22</sup> Of course, the arguments against the at-will rule based on comparisons with either the just-cause provisions of collective bargaining agreements, or the legal protections against unjust dismissals in other countries, rest on a sort of empirical data. My concern here is with the lack of empirical studies that systematically test the competing assumptions made about the operation of the labor market when it comes to job security provisions. Notable exceptions include Issacharoff's recent efforts to bring the insights of cognitive psychology to bear on the problem of contracting for employment security, Issacharoff, *supra* note 21, at 1800-03, and Schwab's experimental exploration of the efficiency and distributive effects of a contract presumption in the context of labor bargaining. Stewart Schwab, *A Coasean Experiment on Contract Presumptions*, 17 J. LEGAL STUD. 237 (1988).

<sup>23</sup> The market-based defense of the at-will rule does not require that *each* employee know the relevant legal rules—only that a sufficient number have adequate information to allow the market to operate competitively. See Alan Schwartz & Louis L. Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630 (1979). For ease of reference, I will refer to this assumption as one of "full information," even though perfect information is not necessary. In Part V below, I consider in greater detail the argument that a competitive market may persist in the face of imperfect information and examine that claim for the labor market in light of my empirical findings.

<sup>24</sup> Epstein, *supra* note 1, at 955.

<sup>25</sup> Morriss, *supra* note 2, at 1929. However obvious the meaning of the at-will rule may be to a law professor, it is not at all certain that it will be clear to the layperson. In any case, it is hardly a correct statement that an employer has no legal responsibility toward the at-

their policies concerning discharge,"<sup>26</sup> Verkerke assumes that workers have the necessary information about prospective employers to make a meaningful choice.

Critics of the at-will rule, by contrast, dispute the assumption that workers have adequate information, arguing that they are likely mistaken about the law and misled by their employers at the time of hiring as to the risks of discharge they are likely to face.<sup>27</sup> One hypothesis is that the various restrictions that the law has imposed on employers—for example, forbidding discharge based on race or sex—have engendered broader expectations on the part of employees that the law protects them from all arbitrary dismissals.<sup>28</sup> Whatever the cause of these inflated expectations, they prevent employees from recognizing the value of guarantees of job security and, therefore, from seeking to secure such protections by contract.

These differing assumptions are crucial because they underlie the divergent conclusions drawn from the observed prevalence of at-will arrangements in the real world. In the absence of any empirical data on the issue, each side has been free to make the assumptions that tend to support its normative conclusions. This study represents a first step in filling this data gap. It consists of a written survey administered to over 330 unemployed workers in the St. Louis metropolitan area. By presenting a series of simple scenarios and asking respondents whether the particular discharges described are lawful, the survey directly tests their knowledge of the default rule of employment at will.

The survey results offer a striking contrast to the assumption of full information commonly made by defenders of the at-will rule. As detailed in Part IV below, respondents overwhelmingly misunderstand the background legal rules governing the employment relationship. More specifically, they consistently *overestimate* the degree of job protection afforded by law, believing that employees have far greater rights not to be fired without good cause than they in fact have. For example, although the common law rule clearly permits an employer to terminate an at-will employee out of personal dislike, so long as no discriminatory motive is involved, an overwhelming majority of the respondents—89%—erroneously believe that the law forbids such a dis-

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will employee. As discussed above, even an at-will employee is legally protected against certain wrongfully motivated discharges. See *supra* note 9.

<sup>26</sup> Verkerke, *supra* note 2, at 873.

<sup>27</sup> See *supra* note 4; see also Peter Stone Partee, Note, *Reversing the Presumption of Employment At Will*, 44 VAND. L. REV. 689, 705 (1991) (asserting that "employers may convey a less-than-accurate image of job security"); Note, *Protecting At Will Employees Against Wrongful Discharge: The Duty to Terminate Only in Good Faith*, 93 HARV. L. REV. 1816, 1831 (1980) [hereinafter Note, *Protecting At Will Employees*] (same).

<sup>28</sup> See, e.g., Leonard, *supra* note 4, at 674.

charge. Such a significant level of misconception is not limited to this particular example. Grouping together six key questions testing respondents' understanding of the at-will rule reveals that less than 10% of them could answer more than half of these questions correctly. The results similarly indicate that workers are misinformed about the legal effect of employer statements regarding job security. In short, this study raises serious doubts about whether workers have the most basic information necessary for understanding the terms on which they have contracted.

Before describing the study in more detail, I first explore, in Part I, the current academic debate surrounding the efficiency of the at-will rule. In Part II, I consider the handful of empirical studies which bear on the issue of worker information, and those studies' limitations in answering the precise issues of concern here—the level of workers' knowledge of the at-will rule and their ability to gather accurate information about prospective employers. Part III describes the survey design and the rationale behind it, while Part IV reports and interprets the results. Finally, in Part V, I consider the implications of a finding that workers systematically misunderstand the governing legal rules for the on-going debate over the wisdom of the at-will rule.

## I

### THE DEBATE OVER THE EFFICIENCY OF THE AT-WILL RULE

In 1984, Richard Epstein offered his classic defense of employment at will, arguing that the common-law rule is justified on grounds of both fairness and utility.<sup>29</sup> Epstein's fairness argument focuses on "the importance of freedom of contract as an end in itself. . . . [as] an aspect of individual liberty."<sup>30</sup> Epstein contends that because the at-will rule merely provides a default presumption, it permits the parties, acting in their own best interests, to arrive at the most efficient arrangement for structuring their relationship.<sup>31</sup> Moreover, he argues, the at-will arrangement is the appropriate default because it *in fact* represents an efficient solution to the contracting problems inherent in any employment relationship.<sup>32</sup>

One possible response to Epstein's argument is to question his normative starting point by asserting that other values besides efficiency matter, or that true human flourishing demands a richer notion of autonomy than mere free-market contracting. Indeed, concerns of fairness, not efficiency, have motivated much of the criticism of the at-will rule. Nevertheless, some critics of the at-will rule

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<sup>29</sup> Epstein, *supra* note 1.

<sup>30</sup> *Id.* at 953.

<sup>31</sup> *Id.* at 951, 956-57.

<sup>32</sup> *Id.*

have engaged Epstein on his own ground, finding fault with his arguments within the framework of a market analysis.<sup>33</sup> Although fairness concerns undoubtedly deserve a central role in any policy debate, this Part focuses solely on the efficiency arguments for and against the at-will rule.

Epstein's efficiency argument begins with the premise that a default rule should be 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."<sup>34</sup> In his view, at-will employment meets both these criteria. He points out that the at-will contract is the predominant form of employment relationship in all trades and professions.<sup>35</sup> Given this fact, any other rule of construction would require the parties to contract around the default in a large number of cases, unnecessarily increasing the costs of reaching agreement.<sup>36</sup>

Moreover, Epstein argues, at-will arrangements *in fact* work to the mutual benefit of both employer and employee by offering a low cost mechanism for limiting abuses on both sides—the threat of firing curbs employee malfeasance and shirking, while the threat of quitting deters employer abuse of power.<sup>37</sup> Epstein argues that although the at-will rule imposes no legal sanction on the employer who acts arbitrarily, reputational effects will put the abusive employer at a competitive disadvantage.<sup>38</sup> The employer who exercises its right to terminate for no reason or a bad reason not only incurs the costs of recruiting and training a replacement worker, but also risks raising its overall labor costs as its remaining employees, observing their employer's arbitrary actions, value their own compensation package less highly and perhaps begin to look elsewhere.<sup>39</sup>

According to Epstein, a further strength of the at-will contract is the manner in which it accommodates the uncertainties inherent in

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<sup>33</sup> See *infra* at 116-19.

<sup>34</sup> Epstein, *supra* note 1, at 951.

<sup>35</sup> *Id.* at 956.

<sup>36</sup> See *id.* at 952.

<sup>37</sup> *Id.* at 965-67.

<sup>38</sup> *Id.* at 967-68.

<sup>39</sup> See *id.* at 968. Of course, the notion that the threat of quitting is an effective deterrent of employer abuse is hardly uncontroversial. Much of the criticism of the at-will rule stems from the contrary belief that employers and employees do not stand on an equal footing, with the employer's power to discharge constituting a significantly more potent threat than an employee's right to quit. The employee may be particularly vulnerable to employer opportunism after accumulating seniority and its attendant benefits over many years of service with a single employer. See, e.g., WEILER, *supra* note 21, at 63-66. Even Epstein acknowledges "that the contract at will works only where performance on both sides takes place in lockstep progression." Epstein, *supra* note 1, at 979. Schwab, however, suggests that asymmetric investments and the potential for opportunism often characterize the career employment relationship. Schwab, *supra* note 6, at 10-11, 13-14.



any employment relationship.<sup>40</sup> Because the parties do not know at the outset whether the match between job and worker is a good one, the at-will contract accommodates this unknown in a sensible way, "allow[ing] 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."<sup>41</sup> In addition, the at-will rule offers the advantage of very low administrative costs. Any departure from at-will employment will entail substantial litigation with all of its attendant costs, including the risk of erroneous verdicts.<sup>42</sup>

Epstein implicitly assumes that the parties would not voluntarily enter into a contract unless the agreement worked to their mutual benefit. Thus, his assertion that the at-will contract is efficient rests in part on its prevalence: "[i]t is simply incredible to postulate that either employers or employees, motivated as they are by self-interest, would enter routinely into a transaction that leaves them worse off than they were before, or even worse off than their next best alternative."<sup>43</sup>

By emphasizing the role of informal norms, as distinct from law, Rock and Wachter propose an alternative explanation for the efficiency of a legal rule of employment at will.<sup>44</sup> They argue that informal norms provide employees with a significantly greater degree of job security than is apparent from the legal rule alone. Drawing on the extensive literature on internal labor markets (ILMs)—the informal rules and practices governing a firm's internal relationships with its employees—they argue that a clear norm forbids firing an employee without cause, despite the employee's formal at-will status.<sup>45</sup> This apparent anomaly—the combination of a legal rule permitting discharge without cause and a strong norm requiring just cause—rep-

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<sup>40</sup> Epstein, *supra* note 1, at 969.

<sup>41</sup> *Id.* at 969. According to Epstein, the at-will contract benefits the employee who "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." *Id.* His argument assumes that the alternative to the at-will contract is a fixed term contract that would equally bind employee and employer for a term of years. This assumption is puzzling because under current law, courts do not require mutuality of obligation in employment contracts. See generally JOSEPH M. PERILLO & HELEN HADJIYANNAKIS BENDER, 2 CORBIN ON CONTRACTS § 6.2 (rev. ed. 1995) (discussing mutuality of obligation in the employment setting). Nonetheless, by making this assumption, Epstein fails to consider why a rational employee faced with uncertainty would not prefer a just-cause contract with no corresponding restriction on the right to quit. Many critics of the at-will rule propose just such an arrangement. See *supra* note 13.

<sup>42</sup> See Epstein, *supra* note 1, at 970.

<sup>43</sup> *Id.* at 956-57.

<sup>44</sup> Edward B. Rock & Michael L. Wachter, *The Enforceability of Norms and the Employment Relationship*, 144 U. PA. L. REV. 1913 (1996).

<sup>45</sup> *Id.* at 1917.

resents a rational response to a set of strategic problems that beset any long-term employment relationship.<sup>46</sup>

As Rock and Wachter explain, both employers and employees make specific investments in their relationship in the form of training and the acquisition of firm-specific skills, generating surpluses to the benefit of both parties.<sup>47</sup> In order to ensure that both parties make such investments, however, some mechanism is needed to constrain overreaching by either side.<sup>48</sup> By curbing abuses, the norms of the ILM encourage the optimal level of investment in the relationship on both sides.<sup>49</sup> These norms are effective because each side is likely to abide by them voluntarily in order to encourage a joint investment in the relationship by the other side.<sup>50</sup> Moreover, the norms are self-enforcing because either party can sanction the other for any violations.<sup>51</sup> The possibility of discharge provides the employer with an effective sanction against employee shirking, and, according to Rock and Wachter, the threat of work slowdowns or unionization, as well as "reputational effects," are sufficient to curb employer abuses.<sup>52</sup> They

<sup>46</sup> See *id.* at 1921-22.

<sup>47</sup> *Id.* at 1922-23.

<sup>48</sup> See *id.* at 1923. The possibility of overreaching exists because of the presence of three factors in an ongoing employment relationship: "(1) match-specific investments, (2) asymmetric information, and (3) transaction costs." *Id.*

<sup>49</sup> For example, one typical ILM norm requires firms to reduce employment, rather than wages, in response to a reduction in demand for their product. Because the firm, but not the worker, has accurate information about market conditions, an employer who could unilaterally lower wages could take advantage of its workers and increase its profits. If, however, the firm's only option in the face of declining demand is to reduce employment and hence, output, it is less likely to exploit its informational advantage at the expense of its workers. See *id.* at 1925-26.

Typical ILM norms include:

wages increase with seniority; a business downturn results in employee layoffs rather than wage reductions; if layoffs occur, junior workers lose their jobs before senior workers; discharges are for cause; if an employer catches an employee shirking, the employer will discharge the employee rather than reduce his wages; and if firms discharge older workers before younger workers, they do so through voluntary retirement mechanisms.

*Id.* at 1921.

<sup>50</sup> See *id.* at 1930.

<sup>51</sup> See *id.* at 1930-31.

<sup>52</sup> *Id.* Rock and Wachter argue that "[f]or the repeat player, departure from the norm will impose costs on the employer: in hiring new employees, in discouraging workers from making investments in match, in 'loss of morale' among existing employees . . . and in higher wages." *Id.* at 1931. They acknowledge that ILM norms are less likely to be effective when the employer is going out of business and the threat of future sanctions no longer has bite. *Id.* at 1932.

However, the efficacy of "reputational effects" in curbing employer abuses, even when dealing with an on-going concern, is not at all certain. See Schwab, *supra* note 6, at 27. Whether employer violations of ILM norms can be effectively sanctioned depends heavily on the characteristics of the employment relationship. Generally, informal norms are effective in governing relations without legal intervention in the context of a close-knit group—one where "informal power is broadly distributed among group members and the

argue that because "the parties have incentives to abide by the norms, without third party enforcement,"<sup>53</sup> these norms do not require legal enforcement in order to be effective.

From this perspective, the failure to include the ILM norm requiring just cause for discharge in individual employment contracts should not be seen as a "gap" to be filled by the courts. Instead, silence on the issue of job security reflects the parties' recognition of the costs involved in third-party enforcement,<sup>54</sup> and a decision to "precommit" not to invoke outside authority.<sup>55</sup> Because the effectiveness of these norms is premised on their self-enforcing nature, Rock and Wachter argue that *legal* enforcement of ILM norms will likely render the relationship less efficient rather than more so.<sup>56</sup> Thus, they conclude that courts should not enforce the informal norms of ILMs, such as a requirement of just cause for termination, when the parties themselves have not expressly made them a part of their contract.<sup>57</sup>

Despite their differences, Rock and Wachter's defense of the at-will rule closely parallels Epstein's. Their arguments share a similar structure: an at-will relationship, or lack of enforceability of ILM norms, must be what the parties want because they did not bargain for any other arrangement.<sup>58</sup> Just as Epstein argues that the prevalence of at-will contracts reflects the parties' choice of a substantive rule governing termination of their relationship, Rock and Wachter assume that at-will contracts reflect the parties' choice of an enforcement mechanism.<sup>59</sup>

For its defenders, the prevalence of the at-will rule in the real world weighs heavily in their conclusion that it represents an efficient arrangement. As Freed and Polsby put it, the simplest explanation for the prevalence of the at-will contract across businesses, regions, and circumstances is that it represents "the 'efficient' solution as between

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information pertinent to informal control circulates easily among them." ROBERT C. ELLICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES* 177-78 (1991). Despite Rock and Wachter's claim that the nonunion ILM is a close-knit group, Rock & Wachter, *supra* note 44, at 1942, it is doubtful that the typical firm, especially a large national or multinational corporation, shares these characteristics.

<sup>53</sup> Rock & Wachter, *supra* note 44, at 1927.

<sup>54</sup> *See id.* at 1932.

<sup>55</sup> *See id.* at 1941.

<sup>56</sup> *Id.* at 1949.

<sup>57</sup> *Id.* at 1917.

<sup>58</sup> The language of "choice" permeates Rock and Wachter's analysis: "legal intervention is likely to be . . . inconsistent with the (ex ante) desires of the parties," *id.* at 1918; the "parties precommit not to use third party enforcement," *id.* at 1941; "the choice between norms and contract is the choice between self-enforcement and third party enforcement," *id.* at 1950.

<sup>59</sup> In his taxonomy of rules, Ellickson labels the latter type of rule a "controller-selecting rule." ELLICKSON, *supra* note 52, at 134.

employers and employees."<sup>60</sup> After all, the common-law rule merely establishes a default presumption; the parties remain free to contract around it if they desire. That they rarely do so is taken as evidence that at-will contracts not only are what employers and employees want, but that they represent the most efficient arrangement as well.<sup>61</sup>

A number of critics assail this conclusion, challenging the assumption that market outcomes necessarily reflect an efficient result.<sup>62</sup> In their view, the nearly total absence of job-security guarantees in the nonunion sector does not so much reflect the desires of the parties as it evidences systematic market failure. Pointing to the prevalence of just-cause provisions in collectively bargained agreements, the critics argue that nonunion workers are unlikely to have such vastly different preferences from their union counterparts that they would neither desire, nor be willing to pay for, a job security guarantee.<sup>63</sup> In diagnosing this market failure, they identify the following likely defects in the bargaining process that lead to the underproduction of just-cause guarantees: imperfect information, employees' inaccurate assessments of risk, employers' misperceptions of cost, signaling problems, and the "public good" nature of guarantees of job security.<sup>64</sup>

*Imperfect Information.* One possible explanation for the failure of individual employment contracts to provide for job security is that employees go into the job search process with inadequate information. A number of commentators suggest that employees misapprehend the degree of job security that legal rules afford.<sup>65</sup> If workers erroneously believe that the law already protects them from unjust discharge, they

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<sup>60</sup> Freed & Polsby, *supra* note 2, at 1098.

<sup>61</sup> See Epstein, *supra* note 1, at 951; Verkerke, *supra* note 2, at 874-75.

<sup>62</sup> E.g., Dau-Schmidt, *supra* note 6, at 1647-52; Issacharoff, *supra* note 21, at 1794-95; Kamiat, *supra* note 21, at 1957; Sunstein, *supra* note 4, at 1055; Willborn, *supra* note 4.

<sup>63</sup> E.g., WEILER, *supra* note 21, at 72-73; Dau-Schmidt, *supra* note 6, at 1651-52; Kamiat, *supra* note 21, at 1967-68.

<sup>64</sup> I do not include in this list of potential "market failures" the common charge that at-will terms result from inequality of bargaining power between employer and employee. Because workers need jobs and jobs are scarce, they are forced to accept employment on terms dictated by the employer. This argument is unlikely to move market advocates, who would find a market failure justifying intervention only in situations of monopoly. Their response to the complaint that "rich employers [can] outbid employees for terms of employment, such as the tenure property, that are valuable to them" is that such an outcome "demonstrates not market failure but market success. A market is successful when it moves resources from lower-value to higher-value uses." Freed & Polsby, *supra* note 2, at 1100.

In this sense, the concern raised by inequality of bargaining power is not so much an allegation of market failure, as an argument based on fairness. These fairness concerns are important to any policy debate, and indeed underlie much of the existing protective labor legislation. For example, the National Labor Relations Act is expressly premised on a finding of inequality of bargaining power between employers and employees. 29 U.S.C. § 151 (1994).

<sup>65</sup> See sources cited *supra* note 4.

will not seek guarantees of job security from their employer. Moreover, even if they correctly understand the legal rules, they may be unable to assess accurately a prospective employer's personnel policies,<sup>66</sup> or to obtain meaningful information as to the actual risk of dismissal they might face with a given firm.<sup>67</sup> Any of these information failures is likely to render employees unable to bargain meaningfully over the issue of job security.

Of course, employer and employee rarely negotiate individual employment contracts in a formal sense. Outside of the collective bargaining context, employer and employee do not sit down face to face and dicker over a long list of employment terms and conditions. Rather, bargaining supposedly takes place implicitly: by offering varying compensation packages, employers compete with one another to attract the best employees.<sup>68</sup> Under this model, if employees value job security, they would accept lower wages, or some other reduction in benefits, in order to obtain the desired term. Once again, however, the efficiency of implicit bargaining rests on the assumption that employees have the information necessary to make meaningful comparisons of the compensation packages offered by different employers regarding the issue of job security. Thus, the possibility of widespread information failure undermines confidence in the efficiency of the contracting process, whether bargaining occurs explicitly or implicitly.<sup>69</sup>

*Employees' inaccurate assessment of risk.* Even if workers have accurate information, they may be unable to rationally process the information they *do* have about the risk of discharge. Some hypothesize that the natural psychological tendency to discount the likelihood of low-probability bad events leads employees to undervalue just-cause protections.<sup>70</sup> The tendency to underestimate not only the likelihood, but also the *costs* of job loss, exacerbates this undervaluation. Although temporary wage loss might adequately measure the costs of termination early in one's career, the same is not true for late-career discharges. Typically, wages, benefits, and opportunities within a firm

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<sup>66</sup> Commentators suggest that this might occur because some workers cannot process the information they receive, *see* Sunstein, *supra* note 4, at 1055, or because an employer encourages an employee's false impression of job security. *See* Note, *Protecting At Will Employees*, *supra* note 27, at 1831.

<sup>67</sup> *See* WEILER, *supra* note 21, at 74; Note, *Protecting At Will Employees*, *supra* note 27, at 1831.

<sup>68</sup> *See* Freed & Polsby, *supra* note 2, at 1098-99 n.1; Verkerke, *supra* note 2, at 873.

<sup>69</sup> Although the presence of imperfect information alone is not necessarily proof of market failure, *see, e.g.*, Schwartz & Wilde, *supra* note 23, the greater the proportion of uninformed market participants, the less likely it is that the market as a whole will behave competitively. I explore this issue more fully in Part V below.

<sup>70</sup> *See* WEILER, *supra* note 21, at 74; Sunstein, *supra* note 4, at 1055; Willborn, *supra* note 4, at 128; Note, *Protecting At Will Employees*, *supra* note 27, at 1831.

all increase with seniority, such that the loss of one's job after many years of service entails far more than a mere loss of wages.<sup>71</sup> Moreover, "endowment effects"—the tendency of individuals to value what they have more than identical things they might obtain—suggest that workers will value their *own* jobs more highly than any calculation of their tangible benefits might suggest.<sup>72</sup> These effects are compounded by the social significance attached to one's job in this society,<sup>73</sup> and likely result in employees seriously underestimating, when initially entering an employment relationship, the consequences of a job loss years down the road.

*Employers' misperceptions of costs.* Some commentators suggest that a similar misperception of risk mars decisionmaking on the employer's side as well. While employees underestimate the risks and costs of suffering an unjust dismissal, employers likely overestimate the costs of wrongful-discharge litigation.<sup>74</sup> Moreover, employers may fail to recognize the benefits of offering just-cause protections. Greater employee loyalty, together with improved hiring and supervisory practices, might prove more profitable in the long run than relying on the threat of discharge.<sup>75</sup>

*Signaling Problems.* Informational asymmetries inherent in the employment contracting process may create signaling problems which further interfere with efficient bargaining over the issue of job security.<sup>76</sup> When entering an employment contract, employees know about the future quality of their work and their likelihood of shirking, and employers know whether they intend to abide by basic fairness norms in handling future discipline and termination. In the absence of a means to verify the claims of the other side, however, neither side is likely to raise the issue of job security. On the one hand, the employee is unlikely to express a desire for just-cause protection, out of fear that the employer will perceive her as a shirker.<sup>77</sup> On the other

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<sup>71</sup> See WEILER, *supra* note 21, at 63-66; Schwab, *supra* note 6, at 25.

<sup>72</sup> See Issacharoff, *supra* note 21, at 1801-02.

<sup>73</sup> See *id.* at 1802-03; WEILER, *supra* note 21, at 64.

<sup>74</sup> See Lauren B. Edelman et al., *Professional Construction of Law: The Inflated Threat of Wrongful Discharge*, 26 L. & Soc'y REV. 47 (1992).

<sup>75</sup> See, e.g., Leonard, *supra* note 4, at 676-77.

<sup>76</sup> See Issacharoff, *supra* note 21, at 1794-95; Kamiat, *supra* note 21, at 1957-60; David I. Levine, *Just-Cause Employment Policies in the Presence of Worker Adverse Selection*, 9 J. LAB. ECON. 294 (1991).

<sup>77</sup> As Kamiat explains:

A relatively risk averse individual who desires long-term employment may seek just-cause protection as a form of insurance against future employer opportunism . . . , may be willing to pay a reasonable price for this insurance (in terms of a wage adjustment reflecting the added costs), and may nevertheless be at least equally likely to perform work of outstanding quality.

Kamiat, *supra* note 21, at 1958. The difficulty for the employee in signaling to the employer the desire for such just-cause protection is that the employer will be unable to distin-

hand, the employer will hesitate to announce its willingness to offer a just-cause term in exchange for a wage discount, fearing that it will attract a greater proportion of employees who are likely to shirk.<sup>78</sup>

*Public Goods.* Other critics theorize that just-cause provisions are underproduced in individual employment contracts because such provisions are "public goods."<sup>79</sup> They argue that just-cause protections are collective in nature because once an employer creates the administrative and adjudicatory mechanisms necessary to support such a term, it would likely be extended to all its employees.<sup>80</sup> While the benefit to employees collectively might well exceed the costs of instituting such protections on a firm-wide basis, individual employees will have an incentive to understate the value they place on a just-cause term in order to position themselves as free riders.<sup>81</sup> Thus, the combination of strategic behavior and informational barriers will likely result in the underproduction of contractual guarantees of job security for nonunion employees.

Defenders of the at-will rule respond to these allegations of market failure by further elaborating their theories on the efficient operation of the labor market with respect to job-security terms. Rejecting the possibilities of market failure that critics of the at-will rule raise, they argue that the number of unjust discharges in the nonunion sector has been exaggerated;<sup>82</sup> that employees are able to learn about the risks of dismissal through experience;<sup>83</sup> that employees are as likely to overestimate as to underestimate the risk of unjust dismissal;<sup>84</sup> that employers are unlikely to misperceive their own best interests in monitoring their agents;<sup>85</sup> that the effects of signaling problems on contracting for just-cause provisions are ambiguous;<sup>86</sup> and that just-cause provisions do not necessarily have the properties of a "public good."<sup>87</sup>

To a considerable extent then, the debate over the at-will rule, at least on efficiency grounds, comes down to which of these competing theories most accurately captures what is actually happening in the labor market.

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guish her from the individual who values just-cause protection "precisely because she expects (or wishes to reserve an option) to perform deficiently at the job . . . tak[ing] advantage of the costs that a just-cause clause would impose on employer efforts to police against shirking." *Id.*

<sup>78</sup> See *id.* at 1959.

<sup>79</sup> WEILER, *supra* note 21, at 75; Kamiat, *supra* note 21, at 1967; Douglas L. Leslie, *Labor Bargaining Units*, 70 VA. L. REV. 353, 356 (1984).

<sup>80</sup> See, e.g., WEILER, *supra* note 21, at 75.

<sup>81</sup> See, e.g., *id.*

<sup>82</sup> See Freed & Polsby, *supra* note 2, at 1106-07; Morriss, *supra* note 2, at 1905-14.

<sup>83</sup> See Morriss, *supra* note 2, at 1930; Verkerke, *supra* note 2, at 887.

<sup>84</sup> See Freed & Polsby, *supra* note 2, at 1105; Verkerke, *supra* note 2, at 898-900.

<sup>85</sup> See Freed & Polsby, *supra* note 2, at 1130-31.

<sup>86</sup> See Verkerke, *supra* note 2, at 902-05.

<sup>87</sup> Freed & Polsby, *supra* note 2, at 1113-18.

## II

THE INADEQUACY OF EXISTING EMPIRICAL EVIDENCE OF  
WORKERS' LEGAL KNOWLEDGE

Only a handful of studies offer any empirical data intended to shed light on the debate over the at-will rule.<sup>88</sup> Although each study offers some useful information, none adequately tests the precise issues that are the focus of this study: the extent to which employees understand the background legal rules governing the employment relationship and are able to acquire information regarding the termination policies and practices of prospective employers.

In one study, Verkerke surveyed employers in five states, inquiring whether and how often they contracted with their nonunion employees for guarantees of job security.<sup>89</sup> He reports that 52% of the employers who responded to the survey contracted explicitly for an at-will relationship, while 33% failed to specify any terms governing discharge.<sup>90</sup> Only 15% of the employers he surveyed expressly agreed to discharge their employees only for just cause.<sup>91</sup> As he acknowledges, these data do not reveal anything about the knowledge or beliefs of individual employees.<sup>92</sup> Nevertheless, Verkerke argues that the contracting practices he documents provide evidence of the contract terms that both employers *and* employees prefer.<sup>93</sup> Based on his finding that an overwhelming majority of employers contracted for at-will employment either expressly or implicitly by remaining silent in the face of the default rule, he asserts that strong support exists for the current default rule of employment at will.<sup>94</sup>

Verkerke's move to bring empirical evidence to bear on what has been a highly theoretical debate should be applauded; however, the conclusions he reaches are vastly overdrawn. The first difficulty arises from the manner in which he interprets his data. Verkerke collected information about employer contracting practices by means of telephone interviews in which employers in Virginia, California, Texas, Michigan, and New York<sup>95</sup> were asked about the types of documents distributed to employees and what statements, if any, these documents

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<sup>88</sup> See, e.g., Elletta Sangrey Callahan, *Employment at Will: The Relationship Between Societal Expectations and the Law*, 28 AM. BUS. L.J. 455 (1990); Frank S. Forbes & Ida M. Jones, *A Comparative, Attitudinal, and Analytical Study of Dismissal of At-Will Employees Without Cause*, 37 LAB. L.J. 157 (1986); Verkerke, *supra* note 2.

<sup>89</sup> Verkerke, *supra* note 2, at 865-69.

<sup>90</sup> *Id.* at 867.

<sup>91</sup> *Id.*

<sup>92</sup> *Id.* at 900 ("[M]y survey data do not reveal the knowledge and beliefs of individual employees.").

<sup>93</sup> *Id.* at 842.

<sup>94</sup> *Id.* at 875.

<sup>95</sup> *Id.* at 865.



made about employee discharges.<sup>96</sup> The statements contained in respondents' employment documents were classified into one of three types: "you have the legal right to discharge employees for any reason or no reason at any time," "you may discharge employees only for reasons of poor or faulty performance of their duties, or . . . employees may only be discharged for specific reasons listed," or "employees are hired on fixed term contracts."<sup>97</sup>

A significant difficulty arises, however, in interpreting the employer practices thus documented. As Verkerke admits, "the legal rules governing the enforceability of such statements differ widely by state."<sup>98</sup> For example, Virginia courts require a signed writing—compliance with the Statute of Frauds—before they will enforce an employer's promises to discharge only for cause,<sup>99</sup> while New York courts demand not only specific language, but proof of reliance as well.<sup>100</sup> California courts, on the other hand, liberally enforce even general promises of job security.<sup>101</sup> Despite the considerable state by state variation he documents in the *legal* consequences of employer statements regarding discharge,<sup>102</sup> Verkerke makes the remarkable assumption that "if a respondent reported that a document required specifically enumerated reasons or established a general good cause requirement for discharge, then that employer intended to provide legally enforceable just cause protection."<sup>103</sup> By glossing over factual and jurisdictional variations which affect the legal consequences of employer statements regarding discharge, Verkerke likely has *overesti-*

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<sup>96</sup> *Id.* app. at 916. Apparently, the survey also asked respondents questions about oral statements made to employees regarding discharge, but Verkerke concludes that these responses were not sufficiently reliable to warrant reporting and analysis. *Id.* at 867.

<sup>97</sup> *Id.* app. at 916. Verkerke apparently relied on respondents to classify the statements contained in their employment documents. *Id.*

<sup>98</sup> *Id.* at 866-67.

<sup>99</sup> See *Progress Printing Co. v. Nichols*, 421 S.E.2d 428, 430 (Va. 1992).

<sup>100</sup> See *Sabetay v. Sterling Drug, Inc.*, 506 N.E.2d 919, 921, 923 (N.Y. 1987); *Weiner v. McGraw-Hill, Inc.*, 443 N.E.2d 441, 445 (N.Y. 1982).

<sup>101</sup> See, e.g., *Foley v. Interactive Data Corp.*, 765 P.2d 373, 388 (Cal. 1988) (stating that the acts and conduct of the parties, including the employer's written termination guidelines, may give rise to an implied contract limiting its power to discharge at will).

<sup>102</sup> Verkerke expends considerable energy in the early part of his article disputing Schwab's "life cycle hypothesis," see Schwab, *supra* note 6, at 11, arguing that "systematic jurisdictional variation, combined with careful judicial attention to the problem of interpreting arguably contractual writings," better explain current case law. Verkerke, *supra* note 2, at 852. Ironically, he abandons this emphasis when interpreting his own data.

<sup>103</sup> Verkerke, *supra* note 2, at 867. In other words, once an employer reports that its employee handbook lists the specific reasons for discharge, its employees are assumed to be protected by a just-cause contract, regardless of the context and circumstances in which the statement is made and regardless of whether the employer is located in New York, where the courts "have rarely seen a handbook provision that they were willing to enforce," *id.* at 847, or California, where the courts "do not appear to have seen an employee handbook provision discussing discharge that they were not willing to enforce," *id.*

mated significantly the number of employers in his sample that expressly contract with employees for just-cause protection.

A more serious problem with Verkerke's analysis is the normative conclusion he derives from his data. Following the standard economic theory of default rules, he argues that the default for employment contracts should be the term that most employers and employees prefer, in order to minimize the costs of explicit bargaining over the issue of job security. Claiming that his survey data provide "the best available evidence of parties' preferences," Verkerke concludes that they "strongly support the prevailing default rule of employment at will."<sup>104</sup>

Verkerke's empirical data may be the best available evidence on the actual contracting practices of employers. However, his claim that they reveal the true preferences of employers and employees on the issue of job security is unsupported. Market outcomes may reflect the parties' preferences when the market is working efficiently, but *whether* the market for job security is efficient—or is characterized instead by systematic market failure—is precisely the point that is controversial. If anything, Verkerke's findings tend to confirm what both sides in the debate have assumed all along—that employment at will is the dominant form of contract in actual practice. Where the two sides differ is in how they interpret that fact. Unfortunately, Verkerke's data offer no help in resolving this dispute. By simply concluding that the contracting practices of employers transparently reflect the parties' preferences,<sup>105</sup> Verkerke falls back on the same controversial assumptions about the efficiency of the labor market on which Epstein and other defenders of the at-will rule rely.<sup>106</sup>

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<sup>104</sup> *Id.* at 897. I argue above that Verkerke's methodology likely has overestimated the number of employers that have contracted with employees for just-cause protections. An upward adjustment in the proportion of at-will contracts might seem at first glance to strengthen his argument that the at-will rule is a good one; however, his normative conclusion is vulnerable not so much because of his numbers, but because of his unfounded assumption that the observed market outcome is the result of an efficient bargaining process.

<sup>105</sup> Verkerke's own observations raise doubts as to whether the employer practices he documents accurately reflect even the desires of employers as to the legal relationships they are creating, let alone the preferences of employees. *Id.* at 867 n.127 ("[T]he interview reports seem to suggest that employers offering just cause protection are no better informed about these highly technical aspects of the law than one might expect the average employee would be."); *id.* at 874 n.153 ("Interview reports suggest that a nontrivial number of employers do not know the law."); *id.* at 901 n.222 ("Interview notes from the survey confirm that a significant proportion of employers are woefully ignorant about the legal consequences of their employment practices.").

<sup>106</sup> Only after he concludes that at-will employment is the appropriate default rule does Verkerke turn to consideration of the various market failure theories posited by critics of the rule. *Id.* at 886-89, 897-912. At this point, his discussion takes on the quality of theoretical speculation, which he decries elsewhere. For example, in discussing the critics' claim that workers have a psychological tendency to underestimate the value of just-cause

In considering the question that is the focus of this study—whether workers understand the legal rules governing the employment relationship—Verkerke admits that his survey data do not provide direct evidence on this issue.<sup>107</sup> Nevertheless, he suggests that they provide an indirect test of the competing theories regarding employees' legal knowledge.<sup>108</sup> According to Verkerke, if information problems in fact cause workers to fail to bargain for just-cause protection, then legally well-informed employees should contract for just-cause at a higher rate than uninformed employees.<sup>109</sup> Hypothesizing that employees are unlikely to be equally uninformed across industries and occupations, he posits that one might expect to see variations by industry and occupation in the levels of just-cause protection.<sup>110</sup> Finding no such variations in his survey data, he concludes that they provide no support for the critics' claim that workers lack accurate information about their legal rights.<sup>111</sup>

While Verkerke may be correct that his data do not support the critics' theory of informational failure, neither do they disprove it. Even if his hypothesis that the level of legal knowledge varies systemat-

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protection, Verkerke argues that "other equally plausible speculations" suggest a different conclusion. *Id.* at 899. He theorizes that because workers likely overestimate their own job performance and underestimate the costs of enforcement, they are therefore as likely to overvalue as to undervalue just-cause protection. *Id.* at 899-900. Verkerke's responses to the other allegations of market failure have a similar flavor. He rejects the critics' suggestion that employers may overestimate the costs of providing just-cause protection by theorizing that it is "equally likely that employers who are ill-informed about the law and its consequences will dramatically underestimate the legal risks to which they expose themselves when they agree to offer just cause protection." *Id.* at 901. Similarly, Verkerke suggests that the signaling problems that arise from informational asymmetries might as plausibly discourage employers from seeking an at-will relationship as they would discourage employees from seeking just-cause protection. *Id.* at 903.

<sup>107</sup> *Id.* at 900. Verkerke speculates that "[e]mployees might equally well underestimate the extent of legal protection they have against discharge," citing data that a very small proportion of employees who believe they have suffered sex or race discrimination actually sue their employers. *Id.* at 887 (citing David M. Trubek et al., *The Costs of Ordinary Litigation*, 31 UCLA L. REV. 72 (1983)). The study by Trubek et al., however, offers no information at all about the level of employees' legal knowledge. Rather, its purpose was to study the resources expended on processing disputes through litigation. Trubek et al., *supra*, at 75. As its analysis suggests, a host of factors having nothing to do with employee perceptions of legal protections—factors such as cost, access to legal counsel, and the assessment of likely outcomes—may influence the proportion of litigated disputes.

<sup>108</sup> Verkerke, *supra* note 2, at 888.

<sup>109</sup> *Id.* Elsewhere, Verkerke argues that workers who have experienced discharge would be expected to demand and receive just-cause protection. *Id.* at 900. Such a result, however, depends upon at least two assumptions: first, that discharged workers are in fact able to assess more accurately their future risks of job loss as a result of their experience; and second, that no other market failures, such as signaling problems, interfere with these workers' ability to bargain for increased job security. As discussed in Part IV below, the results of this study cast serious doubt on the first assumption. Neither Verkerke's data set nor my own helps to empirically assess the second assumption.

<sup>110</sup> *Id.* at 888, 900.

<sup>111</sup> *Id.* at 900.

ically by industry or occupation were proven, a corresponding variation in the level of just-cause protection would be observed only if the other market failures posited by critics of the at-will rule do not in fact exist. Thus, Verkerke's observation that employees of varying occupations at all levels of a firm typically work under identical contractual terms governing discharge<sup>112</sup> does not so much undermine the theory of information failure as it suggests that just-cause provisions have the characteristics of a public good. Ultimately, as Verkerke acknowledges,<sup>113</sup> the theory that information failures interfere with bargaining over job security is best tested by direct empirical evidence, rather than further speculation. The study described in Parts III and IV of this Article directly measures the legal knowledge of a group of workers, providing far more accurate information about the existence of informational failures than the inferential arguments Verkerke makes based on his data.

Three other empirical studies explore more closely the issue of employee beliefs and perceptions regarding job security. However, for the reasons discussed below, these studies are of limited usefulness in measuring the level of employee comprehension of legal protections against unjust discharge.

Two of the surveys focus on general societal *attitudes* towards an employer's right to discharge an employee under certain circumstances.<sup>114</sup> In a 1989 mailed survey in the Syracuse, New York, metropolitan area, Callahan asked respondents whether a discharged employee *should* prevail in a lawsuit against his or her employer in a variety of situations involving employee opposition to illegal or unethical employer activities.<sup>115</sup> Similarly, Forbes and Jones asked respondents in a 1983 telephone survey in Omaha, Nebraska, whether it is ethical for an employer to terminate an employee without a good reason and whether the respondent would support a legal requirement of just-cause before an employer could terminate an employee.<sup>116</sup>

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<sup>112</sup> *Id.* at 888-89.

<sup>113</sup> *Id.* at 887 n.187.

<sup>114</sup> See Callahan, *supra* note 88; Forbes & Jones, *supra* note 88.

<sup>115</sup> Callahan, *supra* note 88, at 464-66, 470. The questionnaire described eight general kinds of employee activity (e.g., refusing to participate in illegal activity, informing superior of another employee's job-related unethical practices) that led to discharge, and asked respondents whether they agreed or disagreed with the conclusion that the employee should prevail in a lawsuit against the employer. See *id.* at 470, 471 tbl.III. It also presented 13 specific fact patterns, most based on reported cases, and again asked respondents whether they believed the law should favor the employee or the employer. See *id.* at 472-73. Callahan's purpose in conducting the survey was to document societal attitudes toward at-will employment and possible legal protections for employees fired for opposing unlawful or unethical employer activity. *Id.* at 456. Ultimately, she concludes that the traditional at-will rule is inconsistent with societal expectations to the extent that it insulates employers from legal liability for such retaliatory discharges. *Id.* at 481.

<sup>116</sup> Forbes & Jones, *supra* note 88, at 165.

The results of these studies are consistent to the extent that both report significant support for legal limitations on an employer's right to discharge at will.<sup>117</sup> However, because these studies were concerned primarily with discovering what respondents believed the law *should* be, rather than testing their knowledge of what the law *is*, they shed little light on the extent to which employees accurately understand the meaning and application of the at-will default rule to individual employment contracts.<sup>118</sup>

A study conducted by Schmedemann and Parks *does* purport to test directly the accuracy of public perceptions regarding certain employment rights.<sup>119</sup> As part of a larger survey assessing the legal and moral obligations created by promissory language in employee handbooks, they tested respondents' knowledge of the legal rights of employees to certain procedural protections in the event of termination.<sup>120</sup> More specifically, they asked respondents to indicate their agreement or disagreement with several statements regarding employees' procedural rights in the event of termination, such as the right to an explanation of the reasons for discharge, or the right to have an upper-level manager review the discharge.<sup>121</sup> Based on the responses, Schmedemann and Parks conclude that the respondents' perceptions of the law—at least as to these procedural protections—are “fundamentally accurate.”<sup>122</sup>

Because of the population surveyed and the nature of the questions, the findings of Schmedemann and Parks provide only limited assistance in assessing the theory that employee misperceptions of their legal rights lead to a failure to bargain over job security. First, the population surveyed—undergraduate and graduate business stu-

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<sup>117</sup> See Callahan, *supra* note 88, at 470-75; Forbes & Jones, *supra* note 88, at 165-66.

<sup>118</sup> Forbes and Jones apparently did ask respondents about their knowledge of the law and reported that only a small percentage “knew that employers hold the right to terminate at any time even without cause.” *Id.* at 165. Unfortunately, they provide very little information about their methodology. For example, the precise question posed to respondents is not clear. In their article, they paraphrase the question as “does an employer have the right to fire an employee without giving a reason?” *id.*, suggesting a focus on *procedural* requirements, but Forbes and Jones then report that very few respondents know that employers can terminate “without cause,” *id.*, a claim about the respondents' knowledge of the *substantive* limits on an employer's right to discharge. In light of the clearly normative cast of the other questions posed in the survey and the risk it creates of biasing responses unintentionally, the form and manner in which the question relating to legal knowledge was posed is particularly critical to obtaining accurate results. Given the lack of methodological detail, it is difficult to assess the reliability of their findings regarding respondents' legal knowledge.

<sup>119</sup> Deborah A. Schmedemann & Judi McLean Parks, *Contract Formation and Employee Handbooks: Legal, Psychological, and Empirical Analyses*, 29 WAKE FOREST L. REV. 647, 650-51 (1994).

<sup>120</sup> *Id.* at 653.

<sup>121</sup> *Id.*

<sup>122</sup> *Id.* at 656.

dents and practicing lawyers—is not representative of most employees.<sup>123</sup> Members of this sample are not only far more educated than the average employee, but their particular areas of study or training—business and law—likely provide them far greater knowledge of the relevant legal rules than the general population. Even more troubling, the authors report that all of the respondents filled out the survey “as part of coursework on topics related to the study.”<sup>124</sup> Schmedemann and Parks give no further information about the context in which the survey was administered, but the fact that the respondents were engaged contemporaneously in coursework related to the subject of the survey further decreases the likelihood that their perceptions of the law are typical of the labor force.

Aside from these concerns about the population surveyed, a further difficulty arises due to the nature of the questions posed. Although Schmedemann and Parks designed this portion of their study “to measure public awareness of th[e] law on discharge of employees,”<sup>125</sup> all of their questions concerned the *procedural* rights of employees in the event of termination. Thus, they prefaced their questions concerning legal entitlements with an instruction to assume that the employee “has been fired for performance reasons.”<sup>126</sup> With this limiting instruction, they excluded from consideration the principal question of interest to the at-will debate: do employees understand that the law offers them no generalized protection from arbitrary or unjust discharge? After all, the at-will rule has been the subject of controversy, not because of the lack of procedural protections for employees fired for performance reasons, but because of the possibility that employers will fire workers for bad reasons or no reason at all. Thus, even if they could generalize their finding that perceptions of employees’ procedural rights are quite accurate, their data tell us little about the extent to which workers understand that the default rule—employment at will—does not require their employer to have any reason at all for terminating their employment.

### III

#### THE SURVEY DESIGN: TESTING EMPLOYEES’ LEGAL KNOWLEDGE AND INFORMATION GATHERING EXPERIENCES

This study focuses on two questions central to the debate over the at-will rule. First, do employees understand the background legal

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<sup>123</sup> See *id.* at 650. The survey sample consisted of 51 graduate students, 169 undergraduate students, and 46 lawyers. See *id.* at n.25.

<sup>124</sup> *Id.*

<sup>125</sup> *Id.* at 653.

<sup>126</sup> *Id.* at 693.

rules governing the employment relationship? Second, are they able to obtain accurate information about a prospective employer's policies and practices regarding dismissal?

Because of a peculiarity of the labor market, answering these questions requires a focus on the knowledge of active job seekers, rather than the workforce in general. Unlike the typical commodity, labor is generally not traded on a "spot market"—a daily auction in which employers bid against each other for the services of prospective employees.<sup>127</sup> Rather, employment relationships tend to be long-term, lasting months, years, or even an entire career. Most workers, most of the time, are not "on the market," actively searching for alternative employment and comparing the compensation packages offered by different employers. As a result, competitive wages and terms tend to be defined at the margins, by the worker looking for a new job rather than by the typical long-term employee.<sup>128</sup> The efficiency of the labor market in setting terms and conditions like job security thus depends more upon the information available to active job seekers than to average employees.<sup>129</sup>

This study explored the adequacy of workers' information by means of a written survey testing respondents' perceptions of their legal rights, as well as asking about their prior experience gathering information about a particular employer before accepting a job. I chose a written survey instrument in order to eliminate potential biases that an interviewer might introduce unintentionally. Using a written instrument also produced consistency in the form in which the data was collected, thereby facilitating analysis. The principal disadvantage of the written survey was the limitation it imposed on the length and complexity of the questions. Because I expected that the population surveyed would include people from a broad range of educational backgrounds, I felt it was imperative to limit the number of questions, to minimize the level of reading difficulty of each question, and to avoid any branching instructions. Thus, the survey did not include any conditional questions to explore particular responses in greater detail.

The survey was administered to several hundred unemployment insurance claimants in St. Louis City and County during August, September, and October of 1996.<sup>130</sup> I chose to survey unemployment in-

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<sup>127</sup> Michael H. Gottesman, *Wither Goest Labor Law: Law and Economics in the Workplace*, 100 YALE L.J. 2767, 2781 (1991).

<sup>128</sup> See Samuel Issacharoff, *Reconstructing Employment*, 104 HARV. L. REV. 607, 621 (1990) (reviewing WEILER, *supra* note 21).

<sup>129</sup> See WEILER, *supra* note 21, at 76.

<sup>130</sup> Throughout most of this period of time, workers were on strike against McDonnell Douglas, one of the largest employers in the St. Louis metropolitan area. Although they were eligible to receive unemployment insurance benefits, these workers were screened

surance claimants for several reasons. First, in order to qualify for state unemployment insurance benefits in Missouri, an individual must have earned a certain minimum amount of wages over roughly the prior 15 months.<sup>131</sup> Thus, all eligible unemployment insurance claimants must have *some* level of experience with, and attachment to, the labor market.<sup>132</sup> Second, continuing eligibility for unemployment insurance benefits requires the claimant to undertake an active job search.<sup>133</sup> Because these individuals are job seekers, the survey captures their beliefs and attitudes close to the point in time most relevant to this inquiry—the moment when they decide to accept or reject a job offer from a particular employer. Finally, the close similarity in the structure of unemployment insurance systems nationwide offers the possibility of studying roughly comparable populations in other states at a future date.

Responses to the survey were collected at the six offices of the Missouri Division of Employment Security, the state agency which administers unemployment insurance benefits, that are located in St. Louis City and County. During the time the survey was conducted,

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out of the sample entirely in order to avoid skewing the results. The survey collected the following demographic information about the respondents: sex (male — 53%, female — 47%); age (under 25 — 14%, 25-34 — 35%, 35-44 — 29%, 45-54 — 15%, 55-64 — 6%, 65 and over — 1%); race (White — 45.9%, Black — 50.5%, Asian/Pacific Islander — .3%, Hispanic origin — 1.2%, Native American — .3%, other — 1.8%); education (no high school diploma — 6%, high school diploma or equivalent — 39%, associate or technical degree — 10%, some college, no degree — 32%, college degree — 7%, some graduate school or graduate degree — 6%); and income (average annual earnings of last job was less than \$10,000 — 19%, \$10,000 - \$14,999 — 26%, \$15,000 - \$24,999 — 27%, \$25,000 - \$49,999 — 23%, \$50,000 - \$74,999 — 4%, \$75,000 and over — 1%).

<sup>131</sup> Eligibility for unemployment insurance benefits is measured in reference to a “base period” which is defined as “the first four of the last five completed calendar quarters.” MO. ANN. STAT. § 288.030(2) (West Supp. 1997). An “insured worker” is one

who has been paid wages for insured work in the amount of one thousand dollars or more in at least one calendar quarter of such worker’s base period and total wages in the worker’s base period equal to at least one and one-half times the insured wages in that calendar quarter of the base period in which the worker’s insured wages were the highest, or in the alternative, a worker who has been paid wages in at least two calendar quarters of such worker’s base period and whose total base period wages are at least one and one-half times the maximum taxable wage base, taxable to any one employer.

*Id.* § 288.030(22).

<sup>132</sup> Of course, not every individual who files for unemployment insurance benefits will be eligible to receive them. Due to the manner in which the data were collected, the population this study surveyed consists of *claimants* as distinct from *recipients* of unemployment insurance benefits. The former group undoubtedly includes some individuals who do not meet the basic eligibility requirements in terms of prior earnings. Nevertheless, all claimants are likely to have *some* work experience, even if they fail to meet the minimum statutory earnings requirement.

<sup>133</sup> In order to be eligible for benefits, a claimant must be “able to work” and “available for work.” MO. ANN. STAT. § 288.040(2) (West Supp. 1997). “No person shall be deemed available for work unless he has been and is actively and earnestly seeking work.” *Id.*



the Division of Employment Security required all unemployment insurance claimants to appear *in person* at a local office in order to file an initial claim for benefits. Those filing an initial claim arrived without an appointment and often needed to wait for some time before meeting with a counselor. While waiting, they were asked if they would be willing to complete the survey form. Although this approach did not guarantee a truly randomized sample of unemployment insurance claimants,<sup>134</sup> it had the advantage of producing a very high response rate. Out of 398 persons approached, 337 agreed to complete the survey, resulting in a nearly 85% response rate.

The survey itself was divided into four parts. Parts I and III contained a series of questions intended to test the respondent's knowledge of the legal rules governing the employment relationship.<sup>135</sup> Part II asked questions designed to discover the extent to which employees were able to learn information about a prospective employer's policies regarding discharge or its general reputation for fairness prior to hire. The remaining questions in Part II sought information about the respondent's attitudes toward, and past experiences with, employers that might influence his or her other responses. Finally, Part IV of the survey asked for general demographic information about the respondent.

The question of whether employees understand the basic legal rules governing the employment relationship can be broken down into three parts. First, do employees know that the default rule is "employment at will"? Second, do employees understand what it means to be employed "at will"? In other words, can they correctly identify whether a given reason for firing an employee is legally permissible under the at-will rule? Third, do employees know under what circumstances the employment-at-will *presumption* is overcome?

The survey collapses the first two questions into a single line of inquiry by describing a series of employee discharges, identifying the reason for each discharge, and asking whether the discharge was law-

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<sup>134</sup> The number of surveys collected at each of the six offices was roughly proportional to the number of claims filed at each office during the third quarter of the previous year. Beyond this, no attempt was made to systematically select which individuals to survey. The surveys were administered during two or three hour time blocks, usually in the mornings or early afternoons early in the week when traffic in the offices was highest. In theory, the results might therefore be biased in favor of individuals who file earlier in the week and earlier in the day. It is difficult to imagine, however, how such a bias might influence the results in any systematic way.

<sup>135</sup> The two parts of the survey testing legal knowledge were separated in order to provide some variation in the form of the questions from the perspective of the respondent. I was also concerned that the questions in Part III—concerning the legal effect of various employer statements contained in an employee handbook or offer letter—might influence responses in Part II—which asks what types of information respondents had about their prospective employer. Therefore, the second set of legal-knowledge questions follows Part II.

ful or unlawful. In this form, the questions directly test the respondents' beliefs as to whether they would be legally protected under the circumstances described. This approach simplifies the form of the questions by eliminating reference to a legal term of art—"at-will employment"—which might cause confusion or be interpreted differently by different respondents.<sup>136</sup> Moreover, it did not seem particularly important to find out whether employees can put the correct legal label on their relationship with their employers; what matters is whether they know when the law affords them legal protection against discharge and when it does not.

Part I of the survey describes eight situations in which an employee is discharged and briefly describes the employer's motive for the discharge.<sup>137</sup> Because the prefatory instructions to this section specifically rule out the existence of any contract, the employee in each scenario is clearly employed at will.<sup>138</sup> In addition, the instructions rule out the possibility of any illegal discrimination based on race, sex, national origin, religion, age or disability. Respondents are then asked whether they believe the discharge to be lawful or unlawful. By varying the reason given for discharge while holding the employee's status (at-will) constant, the questions in Part I directly test the respondents' perception of their legal protections in the absence of any contractual agreement with the employer regarding job security.

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<sup>136</sup> A further difficulty with separating the two issues is that questions directed toward the second line of inquiry—what it means to be "at will"—would tend to suggest the correct response to the first line of inquiry—what is the nature of the relationship in the absence of a contract specifying the duration of employment—thereby influencing the results.

<sup>137</sup> See *infra* Appendix A.

<sup>138</sup> Under the traditional common-law rule, private-sector employees are employed at will in the absence of any contract to the contrary. See *supra* notes 8-9 and accompanying text. However, a different set of rules apply to government employees. Constitutional due process requirements apply when a government employee has an established property interest in her job, see *Perry v. Sindermann*, 408 U.S. 593 (1972), and civil-service rules that typically require cause for discharge cover many public-sector workers, see CHARLES A. SULLIVAN ET AL., *CASES AND MATERIALS ON EMPLOYMENT LAW* 337 (1993). Thus, the analysis that follows in the text applies to *private-sector* workers employed at will.

The questions in Part I generally refer to the employer as the "company," indicating that the employment relationship described is in the private sector and hence not covered by civil service rules. Admittedly, the survey would have been a sounder instrument if the instructions or questions had explicitly made clear that the discharge described occurred in the private sector. However, it is doubtful that this oversight significantly compromised the results. Government employees—those most likely to interpret "the company" to mean a public employer constrained by civil service rules—comprised only 8.6% of the respondents. Excluding their responses, as well as those of respondents who did not identify the industry in which they had worked, does not significantly change the results. See *infra* note 152.

In Missouri, as elsewhere, an employee hired for an indefinite term is presumed to be at-will,<sup>139</sup> and, absent a contrary statutory prohibition, may be fired without liability "for cause or without cause."<sup>140</sup> Although Missouri has declined to follow the more liberal jurisdictions that recognize multiple exceptions to the at-will rule,<sup>141</sup> its courts recognize a public policy exception permitting at-will employees to sue for wrongful discharge when their termination violates some clear mandate of public policy.<sup>142</sup> However, the exception is a narrow one and applies only "when an employer's act of discharging the employee is violative of a statute, regulation based on a statute, or a constitutional provision."<sup>143</sup>

The at-will rule merely states a default rule which the parties are free to avoid by contract. The legally informed employee, therefore, must understand not only the meaning of the at-will presumption, but the circumstances under which it may be overcome as well. Part III of the survey tests this aspect of legal knowledge by asking respondents whether a discharge is lawful or unlawful in light of the employer's written statements regarding job security.<sup>144</sup> In order to isolate the effect of the employer's statements, I held the reason for discharge—

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<sup>139</sup> See *Clark v. Beverly Enters.-Mo., Inc.*, 872 S.W.2d 522, 525 (Mo. Ct. App. 1994).

<sup>140</sup> *Dake v. Tuell*, 687 S.W.2d 191, 193 (Mo. 1985).

<sup>141</sup> Compare *Mitford v. Lasala*, 666 P.2d 1000, 1007 (Alaska 1983) (recognizing "implied covenant of good faith and fair dealing" in employment contracts) and *Merrill v. Crothall-Am., Inc.*, 606 A.2d 96, 101 (Del. 1992) (same) with *Neighbors v. Kirksville College of Osteopathic Med.*, 694 S.W.2d 822, 824 (Mo. Ct. App. 1985) (holding that a claim based on implied covenant of good faith and fair dealing in employment cannot circumvent Missouri's at-will rule); compare *Toussaint v. Blue Cross & Blue Shield*, 292 N.W.2d 880, 892 (Mich. 1980) (holding employer promises in employee handbook enforceable) and *Woolley v. Hoffmann-LaRoche, Inc.*, 491 A.2d 1257, 1258 (N.J.), modified, 499 A.2d 515 (N.J. 1985) (same) with *Johnson v. McDonnell Douglas Corp.*, 745 S.W.2d 661, 662-63 (Mo. 1988) (rejecting "handbook exception" to at-will rule).

<sup>142</sup> *Boyle v. Vista Eyewear, Inc.*, 700 S.W.2d 859, 871 (Mo. Ct. App. 1985).

<sup>143</sup> *Lynch v. Blanke Baer & Bowey Krimko, Inc.*, 901 S.W.2d 147, 150 (Mo. Ct. App. 1995). The leading case in Missouri on the issue spoke of "public policy" in broad terms. *Boyle*, 700 S.W.2d at 871. In 1988, however, the Missouri Supreme Court in *Johnson*, 745 S.W.2d at 663, rejected an employee's claim based on the "public policy" exception. It noted that "[i]n the cases cited by plaintiff the employee had the benefit of a constitutional provision, a statute, or a regulation based on a statute. No statute, regulation based on a statute, or constitutional provision is implicated here." *Id.* at 663 (citations omitted). Subsequently, Missouri courts of appeals have interpreted *Johnson* not as overruling *Boyle*, but as limiting the public policy exception to those situations that threaten violation of a specific statute, regulation based on statute, or constitutional provision. See, e.g., *Yow v. Village of Eolia*, 859 S.W.2d 920, 922 (Mo. Ct. App. 1993); *Kirk v. Mercy Hosp. Tri-County*, 851 S.W.2d 617, 619 (Mo. Ct. App. 1993); *Luethans v. Washington Univ.*, 838 S.W.2d 117, 119-20 (Mo. Ct. App. 1992). Not every regulation, however, indicates a "clear mandate of public policy." *Adolphsen v. Hallmark Cards, Inc.*, 907 S.W.2d 333, 337 (Mo. Ct. App. 1995). General allegations of a violation of unspecified "safety regulations," *id.*, or of a Code of Ethics requiring the exercise of "best judgment," see, e.g., *Lay v. St. Louis Helicopter Airways, Inc.*, 869 S.W.2d 173, 177 (Mo. Ct. App. 1993), are too vague to support a claim for wrongful discharge in violation of public policy.

<sup>144</sup> See *infra* Appendix A.

the employer plans to hire another person to do the same job at a lower wage—constant for each question in Part III and varied the description of the employer's statements regarding job security.

In Missouri, employees cannot easily defeat the at-will presumption for an indefinite hiring. Missouri courts have consistently refused to follow the expansive contract doctrines developed in other states finding guarantees of job security in an employer's general policy statements.<sup>145</sup> Instead, Missouri has hewed to the traditional requirements that an employee seeking to avoid her at-will status must plead and prove "[t]he essential elements of valid contract . . . offer, acceptance, and bargained for consideration."<sup>146</sup> Thus, an employer's unilateral act of publishing an employee handbook does not constitute a contractual offer and no promise of job security can be derived from its provisions.<sup>147</sup> Nor does an employee's quitting a previous job in detrimental reliance on an employer's promise of employment give rise to a claim of promissory estoppel.<sup>148</sup> Indeed, a court has even rejected a written contract with an express "just-cause" clause as insufficient to overcome the at-will presumption.<sup>149</sup> Given this judicial hostility to indefinite term, just-cause contracts, it appears that in Missouri, the at-will presumption can be overcome only by a clear agreement of employment for a fixed term.

Given this legal backdrop, workers in Missouri have little protection against arbitrary discharge in the absence of a specific statutory violation. Tables 1 and 2 summarize the circumstances of each discharge described in Parts I and III of the survey, and indicate whether the discharge is lawful under Missouri law. Only two of the reasons for termination described in Part I—retaliation for reporting an employer's violations of fire regulations to a government agency (Part I, Question 5) and retaliation for refusing to participate in illegal billing practices (Part I, Question 8)—give rise to viable claims for wrongful discharge. In the remaining six situations, an employee has no legal protection against discharge. After the Missouri Supreme Court's clear holding that the issuance of an employee handbook does not constitute a contractual offer,<sup>150</sup> employees cannot derive any legal protection from informal employer statements regarding job security. Thus, each of the terminations described in Part III is lawful.

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<sup>145</sup> See *supra* note 141.

<sup>146</sup> *Johnson*, 745 S.W.2d at 662.

<sup>147</sup> *Id.*

<sup>148</sup> Compare *Rosatone v. GTE Sprint Communications*, 761 S.W.2d 670, 672 (Mo. Ct. App. 1988) (holding employee's reliance on a promise of employment at will insufficient to state a cause of action) with *Grouse v. Group Health Plan, Inc.*, 306 N.W.2d 114, 116 (Minn. 1981) (allowing recovery on promissory estoppel theory).

<sup>149</sup> *Main v. Skaggs Community Hosp.*, 812 S.W.2d 185, 189 (Mo. Ct. App. 1991).

<sup>150</sup> *Johnson*, 745 S.W.2d at 663.

Even assuming that employees understand the relevant legal rules, their ability to bargain effectively over the issue of job security requires that they obtain accurate information about a prospective employer's termination policies and practices. This is true whether the "bargaining" occurs explicitly through direct negotiation over terms, or implicitly by a process of employer competition to attract the best employees by offering attractive packages of wages and benefits. Part II of the survey addresses the extent to which employees are able to gather information about a particular employer by asking respondents about the sources of information they had about their last employer prior to accepting the job.<sup>151</sup> Because of the limitations of the survey format, it could not test more precisely the substance of the information obtained or the influence, if any, it had on the worker's decisionmaking process. More significantly, the survey format offered no reliable way to test the accuracy of the information obtained. Thus, the questions in Part II venture only an exploratory glimpse at the sources of information about prospective employers available to workers.

#### IV

#### THE RESULTS: CHALLENGING THE ASSUMPTION OF FULL INFORMATION

The survey data reveal a striking level of misunderstanding among respondents of the most basic legal rules governing the employment relationship. In Part I, which asked whether certain specified reasons for discharging an at-will employee are lawful, the average score was 51%; in other words, respondents gave correct responses barely half the time. Because each question had only two possible answers—lawful or unlawful—it appears at first glance that respondents' ability to apply the at-will rule to specific factual situations was no better than if they were guessing randomly.

A closer look at the data, however, reveals more systematic errors in the respondents' beliefs about the relevant legal rules. Table 1 reports separately the responses given to each of the eight questions in Part I. Examining the results for individual questions makes clear that the errors are not randomly distributed, but result from respondents' systematic *overestimation* of legal protection in certain circumstances. For example, overwhelming majorities of the respondents erroneously believed that an employer cannot legally fire an employee in order to hire someone else at a lower wage (82.2%), for reporting internal wrongdoing by another employee (79.2%), based on a mistaken belief of the employee's own wrongdoing (87.2%), or out of personal dislike

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<sup>151</sup> See *infra* Appendix B.

TABLE 1  
RESPONSES TO PART I OF SURVEY<sup>152</sup>  
(N=337)

Reason for Discharge	% of Total Responses			Legal Rule in Missouri: Discharge Is	Error Rate
	Lawful	Unlawful	No Response		
1. Employer plans to hire another person to do same job at a lower wage	17.8	82.2	0	Lawful	82.2
2. Unsatisfactory job performance	92.0	7.7 <sup>153</sup>	.3	Lawful	7.7
3. Retaliation for reporting theft by another employee to supervisor	20.8	79.2	0	Lawful	79.2
4. Mistaken belief that employee stole money (employee can prove mistake)	10.4	87.2	2.4	Lawful	87.2
5. Retaliation for reporting violation of fire regulations to government agency	8.9	88.7	2.4	Unlawful	8.9
6. Lack of work	78.6	18.7	2.7	Lawful	18.7
7. Personal dislike of employee	8.0	89.0	3.0	Lawful	89.0
8. Retaliation for refusing to participate in illegal billing practice	10.4	87.2	2.4	Unlawful	10.4

of the employee (89%). Comparison of error rates confirms this systematic bias. When the discharge described is in fact unlawful, the average error rate is 9.6%; in contrast, the average error rate in identi-

<sup>152</sup> As discussed above, *supra* note 138, one concern in interpreting these results is that government employees might answer these questions based on their understanding of civil service rules, rather than the legal rules operating in the private sector. Table 1A reports the results when the responses of government employees, as well as any respondents who did not indicate the industry in which they worked, are excluded.

TABLE 1A (N = 243)

Question	% of Total Responses			Question	% of Total Responses		
	Lawful	Unlawful	No Response		Lawful	Unlawful	No Response
1	18.5	81.5	0	5	8.6	89.3	2.1
2	93.4	6.2	.4	6	81.5	16.0	2.5
3	20.6	79.4	0	7	8.6	88.9	2.5
4	10.3	87.7	2.0	8	10.7	87.2	2.1

<sup>153</sup> That 7.7% of respondents answered this question "lawful" suggests some degree of randomness or noise affected the results. Although a few respondents may have been confused, or guessed randomly, the aggregate responses for the population surveyed exhibit strong patterns which cannot be explained by chance.

fying lawful discharges is 60.7%.<sup>154</sup> Thus, in assessing their legal rights, the respondents overwhelmingly erred in the same direction, tending to believe discharges are unlawful when they are in fact lawful.

Analysis of the results in Part I can be further refined. Two of the eight questions presented rather obvious business reasons for dismissing an employee—unsatisfactory job performance (Part I, Question 2) and lack of work (Part I, Question 6)—and respondents generally understood that such discharges are lawful. This result is not surprising given that these two reasons for discharge would be lawful even under a just-cause standard.<sup>155</sup> In this sense, questions 2 and 6 are not particularly useful in testing the respondents' understanding of the legal default rule of employment at will.<sup>156</sup> Both individuals who accurately understood the meaning of the at-will rule and those who erroneously believed that the law requires an employer to have just cause to discharge an employee should have been able to answer these two questions correctly.

If questions 2 and 6 are eliminated, the remaining six questions test more directly whether respondents believe that an employer may lawfully fire an employee in the absence of a "good" reason. Two of the six reasons for discharge—retaliation for reporting violations of fire regulations (Part I, Question 5) and retaliation for refusing to participate in illegal billing activities (Part I, Question 8)—involve violations of law and therefore are prohibited under the public-policy exception to the at-will rule.<sup>157</sup> The remaining four scenarios fall squarely within the employer's prerogative to fire an employee for a bad reason or no reason at all under the at-will rule, and the discharges described are therefore lawful.

Looking only at these six questions—in which the employer fires a worker for a reason unlikely to be sufficient under a just-cause standard—respondents, on average, answered only 40% of the questions correctly. As noted above, the errors are not randomly distributed. Rather, *for all six questions*, respondents overwhelmingly believed that discharges under the circumstances described are unlawful. The only two questions that large majorities answered correctly (Part I, Ques-

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<sup>154</sup> If questions 2 and 6 are eliminated, the average error rate rises to 84.4%. See *supra* Table 1. This figure arguably provides a more accurate assessment of respondents' understanding of the at-will rule. See *infra* text accompanying notes 155-56.

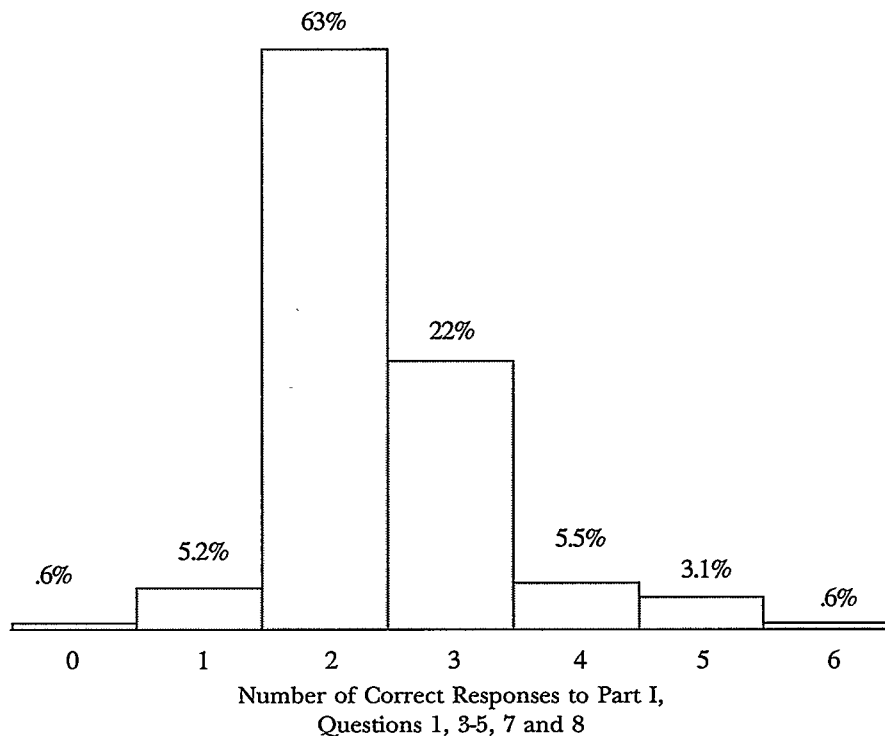
<sup>155</sup> What is surprising is that a significant number of respondents believed that lack of work is an insufficient reason for dismissing an employee.

<sup>156</sup> Although questions 2 and 6 are not helpful in assessing a respondent's knowledge of the at-will rule, they were included in order to provide some variation in the type of situation presented. The goal of Part I was to describe a range of reasons for discharge encompassing good cause, bad cause, and no cause. Questions 2 and 6 describe "good" reasons for discharge.

<sup>157</sup> See *supra* notes 142-43 and accompanying text.

tions 5 and 8) were those in which the discharges described are in fact unlawful. For the remaining four questions, similar majorities persisted in believing—erroneously in those situations—that the discharge is prohibited. Thus, respondents consistently assumed that an employee cannot be discharged without a good reason, apparently believing that workers have something akin to just-cause protection by law.

FIGURE 1  
DISTRIBUTION OF SCORES IN PART I



The distribution of scores is also significant. Figure 1 illustrates how respondents are distributed according to the total number of correct responses they gave. Although a few respondents have very high or very low scores, by far the largest number of respondents—206, or 63%—answered only two of the six questions correctly. The next most frequent score—three correct responses out of six—accounts for another 22% of respondents. Thus, the mean level of correct responses—40%—represents not only an average score, but the most prevalent level of understanding as well.<sup>158</sup>

<sup>158</sup> If, instead, the data had a bimodal distribution with, for example, a large number of respondents exhibiting very low scores and a similarly large number with high scores, the average score might still be 40% correct, but the implications of such a finding would



The results of Part III also reveal a significant degree of misunderstanding about the law. In each of the questions in Part III, the reason for discharge is the same: the employer plans to hire another person to do the same job at a lower wage, what I call a "pure cost-saving discharge." What varies are the employer's statements regarding job security that might be interpreted as creating a binding contract. As seen in the results summarized in Table 2, respondents again appear to have overestimated the protections afforded by law, with large majorities believing that pure cost-saving discharges under each of the four circumstances described are unlawful, when in fact they are not.<sup>159</sup>

TABLE 2  
RESPONSES TO PART III OF SURVEY  
(N=337)

Reason for discharge is constant: employer discharges employee in order to hire another person to do the same job at a lower wage.					
Nature of Employer Statement	Nature of Contract in Missouri <sup>160</sup>	Discharge Is	% of Total Responses		
			Lawful	Unlawful	No Response
1. Personnel Manual states: "Company reserves the right to discharge employees at any time, for any reason, with or without cause."	At-will	Lawful	36.2	62.6	1.2
2. Company sends letter offering "permanent employment."	At-will	Lawful	13.9	84.9	1.2
3. Personnel Manual states: "If you successfully complete a 90 day probationary period, you become a permanent employee."	At-will	Lawful	16.0	82.5	1.5
4. Personnel Manual states: "Company will resort to dismissal for just and sufficient cause only."	At-will	Lawful	16.3	81.9	1.8

Although Part III was originally intended to test whether respondents believed that certain employer statements give rise to just-cause protections, a difficulty arose in interpreting the aggregate data. By

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be quite different. In such a situation, it would be far more plausible that the substantial proportion of legally informed workers might have an impact on the market equilibrium regarding job-security terms.

<sup>159</sup> The Missouri Supreme Court made clear in *Johnson v. McDonnell Douglas Corp.*, 745 S.W.2d 661, 662 (1988), that informal assurances of job security such as may be found in an employee handbook, personnel manual, or offer letter are insufficient to overcome the at-will presumption.

<sup>160</sup> For a discussion of the case law surrounding the lawfulness of these discharges, see *supra* notes 145-49 and accompanying text.

holding constant the reason for discharge—pure cost-savings in the form of lower wages—but varying the employer statements that might constitute a contractual promise of job security, I had intended to isolate the effect of those statements on the respondents' perceptions of legal protection for the employee. However, because 82.2% of the respondents indicated in Part I that they believed a pure cost-saving discharge is unlawful, even without any promissory statements by the employer,<sup>161</sup> the aggregate data for Part III conflate the responses of those who mistakenly believed the employer's statements create enforceable legal rights and those who believed that a pure cost-saving discharge is unlawful, regardless of what the employer does or does not say.

In order to isolate the effect of the employer statements on the respondents' perceptions of legal protection, I disaggregated the responses of those who initially believed a pure cost-saving discharge to be lawful from those who believed it unlawful. Table 3 reports the responses to Part III of the former group (i.e., all those whose answer to Part I, Question 1 was "lawful"). Forty-five percent of these respondents believed an otherwise lawful discharge to be unlawful when the employer describes the employment as "permanent" (Part III, Questions 2 and 3). An even larger proportion—58%—changed their an-

TABLE 3  
RESPONSES TO PART III BY RESPONDENTS WHO BELIEVE A PURE  
COST-SAVING DISCHARGE IS LAWFUL  
(I.E., RESPONSE TO PART I, QUESTION 1 WAS "LAWFUL")  
(N=60)

Reason for discharge is constant: employer discharges employee in order to hire another person to do the same job at a lower wage.				
Nature of Employer Statement	Legal Rule in Missouri: Discharge Is	% of Total Responses		
		Lawful	Unlawful	No Response
1. "Company reserves the right to discharge employees at any time, for any reason, with or without cause."	Lawful	90.0	10.0	0
2. Company sends letter offering "permanent employment."	Lawful	55.0	45.0	0
3. "If you successfully complete a 90 day probationary period, you become a permanent employee."	Lawful	55.0	45.0	0
4. "Company will resort to dismissal for just and sufficient cause only."	Lawful	41.0	58.0	0

<sup>161</sup> See *supra* Table 1.

TABLE 4  
 RESPONSES TO PART III BY RESPONDENTS WHO BELIEVE A PURE  
 COST-SAVING DISCHARGE IS UNLAWFUL  
 (I.E., RESPONSE TO PART I, QUESTION 1 WAS "UNLAWFUL")  
 (N=277)

Reason for discharge is constant: employer discharges employee in order to hire another person to do the same job at a lower wage.				
Nature of Employer Statement	Legal Rule in Missouri: Discharge Is	% of Total Responses		
		Lawful	Unlawful	No Response
1. "Company reserves the right to discharge employees at any time, for any reason, with or without cause."	Lawful	24.6	74.0	1.4
2. Company sends letter offering "permanent employment."	Lawful	5.1	93.5	1.4
3. "If you successfully complete a 90 day probationary period, you become a permanent employee."	Lawful	7.6	90.6	1.8
4. "Company will resort to dismissal for just and sufficient cause only."	Lawful	10.8	87.0	2.2

swers from "lawful" to "unlawful" when the employer's personnel manual states that the "[c]ompany will resort to dismissal for just and sufficient cause only" (Part III, Question 4). Thus, even among respondents who knew that an employer may lawfully discharge an employee solely in order to reduce its wage costs, a significant proportion erroneously believed that informal employer statements, found in an offer letter or personnel manual, create legally enforceable protections against dismissal.

Table 4 reports the responses to Part III of those who believed that a pure cost-saving discharge is unlawful, even in the absence of any contractual agreement regarding job security (i.e., all those whose answer to Part I, Question 1 was "unlawful"). Not surprisingly, overwhelming majorities in this group continued to believe a pure cost-saving discharge is unlawful when the employer makes statements referring to "permanent" employment or a requirement of "just and sufficient cause" for dismissal (Part III, Questions 2-4). More surprising, and more troubling, a very high proportion of these respondents—74%—continued to believe that such a discharge is unlawful, even in the face of an employer statement that it "reserves the right to discharge employees at any time, for any reason, with or without cause" (Part III, Question 1). In other words, for nearly three-quarters of those who had a pre-existing belief that the law limits an employer's

right to discharge without cause, a strong disclaimer clearly describing an at-will relationship had no effect on their prior beliefs.

The survey results indicate that respondents seriously overestimated the level of job security afforded by law.<sup>162</sup> These findings conflict with one of the basic assumptions underlying the neoclassical economic defense of the at-will rule—that both employers and employees understand the terms of their bargain. Whether the assumption is a faulty one, however, depends on the extent to which the unemployment insurance claimants surveyed here are representative of active job-seekers. In other words, can the results of this survey, which reveal a profound misunderstanding of the most basic legal rules governing the employment relationship, be generalized?

As an initial matter, the population surveyed is likely to be representative of unemployment insurance claimants in the St. Louis region. The method of data collection is not biased towards any particular subgroup within the population of unemployment insurance claimants. Although the survey only captures the perceptions of unemployment insurance claimants in a Midwestern metropolitan area, there is no reason to believe that workers in the St. Louis area are particularly ill-informed about legal rules compared to their counterparts elsewhere.

A more serious question is whether unemployment insurance claimants are typical of all job-seekers. The population surveyed includes neither new entrants to the labor market, who are ineligible for unemployment insurance benefits, nor the substantial number of workers who move from job to job without experiencing a period of involuntary unemployment. Finally, better compensated employees

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<sup>162</sup> One difficulty that may complicate any effort to document individual beliefs is the possibility that individuals will be motivated by factors external to the survey to give less than honest answers. For example, in this study, respondents were applying for unemployment insurance benefits, raising a risk that their responses might be distorted by a belief that their answers would affect their receipt of benefits. Alternatively, respondents might be tempted to give answers reflecting what they *wished* the law were given their recent experience of job loss, rather than what they truly believe the law to be.

I attempted to minimize these risks in the following ways. First, the cover sheet of each survey identified it as part of an academic research project, then stated in boldface that the responses "WILL NOT BE SEEN BY ANYONE AT THE DIVISION OF EMPLOYMENT SECURITY." This language emphasized that the responses would not influence the receipt of benefits, and indeed, would not even be seen by the decisionmakers. Second, the prefatory instructions to Parts I and III of the survey direct respondents to "Answer each question according to whether you believe *a court of law* would find the discharge to be lawful or unlawful, NOT what you would like the result to be," highlighting the distinction between what the law *is* and what it *should be* and focusing respondents' attention on their beliefs as to the former.

Every methodology has its limits and so it remains possible that despite the cautionary language, external motivations influenced responses to the survey. Ultimately, of course, only further empirical study can evaluate the existence, direction, and extent of any such influence.

may be less likely to file for unemployment insurance benefits, even when they experience an involuntary job loss. The lower proportion of wage replacement for these workers, together with the greater likelihood that they have accumulated some savings to cushion the job loss, makes it much less likely that they will go to the trouble of appearing at a local unemployment insurance office, filing a claim, and reporting regularly to the agency in order to receive benefits.

The fact that new entrants to the labor market are by definition excluded from the population surveyed is not particularly troubling. If anything, new entrants are even *less* likely than experienced workers to be aware of and fully understand the applicable legal rules. If their omission from the sample has any effect at all, it will bias the results in favor of better informed workers.

Excluding job seekers who are currently employed, and hence have no need of unemployment insurance benefits, is more problematic. The population tested in this survey is distinguished by the fact that most of them<sup>163</sup> are *job losers*—individuals who have been forced back into the labor market as a result of an involuntary termination.<sup>164</sup> The direction of any bias that might result from surveying workers who have experienced a job loss, however, is unclear. On the one hand, one might expect this group to be more knowledgeable than the average worker. Having actually experienced an involuntary termination, these workers may be less naïve about the risks of discharge, and likely will be better educated as to the legal rule permitting employers broad discretion to fire their employees. Indeed, defenders of the at-will rule have argued that the individual con-

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<sup>163</sup> I say "most" because a significant number of initial claimants for unemployment insurance benefits are unemployed because they voluntarily quit their most recent job. Such an individual is disqualified from receiving benefits unless he can show that he quit for "good cause attributable to such work or to the claimant's employer," MO. ANN. STAT. § 288.050.1(1) (West Supp. 1997). Unfortunately, no reliable figures exist as to the proportion of initial claimants who are unemployed because they quit their most recent job. Nevertheless, a rough estimate is possible. Comparing the number of agency determinations regarding disqualification for a voluntary quit during a one year period ending September 30, 1996 with the number of new claims filed during that same period suggests that approximately 18% of initial claimants lost their most recent job through a quit rather than a layoff or firing. Robert Goulson, Research Analyst IV with the Missouri Division of Employment Security, provided the numbers that form the basis for this calculation (Feb. 21, 1997 interview notes on file with author).

<sup>164</sup> Generally, unemployment insurance benefits are available to "insured workers," defined according to their prior earnings, *see supra* note 131, who have lost their jobs through no fault of their own. A claimant discharged for "misconduct connected with the claimant's work" may be disqualified from receiving benefits for four to sixteen weeks, depending upon the seriousness of the misconduct. MO. ANN. STAT. § 288.050.2 (West Supp. 1997). Thus, unemployment insurance recipients generally have been either laid off or fired for reasons not amounting to serious misconduct. Unemployment insurance *claimants* will also include those fired for serious misconduct, even though they may later be disqualified in full or in part.

tracting process can be relied on to produce an efficient result in part because employees will surely learn from their past mistakes. For example, Verkerke argues that "many nonunion workers will have experienced discharge themselves or have friends who have been discharged, giving them an opportunity to discover the actual extent of legal protections that are available."<sup>165</sup> If this theory holds true, then this survey *underestimates* rather than overestimates the degree of employee misunderstanding of the law.

On the other hand, maybe workers who are better informed about the law, who realize that they have no legal protection against unjust discharge in the absence of a contract, can better protect themselves from involuntary termination and are therefore less likely to appear among the unemployed. For example, a risk-averse employee who fully understands the meaning of the at-will doctrine might seek out unionized jobs in order to gain the just-cause protections of a collective bargaining agreement, or make the effort to investigate prospective employers' track records on dismissals and avoid working for a company with a reputation for unfairness.<sup>166</sup> If so, then unemployment insurance claimants are likely *less* knowledgeable than the average worker and this survey may *overestimate* the extent to which employees are misinformed about the relevant legal rules.

Any tendency to overestimate employee misperceptions for this reason, however, would apply only to the subset of unemployment insurance claimants who have been *fired*, not the substantial number unemployed as a result of a quit or economic layoff.<sup>167</sup> Because economic layoffs are permissible even under a just-cause standard, the

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<sup>165</sup> Verkerke, *supra* note 2, at 887. Epstein and Morriss make similar arguments that a learning process will take place for the discharged employee. Epstein, *supra* note 1, at 955 ("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."); Morriss, *supra* note 2, at 1929-30.

<sup>166</sup> However, the legally informed employee is unlikely to negotiate an individual just-cause contract. Doing so would require overcoming a number of strategic barriers. See *supra* Part I. Moreover, observations of actual contracting practices, including Verkerke's study, indicate that employers simply do not enter into such contracts except with a very few highly skilled employees. Verkerke, *supra* note 2, at 866 n.126, 867 n.129.

<sup>167</sup> Again, no reliable figures exist as to the number of unemployment insurance claimants who quit or were laid off as opposed to being fired. However, it is possible to estimate their proportion within a broad range. In response to a question on the survey asking "have you ever been fired from a job?", more than 35% of those responding answered "no." Because the question encompasses past experiences of job loss, this figure provides a lower bound on the proportion of respondents who are currently unemployed as a result of a layoff or quit, rather than a firing. An upper bound can be estimated by examining the ratio of agency determinations regarding disqualifications for misconduct to new claims—30%—which suggests that as many as 70% of claimants may be unemployed due to a layoff or a quit rather than a firing. Robert Goulson, Research Analyst IV with the Missouri Division of Employment Security, provided the numbers that form the basis of this calculation. (Interview, Feb. 21, 1997).

legally knowledgeable employee has no particular advantage in avoiding these terminations. Similarly, there is no reason to believe that legal knowledge correlates systematically with the likelihood of quitting. Thus, even if true, the theory that legally informed workers can better avoid involuntary terminations would not affect the results for a substantial proportion of the population surveyed.

Ultimately, only further empirical testing can resolve this issue. The most direct method of determining whether the unemployment insurance claimants I surveyed are representative of all active job seekers is to survey different groups of workers and compare the results. With two competing hypotheses correlating the experience of job loss with legal knowledge in opposite directions, it is impossible to predict how the results reported here for unemployed workers might deviate from the level of knowledge among job seekers generally. In the absence of any empirical evidence of the nature and direction of any such bias, however, these data strongly indicate that worker misperceptions about the law are significant and widespread.

As Tables 5 and 6 illustrate, respondents' understanding of the at-will rule appears to correlate positively with the level of both education and prior earnings. If, as hypothesized above, better educated and better paid employees are underrepresented in this sample, the survey's results of the survey may overstate the degree of misunderstanding of the law in the workforce as a whole. Although the survey data offer no direct measure of socio-economic status, respondents were asked to provide their highest level of educational attainment. Of those 25 years of age and older who responded to this question, 94% had completed high school, while only 14.8% had received a college degree. Roughly comparable statistics for the combined population of St. Louis City and County are 76.9% and 25.3%, respectively.<sup>168</sup> Based on these figures, the population surveyed appears, if anything, weighted toward the middle of the scale in terms of educational attainment.

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<sup>168</sup> The United States Bureau of the Census reports the percentage of persons 25 years of age or over with a high school diploma or higher, and a Bachelor's degree or higher. UNITED STATES BUREAU OF THE CENSUS, COUNTY AND CITY DATA BOOK 330 (1994). The percentages reported in the text are derived by calculating a weighted average, based on population, of the figures provided for St. Louis City and St. Louis County for 1990. These figures for the population of St. Louis City and County are not limited to labor market participants. Nevertheless, they give a rough sense of the representativeness of the survey population with respect to educational attainment.

TABLE 5  
PERCENTAGE CORRECT RESPONSES IN PART I BY  
EDUCATIONAL LEVEL<sup>169</sup>

Educational Level	% Correct Responses in Part I (N = 320)	% Correct Responses in Part I, Excluding Questions 2 and 6 (N = 322)
No high school diploma	46.9 (N = 20)	35 (N = 20)
High school diploma or equivalent	48.8 (N = 125)	37.5 (N = 125)
Associate or technical degree	50.8 (N = 30)	39.2 (N = 31)
Some college, no degree	52.8 (N = 102)	40.8 (N = 103)
College degree	56.0 (N = 25)	44.0 (N = 25)
Some graduate school or graduate degree	61.8 (N = 18)	50.0 (N = 18)

TABLE 6  
PERCENTAGE CORRECT RESPONSES IN PART I BY  
EARNINGS LEVEL<sup>170</sup>

Average Annual Earnings (most recent job)	% Correct Responses in Part I (N = 288)	% Correct Responses in Part I, Excluding Questions 2 and 6 (N = 290)
Less than \$15,000	48.6 (N = 131)	37.0 (N = 131)
\$15,000-24,999	53.0 (N = 78)	41.4 (N = 79)
\$25,000-49,999	55.0 (N = 65)	42.2 (N = 66)
\$50,000 and over	56.2 (N = 14)	44.0 (N = 14)

The effect of any resulting bias, however, should not be overstated. Even respondents with the highest educational and income levels are seriously misinformed about the legal rules governing an employer's right to discharge. As discussed above, a respondent's score on Part I most accurately reflects her understanding of the at-will rule when questions 2 and 6—poor work performance and lack of

<sup>169</sup> An F test yielded statistically significant differences in the percentage of correct responses between the levels of education. For the first column (% correct responses in Part I),  $F=4.615$ ,  $p=0$ , and for the second column (% correct responses in Part I, excluding questions 2 and 6),  $F=3.53$ ,  $p<.01$ . The number of responses reported in the two columns is different due to slight variations in the number of respondents who answered each of the questions necessary for calculating an average score on the total of eight (for the first column) or six (for the second column) questions, and who provided a response to the question regarding educational level.

<sup>170</sup> An F test yielded statistically significant differences in the percentage of correct responses between the levels of income. For the first column (% correct responses in Part I),  $F=5.15$ ,  $p<.01$ , and for the second column (% correct responses in Part I, excluding questions 2 and 6),  $F=3.004$ ,  $p<.05$ . The number of responses reported in the two columns is different due to slight variations in the number of respondents who answered each of the questions necessary for calculating an average score on the total of eight (for the first column) or six (for the second column) questions, and who provided a response to the question regarding income level.



work—are eliminated because these reasons for discharge are lawful under either an at-will or a just-cause standard. When these two questions are excluded, the average level of correct responses for those with some graduate education is 50% and for those with annual earnings greater than \$50,000 is 44%.<sup>171</sup> Because the numbers of respondents who fall into these two categories are quite small—18 and 14 respectively<sup>172</sup>—and likely overlap, it is difficult to draw definitive conclusions about how strongly education and income influence the respondents' level of legal knowledge. Nevertheless, this study suggests that although legal knowledge probably correlates positively with education and/or income, a significant degree of misunderstanding of the law persists even among the best educated and most highly compensated workers. Based on their responses to the six diagnostic questions,<sup>173</sup> these workers could not correctly identify whether a discharge was lawful more than half the time.

In any case, it makes little sense to speak of a single labor market. "The" labor market is composed of multiple, separate markets, each populated by a different set of players. The janitor who never finished high school obviously does not compete in the same labor market as the engineer with a Ph.D. Even if better educated employees were shown to be well informed about the law, this study suggests that at least some labor markets, particularly those for less skilled labor, are characterized by widespread information failures in the form of employee misperceptions about the level of job security protection afforded by law.

Part II of my survey was intended to explore the extent to which employees are able to gather information about a prospective employer's policies and practices regarding termination *before* they accept a job. The results, summarized in Table 7, suggest that a substantial proportion of workers have access to *some* source of information regarding a prospective employer's dismissal policies. Only 22.6% of respondents answered "no" to each of the questions listed in Table 7, indicating that they had no information from any of the listed sources about the risk of discharge at a particular firm.

Although these results suggest that a significant proportion of workers have some relevant information, it is difficult to draw any

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<sup>171</sup> See *supra* Tables 5, 6.

<sup>172</sup> See *supra* Tables 5, 6.

<sup>173</sup> Recall that two of the eight questions in Part I of the survey describe reasons for discharge that would be lawful under either a just-cause or at-will standard, and thus are not useful in distinguishing those who believe they have just-cause protections from those who truly understand the meaning of the at-will rule. See *supra* text accompanying notes 155-56. The term "diagnostic questions" refers to the remaining six questions that directly test whether a respondent believes the employer may fire an employee in the absence of a good reason. See *supra* pp. 135-36.

TABLE 7  
RESPONSES TO QUESTIONS IN PART II REGARDING  
INFORMATION GATHERING EXPERIENCES

Question	% of Total Responses		
	Yes	No	Don't remember
Before you accepted your most recent job . . .			
did the employer give you a copy of an employee handbook or personnel manual?	51.0	46.9	2.1
did the employer give you any written description of its policies for discharging employees?	43.0	53.4	3.6
did the employer tell you verbally what its policies were for discharging employees?	37.6	56.7	5.7
did anyone else (for example, a friend or family member) tell you about the employer's policies for discharging employees?	14.3	83.0	2.7
did you hear from anyone else (for example, a friend or family member) whether the employer treats its employees fairly or not?	32.2	62.7	5.1

strong conclusions from this data. First, the responses provide no indication of the accuracy of the information obtained. Of even greater concern, the results to Part I of the survey raise considerable doubts as to the extent to which respondents can accurately assess and effectively use the information they receive. If workers misunderstand the legal rules governing the employment relationship, they are unlikely to recognize the significance of specific employer policies. Put another way, an employer's articulated dismissal policies may not appear particularly significant to the employee who believes she cannot be fired legally without just cause. Moreover, as seen in Table 7, the most common way of obtaining pre-hire information about an employer appears to be through receipt of an employee handbook, personnel manual, or other written description of employer policies. Yet, as discussed above, the respondents' ability to process written information, particularly when it contradicts their preconceived beliefs about the law, appears to be quite limited. The results of Part II provide little evidence of the quality of information obtained and the worker's ability to use it effectively. Yet these factors are far more significant than the mere quantum of information gathered; after all, bad information or the inability to process potentially useful information are themselves forms of market failure. Thus, based on this study, it is difficult to evaluate whether workers are able to obtain sufficient information about prospective employers to meaningfully negotiate issues of job security.

## V

THEORETICAL IMPLICATIONS: THE CASE FOR A  
JUST-CAUSE DEFAULT

As discussed in Part I above, the efficiency argument in favor of the at-will rule draws force from the prevalence of at-will contracts in the real world and the faith that the observed market outcome reflects an efficient bargaining process. This faith, however, rests on a number of assumptions, including the assumption that workers have full information, or at least sufficient information to protect their own best interests in the contracting process. The results of this empirical study cast serious doubt on that assumption, strongly indicating that workers overestimate their legal rights, mistakenly believing that the law affords them far greater protection against unjust discharge than it in fact does.

These findings force a dramatic shift in the traditional economic picture of the employment contracting process. Rather than assuming that both employer and employee act "in full possession of their faculties and their own interests,"<sup>174</sup> the model of the labor market—at least as to job security terms—must take into account that at least one of the parties is likely seriously misinformed about the background rules against which bargaining takes place. Employees who systematically overestimate the level of job protection afforded by law will not be able to accurately assess the value of contractual guarantees of job security, thus undermining their ability to negotiate effectively over the issue. Nor can efficient bargaining be assumed to take place implicitly; without an accurate understanding of the significance of an employer's policies regarding dismissal, employees cannot make meaningful comparisons between the compensation packages offered by competing employers on the issue of job security. Put another way, silence in the face of a presumption of at-will employment says little about employees' preferences if they are wholly unaware of the default rule.

Defenders of the at-will rule are likely to respond to the findings that workers are seriously mistaken about their legal rights by arguing that information failure alone does not necessarily produce an inefficient outcome. For example, Schwartz and Wilde have argued that consumer markets often remain competitive even in the face of imperfect information.<sup>175</sup> Contending that a focus on individual knowledge and behavior is mistaken,<sup>176</sup> they describe a model in which a small proportion of well-informed searchers can drive the market

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<sup>174</sup> Freed & Polsby, *supra* note 2, at 1098.

<sup>175</sup> Schwartz & Wilde, *supra* note 23.

<sup>176</sup> *Id.* at 637-38.

equilibrium toward a competitive price as firms compete for their business.<sup>177</sup> So long as firms cannot discriminate effectively between informed and uninformed consumers, this competition will tend to drive down prices for all consumers, benefiting even uninformed market participants.<sup>178</sup> Because they believe that "markets are likely to behave much better in the face of imperfect information than is commonly supposed,"<sup>179</sup> Schwartz and Wilde argue that imperfect information alone cannot justify legal intervention.<sup>180</sup>

Under their model, the ability of informed shoppers to influence the market price depends upon the ratio of comparison shoppers to the total number of shoppers in the market.<sup>181</sup> If a sufficiently high ratio of comparison shoppers is present, the market will generate competitive prices and terms, and the efforts of the informed searchers will protect even uninformed market participants.<sup>182</sup> A smaller proportion of comparison shoppers may not produce a competitive equilibrium, resulting instead in a distribution of prices ranging upward from the competitive price to the monopoly price.<sup>183</sup> Thus, the crucial question, under Schwartz and Wilde's model, is whether the proportion of informed consumers has fallen so low that the existence of imperfect information *actually* results in noncompetitive prices and terms.<sup>184</sup>

As they recognize, answering this question precisely entails enormous practical difficulties.<sup>185</sup> Nevertheless, Schwartz and Wilde speculate that under certain conditions, the market for durable goods like electric clothes dryers will produce competitive prices, even when as

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<sup>177</sup> *Id.* at 638. Of course, this model depends upon a number of assumptions. Schwartz and Wilde assume that "in mass transactions it is usually too expensive for firms to distinguish among extensive, moderate, and nonsearchers"; that "it would often be too expensive to draft different contracts for each of these groups"; and that "the preferences of searchers are positively correlated with the preferences of nonsearchers." *Id.* These assumptions, however, do not necessarily hold true in all markets. *See, e.g.,* Lynn M. LoPucki, *The Unsecured Creditor's Bargain*, 80 VA. L. REV. 1887, 1920 (1994) (arguing that the necessary conditions are not present in the market for unsecured credit).

<sup>178</sup> *See* Schwartz & Wilde, *supra* note 23, at 638.

<sup>179</sup> *Id.* at 655.

<sup>180</sup> *Id.* at 682.

<sup>181</sup> *Id.* at 650.

<sup>182</sup> *Id.*

<sup>183</sup> *See id.*

<sup>184</sup> *See id.* at 631.

<sup>185</sup> *Id.* at 654-55. The mathematical model they develop for the consumer market requires not only data on the ratio of comparison shoppers to the total number of shoppers, but information regarding the "common limit price" (the maximum price consumers would pay for a given product), each firm's fixed cost in producing the relevant good, the marginal cost of production, and the "capacity constraint" (i.e., the "level of output that minimizes average cost"). *Id.* at 650. Deriving reliable empirical estimates for any one of these variables in a real consumer market would be a daunting task; finding comparable measures in the market for a "good" like job security is virtually impossible.

few as one-third of consumers engage in comparison shopping.<sup>186</sup> Assuming its validity for the consumer market, their model suggests that information problems do not necessarily result in market failure. However, even if their model could appropriately be applied to the labor market,<sup>187</sup> it offers little assurance that the "market" for job security operates efficiently in light of the systematic misunderstanding of the relevant legal rules documented in this study.

Attempting to apply the insights of their model to a complex term like job security raises the difficult theoretical question of what it means to be "informed." In Schwartz and Wilde's model, the comparison shopper is by definition "informed" because they assume goods are homogenous, and consumers are concerned only with price.<sup>188</sup> Simply by visiting different stores and comparing prices, the comparison shopper "knows" all the relevant terms. Job security terms, by contrast, are difficult to discover and understand. In order to effectively compare the terms offered by different employers, the truly "informed" worker not only needs to understand the meaning of the legal presumption of at-will employment, she also must have sufficiently accurate information about the discharge policies and practices of a particular firm.

Even if the analysis is simplified by focusing solely on *legal* information, an adequate definition of what it means to be "legally informed" is still required. In other words, when assessing the proportion of "informed" market participants in the context of the "market" for job security terms, how much knowledge is enough?

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<sup>186</sup> *Id.* at 651-54. This figure is apparently not based on any empirical evidence, but upon their assumptions that firms' standard markup on variable costs is 100%, that average variable cost can be a proxy for marginal cost, that the average variable cost for an electric clothes dryer is \$200, and that the mean consumer limit price is \$500. I have no idea whether or not these are plausible assumptions for the durable goods market, but the validity of their one-third figure obviously rests on the accuracy of these assumptions, as well as on the theoretical soundness of their model.

<sup>187</sup> There is reason to doubt that their model accurately describes the labor market. They assume that consumers use a mixture of "sequential" and "fixed sample size" strategies when searching for goods. *Id.* at 647-48. The "sequential" strategy entails visiting firms in sequence "until the marginal cost of further search is greater than or equal to the marginal gain." *Id.* at 643. The "fixed sample size" strategy entails choosing in advance a fixed number of stores to visit and comparing the prices offered by each. *Id.* at 646-47. Workers, however, have significantly less control over their search strategies than the typical consumer. Their ability to "comparison shop" depends upon the number and timing of job offers they receive. Once the worker receives an offer, the cost of continuing the search—which may jeopardize the original offer—is far greater than the cost of merely driving to another store, particularly if the worker is unemployed.

The potential gains from searching may also differ. For example, Schwartz and Wilde note that the gain from continuing a search may include not only the prospect of finding a better price, but also the pleasure of shopping itself. *Id.* at 648. Although this theory may be plausible in the consumer market, it is hardly likely to apply to searches in the labor market.

<sup>188</sup> *Id.* at 642.

Should a worker be considered "informed" only if she can accurately identify all of the circumstances under which an employer can discharge its employee without liability? Or is it sufficient to have a general understanding that the at-will presumption permits the employer broad latitude in terminating employment, without a precise understanding of the particulars? Framed in terms of this study, what percentage of correct responses to the survey questionnaire indicates that a respondent is "legally informed"?

Any effort to quantify the matter masks far deeper questions about what it means to "know" or to be "informed." Nevertheless, it is useful to attempt a rough measure of the significance of this study's findings. One possibility is to define "legally informed" workers as those who correctly answered more than 50% of the diagnostic questions<sup>189</sup> in Part I of the survey—i.e., those who were able to do better than random chance. Using this very generous measure, the data from this study suggest that fewer than 10% of the respondents in the sample are "legally informed."<sup>190</sup> Although the many differences between the labor and consumer markets make any direct comparisons perilous, that 10% figure—well below the one-third proportion of informed consumers Schwartz and Wilde conclude is sufficient for a competitive market in durable goods<sup>191</sup>—casts serious doubts on the claim that the market for job security terms will behave competitively even in the face of widespread information failure.

Because this study puts the efficiency of the individual contracting process in doubt, the choice of a default rule is no longer simple. Traditional economic theory teaches that a default rule should be set at the terms the parties themselves, or at least most of them, would have chosen in the absence of transactions costs, in order to reduce the costs of reaching agreement.<sup>192</sup> Thus, defenders of the at-will rule commonly argue that the frequency with which the at-will contract is found in the real world indicates its desirability as a default term.<sup>193</sup> Their argument, however, ignores the possibility that the parties may sometimes fail to bargain around a default rule, not because it is efficient, but because there are barriers to doing so.<sup>194</sup> This study confirms the existence of one such barrier—employee misap-

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<sup>189</sup> See *supra* note 173.

<sup>190</sup> See *supra* Figure 1.

<sup>191</sup> Schwartz & Wilde, *supra* note 23, at 651-53.

<sup>192</sup> See, e.g., Charles J. Goetz & Robert E. Scott, *The Mitigation Principle: Toward a General Theory of Contractual Obligation*, 69 VA. L. REV. 967, 971 (1983).

<sup>193</sup> See, e.g., Epstein, *supra* note 1, at 948; Verkerke, *supra* note 2, at 874-75.

<sup>194</sup> See Jason Scott Johnston, *Strategic Bargaining and the Economic Theory of Contract Default Rules*, 100 YALE L.J. 615, 619 (1990); see also Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 VA. L. REV. 821, 866 (1992) (identifying as possible barriers the costs of contracting around the rule and the possibility of lack of knowledge about the rule).

prehensions of the job security protections law affords. With strong evidence that many employees do not know or understand the relevant default rule, the observed market outcome can no longer be assumed to be a reliable indicator of the true preferences of the parties. Furthermore, without an easy way to determine what the parties would prefer in the absence of transactions costs, the traditional economic exhortation to set the default rule where the parties "would have wanted" no longer offers clear guidance.

Ayres and Gertner propose an alternative theory of default rules, arguing that under certain circumstances the default term should be one the parties would *not* want.<sup>195</sup> Such "penalty default" rules are appropriate when strategic considerations prevent a better informed party from revealing relevant information—information that might increase the contract's overall value—because concealing the information will allow it to capture a greater portion of the gains from contracting.<sup>196</sup> In such a situation, a penalty default set contrary to the interests of the better informed party will induce information sharing.<sup>197</sup>

Issacharoff suggests that "employment is a prime arena for the use of penalty default rules,"<sup>198</sup> given that employees are disadvantaged by their relative lack of information going into the hiring process. While the employer has access to inside information about the firm, the employee cannot raise concerns about her long-term prospects there without appearing to signal that she is a likely shirker.<sup>199</sup> The effect of this informational asymmetry is compounded by disparities in bargaining power<sup>200</sup> and certain cognitive limitations impairing the employee's ability to fully anticipate at the time of hiring the consequences of a discharge years later.<sup>201</sup> Under these circumstances, Issacharoff argues, a penalty default rule might appropriately induce the employer—the party with superior information and bargaining power—to clearly specify the terms of employment.<sup>202</sup>

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<sup>195</sup> Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87 (1989).

<sup>196</sup> As Ayres and Gertner nicely put it, "[R]evealing information might simultaneously increase the total size of the pie and decrease the share of the pie that the relatively informed party receives. If the 'share-of-the-pie effect' dominates the 'size-of-the-pie effect,' informed parties might rationally choose to withhold relevant information." *Id.* at 99.

<sup>197</sup> See *id.* at 98.

<sup>198</sup> Issacharoff, *supra* note 21, at 1793.

<sup>199</sup> *Id.* at 1794-95.

<sup>200</sup> Issacharoff compares the hiring process to "a first date between a polygamist and a monogamist. The employer has entered into a number of contemporaneous courtships such that there is a diversification of the risk associated with any individual affair. By contrast, the employee in a stable working relationship is restricted to faithful monogamy. . . ." *Id.* at 1795.

<sup>201</sup> *Id.*

<sup>202</sup> *Id.*

While Issacharoff focuses on the employer's superior access to information about the employee's future prospects with the firm, this study suggests an additional informational asymmetry affecting the contracting process—the employee's lack of knowledge of the relevant default rule. If employees mistakenly believe that employers must have just cause to fire them, employers who know better will have little incentive to inform them of the true default rule. By keeping silent, employers can retain the benefit of a legal right to fire at will without having to offer higher wages to compensate their employees for the lack of job security. In contrast, if the default rule requires just cause for termination, employers who value the unconstrained right to discharge would have strong incentives to explain the legal default to prospective employees and to bargain with them for a change of terms.<sup>203</sup>

Of course, a finding that employers are no better informed about the relevant legal rules than employees would weaken this argument. Although no systematic study of the issue apparently exists, Verkerke's observations suggest that a significant degree of confusion exists among employers as well.<sup>204</sup> Still, it is unlikely that misapprehensions about the law on the part of employers are as widespread or as serious as they appear to be among employees. First, employers, particularly large employers, are far more likely than individual employees to have access to legal counsel who can inform them of the correct rule. Moreover, employers are repeatedly and frequently players in the labor market. The experiences of even a modest-sized employer—accumulated from simultaneous relationships with multiple employees over long periods of time—are likely to vastly exceed the cumulative job market experience of any single individual, even the unreformed job-hopper (who is unlikely to care much about long-term job security anyway). As Ayres and Gertner remark, "[i]f one side is repeatedly in the relevant contractual setting while the other side rarely is, it is a sensible presumption that the former is better informed than the latter."<sup>205</sup> Given that the employer likely has superior information about the relevant legal rules, the issue of job security seems precisely the sort of situation calling for the use of a penalty default.

Although I have focused thus far on the implications of my empirical findings for the efficiency-based defense of the at-will rule, concerns about autonomy reinforce the case for moving to a just-cause default. The principle of freedom of contract is often invoked in the

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<sup>203</sup> Ayres and Gertner suggest that the rationale for imposing a penalty default against the relatively informed party is particularly strong "when the uninformed party is also uninformed about the default rule itself." Ayres & Gertner, *supra* note 195, at 98.

<sup>204</sup> See *supra* note 105.

<sup>205</sup> Ayres & Gertner, *supra* note 195, at 98.



employment context, not only because it tends "to promote the efficient operation of labor markets," but also because it "advance[s] individual autonomy."<sup>206</sup> However, if most workers are seriously mistaken about the legal rules governing the employment relationship, as this study suggests, then their "choice" not to contract around the at-will default by remaining silent is illusory. When the default rule is not only unknown to workers, but also contrary to their widely held beliefs, imposing the at-will term does not advance autonomy.

Barnett argues that taking seriously the role of consent in contracts requires choosing "'conventionalist default rules'"—rules that reflect commonly shared expectations in the relevant community.<sup>207</sup> Such an approach increases the likelihood that when default terms are brought into play to fill a contractual gap, they will *actually* reflect what the parties would have wanted if they had expressly addressed the issue. When both parties know the default rule and the costs of contracting around it are low, their silence on the matter can be taken as consent.<sup>208</sup> However, presuming consent is more problematic if the default rule is costly to discover or to contract around.<sup>209</sup> Nevertheless, when the parties tacitly share certain commonly held assumptions, they may implicitly have intended the same thing, even though they never discussed or even consciously considered the particular issue. In such a case, Barnett asserts, a default rule that coincides with conventional understanding is most likely to mirror the parties' intentions, whether consciously held at the time of contract formation or not.<sup>210</sup>

According to Barnett, this consent-based approach to selecting default rules further suggests that when only one party is likely to know the law, the default rule should reflect "the commonsense understanding of the community to which the rationally ignorant party belongs."<sup>211</sup> Such a rule increases the likelihood that any resulting agreement will truly reflect the parties' intentions because the legally knowledgeable party will expressly bargain over the issue whenever it

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<sup>206</sup> Epstein, *supra* note 1, at 951.

<sup>207</sup> Barnett, *supra* note 194, at 875.

<sup>208</sup> See *id.* at 866. In such a situation, the content of the default rule is relatively unimportant because the parties can easily negotiate around it if they prefer alternative terms.

<sup>209</sup> See *id.*

<sup>210</sup> *Id.* at 876-82.

<sup>211</sup> *Id.* at 895. The "rationally ignorant party" is one who is involved in small one-shot or infrequent transactions, making it irrational to incur the costs of learning the default rule. See *id.* at 886. According to Barnett, when contracting with the one-shot player, "the onus should fall upon the repeat player to contract around the [default] rule." *Id.* at 892. Although workers today are rarely "one-shot" players in the strictest sense, they are "players" on the labor market far less frequently than employers. Because the costs to them of learning the correct rule are significantly greater than for employers, and because they appear to be unaware of the current default rule, workers are the "rationally ignorant parties" to the employment contract under Barnett's consent theory of contract.

seeks terms that deviate from the conventional understanding of the rationally ignorant party.<sup>212</sup> Because employers are more likely to be legally informed than workers,<sup>213</sup> a consent-based theory of contract suggests that the default rule in employment should reflect workers' commonly held belief that discharge must be based on cause.

Thus, given the widespread misunderstanding of the at-will rule among workers, theoretical considerations of both efficiency and autonomy point in the direction of adopting a just-cause default. Whether such a change in the default rule would in fact make individual bargaining over job security more efficient, however, depends upon a number of unknown factors. For example, even in the absence of significant information problems, the possibility remains that cognitive limitations, signaling problems, or the public goods nature of just-cause terms may distort the labor market for job-security terms.<sup>214</sup> Moreover, this study raises the concern that even imposing a just-cause "penalty default" may not achieve its purpose of improving the bargaining process by inducing information sharing. Recall that in this study, three-quarters of respondents who thought that the law protects an employee against a pure cost-saving discharge persisted in that erroneous belief even in the face of an employer statement that it reserves the right to fire for any reason at all.<sup>215</sup> This finding suggests that a simple disclaimer will be ineffective in informing workers of their legal status, especially when it contradicts their pre-existing beliefs about their legal rights.

Raising the barriers to contracting around the just-cause default might address this latter concern. For example, courts could require clear and unambiguous evidence of the parties' assent to an at-will relationship in order to insure that employers had carefully and fully explained both the meaning of a just-cause standard and the loss of job tenure rights a move to an at-will contract would entail. Of course, the more difficult it becomes to contract around a default rule, the more closely it will resemble an immutable rule.<sup>216</sup> Justifying a mandatory just-cause standard on grounds of economic efficiency, however, requires far more evidence than this study offers. For even if the presence of widespread information failure casts doubt on the efficiency of the individual bargaining process, a mandatory just-cause requirement has yet to be proven *more* efficient. As Dau-Schmidt argues,

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<sup>212</sup> *Id.* at 895.

<sup>213</sup> If it turns out that employers and workers share the same misapprehensions about the law, a consent-based theory of contract would still suggest adoption of a just-cause default rule as reflecting the conventional understandings in the relevant community. *See id.* at 880-81.

<sup>214</sup> *See supra* notes 70-81 and accompanying text.

<sup>215</sup> *See supra* Table 4.

<sup>216</sup> *See Ayres & Gertner, supra* note 195, at 120; Epstein, *supra* note 1, at 952.

any policy prescription must take into account not only the failures of individual bargaining, but also the ability of alternative institutions to effectively address issues of job security.<sup>217</sup> Making such a comparison of institutional competencies calls for further empirical study, both to test the other allegations of market failure raised by critics of the at-will rule as well as to estimate the costs of alternative legal regimes. Without clear empirical findings, the theoretical arguments based on economic efficiency simply cannot provide a determinative answer to the normative question of how far the law should go in protecting the worker's interest in job security.

### CONCLUSION

For too long, the debate over the at-will rule has proceeded primarily on theoretical grounds. Critics and defenders alike have relied on theory to argue for reforming or maintaining the traditional rule. However, theory is only as good as the assumptions on which it rests. Moreover, when opposing sides begin with very different assumptions, pure theory offers no way of resolving the dispute.

Empirical work provides a means for testing the competing intuitions—often unarticulated—that so often underlie disputes over the content of law. This study presents such a test of the assumptions about the accuracy of workers' information that underlie the debate over the at-will rule. The results strongly indicate that the assumption of full information implicit in the market-based defense of the at-will rule is a flawed one. Of course, a single study cannot definitively resolve difficult and disputed questions, even empirical ones. However, if skeptics question whether the population surveyed here is truly representative of the workforce, the best way to resolve such doubts is through careful empirical testing of other sample populations, not further speculation. Moreover, until such studies produce contrary results, the findings documented here offer uncontradicted evidence that workers systematically overestimate their legal protections against arbitrary and unjust discharge.

Throughout this Article, I have focused on efficiency arguments to the neglect of fairness considerations. This limitation necessarily followed from the nature of my inquiry, which narrowly focused on one crucial assumption implicit in arguments over the efficiency of the at-will rule. In so limiting my discussion, I have not meant to suggest that concerns based on fairness and justice have no role in shaping legal rules. To the contrary, such concerns are not only appropriate, but ultimately inescapable. By contradicting a key assumption of the traditional economic defense of the at-will rule, this

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<sup>217</sup> Dau-Schmidt, *supra* note 6, at 1646.

study undermines the faith that observed market outcomes reflect an efficient solution. But though its findings are more consistent with assumptions commonly made by critics of the at-will rule, these data offer no certainty that a mandatory just-cause requirement would prove more efficient. At most, the results of this study suggest the appropriateness of a just-cause default rule. However, predicting the practical effect of such a change in the default rule requires an exploration of additional factors beyond the scope of this study.

Further empirical work will undoubtedly shed greater light on the relative costs and benefits of varying legal regimes, but I suspect that efficiency considerations alone will never provide a determinate answer to the choice of a legal rule. For outside the realm of theory, the practical difficulties involved in "proving" the superior efficiency of one rule over another are enormous and likely intractable. Moreover, arguments relying solely on grounds of efficiency ignore the deeper question of whether, as a normative matter, efficiency concerns should control. Though my focus here has been on the competing market arguments, I believe that ultimately the choice of a legal rule assigning job-tenure rights must encompass concerns far broader than mere efficiency.

## APPENDIX A

QUESTIONS REGARDING LEGAL KNOWLEDGE  
[PARTS I AND III OF SURVEY]

## PART I

This section describes different cases in which an employee is discharged from his job. For each case, you will be asked whether the discharge was lawful or unlawful.

In each case, *the employee is NOT represented by a union and the employee was NOT discharged because of his or her race, sex, national origin, religion, age or disability.*

Also, *there is no formal written or oral agreement between the employee and employer stating the terms of the employment.*

Answer each question according to whether you believe *a court of law* would find the discharge to be lawful or unlawful, NOT what you would like the result to be.

1. Company discharges Employee in order to hire another person to do the same job at a lower wage. Employee's job performance has been satisfactory. The discharge is:

lawful \_\_\_\_\_

unlawful \_\_\_\_\_

2. Company discharges Employee because of unsatisfactory job performance. The discharge is:

lawful \_\_\_\_\_

unlawful \_\_\_\_\_

3. Employee is discharged because he reported to his supervisor that another employee has been stealing company property. The discharge is:

lawful \_\_\_\_\_

unlawful \_\_\_\_\_

4. Employee is discharged because Company mistakenly believes Employee has stolen money. Employee is able to prove in court that Company is mistaken. Employee's job performance has been satisfactory. The discharge is:

lawful \_\_\_\_\_

unlawful \_\_\_\_\_

5. Employee is a cook and sees several violations of fire regulations at the restaurant. Employee complains to supervisor of the violations, then reports them to a government agency. Employee is discharged for reporting the violations. The discharge is:

lawful \_\_\_\_\_

unlawful \_\_\_\_\_

6. Company discharges Employee because there is no longer enough work. The discharge is:

lawful \_\_\_\_\_

unlawful \_\_\_\_\_

7. Employee is accused of dishonesty. Supervisor knows that Employee is not dishonest, but discharges him anyway, because he dislikes Employee personally. Employee's job performance has been satisfactory. The discharge is:

lawful \_\_\_\_\_ unlawful \_\_\_\_\_

8. Employee discovers that Company has been violating the law by charging customers for services which were not actually provided. Employee is discharged because he refuses to participate in Company's illegal billing practices. The discharge is:

lawful \_\_\_\_\_ unlawful \_\_\_\_\_

[Questions from Part II regarding respondents' information gathering experiences appear in Appendix B.]

### PART III

In each case below, *the employee is NOT represented by a union and the employee was NOT discharged because of his or her race, sex, national origin, religion, age or disability.*

Answer each question according to whether you believe *a court of law* would find the discharge to be lawful or unlawful, NOT what you would like the result to be.

1. Company's Personnel Manual states that "*Company reserves the right to discharge employees at any time, for any reason, with or without cause.*" Employee performs his job satisfactorily for several years. The Company discharges Employee in order to hire another person to do the same job at a lower wage. The discharge is:

lawful \_\_\_\_\_ unlawful \_\_\_\_\_

2. Company sends a letter to Employee offering "*permanent employment.*" Employee accepts the offer and performs his job satisfactorily for several years. The Company discharges Employee in order to hire another person to do the same job at a lower wage. The discharge is:

lawful \_\_\_\_\_ unlawful \_\_\_\_\_

3. Company's Personnel Manual states that "*If you successfully complete a 90 day probationary period, you become a permanent employee.*" Based on this statement, Employee leaves his current job to work for Company. Employee passes the probationary period and performs his job satisfactorily for several years. The Company discharges Employee in order to hire another person to do the same job at a lower wage. The discharge is:

lawful \_\_\_\_\_ unlawful \_\_\_\_\_

4. Company's Personnel Manual states that "*Company will resort to dismissal for just and sufficient cause only.*" Based on this statement, Employee leaves his current job to work for Company. Employee performs his job satisfactorily for several years. The Company discharges Employee in order to hire another person to do the same job at a lower wage.

The discharge is:

lawful \_\_\_\_\_

unlawful\_\_\_\_\_

## APPENDIX B

QUESTIONS REGARDING INFORMATION GATHERING  
EXPERIENCES [FROM PART II OF SURVEY]

The questions in this section ask about your beliefs and experiences regarding job security. "Your most recent job" means your current job, or, if you are unemployed, your last job (other than temporary or contract work).

*Before* you accepted your most recent job, did the employer give you a copy of an employee handbook or personnel manual?

Yes \_\_\_\_\_ No \_\_\_\_\_ Don't remember \_\_\_\_\_

*Before* you accepted your most recent job, did the employer give you any written description of its policies for discharging employees?

Yes \_\_\_\_\_ No \_\_\_\_\_ Don't remember \_\_\_\_\_

*Before* you accepted your most recent job, did the employer tell you verbally what its policies were for discharging employees?

Yes \_\_\_\_\_ No \_\_\_\_\_ Don't remember \_\_\_\_\_

*Before* you accepted your most recent job, did anyone else (for example, a friend or family member) tell you about the employer's policies for discharging employees?

Yes \_\_\_\_\_ No \_\_\_\_\_ Don't remember \_\_\_\_\_

*Before* you accepted your most recent job, did you hear from anyone (for example, a friend or family member) whether the employer treats its employees fairly or not?

Yes \_\_\_\_\_ No \_\_\_\_\_ Don't remember \_\_\_\_\_