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Policing Employment Contracts within the Nexus-of-Contracts Firm

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The decade of the 1980s witnessed a revolution in the practices and theory of the business corporation. The dramatic wave of takeovers, buy-outs, mergers, and bust-ups of the decade rippled through our institutional and conceptual world and left behind a new topography of economic and power relationships. At its most immediate level, the wave of corporate restructurings produced unprecedented wealth for corporate raiders, enormous commissions for investment bankers, and substantial gains for many stockholders. At the same time, it left devastation for employees and the communities in which they live.

In the United States, hundreds of thousands of employees lost their jobs as a result of the merger-mania of the decade.¹ In addition, the new jobs created and the newly reorganized jobs offered lower wages and fewer benefits than the jobs they replaced.² Thus the decade was one in which there was a redistribution of wealth from employees to corporate raiders, stockholders, and upper management. Indeed, some scholars have argued that there was not merely a passive wealth redistribution, but rather a coercive transfer.³

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† An earlier version of this paper was delivered at the Workshop on Corporate Accountability and Control at Warwick University, July 1991.

1 The AFL-CIO estimates that over 500,000 jobs were lost in the 1980s as a result of takeovers and corporate restructurings. *Hostile Takeovers: Hearings before the Senate Committee on Banking, Housing, and Urban Affairs*, 100th Congress, 1st Sess. 262 (8 April 1987) (testimony of Thomas P. Donahue, secretary-treasurer, AFL-CIO). See also Andrei Shleifer and Lawrence Summers 'Breach of Trust in Hostile Takeovers' in Alan J. Auerbach (ed.) *Corporate Takeovers: Causes and Consequences* 33, 41-2 (Chicago 1985). Some economists have disputed the claim that takeovers cause layoffs or have otherwise harmed employees. However, all such studies to date suffer from serious methodological flaws. For a critique of these studies, see Katherine Van Wezel Stone 'Employees as Stakeholders under State Nonshareholder Constituency Statutes' (1991) 21 *Stetson LR* 45, 45-7 and n4.

2 Lawrence Mishel and David M. Frankel *The State of Working America, 1990-91* (Armonk NY: Economic Policy Institute, M.E. Sharpe Inc. 1991) 69-127; Frank Levy and Richard J. Murnane 'U.S. Earnings Levels and Earnings Inequality: A Review of Recent Trends and Proposed Explanations' (1992) 30 *J. of Econ. Lit.* 1333, 1346-51

3 See John C. Coffee Jr 'Shareholders Versus Managers: The Strain in the Corporate Web' (1987) 85 *Mich. LR* 1, 70; Shleifer and Summers, *supra* note 1, 33, 41-2.

Further, in the 1980s, new norms of economic life arose to accompany the new forms of business behaviour, norms that celebrated rugged individualism and denigrated collectivist solutions to social problems. As a result, a legal climate emerged that made it difficult for the labour movement to protect its members or its own organizational survival in the face of business change.⁴

Two statistics tell the story. First, despite the unprecedented boom in the financial and real estate markets in the decade, the wages of production workers in the United States declined 8 per cent between 1979 and 1987.⁵ Second, in the same period, union membership in the United States declined, in absolute numbers, by 25 per cent. By 1990, only 16 per cent of the non-agricultural workforce belonged to unions.⁶ Thus the decade of the 1980s signified a deterioration of workers' standard of living and a demise in their collective organizational strength.

There are several attitudes one could adopt towards these developments. One is that the job losses that follow corporate restructurings are not a problem, because an employee who loses her job will get another one at a wage equal to the value of her marginal product. In the meantime, according to this view, everyone is better off because production has been made more efficient. Maybe employees pay some slight cost in terms of transitional unemployment, but it is short-lived and more than offset by the net gains from capital mobility.

That is the view of neoclassical economic theory. While it neatly fits the theory, it lacks credibility.⁷ The evidence of extensive and lengthy job

4 See, for example, Lee Modjeska 'The Reagan NLRB, Phase I' (1985) 46 *Ohio State LJ* 95, 131 (describing 'the [Reagan era] Board reversals [that] profoundly alter the preexisting balance of labor management relations'); James B. Atleson 'Reflections on Labor, Power, and Society' (1985) 44 *Maryland LR* 841, 871 (arguing that recent Board and Supreme Court decisions have weakened union power, and that these decisions reflect, and further, the growing imbalance of power between unions and corporate structures); William B. Gould 'Some Reflections on Fifty Years of the National Labor Relations Act: The Need for Labor Board and Labor Law Reform' (1986) 38 *Stan. LR* 937, 939 (arguing that the Reagan Board has exhibited a pronounced hostility to unions and collective bargaining). See also Katherine Van Wezel Stone 'Labor and the Corporate Structure' (1988) 55 *Chi. LR* 73 (detailing recent legal decisions that have restricted power of unions to influence strategic decision-making).

5 Private non-agricultural weekly earnings for production and related workers, indexed in 1977 constant dollars, have been as follows: 1978 \$183.90, 1979 \$183.40, 1980 \$172.70, 1983 \$171.30, 1985 \$170.40, 1987 \$169.30. Statistical Abstract of the United States (1989) 404, table 663

6 Bureau of Labor Statistics, Employment and Earnings (January 1991)

7 Clive Bull 'The Existence of Self-Enforcing Implicit Contracts' (1988) 102 *Q. J. of Econ.* 147, 147 (crucial aspects of labour market behaviour 'have proven inexplicable if the labor market is modeled as a sequence of spot auction markets')

loss is too convincing, and the stories of human suffering too poignant, to gainsay the fact that corporate transformations and restructurings have imposed serious costs on employees.

There is another view, which says that employees pay a price for corporate transformation, but the payment is ultimately for the greater good. Someone has to pay, so why not employees? In this Darwinian world, it is said that if employees wanted to strike a better deal and shift the costs to someone else, they should try to do so. For example, they could unionize and bargain collectively for provisions that ensure that the costs of corporate restructurings are not borne by them. Alternatively, they could invest in human capital and learn valuable skills or even a profession, thereby enhancing their labour market power. If they cannot or do not choose either to unionize or to invest in human capital, then they will be the ones to pay the price of economic restructuring, and deservedly so. Neither sentiment nor law should aid the weak, the lazy, or the mealy-mouthed. I call this the Darwinian view.⁸

Both the neoclassical view and the Darwinian view draw support from the new contractual theory of the firm.⁹ Fifteen years ago, Jensen and Meckling deconstructed the concept of the business firm, announcing that the firm only exists as a metaphor for the contractual relations between a set of constituent parts.¹⁰ These parts include capital (subdivided into equity, capital, and debt), labour (subdivided by various levels of skill, from unskilled to professional to managerial), suppliers of raw materials, customers for output, and the communities in which the firm operates. The different parts come together to form what we know as the modern business firm. The parts are interdependent insofar as each is better able to pursue its interests if it does so in conjunction with the others. The way that the parts come together is defined by private contracting and external law. That is, contract and legal regulation define the relations of dependency, power, and advantage between the various constituencies of the firm.

The nexus-of-contracts view of the firm contains an embedded normative assumption about the terms of the contract itself. It suggests that by

8 Examples of this view are found in Richard Epstein 'In Defense of Employment at Will' (1984) 51 *Chi. LR* 947; Jonathan R. Macey 'Externalities, Firm-Specific Capital Investments, and the Legal Treatment of Fundamental Corporate Change' (1989) *Duke LJ* 173, 194-5.

9 For an in-depth discussion of the new contractual theory of the firm, see William W. Bratton 'The New Economic Theory of the Firm: Critical Perspectives from History' (1989) 41 *Stan. LR* 1471.

10 Michael C. Jensen and William H. Meckling 'The Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 *J. Fin. Econ.* 305, 311

making a contract, each side expresses its own priorities and preferences and bargains to its best advantage. In the end, both sides benefit from making the deal – otherwise it would not have been made. The fact that both benefit provides a justification for the terms of the deal and a powerful reason to reject all public intervention into terms.¹¹

The nexus-of-contracts view of the firm provides a vantage point to evaluate employees' position in the firm. It says that employees' relationship to the firm, like that of the other parts, is defined by private contract and by the legal regulations that constrain or delimit those contracts. As applied to employees, the normative message of the contractarian framework is that employees who are laid off in response to corporate change have experienced the consequence of a contract to which they knowingly and willingly agreed. They chose to contract for present wages instead of job security and therefore risked the consequence. They bought a ticket and lost the lottery.

Here I want to challenge the neoclassical and the Darwinian views about the impact of corporate restructurings on employees, and to propose a different view of the labour contract and labour-capital relations, one that provides employees with some protections against corporate restructuring and with a role in corporate governance. To do this I also want to contest the normative message contained in the contractual theory of the firm.

My argument has four parts. First I argue that there is no such thing as a free market for labour that is not itself the product of regulation. Bargaining outcomes are not a simple function of pre-existing power relations: They are mediated, shaped, enhanced, or diminished by the background legal rules in effect. Thus we cannot treat the outcomes of bargaining as normatively privileged.

Second, I look at the particular form of the labour contract that prevails in the West today. I show that even within the existing background rules of contracting, employment contracts are being repeatedly and systematically breached by employers when they undertake mass layoffs in conjunction with corporate restructurings. It is incorrect to say that employees have contracted for wages instead of job security. Rather, employees have contracted for both, but they are finding that they cannot enforce the security aspects of their deals.

Third, I look at the available means for employees to enforce their promises of job security. I examine the possibilities both for individual contracting mechanisms and for collective contracting through the mechanism of unionization and collective bargaining. I conclude that under

11 Epstein, *supra* note 8, 953–5

existing legal rules, neither individual nor collective contracting provides adequate enforcement for such promises.

In the last section of this paper I consider several different approaches that have been proposed for revising the background rules governing labour relations. I conclude that an expansive conception of collective bargaining, one in which unions are empowered to contend for a greater voice in corporate decision-making, is the only one that can effectively protect employees' reasonable expectation of job security.

1 *Legal regulation and policy choices define the market*

A market is a set of legal rules and institutional arrangements that bring together buyers and sellers.¹² Legal regulation shapes the markets in which contracts are made. As Nobel Laureate Ronald Coase recently said:

[T]he rights which individuals possess, with their duties and privileges, will be, to a large extent, what the law determines. As a result, the legal system will have a profound effect on the working of the economic system and may in certain respects be said to control it ...

It makes little sense for economists to discuss the process of exchange without specifying the institutional setting within which the trading takes place, since this affects the incentives to produce and the costs of transacting.¹³

In employment relations, legal regulation plays a particularly prominent role. Legal rules determine such matters as who can be a party to a wage contract, what are the permissible terms of such a contract, what are the compulsory terms, what methods the parties can utilize to improve their contracting position in relation to the other, and what are the consequences of breach. The particular way that these issues are settled is constitutive of the relative power of employers and employees. And the relative power of the parties determines the bargains they will strike. Thus the particular rules governing the contracting process have distributive consequences.¹⁴

12 Edwin Mansfield *Microeconomics, Theory and Applications* (4th ed.) (New York: W.W. Norton 1982) 20-1. See also Roy J. Ruffin *Intermediate Economics* (2d ed.) (Harper Collins 1992) 11 (a market is an institution through which people regularly exchange scarce goods and services); Ronald Coase 'The Institutional Structure of Production' (1992) 82 *Am. Econ. Rev.* 713, 714 (equating the market with 'the institutional arrangements which govern the process of exchange').

13 Coase, *supra*, 717-8

14 See Stone, *supra* note 4, 86-120 (on aspects of labour law that allocate power between labour and management). For a more general treatment of this proposition,

Any discussion of employment contracts assumes a great many background legal rules that have shaped its terms. One of the types of rules that have the greatest distributive consequences is that governing the right to strike and engage in economic warfare. For example, without knowing whether or not workers can legally combine and strike, we do not know whether they have enough economic power to achieve their bargaining goals. Similarly, even if workers have a right to combine and strike, we still cannot judge the effectiveness of the strike weapon without knowing whether they also have the right to picket, to engage in a partial strike, to call for consumer boycotts, to engage in secondary labour boycotts, and so forth. Further, to judge the power of the strike weapon, we have to know whether the employer can lawfully carry on operations during the strike, whether the strikers are ensured their jobs back at the end of the strike, or whether, instead, the employer can permanently replace them. We would also have to know whether those strikers entitled to reinstatement are also entitled to full seniority or merely to reinstatement as new hires, and whether the employer is permitted to use other extraordinary means to procure replacements, such as to offer them premium wage rates or superseniority. Further, we would want to know whether the replacements have any rights against the union or the employer if they are displaced at the end of a strike. That is, even if workers have a right to strike, we have to know which of the many possible rights that make up the bundle called a 'right to strike' they have in order to know what the right means and evaluate its consequences. To know this, we need to look at not only the labour laws, but the criminal conspiracy laws, antitrust laws, trespass laws, tort, contract, and property laws as well. A right to strike can and does take many different forms in different legal systems.¹⁵

Similarly, the legal rules governing union organizing have powerful distributive consequences.¹⁶ If workers can organize freely, without fear of either discharge by their employer or criminal prosecution by the state, then they can more easily collectivize and enhance their bargaining power. If their ability to organize is subject to legal constraint, then they

see Robert Hale 'Coercion and Distribution in a Supposedly Non-Coercive State' (1923) 38 *Pol. Sci. Q.* 470, 474-8 (all incomes in society are a function of the amount of coercion one can legally bring against others).

15 See generally Katherine Van Wezel Stone 'Legal Regulation of Economic Weapons: A Comparative Perspective' in Bruno Stein (ed.) *Proceedings of the N.Y.U. 43rd Annual Conference on Labor* (Little, Brown 1990) 79.

16 See generally Paul Weiler *Governing the Workplace* (Harvard University Press 1990) (demonstrating impact of legal rules governing union organizing on union success rates).

lose that advantage. In the United States there are a myriad of detailed doctrines concerning precisely what employers may and may not lawfully do to discourage their employees from unionizing, doctrines that change from time to time.¹⁷ They are all distributive in their impact.¹⁸

Bargaining rules are also distributive. If an employer is required to bargain before it makes major changes in strategic business practices, then employees have a bargaining chip they can either play or trade for something else. Thus they enter the contracting arena with more clout than if the rule were otherwise. Conversely, if employers are not required to bargain about strategic-level corporate decisions that affect the existence of jobs, then union bargaining power is diminished.

Because the background legal rules governing labour relations are not conventional and fixed, all labour law rules involve normative choices concerning the distribution of power and advantage.¹⁹ Each choice of rule enhances the power of one side at the expense of the other. There is no neutral ground, no legal state of nature, upon which contracting can take place.

As a result, the terms of the labour contract are largely determined by the legal rules governing organizing, bargaining, and economic conflict. Thus, for example, if workers routinely fail to contract for job security, we cannot conclude that they do not value that goal; it is equally possible that the legal rules make it difficult, or even impossible, to obtain such a term in their contracts. Therefore, in response to the Darwinian claim that workers who lose their jobs 'got what they bargained for,' we can answer, 'they got the bargain that society gave them.'

II *The nature of the labour contract*

Even within existing background rules of labour relations, we cannot conclude, as do the neoclassicists and the Darwinists, that employees who suffer job loss as a result of corporate restructuring got what they

17 See, for example, *Midland National Life Insurance Co.* 263 NLRB 127 (1982) (discussing changes in rules governing employer speech in election campaign).

18 Thus, for example, a rule that prohibits an employer from firing a union activist for engaging in organizing activities assists union organizing and enhances workers' market power. A rule that gives employers free rein to resist union organizing by any otherwise legal means, including dismissing union activists, has the opposite impact. Similarly, a rule subjecting union organizing to antitrust liability diminishes employee market power, while one that permits unions to engage in secondary boycotts in order to pressure employers to recognize and bargain with them enhances it.

19 See Karl Klare 'Workplace Democracy and Market Reconstruction: An Agenda for Legal Reform' (1988) 38 *Catholic U. LR* 1.

bargained for. If employees' relationship to the firm is indeed a product of contracting with the other groups that make up the firm, we have to know something about those contracts in order to ascertain whether the risk of involuntary, unprovoked dismissal was part of the deal. That is, we have to ask, what are the terms of employees' contracts with their firms, and are those contracts being performed?

A. THE CONVENTIONAL VIEW OF THE LABOUR CONTRACT

According to the conventional legal view, the labour contract is not really one contract, but rather a series of discrete contracts for the performance of certain work tasks in exchange for a monetary wage. The law presumes that the employment relationship is a contract that lasts from moment to moment, each moment signifying the completion of one contract and the commencement of a new one. At the end of each of these momentary cycles, the contract is fully performed, and no further sums of money or other obligations linger. This conventional conception of the labour exchange underlies the American at-will employment doctrine, which says that either party is free to terminate the relationship at the completion of any cycle by merely refusing to enter into another one.

Neoclassical economic theory has a view of the price at which the labour contract will be made that is consistent with the conventional legal view of the labour exchange. It says that the price at which a worker is paid is equal to the value of her marginal product. The value of the worker's marginal product will tend to equalize across firms, each of which are earning the exact same normal rate of profit. Thus there develops a single prevailing competitive wage rate for each type of labour.²⁰

The neoclassical view of wage determination is consistent with the conventional view of the labour exchange because it suggests that the labour-capital exchange is paid the competitive rate at each moment, and is therefore fully executed on both sides as it goes along.²¹ That is, the employment relationship is an instantaneous, pay-as-you-go exchange. No obligations linger; neither side is creditor or debtor vis-à-vis the other.²² Thus the conventional theory of the labour exchange, the at-will employment rule, and the marginal productivity theory of wage

20 Lloyd G. Reynolds, Stanley H. Masters, and Colletta H. Moser 'Simple Labor Market Models' in *Labor Economics and Labor Relations* (10th ed.) (Englewood Cliffs NJ 1991) 14-36

21 See, for example, Boyan Jovanovic 'Job Matching and the Theory of Turnover' (1979) 87 *J. Pol. Econ.* 972, 973.

22 I refer here not to the frequency at which payment is tendered, but rather to the rate at which pay is said to be 'earned' - that is, the point at which the worker's right to receive payment 'vests.'

determination are three mutually reinforcing aspects of the conventional description of the employment relationship. Together they paint a powerful picture of the labour contract as a consensual transaction in which the terms are set by external and inexorable market forces, and each side, by entering into the exchange, stands to benefit.

All aspects of this picture have been challenged many times on many different grounds. The at-will rule has been challenged on the grounds that it ignores factors of power, reliance, duress, inequality, and so forth.²³ The marginal product theory of wage determination has been challenged on the grounds that it ignores the impact of employment discrimination, imperfect information, sticky wage scales, and other market imperfections, and for not comporting with empirical evidence about wage rates.²⁴ In addition, many scholars have argued that the wage contract is not like other contracts, that it is unique, and that it is not subject to the rules governing a competitive market in the first place.²⁵

In general, it is scholars on the left who argue that labour contracts are not like other contracts. For example, Claus Offe argues that labour is not a commodity and thus does not conform to the economic laws of commodity exchange. He writes:

First, unlike genuine commodities, [labour] is not created for the purpose of sale in a market ... The decision to produce the fictive commodity labour is not reached in market-oriented enterprises but, rather, in families and other agen-

23 On the issue of power, see Samuel Bowles and Herbert Gintis 'Contested Exchange: New Microfoundations for the Political Economy of Capitalism' (1990) 18 *Pol. & Soc.* 165-222. Professors Bowles and Gintis have developed an economic model of the at-will employment relationship that illuminates ways in which factors of power operate. They argue that, in competitive equilibrium, workers receive a wage greater than their reservation wage and, in exchange, provide a level of effort that is greater than the minimum required to avoid dismissal for shirking. As a result, labour markets are non-clearing markets: there are always many equally qualified potential employees ready and able to step in should the employer want to replace a worker whose performance is not up to par. This fact gives the employer power in the relationship. On the presence of duress, inequality, and reliance in employment relationships, see generally Jack Beerman and Joseph Singer 'Baseline Questions in Legal Reasoning: The Example of Property in Jobs' (1989) 23 *Georgia LR* 911; Jay M. Feinman 'The Development of Employment at Will Rule' (1976) 20 *Am. J. Leg. Hist.* 118, 132-3.

24 For a summary of the major criticisms of marginal theory of wage determination, see generally Bruce E. Kaufman 'The Postwar View of Labor Markets and Wage Determination' in B. Kaufman *How Labor Markets Work: Reflections on Theory and Practice* (Lexington MA: Lexington Books 1988) 146-203. See also Martin Segal 'Post-Institutionalism in Economics: The Forties and Fifties Revisited' (1986) 39 *Industrial & Lab. Rel. Rev.* 388, 389-91.

25 See notes 26 and 27, *infra*, and accompanying text.

cies of socialization where motivations are largely distinct from that of marketability ...

Second, labour power differs from conventional commodities because of its market variability and plasticity ... The employment contract is clearly determined only with respect to pay, whereas the specifications for concrete work tasks – the circumstances of labour exertion, work intensity, etc. – remain relatively underdefined. This gap of indeterminacy is closed in the firm through managerial authority ('command of labour').

Third, the 'commodity' labour power is not clearly separable from its owner ... Every buyer of labour power must rely on the participation of the worker since, on the one hand, that buyer cannot exclusively control the purchased commodity, and, on the other, the utilization of labour power is linked inextricably to the cooperation of the owners. The worker must also *want* to work; the fundamental problem in every company or organization consists accordingly in inducing the worker, as the subject of labour power, to cooperate.²⁶

The reason some scholars argue that labour contracts are different from other contracts is to escape the laissez-faire policy conclusions that seem to flow from the contract and market model of commodity exchanges, and to justify instead some sort of externally imposed protective regulation.²⁷ While that goal is laudable, however, it cannot be achieved merely by asserting that labour contracts are unique. All contracts are unique in some respects.²⁸ Contemporary contract law is broad enough to embrace open-ended and partially specified agreements, even those

26 Claus Offe *Disorganized Capitalism* 56–7 (Cambridge MA: M.I.T. Press 1985). Samuel Bowles and Herbert Gintis have also argued that the unique nature of the employment contract makes it subject to different laws. S. Bowles and H. Gintis *Democracy and Capitalism: Property, Community and the Contradictions of Modern Social Thought* (New York 1986) 77. See also Ken Vogel 'Administering Labor Contracts Using Transaction-Costs Economics' (1983) 5 *Law & Policy Q.* 129, 133 (on unique nature of the labour contract).

27 See, for example, Hugh Collins 'Market Power, Bureaucratic Power, and the Contract of Employment' (1986) 15 *Industrial LJ* 1 (arguing that employment relations are not merely contractual but also bureaucratic, and therefore should be subject to natural law conceptions of fairness and due process).

28 For example, Stewart Macauley and Ian MacNeil have shown that long-term contracts between parties who have ongoing relationships are very different from those governing one-shot deals between strangers. See Stewart Macauley 'Non-contractual Relations in Business: A Preliminary Study' (1963) 28 *Am. Soc. Rev.* 55; Stewart Macauley 'An Empirical View of Contract' (1985) *Wisc. LR* 465; Ian MacNeil 'Contracts: Adjustments of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law' (1978) 72 *Nw. LR* 854, 989; Ian MacNeil *The New Social Contract: An Inquiry Into Modern Contractual Relations* (1980) 54. See also Clyde Summers 'Collective Agreements and the Law of Contracts' (1959) 78 *Yale LJ* 525, 565–6.

that fail to specify such seemingly important terms as price and time of performance.²⁹

While there is no doubt that employment contracts have special qualities, I think it is futile to deny that they are contracts, or that they function in a market. Rather, I think it is more productive to be precise about the terms of the contracts, to examine the background rules against which they were negotiated, and to determine whether the contracts are being enforced. Out of this inquiry, we can consider arguments for different types of legal intervention in the wage bargain.

B. AN IMPLICIT CONTRACT MODEL OF THE EMPLOYMENT RELATIONSHIP

In the 1970s, some labour economists noted that, contrary to neoclassical theory, the terms of the labour contract do not correspond to a process by which employers attempted to match the marginal costs of labour with its marginal revenues. Rather, these economists suggested that there is a labour market internal to the firm, according to which rewards such as raises, bonuses, and promotions are distributed. This internal labour market is governed by considerations of productivity, morale, and incentives, as well as by considerations of prevailing wage rates and technical efficiency.³⁰

Since then, a number of labour economists have developed a model of career wage trajectories to explain wages in the internal labour market.³¹ The internal labour market of career compensation describes the compensation function for employees through various phases of their

29 See, for example, UCC § 2-305(1) (West 1989) ("The time for shipment or delivery or any other action under a contract if not ... agreed upon shall be a reasonable time."); UCC § 2-309(1) (West 1989) ("The parties if they so intend can conclude a contract for sale even though the price is not settled. In such a case the price is a reasonable price at the time for delivery."). The UCC also provides for requirements and output contracts, which are contracts in which the quantity term is not fixed. See UCC § 2-306 (West 1989). See generally David Charny 'Hypothetical Bargains: The Normative Structure of Contract Interpretation' (1991) 89 *Mich. LR* 1815 (on the wide-ranging techniques judges use to fill in gaps in contracts).

30 See Peter B. Doeringer and Michael J. Piore *Internal Labor Markets and Manpower Analysis* (1971) 1-2 (defining internal labour markets). See also Kaufman, *supra* note 24, 145, 154-74 (discussing origin of this view in work of postwar labour economists Clark Kerr, John Dunlop, Julius Lester, and Lloyd Reynolds).

31 See Ronald G. Ehrenberg and Robert S. Smith *Modern Labor Economics: Theory and Public Policy* (4th ed.) (1991) 425-30; Edward P. Lazear 'Agency, Earnings Profiles, Productivity, and Hours Restrictions' (1981) 71 *Am. Econ. Rev.* 606; Robert Hutchens 'Delayed Payment Contracts and a Firm's Propensity to Hire Older Workers' (1986) 4 *J. Lab. Econ.* 439; Robert Hutchens 'A Test of Lazear's Theory of Delayed Payment Contracts' (1987) 4 *J. Lab. Econ.* S153; James M. Malcomson 'Work Incentives, Hierarchy, and Internal Labor Markets' (1984) 92 *J. Pol. Econ.* 486; Edward P. Lazear 'Why Is There Mandatory Retirement?' (1979) 87 *J. Pol. Econ.* 1261.

employment. By doing so, it demonstrates the way in which employees are vulnerable to expropriation by other groups within the firm.³²

In brief, the model is as follows: Both companies and workers invest in the acquisition of skills and knowledge on the job – skills and knowledge that are necessary for employees to function productively. Some of this investment in human capital is general and gives workers an asset they can sell in the general labour market. However, some of this investment is firm-specific, so that the knowledge gained redounds primarily to the firm.³³ Employees benefit from acquiring firm-specific capital only if their firm rewards them for acquiring it.

Because some of the investment employees make in their training is firm-specific, the employees' value to their employer increases over time as they acquire such firm-specific capital, while their value to other employers may not. The interaction between employees' compensation and the value of their marginal product over time has thus been represented on the accompanying graph.³⁴ Stated briefly, the graph shows that in the first phase of employment, a new employee in an internal labour market is paid an amount that equals or is slightly greater than the value of her marginal product and less than the value of her opportunity wage – the amount she could command in the general labour market. This is because she is acquiring human capital, and both she and her employer are investing in its acquisition. As stated earlier, some of this human capital is firm-specific and some is not.

32 This model has been called a theory of life cycle earnings because it posits a relationship between wages and marginal productivity over a worker's life cycle rather than at each moment in time. Robert Willis 'Wage Determinants: A Survey and Reinterpretation of Human Capital Earnings Functions' in Orley Ashenfelter and Richard Layard (eds) *Handbook of Labor Economics* 525, 594–8 (Amsterdam 1988). See Ehrenberg and Smith, *supra* note 31, 245–9 and 425–30; Lazear 'Mandatory Retirement' *supra* note 31. Some labour economists reject the life cycle earnings theory and instead argue that each worker is paid the value of her marginal product at each moment in time. See, for example, Jovanovic, *supra* note 21, 972, 973. While there is empirical evidence to support both the life cycle earnings theory and the competing human capital theory, 'a clearcut resolution of this question awaits further research.' Willis, *supra*, 597–8.

33 See generally Doeringer and Piore, *supra* note 30, 13–40 (defining general and firm-specific skills); see also Willis, *supra* note 32, 594. See generally Reynolds, Masters, and Moser, *supra* note 20, 150–2, 565–8 (describing internal labour markets).

34 This graph appears in Wachter and Cohen 'The Law and Economics of Collective Bargaining: An Introduction and Application to the Problems of Subcontracting, Partial Closure and Relocation' (1988) 36 *U. Pa. LR* 1349, 1362. It is a variation on a diagram first developed by Lazear. See Lazear 'Mandatory Retirement' *supra* note 31, 1265. See also Gary Becker *Human Capital* (1975) 23, chart 1 (charting relation of earnings to age).

At some point the employee acquires enough capital to become useful to the employer, that is, the value of her marginal product rises. This is phase two. In the second phase of employment, the employee is paid less than the value of her marginal product. Hence the firm is already benefiting from their joint investment of phase one.

What is most notable about phase two is that the employee is paid not only less than the value of her marginal product but also less than her opportunity wage. Why, we might ask, would anyone accept a rate of pay that is lower than she could earn elsewhere? The reason is that in this phase, the employee has an expectation that the job will be steady and the wage will keep rising throughout her working career. For that expectation, she defers compensation. The expectation is created by the employer and is a defining element in the notion of the internal labour market.³⁵ Thus, in phase two, the employee is investing in acquiring human capital and is deferring compensation.

In the third phase, the firm-specific nature of the human capital the employee has acquired means that she is worth more to her employer than she is to other employers. Hence, the value of her marginal product to her employer is greater than the value of her marginal product to other employers. In this period she is paid more than her opportunity wage but less than the value of her marginal product.

35 On the origin of internal labour markets and the personnel theory that underlies them, see Katherine Stone 'The Origin of Job Structures in the Steel Industry' in David Gordon, Micheal Reich, and Richard Edwards *Labor Market Segmentation* (Lexington Books 1974) 27-85.

And in phase four – the employee's later years – her productivity begins to lag. However, due to customs, norms, policies, or incentive schemes, her pay is not reduced. Instead, her wage level either continues to rise or levels off. Thus in this period she is paid more than the value of her marginal product and more than her opportunity wage. This is the recoupment stage in which the employee recoups on her investment in firm-specific training and deferred compensation.

The graph suggests that during the middle two periods, workers have made an investment for which they have not yet been compensated, and for which they anticipate deferred compensation. If they suffer involuntary job loss during that period, their investment is lost. As they approach the end of phase three and near the beginning of phase four, they are particularly vulnerable to involuntary job loss.³⁶

Workers' investments in firm-specific capital and deferred compensation are made not on the basis of some explicit contractual arrangement, but rather take the form of an implicit contract.³⁷ The implicit contract in the internal labour market is that in the early phases of their career, employees will be paid less than the value of their marginal product and less than their opportunity wage in exchange for a promise of job security and a wage rate later in their working lives that is greater than the value of their marginal product and their opportunity wage.³⁸ Thus employees are investing in the firm during their training and high-productivity periods with the expectation of recouping on the investment in their declining years.³⁹

In order to accept the internal labour market model and the notion of an implicit contract by which employees defer compensation, one must understand why employers would make such a promise and why em-

36 Of course, the amount of investment made in the middle period, and the point at which one moves from the middle period of investing to the later period of recouping the deferred compensation, depends upon the shape of the particular curve in the particular case. And for any particular person, the precise point at which she moves from phase three to phase four cannot be known in advance.

37 See the discussion on the reason why the promises are implicit rather than explicit, *infra* notes 58–66 and accompanying text.

38 On the implicit contract in the internal labour market see Reynolds, Masters, and Moser, *supra* note 20, 171–5; Ehrenberg and Smith, *supra* note 31, 425–6; Willis, *supra* note 32, 597. See also Oliver Williamson *The Economic Institutions of Capitalism: Firms, Markets, and Relational Contracting* (New York 1985).

39 Sherwin Rosen 'Implicit Contracts: A Survey' (1985) 23 *J. of Econ. Lit.* 1144, 1147 ('wage income is in part an installment payment on specific-investments'); see also Segal, *supra* note 24, 400–1 (discussing empirical studies that 'reinforce the view ... that many managerial practices concerning hiring, promotions, and wages reflect an approach in which the process of employment is seen as representing a long-term relationship between the firm and its individual workers').

employees would accept it. Nobel Laureate Gary Becker provides part of the explanation. He argues that employers make an implicit promise of deferred compensation in order to induce employees to invest in firm-specific training. Without that promise, he says, employees will not voluntarily invest in such training. And if they do not, those employers that require employees to have firm-specific skills will have to pay for the training themselves. Yet, if they do, such firms bear a risk that the trained employees will leave their firm. In order to induce employees to share the risk of turnover, Becker says, employers get employees to share some of the costs of firm-specific training by 'offer[ing] higher wages after training than could be received elsewhere.'⁴⁰

The Becker explanation is a plausible model of rational employer behaviour.⁴¹ It becomes even more powerful when joined with a historical understanding of the role of implicit promises of job security and deferred compensation in personnel relations. Historically, the implicit promise has served at least two employer goals. First, since the beginning of this century, the dominant theory in management and personnel relations in the United States has been that employers should encourage employees to stay with the firm a long time.⁴² Thus human-relations specialists have advised employers to promote employee attachment to the firm by offering rewards for long and loyal service. The rewards can take many forms, including corporate welfare policies, longevity bonuses, and so forth. By far the most important form of reward was the creation of hierarchically arranged job ladders and telling employees that they could expect advancement in status and pay as the years went by. Personnel theorists told employers that if they encouraged employment longevity, employees would begin to internalize the goals of the firm. Such employees would be motivated, their morale and productivity would be high, and their tendency to shirk, sabotage, or unionize would disappear.⁴³ This view was adopted by many of the great nineteenth- and early twentieth-century captains of industry, including Andrew Carnegie and Henry Ford.

The second issue that the implicit promises serve involves the problem of training. Management has long struggled with the problem of how to

40 Gary Becker, *supra* note 34, 29-30

41 See also Weiler, *supra* note 16, 64-7 and 140-50 (describing benefits to employers of long-term career relationships with their employees).

42 Sanford Jacoby *Employing Bureaucracy: Managers, Unions and the Transformation of Work in American industry, 1900-1945* (New York: Columbia University Press 1985) 115-26

43 See, for example, Meyer Bloomfield *Labor and Compensation* 295-8 (New York: Industrial Extension Institute 1921). See generally Stone, *supra* note 35, 27, 45-54.

induce older, more experienced workers to impart their firm-specific, or job-specific, knowledge to new recruits.⁴⁴ Older workers know that if they train their juniors, they may well be replaced as soon as their own speed, dexterity, and strength begin to fade. Yet if they do not provide new workers with such training, years of valuable knowledge and experience are lost to the firm. Personnel managers have used many techniques to solve the training problem, including suggestion boxes, quality circles, and the like. However, the most effective means to induce knowledge sharing is simply to promise workers that they will not be fired in their later years, despite some decline in their faculties. The implicit promise of job security and deferred compensation in the internal labour market thus solved the training dilemma as well as providing incentives for employees to invest in firm-specific human capital.⁴⁵

So for almost one hundred years, promises of job security have been made to employees in many forms, including explicit oral assurances made by supervisors, promotion policies outlined in employment manuals, and a corporate culture transmitted informally through the grapevine. They have served as the fundamental fact of life in most medium-sized and large modern establishments, industrial and service sectors alike. Implicit promises are made in both union and non-union workplaces. In unionized shops, collectively bargained seniority provisions, just cause for discharge clauses, pension vesting rules, and other mechanisms reinforce the implicit promises.

It has been suggested that because the promises are implicit, they are ambiguous as to their terms. In particular, it has been argued that there is no way to know whether the risk of premature dismissal has been calculated into the wages from the start.⁴⁶ However, the implicit promises of job security that managers make to employees are not ambiguous or imaginary. They are messages intentionally and repeatedly conveyed to workers inside internal labour markets, disseminated with the intention that they be believed. They are the ubiquitous employer statements, found in words, writings, and deeds, to the effect that 'If you work here, if you do a reasonable job and don't cause trouble, you have a job for life.'⁴⁷ Some American courts have noted that statements of this sort serve

44 See Stone, *supra* note 35, 56-8.

45 See Williamson, *supra* note 38.

46 See, for example, Hugh Collins in S. Piccioto, C. Scott, and J. McCahery *Corporate Accountability* (Oxford University Press 1993).

47 See, for example, Williamson, *supra* note 38, 1149 ('an implicit contract must be interpreted in the "as if" sense of an explicit one, as a mutual understanding between worker and employer that the invisible handshake implies').

American business precisely because they have been believed.⁴⁸ On that basis, some courts have found implicit promises to be enforceable.⁴⁹

Why would employees accept such a promise and voluntarily agree to defer compensation? The answer is that one of employees' primary concerns is job security. This is reflected in the well-known fact that civil service jobs are highly coveted by blue-collar workers. Indeed, Selig Perlman, one of America's foremost labour historians, observed as long ago as 1928 that the single most powerful unifying theme in American labour history is the concern of workers for job security. He explains all of American labour history as an effort by workers to create forms of employee organization – job-conscious unionism – to achieve that goal.⁵⁰

To the extent that employees, whether as individuals or collectively, want job security, it is reasonable that they would accept a career wage trajectory like the one described in the internal labour market theory, so long as the employer's implicit promises are credible or enforceable. The problem of today is that however credible those promises were in the past, they are no longer. Thus some specific legal enforcement means must be devised.

III *The problem of enforcing the implicit contract*

The career wage model highlights the enforcement problem. It shows that employers have an incentive to renege on the implicit promises of job security and deferred compensation just as workers are entering the recoupment stage. That is, the employment relationship contains a built-in incentive for managers to breach their implicit promises and appropriate that investment to the firm or themselves.⁵¹ This is true regardless

48 See *Toussaint v. Blue Cross & Blue Shield of Mich.* 408 Mich. 579, 613 (1980) (enforcing job security promises made in employment manual because employers benefited by obtaining an 'orderly, cooperative and loyal workforce'); *Thompson v. St. Regis Paper Co.* 102 Wash.2d 219, 230 (1984) (en banc) (employer handbook promises of job security and fair treatment induce employees to remain on the job).

49 See, for example, *Woolley v. Hoffman-La Roche* 99 NJ 284, 297–8 (1985), mdf'd 101 NJ 10 (1985) (company's personnel manual, which set out procedures for termination, is contractually enforceable and courts should construe such manuals 'in accordance with the reasonable expectations of the employees'); *Pugh v. See's Candies, Inc.* 116 Cal. App.3d 311 (1981) (vague promises of job security made to 32-year employee are enforceable); accord, *Fletcher v. Wesley Med. Ctr.* 585 F.Supp. 1260, 1263–4 (D. Kansas 1984); *Salimi v. Farmers Ins. Group* 684 P.2d 264 (Colo. App. 1984).

50 Selig Perlman *A Theory of the Labor Movement* (1949 ed.) 252–3

51 Note 'Employer Opportunism and the Need for a Just Cause Standard' (1989) 103 *Harv. LR* 510, 523. Whether that appropriated surplus ultimately redounds to the

of the moral character or personal intentions of the manager. Indeed frequently the manager who lays off a late-career employee was not even with the firm at the time the employee was hired and had nothing to do with whatever implicit promise was given.

Because employees' contracts for deferred compensation are implicit, they do not carry the usual legal enforcement mechanisms. Some economists have argued that legal rules to enforce such contracts are not necessary because firms will generally honour such contracts and punish managers who breach them. This argument has two variations. One focuses on the firm's reputation in the outside world, and says that a firm that repeatedly violates employees' reasonable expectations of job security will not be able to attract the workers it needs. To avoid getting a reputation for engaging in opportunistic firings, a firm will honour its implicit contracts.⁵² However, in large and widely dispersed labour markets this argument is not plausible. In such settings, there is no reliable means by which information about firings can be transmitted on a regular basis, so that reputational factors cannot serve the policing function.⁵³

The other variant of the argument that implicit contracts are self-enforcing focuses on the role of reputation within the firm itself. This view attempts to show that internal organizational goals are served by honouring implicit contracts. David Kreps, for example, points out that in employment relations, unforeseen contingencies necessarily arise. In a hierarchical relationship, one party must agree to permit the other to exercise discretion in the face of such contingencies, even though that party is vulnerable to the opportunistic exercise of the other's discretion.⁵⁴ Using non-cooperative game theory, Kreps demonstrates that in order for the organization to succeed and the relationship to continue, the party exercising discretion must act honourably and honour implicit contracts often enough to develop a reputation for being trustworthy.⁵⁵ When the hierarchically superior party does not have such a reputation,

manager in the form of higher salary or redounds to the shareholders in the form of higher dividends is a function of the contract and power relations between those two groups.

52 See, for example, Macey, *supra* note 8, 173; Williamson, *supra* note 38, 259-61. See also Epstein, *supra* note 8, 967-8.

53 Paul Fenn and Christopher J. Whelan 'Job Security and the Role of Law: An Economic Analysis of Employment at Will' (1988) 20 *Stan. J. Int. Law* 353, 372-9; Note 'Employer Opportunism' *supra* note 51, 524-5

54 David Kreps 'Corporate Culture and Economic Theory' in James Alt *Perspectives in Positive Political Economy* (Cambridge 1990) 90

55 *Ibid.* 116

the inferior party will refuse to trust and will refuse to engage in any more transactions.⁵⁶ The need for firms to develop a reputation for being trustworthy and to disseminate trust through a multi-layered management structure gives rise to a corporate culture.⁵⁷

The corporate culture argument may be a plausible account of firm labour during 'normal' times, when both management and employees share a commitment to their long-term relationship as defined by their internal labour market job structures such as seniority systems, internal promotion ladders, and pensions. However, during 'abnormal times' such as mergers or buyouts, management's view of the employment relationship may change. During such periods, a corporate culture can undergo cataclysmic changes. New managers come into power, and they may have no stake in upholding prior reputations. To be sure, they have their own reputations to establish, but in many respects they begin with a clean slate. With new managers, a new corporate culture, and often a substantially new workforce, old implicit promises are history.

Thus in a merger or buyout situation, employees may continue to view the relationship as an ongoing relationship governed by the terms of the implicit promise, while management may view it in short-term efficiency terms. At that point, the incentive of managers to breach, together with the power they have to do so under current legal rules, leaves employees vulnerable. Because their implicit promises of job security are not self-enforcing, they need some means of protection.

The legal system has set up substantial difficulties for employees to police and enforce their implicit contracts. Some commentators have suggested that employees should make their implicit contracts explicit at the time of hire and thereby avoid the enforcement difficulties,⁵⁸ but there are several problems with that suggestion. First, most employment is at-will, so that explicit terms settled at the time of hire are subject to perpetual renegotiation, de facto modification, and implied waiver. Even

56 Ibid. 124

57 See also Bull, *supra* note 7, 149–54 (reputational effects within firms give employers and employees incentive to abide by implicit promises despite the absence of legal enforceability).

58. See, for example, Jonathan Macey 'Firm-Specific Capital Investments' (1989) *Duke LJ* 173, 192 (arguing that by forming unions, employees can contract to appropriate the firm's capital investment, thereby counterbalancing any danger of expropriation by the other side); Alexander C. Gavis 'A Framework for Satisfying Corporate Directors' Responsibilities Under State Nonshareholder Constituency Statutes: The Use of Explicit Contracts' (1990) 138 *U. Penn. LR* 1451 (arguing that employees can protect their implicit contracts and investment in human capital by use of explicit contracts for severance payments, successorship clauses, and employee stock ownership plans).

if employees could negotiate an employment contract that contained a promise of lifetime career employment, the law presumes that any employment contract that purports to be permanent is at-will.⁵⁹ It takes extraordinary expressions of intent to create a long-term contract and to convince a court that an employment contract is anything other than at-will.⁶⁰ Second, given the complexity of employment relationships and the many unknown factors that affect their success, neither employees nor employers are likely to want to contract for whole-career employment at the outset of the relationship. And even if employees were willing to do so in exchange for job security, employers are not likely to want to.⁶¹ Given that at the time of hire, employees have not yet acquired any firm-specific capital and hence their bargaining power vis-à-vis the employer is at its nadir, the employer's position is likely to prevail.⁶²

Unable to achieve protection by bargaining on an individual basis, employees often try to gain protection by unionizing and bargaining on a collective basis. Unions can play a role as enforcers of the implicit contracts of employees to defer compensation within the internal labour market. They can do this without forcing both sides to lock into a lifetime employment contract prematurely or unwittingly. Thus, for example, typical union contract clauses that permit an employer to fire an employee only for 'just cause,' or that impose a seniority principle to govern layoffs, function during normal periods to prevent firms from reneging on their implicit contracts and appropriating the workers' investment in deferred compensation.

However, during times of corporate restructuring, unions are not able to police or enforce the implicit contracts. The ability of unions in the United States to contract to protect their members against unfavourable strategic-level corporate decisions has been severely restricted by specific labour law rules.⁶³ For example, union efforts to prevent an employer from establishing a non-union subsidiary and transferring union work to it (a practice known as double-breasting) have been held to be illegal

59 See *Valentine v. General American Credit, Inc.* 420 Mich. 256, 362 NW.2d 628 (1984).

60 See Donald W. Brodie 'Individual Contracts of Employment (Part II)' (October 1988) *Labor LJ* 663, 666-70.

61 Bull, *supra* note 7, 151-3, claims that long-term employment contracts are unsatisfactory for employers because they cannot obtain judicial enforcement of the aspects of the contract that concern the workers' level of effort. He argues that given the difficulty of enforcing effort clauses, employers rely on implicit contracts.

62 See, for example, Bowles and Gintis, *supra* note 23 (demonstrating that there is a structural asymmetry of power in employment relations due to the non-clearing nature of the labour market, even under conditions of competitive equilibrium).

63 For a detailed treatment of this issue, see Stone, *supra* note 4, 73.

secondary boycotts.⁶⁴ Similarly, labour law rules prevent unions from bargaining for a direct role in management decision-making.⁶⁵

Furthermore, employees are constrained by the practicalities of labour relations. The most commonly suggested contractual solutions, such as bargaining for severance clauses that would protect employees' interests in deferred compensation, or bargaining for direct job protection, have all proven to be either fraught with moral hazard and other drafting problems, or impossible to enforce in a meaningful way.⁶⁶

Because the labour law rules, at least in the United States, make enforcement of employees' implicit contracts problematic, it is important to consider what other enforcement means are available.⁶⁷ In recent years, scholars and legislators have considered a variety of other proposals to revise the background rules of the labour exchange in a way that would enable workers to enforce their employer's implicit promises of job security and deferred compensation. These proposals can be clustered into three distinct approaches: (1) individual regulatory approaches, (2) collectivist contractual approaches, and (3) collectivist regulatory approaches. Below I consider each of these briefly.

IV *Proposals for protecting employees' interests in their firms*

A. INDIVIDUAL REGULATORY APPROACHES

In the past two decades in the United States, some state legislatures and courts have tried to find ways to enable individual employees to enforce their implicit contracts of job security. This trend began in the 1970s, when some state courts created exceptions to the at-will doctrine to vindicate important public policies such as serving on jury duty or preventing perjury. In the face of the massive corporate dislocations of the

64 See *D'Amico v. Painters District Council* 51, 120 LRRM 3473 (D.Md. 1985). See also *Carpenters v. Stevens* 743 F.2d 1271 (9th Cir. 1984) (refusing to enforce union contract clause that would have limited double-breasting practices).

65 *N.L.R.B. v. Yeshiva University* 444 US 672 (1980); *College of Osteopathic Medicine*, 265 NLRB 295 (1982). See also *Harrah's Lake Tahoe Resort Casino*, 307 NLRB 29 (1992) (effort by employee to induce other employees to help form employee stock ownership plan that would acquire majority stake in employer's stock is not protected activity under the labour law).

66 See Stone, *supra* note 1, 59-64.

67 The argument here is that an employer has an obligation on the basis of an implicit promise that induced reliance. Unlike Joseph Singer, who, in 'The Reliance Interest in Property' (1988) 40 *Stan. LR* 611, argues that workers have a property right in their plants on the basis of their reliance, I am attempting to build on, and extend, the idea of contract embodied in the wage relationship. Thus this analysis is akin to modern unilateral contract theory and promissory estoppel in its effort to protect the vulnerable party in a contract.

1980s, more and more courts developed other exceptions to the at-will rule, exceptions that come not from a desire to vindicate some external public policy but rather from a desire to enforce an implicit promise of job security. To this effect, some courts have found personnel practices such as employment handbooks and supervisory reassurances to be promissory in nature and contractual in effect, even when conventional contract law doctrine would not dictate such treatment. In doing so, courts are de facto enforcing the employer's implicit promise.⁶⁸

Some state legislatures have gone further and have revised their corporate laws in ways that help workers protect their implicit contracts in the face of a takeover or other corporate restructuring. For example, over half the states have revised their corporate laws in the past few years to impose fiduciary duties on directors and managers on behalf of employees. These statutes, called non-shareholder constituency statutes, permit managers to take the interests of employees into account when making strategic-level decisions.⁶⁹ In addition, two states have enacted legislation that requires companies to pay severance benefits to employees who lose their jobs as a result of corporate restructuring.⁷⁰

These measures attempt to limit the ability of employers to breach their implicit contracts. However, they are inadequate. First, it is expensive for individual workers to bring the legal actions necessary to vindicate these statutory rights, and thus, even with these measures, many breaches go unremedied.⁷¹ Second, the individual regulatory

68 See cases cited in notes 48 and 49, *supra*.

69 Considered by some scholars a 'revolution in corporate law,' the stakeholder statutes redefine the director's fiduciary duty away from the shareholder to other constituent groups within the firm. David Millon 'Redefining Corporate Law' (1991) 24 *Indiana LR* 223. See also Marlene O'Connor 'Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty To Protect Displaced Workers' 69 *N. Carolina LR* 1189, 1231 (stakeholder statutes profoundly alter basic foundations of corporate law). For a listing of the state statutes, see Stetson Law Review Symposium 'Corporate Malaise - Stakeholder Statutes: Cause or Cure?' (1991) 21 *Stetson LR* 279, appendix. See also James J. Hanks 'Evaluating Recent Legislation on Director and Officer Liability Limitation and Indemnification' (1988) 43 *Bus. Law* 1207, 1246-53.

70 See Pa. Stat. Ann., tit. 15, §§ 2581-7 (Purdon supp. 1991) (providing that an eligible employee is entitled to a one-time, lump sum payment of severance compensation if the employee is terminated within 90 days prior to, or two years subsequent to, a 'control share approval'); Mass. Gen. L. Ch. 149 § 183(b) (1988) (providing that any employee fired within two years of a takeover is eligible for a lump sum payment from the acquiror equal to twice the employee's weekly compensation times the number of years of service).

71 A study by the Rand Institute for Civil Justice of 120 wrongful discharge cases brought in California between 1980 and 1986 found that over 53 per cent were

approach relies on the largesse of state courts and legislatures to aid employees. But what the legislatures and courts can give, they can take away. Third, the corporate stakeholder statutes, which purport to permit directors to take employee interests into account in making strategic decisions, do not actually give employees any meaningful protection. With the exception of the Connecticut statute, all the statutes speak in permissive tones. They say directors *may* consider the interests of other constituencies. And none of the statutes give employees standing to sue to enforce whatever fiduciary duties they create.⁷² Even if the statutes were amended to provide enforceable rights, given the business judgment rule, the range of stakeholder interests, and the conflicts between them, the statutes would merely amplify managerial discretion.⁷³

B. COLLECTIVIST CONTRACTUAL APPROACHES

Because the individual-based approaches to enforcing workers' implicit contracts are inadequate, it is important to consider collectivist approaches that might prove more effective. One such effort has been made by Oliver Williamson. In his book *The Economic Institutions of Capitalism*,⁷⁴ Williamson argues that the problem of worker vulnerability that results from making investments in firm-specific capital has been solved by collective bargaining.⁷⁵ He says that workers whose jobs entail substantial investments in firm-specific human capital have developed a mechanism, which he calls an alternative bilateral governance mechanism, to protect these investments. The mechanism is the industrial pluralist system of collective bargaining that exists in the United States. Thus he concludes that workers can police their implicit contracts by unionizing.⁷⁶

However, as we have seen, the current legal rules governing collective bargaining in the United States make it difficult if not impossible for unions to protect workers against strategic-level corporate decisions that threaten their jobs. Therefore, to enable workers collectively to police

brought by executives or middle management. James Dertouzos, Elaine Holland, and Patricia Ebener *The Legal and Economic Consequences of Wrongful Termination* (Rand Corp. 1988) 19-21

72 See critique of these statutes in Katherine Van Wezel Stone, *supra* note 1.

73 See James J. Hanks Jr 'Playing with Fire: Nonshareholder Constituency Statutes in the 1990s' (1991) 21 *Stetson LR* 97, 103-6; Macey, *supra* note 58, 44.

74 Williamson, *supra* note 38

75 *Ibid.* Williamson, like this author, argues that the firm-specific nature of employees' investments in their jobs raises the possibility of opportunistic expropriation of their investment. However, he does not share the analysis presented here of deferred compensation and the career wage profile.

76 *Ibid.* 250-2

their implicit contracts, we must conceive of alternative models of collective bargaining and revise the background rules of labour law.

I advocate a form of regulation of collective bargaining that places primary emphasis on union participation in strategic-level corporate decisions.⁷⁷ Such an expanded bargaining model would treat labour on an equal footing with all other contenders for power within the concern. Labour would then be able to bargain with the other groups for a governance role and to utilize its economic weapons and other forms of clout in order to obtain such a role. This view is consistent with the nexus-of-contracts view of the firm, which focuses attention on power of the firm's various constituents within the entity as a whole. To be sure, no group has an a priori privileged relation to the entity as a whole; all use their own particular input and their own type of leverage to strike the best bargain they can.

From this perspective, we can imagine collective bargaining transposed to the boardroom, where unions can then contend not only with management, but with all the other constituent groups that comprise the firm. This shift is already occurring in the United States in Chapter 11 bankruptcy reorganization proceedings, where unions sit on creditors committees and negotiate with all the different classes of creditors about every aspect of the fate of the enterprise. Similar forms of expanded bargaining are occurring in the capital markets during work-outs and takeover battles.⁷⁸ Collective bargaining is beginning to spill over its borders and claim new roles in corporate life. Such participation would enable unions to influence those corporate decisions that most profoundly affect their members.

The nexus-of-contracts view of the firm assumes that the constituent groups bring to their bargaining position whatever legal rights, powers, and immunities they have under external sources of law. Thus, for example, creditors have various liens, collection procedures, and priorities that are defined under a variety of state and federal laws. These rights form the background against which creditors make their bargains with other groups within the firm. So too, if employees have rights under external law, those rights would form part of the definition of the economic clout that employees have and can exercise in their bargaining with the other groups.

This model, however, requires careful consideration of the rules governing economic weapons. Unions only have clout in negotiations

⁷⁷ See generally Stone, *supra* note 4.

⁷⁸ *Ibid.* 75-9

with other constituents of the firm to the extent they can bring to bear a credible threat of withholding their investment and thereby adversely affecting the others. The ability to withhold investments and the consequence to others, that is, the 'negative market power' of unions, is determined by the legal rules governing strikes, secondary boycotts, picketing, and so forth. Thus this model is incomplete without specifying the background legal rules of economic warfare.

C. COLLECTIVIST REGULATORY APPROACHES

There is yet another approach to the problem of enforcing workers' implicit contracts: a collectivist regulatory approach involving rights to collective participation conferred by statute, as is found in some of the co-determination and works council legislation of some European countries. While that approach seems to hold a great deal of promise as a means of countering the asymmetry in enforcement of promises in the internal labour market, it is not likely to find a welcome reception in the United States in the near future.⁷⁹ Such an approach would have to be enacted at the federal level, and given political realities, that is not likely to occur. The labour movement was unable to enact a much more modest effort at labour law reform in 1978 despite the existence of a Democrat-controlled Congress. Currently, labour unions in the United States are attempting to modify the rules of economic warfare to prohibit employers from utilizing strike replacements. A change in labour employment relations as sweeping as mandatory co-determination or works councils is one that will probably have to await another day.

V Conclusion

I have attempted to analyse the impact of the wave of corporate restructurings of the 1980s on workers. I have argued that in the course of these restructurings, wealth has been transferred from employees to other groups within the firm by means of breaches of the workers' implicit contracts for deferred compensation. I also have shown how the legal definition of the employment contract and some views of the labour market have made it difficult for workers to defend or enforce their implicit contracts. I have also presented some of the current proposals to redress the problem of policing implicit contracts, and have argued in

⁷⁹ See Clyde Summers 'Codetermination in the United States: A Projection of Problems and Potentials' (1982) *J. of Comp. Corp. L. & Sec. Reg.* 155 (describing problems of implementing co-determination in climate of American labour relations and suggesting solutions).

favour of a collective empowerment approach rather than an individual rights approach. Whether or not one agrees with the specific solutions advocated here, it is my hope that by developing an understanding of the problem of worker vulnerability, we can move towards a more socially accountable model of the firm and a more effective means of providing workplace justice.