THE ENDOWMENT EFFECT AND THE EMPIRICAL CASE FOR CHANGING THE DEFAULT EMPLOYMENT CONTRACT FROM TERMINATION "AT-WILL" TO "FOR-CAUSE" DISCHARGE

I. INTRODUCTION

Flowing from a long history of common law precedent, and rationalized by traditional economic legal analysis, the default employment contract in all states, except Montana, is for "at-will" employment.[1] That is, the employment relationship between worker and his or her employer continues so long as it is the will of both parties. The common phrase used to describe employment at-will is that an employee can be discharged for "any reason, or no reason at all."[2] However, recent empirical research has demonstrated that workers misconceive their legal rights, and that the "endowment effect"[3] tends to make the outcomes of employment negotiations strongly favor the employer. This Article attempts to describe the strengths of the new empirically based arguments for changing the default employment contract rule to "for-cause"[4] discharge, as well as to highlight areas that have not been adequately addressed by the current research or literature. Part II provides some background information about the traditional law and economics approach to studying law and describes some challenges to that approach from empirical research. Part III delves more deeply into the nuances of human behavior, specifically the endowment effect, which runs contrary to the expectations of traditional economic theory, and then applies current understanding of the endowment effect to the issue of whether the current default employment contract terms should be changed from "at-will" to "for-cause." Part IV describes several counterarguments to making any change to the current default employment contract. Part V notes several areas where research about the endowment effect is lacking, and suggests studies that could prove beneficial to the current debate. Finally, Part VI concludes with a proposal that states should consider changing their default

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1. *See* Wrongful Discharge From Employment Act (WDFEA) MONT. CODE ANN. §§ 39-2-901 et seq. (2001); *see also* Whidden v. Nerison Inc., 981 P.2d 271 (Mont. 1999) (definitively interpreting WDFEA as effectively eliminating and impliedly repealing the At-Will Act; also overruling Montana case precedent to the contrary). *See generally* 1 HENRY H. PERRIT, JR., EMPLOYEE DISMISSAL LAW AND PRACTICE § 1.1-1.63 (4th ed. 1998) (providing an introduction to the employment at-will doctrine and recent developments within each of the states).

2. *E.g.*, Cass R. Sunstein, *Human Behavior and the Law of Work*, 87 VA. L. REV. 205, 214-15 (2001).

3. Richard Thaler, *Toward a Positive Theory of Consumer Choice*, 1 J. ECON. BEHAV. & ORG. 39, 44 (1980) (referring to the now well-documented fact that people value things they have more than equivalent things they do not have).

4. David Millon, *Default Rules, Wealth Distribution, and Corporate Law Reform: Employment At-Will Versus Job Security*, 146 U. PA. L. REV. 975, 992 (1998). "Just cause" generally means "security of tenure, except in cases of worker malfeasance or nonfeasance," or in cases where economic necessity demands that a company lay off or fire workers. *Id.*

employment contract rules from "at-will" employment to "for-cause" discharge, despite that all the peculiarities of the endowment effect which are not yet known.

II. TRADITIONAL LAW AND ECONOMICS AND SOME CHALLENGES FROM EMPIRICAL RESEARCH

A. A Brief History of Law and Economics

By the 1960s a broad movement had begun in legal studies. In 1960 Ronald Coase's groundbreaking and now much cited work, which evaluated legal rules from an economic perspective, solidified the movement.[5] That is, questions were phrased: Will this rule help or hurt the exchange of entitlements between parties? Will a proposed change create more or less efficiency among those it affects?[6] Soon, the Law and Economics school of legal analysis blossomed, and for several decades there was a rush to examine all areas of law under its microscope.[7] Unfortunately, Law and Economics relies very heavily upon assumptions, which though logical and sensible, are not always supported by empirical research.[8]

The basis of modern microeconomics is rational choice theory (RCT),[9] and, consequently, it is the basis of the modern economic analysis of the law.[10] The problem with zealously applying the principles of rational choice theory to everything is that some of the assumptions upon which it is based have been shown to be erroneous.[11]

B. A Factual Flaw in Traditional Law and Economic Assumptions about Employment Contracts

The traditional economic analysis of the law posits that since it appears most employment contracts are for at-will employment, then that must be the efficient outcome of bargaining.[12] The working theory is that though employers may benefit from the pervasive existence of at-will employment, workers must also receive some degree of compensation for that condition

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

6. Efficiency essentially means the same thing in the Law and Economics approach to legal studies as it does in common use, that is, ease or conservation of resources.

7. *See* Richard A. Epstein, *Law and Economics: Its Glorious Past and Cloudy Future*, 64 U. CHI. L. REV. 1167 (1997).

8. *See* Russell Korobkin, *The Endowment Effect and Legal Analysis*, 97 NW. U. L. REV. 1227 (2003).

9. Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CAL. L. REV. 1051, 1060 (2000).

10. *Id.*

11. *Id.* at 1055. "There is simply too much credible experimental evidence that individuals frequently act in ways that are incompatible with the assumptions of rational choice theory." (footnotes omitted) *Id.*

12. Richard A. Epstein, *In Defense of the Contract At Will*, 51 U. CHI. L. REV. 947 (1984). *See generally* J. Hoult Verkerke, *An Empirical Perspective on Indefinite Term Employment Contracts: Resolving the Just Cause Debate*, 1995 WIS. L. REV. 837 (1995) (using an empirical survey of employers' habits to show the wide acceptance and, therefore, positive nature of employment-at-will).

of employment.[13] However, surveys of workers' beliefs (and even professionals' beliefs) conducted within the last fifteen or so years, show that most employees enter into their employment contracts based upon an erroneous assumption that they have a legal right to "just-cause" discharge.[14] In other words, employees believe they have legal protection from being fired for reasons they believe to be unfair or wrong; that their discharge must be justified under the law.[15]

To a degree, this is correct—employees cannot be fired for a variety of bad reasons, like discrimination based on race or sex.[16] However, they do not include the desire to hire someone for less pay, or firing an employee because he or she is personally disliked.[17]

Richard Epstein wrote his now classic defense of employment at-will in 1984, claiming that the common law rule is justified on principles of both fairness and utility.[18] Although certainly not their only argument, he and others have strongly relied upon the prevalence of the at-will rule in the real world to buttress their argument that it represents an efficient bargain.[19]

Understandably, "[a] number of critics assail this conclusion . . . 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."[20] As Pauline T. Kim noted,[21] critics have identified several specific 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."[22] Ultimately, the result of employees' misperceptions of their legal protection is that they are not motivated to inquire into a company's policies, or to negotiate for better job security.[23]

Many reform-minded scholars advocate that the best remedy for this is to change the default employment contract rule to strongly favor workers instead of employers.[24] A waivable for-cause employment default would force employers wanting at-will employees to directly address the issue of

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13. Epstein, *supra* note 12, at 955 ("It is hardly plausible that contracts at will could be so pervasive in all businesses and at all levels if they did not serve the interests of employees as well as employers.").

14. Mark V. Roehling, *The "Good Cause Norm" in Employment Relations: Empirical Evidence and Policy Implications*, 14 EMPLOYEE RESPONSIBILITIES & RTS. J. 91 (2002) (surveying thirteen studies, all indicating that there are common misconceptions about the nature of employment security).

15. *Id.* at 98 ("That is, [people] believe that the law is as they think it should be.").

16. *E.g.*, federal laws like 42 U.S.C.A. § 2000e-2(a), part of the Civil Rights Act of 1964, prohibit such employer action; additionally, many state laws mirror the Civil Rights Act of 1964.

17. Pauline T. Kim, *Bargaining with Imperfect Information: A Study of Worker Perceptions of Legal Protection in an At-Will World*, 83 CORNELL L. REV. 105, 110 (1997) ("the common law rule clearly permits an employer to terminate an at-will employee out of personal dislike").

18. Epstein, *supra* note 12, at 955.

19. Pauline T. Kim, *supra* note 17, at 115.

20. *Id.* at 116.

21. *Id.*

22. *Id.*

23. *See id.* at 116-17.

24. *See* Sunstein, *supra* note 2.

employment security when they hire a worker, and would allow employees the opportunity to trade their job security for other benefits.[25]

Interestingly, most of the debate prior to Kim's research was based upon an academic assumption that workers were aware that their default employment status was "at-will."[26] The value of Kim's empirical research in this context is particularly high.

Prior to Kim's 1997 study, few studies had examined working class Americans' understanding of the at-will nature of their employment.[27] Most of them did not closely examine employees' beliefs about their *legal* protection in an at-will context; rather the studies often assessed whether dismissals under certain conditions were "fair" or not; or they tested what people thought the law should be, not their understanding of the law as it exists. Nevertheless, some researchers have argued that the nine studies that occurred before Kim's study indicate that most people, even college or graduate students, believe the law offers them more protection from unjust discharge than it does.[28]

Kim's findings highlight the striking misperceptions most workers have about their legal rights as employees, and indeed, "force a dramatic shift in the traditional economic picture of the employment contracting process."[29]

C. A Behavioral Flaw in the Traditional Law and Economic Assumptions about Employment Contracts

The use of the Coase Theorem is a flawed application of rational choice theory that is of particular importance for employment contracts. This concept holds that where transaction costs are minimal, the initial allocation of legal entitlements between two parties does not matter because the parties will be able to bargain to an agreement, and will reach the same agreement regardless of the initial entitlement.[30] This assumption is particularly relevant with default rules in contracts, which fill in gaps in agreements when the parties fail to specify terms in a contract. In the employment contract context, where by default, unless otherwise specified, contracts are for an at-will term, this assumption means that if the parties wanted to specify that employment would be continuous unless there was a just-cause for dismissal, the parties could easily contract for such terms.

The Coase Theorem, however was developed before the endowment effect was discovered, and "[it] is important to remember that, unlike the

25. *See id.* at 231-32.

26. *E.g.*, Epstien, *supra* note 12, at 955 ("Nor is there any reason to believe that [employment] contracts are marred by misapprehensions, since employers and employees know the footing on which they have contracted: the phrase 'at-will' is two words long and has the convenient virtue of meaning just what it says, no more and no less.").

27. *See* Roehling, *supra* note 14.

28. *Id.* at 94-96.

29. Kim, *supra* note 17, at 147.

30. Cass R. Sunstein, *Switching the Default Rule*, 77 N.Y.U. L. REV. 106, 111-12 (2002); *see also* Coase, *supra* note 5.

Coase Theorem, the endowment effect is not a theoretical prediction, but rather an empirical finding."[31]

The traditional Law and Economics approach and the newer, so-called "Behavioral Law and Economics" (BLE) approach do not greatly differ in the respect that both are attempts to anticipate human behavior. The real difference lies in the newer method's use of behavioral research. BLE questions conventional wisdom regarding the exchange of goods or entitlements, and its use often results in the conclusion that certain existing legal rules—like the employment at-will default—are no longer justifiable using solely an economic rationale.

The endowment effect has been defined as "the principle that people tend to value goods more when they own them than when they do not."[32] It "describes the propensity of people to value what they have more dearly than they would a corresponding opportunity to acquire the same good."[33] Additionally, it can be considered a subset of the "status quo bias," which describes how "individuals tend to prefer the present state of the world to alternative states, all other things being equal."[34] The endowment effect expresses the idea that people tend to be loss averse, or disliking losing things they have more than liking gaining something of equal value.[35] In one famous experiment, a researcher:

> [g]ave some subjects coffee mugs and then offered to trade them a large Swiss chocolate bar for the mug, and he gave others the large chocolate bar and offered to trade them one of the same mugs for their chocolate. Of the subjects endowed with the mug, only 11% chose to give it up for the chocolate bar, while only 10% of the subjects endowed with the chocolate bar were willing to give it up for the mug.[36]

Participants clearly showed a strong desire to keep whatever they were initially endowed with, despite the fact that the initial allotment was done at random.[37] "[T]he endowment effect is undoubtedly the most significant single finding from behavioral economics for legal analysis to date."[38]

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31. Korobkin, *supra* note 8, at 1241.
32. *Id.* at 1228.
33. Samuel Issacharoff, *Can There Be a Behavioral Law and Economics?*, 51 VAND. L. REV. 1729, 1734 (1998).
34. Korobkin, *supra* note 8, at 1228-29.
35. Issacharoff, *supra* note 33, at 1734-35.
36. Korobkin, *supra* note 8, at 1233 (footnotes omitted, citing Jack L. Knetsch, *The Endowment Effect and Evidence of Nonreversible Indifference Curves*, 79 AM. ECON. REV. 1277 (1989)).
37. *Id.*
38. *Id.* at 1229 (footnotes omitted).

III. THE NUANCES OF THE ENDOWMENT EFFECT AND ITS APPLICATION TO THE EMPLOYMENT AT-WILL DEBATE

A. Nuances of the Endowment Effect

1. Difficulty in Applying Endowment Effect Research to Legal Analysis

Commentators have noted that often legal scholars fail to fully grasp the subtleties of the effect, some of which are "(1) [t]hat the existence and extent of the endowment effect is context dependent (and, in addition, not fully understood) and (2) that the explanation for why the endowment effect exists, which is also not well understood, should often affect its normative implications."[39]

Furthermore, "applying the endowment effect to legal policy questions requires care, nuance, and a healthy degree of respect for what we still do not know about how the effect operates."[40]

2. Properties of the Endowment Effect

As early as the 1970s, scientists were researching how people make decisions when limited information is available. Tversky and Kahneman explored three heuristics, or mental shortcuts, that are used when people make judgments under uncertainty, which include representativeness, availability, and anchoring.[41]

Another is the "endowment effect." This heuristic describes the how people value that which they have (or with which they are "endowed,") more than that which they do not.[42] Many psychologists have over the years devised at least tentative answers to several questions, including the questions of when people exhibit the "endowment effect" and whether everyone, including experts, exhibit the effect at some point.

For example, there is evidence indicating that the effect is stronger when something is obtained as a result of proficiency or talent instead of as the result of chance.[43] Additionally, the more dissimilar two items are in their comparison (and consequently, the more difficult to determine whether a trade will be profitable) the more likely people are to place a higher value on keeping what they have, and the endowment effect will be stronger.[44] When there is no similar substitute item available, the effect is strong as well.[45]

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39. *Id.*
40. *Id.* at 1230.
41. *See generally* Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases,* 185 SCI. 1124 (1974).
42. Korobkin, *supra* note 8, at 1228.
43. *Id.* at 1236.
44. *Id.* at 1238; *see also* Gretchen B. Chapman, *Similarity and Reluctance to Trade,* 11 J. BEHAV. DECISION MAKING 47 (1998).
45. Korobkin, *supra* note 8, at 1238.

Also, it is important to note that actual physical possession of an item is not required for an endowment effect to take place. For example, a 1997 experiment revealed that merely possessing a coupon for an item increased the attachment people had to that item, despite not truly owning the item.[46]

Other experiments have shown that the transaction demand, or desire for the parties to complete a deal, moderates the endowment effect.[47] "Specifically, as transaction demand increases, owners may be more inclined to sell and potential buyers may be more inclined to buy."[48] Here, the research indicates that one factor that may influence transaction demand is whether the reason to own a particular good is to own it or to trade it.[49] Another recent study highlights the effect that perceived necessity has on the endowment effect, finding that the more people believe something is necessary for their survival the more likely the endowment effect will be exhibited in their behavior.[50]

Following a recent experiment in which several types of wines were given to study participants, several researchers suggested that experts might be more susceptible to the endowment effect than laymen because they can identify objects with greater specificity—they observe the fine distinctions that non-experts cannot.[51]

3. Causes and Explanations for the Endowment Effect

There are many explanations suggested in the literature as to what might cause the endowment effect, ranging from particular unnatural experimental conditions, wealth disparities, or a manifestation of loss aversion.[52] However, very few authors bother to analyze the effect as though it must be an evolutionary adaptation, by which our ancestors were better able to survive through it. It is possible that, rather than stemming from something learned in life, the tendency to exhibit the effect is hardwired into our genes. There is nothing revolutionary about this statement.[53] However, legal professionals have yet to embrace such rationale in their analysis.[54] Perhaps there is only limited utility in understanding the evolutionary purpose of the endowment effect, but any explanation of why a phenomenon occurs can help predict future behavior more accurately.

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46. Sunkar Sen & Eric J. Johnson, *Mere-Possession Effects Without Possession in Consumer Choice*, 24 J. CONSUMER RES. 105 (1997).

47. David R. Mandel, *Beyond Mere Ownership: Transaction Demand as a Moderator of the Endowment Effect*, 88 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 737 (2002).

48. *Id.*

49. *Id.* at 745.

50. Frank W. Wicker et al., *Studies of Loss Aversion and Perceived Necessity*, 129 J. PSYCHOL. 75 (1994).

51. Eric van Dijk & Daan van Knippenberg, *Trading Wine: On the Endowment Effect, Loss Aversion, and the Comparability of Consumer Goods*, 19 J. ECON. PSYCHOL. 485, 494 (1998).

52. Korobkin, *supra* note 8, at 1242.

53. *See, e.g.*, Tversky & Kahneman, *supra* note 41.

54. *See generally* Neel P. Parekh, *Theorizing Behavioral Law and Economics: A Defense of Evolutionary Analysis and the Law*, 36 U. MICH. J.L. REFORM 209 (2002).

Overall, the precise reason people exhibit the endowment effect is not known. Were the endowment effect to predominately be triggered by contextual factors not present in employment contracts, then the entire debate about employment at-will, at least so far as the endowment effect is concerned, is moot. Nevertheless, since the endowment effect has not been observed across a broad spectrum of conditions, one can at least cautiously apply knowledge of the effect's nuances to the problem of default employment contracts.

B. Application of Endowment Effect Properties to the Employment At-Will Debate

Generally, it appears that were the default rule switched to favor employees over employers, the outcome of bargaining would be different from what it is now because "the entitlement will have a tendency to stick."[55] Many of the nuances described above are useful in determining whether the endowment effect would be exhibited strongly or weakly in the employment contract-forming context.

The fact that employers are not endowed with a beneficial default employment rule because of any proficiency or talent on their part would tend to reduce their preference for maintaining the status quo.[56]

Since the alternative to at-will employment is quite different, employers and employees may be much more reluctant to willingly switch to contract terms with which they are not familiar.[57] In other words, because the differences between employment at-will and for-cause discharge are so great, employers are much more likely to strongly exhibit the endowment effect—to cling to their right to fire their workers at-will.[58]

On the other hand, the power of the endowment effect could be reduced by negotiating around a default rule when close substitutes are available.[59] But in this case, there is no close substitute for a default employer right to discharge workers at-will.

Though it is true that being endowed with a default employment contract is not like being endowed with a candy bar or coffee mug, research shows that such a rule could still create an endowment effect at the interviewing or negotiating table.[60]

The need for transaction demand reduces the power of the endowment effect,[61] but almost always any individual worker cannot have the bargaining power of his or her employer. Plus, employers do not seem to be interested in selling their right to fire at-will. Such intent to use an endowment, as op-

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55. Sunstein, *supra* note 30, at 118.
56. Korobkin, *supra*, note 8, at 1236.
57. *See* Korobkin, *supra* note 8, at 1238; *see also* Chapman *supra* note 44.
58. *Id.*
59. *Id.* at 1238.
60. *Id.*
61. Mandel, *supra*, note 47, at 737.

posed to intent to sell or trade it, leads to a greater endowment effect.[62] Even if employees were very motivated to bargain around the default rule, their employers' transaction demand may be so low as to foreclose any negotiation about employment security.

Additionally, the perceived necessity of an item to a person's survival contributes to the exhibition of the endowment effect.[63] An employer, fearful of hiring mediocre workers and being forced to keep them because of a "for-cause" employment contract, may feel like he or she needs to keep his or her right to fire as a matter of economic necessity.[64] Of course, what matters is not whether being able to fire workers at-will is *truly* an economic necessity, just whether it is *perceived* as one.[65] Most likely, employers would exhibit the endowment effect strongly because they probably believe it is important to have that kind of authority over their workforce.

Another important point is that employers are almost always the experts at the contracting table, and they are much more likely to discern fine distinctions in a contract. Employers are very likely to notice a difference between employing their workers at-will or giving them job security through a for-cause discharge policy. Granted, the employees are likely to notice the practical difference as events unfold, but they still may not perceive them at the bargaining table.

One interesting point, described by Cass R. Sunstein, is that even though people are loss averse, "whether an event 'codes' as a loss or a gain depends not on simple facts but on a range of contextual factors, including how the event is framed."[66] The reference point is usually the status quo, but "it is possible to manipulate the frame so as to make a change code as a loss rather than a gain, or vice-versa."[67] For example, in an attempt to sell energy efficient air conditioners, a company could either say that they will save X amount of money over so many years, or that if a consumer does not buy them, he will lose X amount of money over so many years. The second framing of the air conditioners' advantages would work better for the company because individuals are averse to losing things they already have, rather than saving something they do not yet possess.

In the employment context, the default rule is the frame against which both employers and employees would measure employment offers while bargaining together. Unfortunately, workers today do not understand the legal default, so we cannot be certain how an employee would act if he always approached a job with the understanding that most places hire only at-will employees. If employers were equally mistaken about the legal default in employment contracts, perhaps there would be no incentive to change the law. However, that is not likely to be the case.

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62. *Id.*
63. Wicker, *supra* note 50.
64. *See id.*
65. *Id.*
66. Cass R. Sunstein, *Economics and Real People*, 3 GREEN BAG 2d 397, 401 (2000).
67. *Id.*

C. Suggestions for Legal Reform Based Upon Empirical Research and the Endowment Effect

As David Millon wrote, "contrary to economic orthodoxy, changing the current default rule to job security could have significantly favorable distributive consequences for workers."[68] The current default greatly favors employers over employees. Employers are typically repeat players in employment contract making, and have the advantage of accumulated experience. Additionally, they usually can more easily afford legal counsel.

Even more troubling than unequal bargaining power to reformers is the fact that research, like Kim's, shows that under the current state of affairs, employers do not even have to bargain for at-will employment, since employees assume that the law is for-cause discharge.[69] The employer gets the benefit of at-will employment (or really, at-will discharge, to frame it another way), without having to compensate employees for it.[70]

At least one scholar suggests establishing a legal default specifying a strong, but waivable, worker's right to have just cause employment security, so long as there were legal minimum floors below which a worker could not contract.[71]

> The principle purpose of this approach is to ensure that employers fully disclose contractual terms to employees and allow employees to waive only when waiver is thought to be worthwhile, without producing the rigidity, inefficiency, and potential harm to workers and consumers alike that are created by systems of nonwaivable, "one-size fits all" terms. This basic idea could be applied to both unionized and non-unionized workplaces. It could even be applied to the question of whether workers are collectively organized at all: A default rule might specify collective organization and allow workers to opt out rather than specifying the opposite and allowing them to opt in.[72]

Another remedy might be to simply keep the default contract term being "at-will," but then it would be presumed to become "for-cause" after a certain amount of time. This compromise would have the benefit of allowing employers to fire their deficient employees without worry within a fixed time (a year, for example) after they were initially hired, while simultaneously benefiting the remaining employees with job security.

Of course, there are several powerful counterarguments to the claims made by the behavioralists.

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68. Millon, *supra* note 4, at 1015.
69. Kim, *supra* note 17.
70. *See id.*
71. Sunstein, *supra* note 2, at 206.
72. *Id.* at 207-208.

IV. COUNTERARGUMENTS TO CHANGING THE DEFAULT RULE

There are certainly many reasonable arguments based on policies like freedom of contract for keeping employment at-will the default rule. To catalog all the viewpoints and arguments here would be to digress too far from the role empiricism and the endowment effect have on the ongoing debate. Consequently, only a cursory discussion of non-empirical based arguments is presented here.

Counterarguments to this change in default rules include legal scholars who argue that at-will employment is good, and ought to be continued.[73] Richard A. Epstein argued that while "critics of the contract at-will all point out imperfections in the current institutional arrangements, . . . they do not take into account the nonlegal means of preserving long-term employment relationships, and they ignore the greater imperfections that are created under alternative legal rules."[74]

Other scholars would reject any effort to create a for-cause discharge rule, on the grounds that such an arrangement is not favored by any of the market players, and that creating a default rule favoring employees would have no effect anyway, since the parties would ultimately negotiate to the same position regardless of the default rule.

J. Hoult Verkerke reinforced these arguments, noting that employment at-will is extremely prevalent throughout the states, and that individuals that one would think would be able to negotiate an employment contract with job security do not.[75] However, his research was subsequently overshadowed by Kim's study, and, even at the time, it did not address concepts similar to what Kim later studied (that workers do not understand that they have no legal protection for being discharged without cause).

Professor Issacharoff argues that the use of the endowment effect to advocate for changes in legal rules has a very limited utility, partly because behavioral models have already been taken into account in devising various laws, even employment law.[76] He points out that, for example, the Age Discrimination in Employment Act has been designed based on the understanding that there are "asymmetric stakes in the dismissal of a long term employee."[77]

Professor Issacharoff, however, appears to over-generalize the insights gained from behavioral research—so much so that they no longer contribute anything new to the field. The fact that some laws are passed with an understanding of the differences in bargaining power between a corporation and, for example, an average consumer, does not mean that the law is taking into account the more specific effects of little known, but widely exhibited, psychological propensities. Professor Issacharoff does retreat somewhat when

73. *See* Epstein, *supra* note 12.
74. *Id.* at 951.
75. Verkerke, *supra* note 12, at 838.
76. Issacharoff, *supra* note 33, at 1736.
77. *Id.*

he later gives more credit to the young field, limiting his criticism to saying that even though the "richer behavioral model is instructive for showing the limitations of the economic model's incomplete understanding of human behavior, it does not yet augur in a new school of legal analysis."[78]

The most persuasive arguments against making any changes to the default employment contract based upon behavioral research can be found in Professor Mitchell's recent article.[79] Mitchell makes several very broad criticisms of the new behavioralism of legal analysis, including the limitations of behavioral research, its proponents' "pessimism bias," and a lack of peer-reviewed legal journals.[80] Professor Mitchell's criticisms are justified. "Research . . . should of course continue, but more cautiously and carefully, and the conclusions drawn from empirical research should be as precise as possible and should be accompanied by self-critical candor."[81]

One cannot seriously disagree with most of Professor Mitchell's criticisms, but, on the other hand, endowment effect research is particularly robust, and clearly has a potential impact on employment contracts. Therefore, at least in the area of employment contracts, the need for more and better research does not appear as severe.

V. RECOMMENDATIONS FOR RESEARCH

Despite its broad promises, there are some clear limitations on the benefits of behavioral psychology to the study of at-will employment. For example, there are problems with both the quantity and quality of research that has been done in the field.[82] Additionally, though empirical research may tell us what most employees think, or that the endowment effect causes certain predictable irrational behavior, it cannot tell us that as a policy decision we should construe at-will employment as good or bad for most workers or the economy.[83]

More specifically though, there are some problems with the current research on worker perceptions and the endowment effect. One topic that is not addressed by the literature is whether the common worker also thinks that he has to give a certain amount of notice before he leaves his job. It may be the norm for workers to give "two weeks notice" but that does not mean that they have a contractual obligation to do so. Do employers naively assume that their at-will employees have to give them two weeks notice; do they specify so in the contract? Does the fact that employers are repeat players and are probably comparatively sophisticated affect whether their

78. *Id.* at 1739.
79. *See* Gregory Mitchell, *Taking Behavioralism Too Seriously? The Unwarranted Pessimism of the New Behavioral Analysis of Law*, 43 WM. & MARY L. REV. 1907 (2002).
80. *Id.* at 1907-38.
81. *Id.* at 2021.
82. Gregory Mitchell, *Why Law and Economics' Perfect Rationality Should Not Be Traded for Behavioral Law and Economics' Equal Incompetence*, 91 GEO. L.J. 67 (2002).
83. *See* Samuel Issacharoff, *The Difficult Path from Observation to Prescription*, 77 N.Y.U. L. Rev. 36, 46 (2002).

assumptions about at-will employment should be corrected through legislation or other rules?

Several journal articles address the endowment effect from the perspective of a changed default rule, and describe potential problems for both workers and employers from a change in the default rule.[84] However, most literature on the subject of at-will employment only rarely attempts to understand the endowment effect upon *management* using the law as it exists today. What may be the case is that employers are unwilling to sell job security even when it would be to their economic advantage to do so.

Also, when it comes to explaining the causes of the endowment effect, few legal researchers appear interested in exploring the possibility that our evolutionary past has hardwired us to exhibit the effect. A cursory nod is sometimes given to biological anthropology, or evolutionary psychology,[85] but rarely do legal scholars apply that research to understanding the power the endowment effect vis-à-vis employee welfare. Moreover, even if the endowment effect is biologically hardwired into our minds, might particular cultures encourage the effect more than others?

Furthermore, and perhaps most interesting, very few researchers have empirically studied the effects of the default employment rule change in Montana from at-will to for-cause.[86] It is a shame that while the debate has been ongoing among researchers and scholars for years as to what the effects of a default rule change might be, only a few have actually studied what has happened in the only state that has changed its default rules.[87]

Finally, with the increasing influence of psychological research on the study of legal rules, the need for confidence in the underlying research is becoming more critical.[88] Perhaps the editors of existing Law and Psychology journals should consider having their more empirically-based articles peer reviewed before publication, even if simply by psychologists in nearby University departments.

VI. CONCLUSION

In sum, states should consider changing their default rules of employment contracts as most employees approach the employment bargaining table assuming that they have legal protection from at-will discharge and do not have the resources or bargaining power of management. Moreover, they

84. *See, e.g.*, Korobkin, *supra* note 8, at 1275-79; Millon, *supra* note 4, at 995-1019; Sunstein, *supra* note 2, at 246-47.

85. *See, e.g.*, Korobkin, *supra* note 9, at 1070, 1076, and 1085.

86. *See* Marc Jarsulic, *Protecting Workers from Wrongful Discharge: Montana's Experience with Tort and Statutory Regimes*, 3 EMPLOYEE RTS. & EMP. POL'Y J. 105 (1999) (being the only published paper, as of April 10, 2004, empirically analyzing Montana data on wrongful discharge since the enactment of the WDFEA).

87. *See generally* Leonard Bierman & Stuart A. Youngblood, *Interpreting Montana's Pathbreaking Wrongful Discharge from Employment Act: A Preliminary Analysis*, 53 MONT. L. REV. 53 (1992); Donald C. Robinson, *The First Decade of Judicial Interpretation of the Montana Wrongful Discharge from Employment Act (WDEA)*, 57 MONT. L. REV. 375 (1996).

88. *See* Mitchell, *supra* note 79, at 1929-31.

are further disadvantaged by the endowment effect. That every nook and cranny of this phenomenon may not yet be fully understood is merely a missing link in an otherwise widely exhibited and empirically demonstrated psychological predilection. Therefore, states should seriously consider changing their default rules of employment contracts.

Discussion and application of the legal implications of psychological and behavioral economic research is only just beginning. In the coming years, traditional law and economics analysis will continue to find its assumptions challenged by empirical research, the debate on employment contract default rules being but a small part of that revolution in scholarship.

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† I dedicate this Article to my family, whom I love.