LABOR AND LEMONS: EFFICIENT NORMS IN THE INTERNAL LABOR MARKET AND THE POSSIBLE FAILURES OF INDIVIDUAL CONTRACTING

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INTRODUCTION

Edward Rock and Michael Wachter's article, The Enforceability of Norms and the Employment Relationship, contains two very different arguments. The first I find powerful; the second, unpersuasive.

The first, and far more general, argument focuses on the possible costs of rendering legally enforceable the informal norms adopted by parties in consensual economic relationships. The authors contend that the absence of an explicit contractual term rendering a norm legally enforceable may mean that the parties are following a strategy of exclusive reliance on self-enforcement, to their mutual benefit. They conclude that, even where the norms ordering a private relationship are themselves efficient—and even where such norms are unambiguously accepted by the parties as governing their relationship—it does not necessarily follow that the state should render those norms legally enforceable.

This conclusion seems to me to be clearly correct, as does their reasoning: (i) the legal enforcement of norms is likely to have transaction costs, including the costs of proving disputed facts to third parties, of defining the norms themselves to third parties, and of altering otherwise efficient behavior to account for the possibility of erroneous third party decisions; (ii) parties may be able to structure relationships involving mutually dependent investments in a way in which norms are effectively self-enforcing, protecting the parties against opportunistic behavior without needing legal enforcement; and (iii) if norms can be relied on to be "self-enforcing," rational parties may reject legal enforcement, relying instead on less costly self-enforcement schemes and sharing the savings.

In essence, arguing against any simplistic notion that it is cost-free to subject informal consensual relations to formal legal

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(1953)
enforcement schemes, Rock and Wachter counsel: "If it isn't broken, don't fix it."

So far, so good.

But the issue in any given case is, obviously, whether the relationship at issue "is broken," that is, whether, in a particular context, self-enforcement is an effective alternative to third party judging. Where self-enforcement cannot effectively sanction opportunistic breaches of norms, state schemes of enforcement may well extend benefits that outweigh their costs. And, in a context where market failures render contracting costly or impossible, we should not expect to see norms embodied in formal contracts, even where state enforcement of the norms will be beneficial.

In Rock and Wachter's second argument, which constitutes the central thesis of their article, they tell a highly detailed story regarding the worker protective norms that govern internal labor markets in the private, non-union employment context. They conclude that their theoretical model validates the unreformed and controversial legal regime of employment-at-will, under which virtually all of the norms in question are legally unenforceable. But, in presenting their "if-it isn't-broken-don't-fix-it" argument, the authors never seriously consider the possibility that the regime in question may indeed be "broken." That is, they never seriously consider the possibility that the worker protective norms at issue may not be effectively self-enforced and that the absence of formal agreements may reflect serious contracting problems, rather than a state of efficient contracting. While the factors they emphasize certainly play some role in explaining the virtual absence of individual just-cause contracts, so too may a variety of serious contracting problems—left unexamined by Rock and Wachter—that support far less optimistic interpretations of the employment relationship and that might well justify various kinds of state intervention.

I. INTERNAL LABOR MARKETS AND POSSIBLE EMPLOYER OPPORTUNISM

As the authors recognize, the regime at issue is one in which a host of employee protective norms (internal labor market norms) induce employees to make long-term investments in specific firms, thus tying the employees to those firms. In contrast to the near-uniform practice in unionized employment, these norms are
virtually never embodied in express contracts.\(^1\) Moreover, in contrast to the legal rules of virtually every other industrial democracy, these norms are deemed to be largely unenforceable by the legal system in the absence of express contracts (the employment-at-will rule).\(^2\)

In the internal labor market context, an unconstrained employer freedom to discharge would create a serious problem of employer opportunism, which would deter optimal investments in human capital.\(^3\) An employee's firm-specific investments may, over the employee's work life, generate substantial value within the firm; but, those investments may also leave the employee less valuable over time with other firms, rendering the employee uniquely dependent on her current firm. The employee is further tied to the firm by accepting a promised schedule of career compensation that is backloaded (in part to enhance the power of the employer to police employee shirking). Among the results are: (i) the employee's promised compensation will, at some point, be significantly higher than she could obtain at a different firm, and (ii) her promised compensation, at the end of her career, may be higher than her marginal productivity within the firm.\(^4\) All these factors may provide an employer with powerful incentives to breach the implied agreement late in the employee's career—for example, by unjustly

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\(^1\) As Rock and Wachter recognize, the union and non-union setting often embrace virtually the same internal labor market norms; but, in the union setting, many of these norms (most significantly, the norm of just-cause termination) are expressly embodied in contract terms, so that employees can enforce them through some form of third party adjudication. The system of adjudication used for enforcement is almost uniformly a jointly negotiated and administered grievance-arbitration system. See Edward B. Rock & Michael L. Wachter, *The Enforceability of Norms and the Employment Relationship*, 144 U. Pa. L. Rev. 1913, 1927-28, 1940, 1942 (1996).


discharging the employee (or by threatening to discharge in return for wage concessions)—since the norm against unjust discharge is legally unenforceable.\(^5\)

Although Rock and Wachter accept that investment in firm-specific human capital will be suboptimal to the extent that employees fear employer breaches of the relevant norms, they tell a complex story regarding how these norms might be self-enforcing and conclude that—despite the legal unenforceability of the norms—no legal reform is needed. Their story reduces, however, to an assertion that the near-uniform absence of non-union just-cause contracts demonstrates that employers are adequately constrained by the reputational costs of breaching the just-cause norm, leaving employees with no significant need (or desire) for the costly protection of legal enforceability.\(^6\) They never earnestly consider that this pattern of noncontracting may reflect serious contracting problems in the non-union internal labor market, rather than efficient choices by the parties.

\(^5\) The role of the employment-at-will rule in facilitating such opportunism is clearest in the case of an employer's unjust discharge of a senior employee whose promised compensation exceeds his marginal productivity (since it includes a significant component of deferred compensation). See Schwab, *supra* note 3, at 43-47. In contrast, the ability of an employer to behave opportunistically by reducing a mid-career employee's promised compensation level to some point closer to that employee's external wage may be less dependant on the employment-at-will rule. Such opportunism does not, after all, take the form of an unjust discharge. See id. at 47-48. But even this kind of employer opportunism may still be facilitated by the employment-at-will rule (albeit less directly), since the credible threat of easy discharge will enable the employer to deter possible employee self-help measures that might otherwise, in turn, deter such employer opportunism (for example, threats of discharge might deter employee complaining that could impose reputational costs on the employer or might deter marginal employee reductions in effort that would lower productivity but that would be difficult to prove under an enforceable just-cause regime).

\(^6\) The near-uniform absence of formal contracts, they urge, "immediately raises a red flag" for any who would advocate state enforcement: "if the parties could not solve the problem of opportunism" through self-help, "why is it that the parties [do] not address the problem contractually?" Rock & Wachter, *supra* note 1, at 1938 n.48. The authors further note that, where reformist judicial doctrines have implied contract rights from the "just-cause" norm itself, employers and employees have often responded with express contractual disclaimers of such legal protection. See id. at 1935 n.44.
II. LABOR MARKETS AND "LEMONS PROBLEMS"

An analysis of why private employment contracting might not produce express terms embodying a just-cause termination standard might begin, as Rock and Wachter begin, with recognition that enforcing any such term would increase the costs to the employer of policing against employee shirking. Rock and Wachter conclude from this analysis that the parties’ failure to adopt a just-cause provision reflects a judgment that employers are not likely to engage in opportunism to an extent that would justify these costs (divided between the parties). But this conclusion does not follow.

A very different, but at least equally plausible, story focuses on how individual employment contracting over a just-cause term would present the parties with issues of unverifiable quality and asymmetric information regarding quality. The resulting contracting problems of signalling and adverse selection could lead to the breakdown of private individual contracting for the just-cause term. Under such circumstances, the failure of the nonunion labor market to produce just-cause terms through private contracting says little about how highly employees might value such terms or about the efficiency of such terms.7

In essence, this story applies the “lemons problem” described in George Akerlof’s The Market for “Lemons”: Quality Uncertainty and the Market Mechanism8 to the employment contracting context. Borrowing a phrase from the used car market, Akerlof’s “lemons problem” is the inefficiency that characterizes a market in which buyers cannot easily verify the quality of goods offered by sellers, and sellers have superior (but hard to warrant) information regarding the quality of the goods they offer. In such a market, Akerlof shows, the ability of dishonest sellers to misrepresent the quality of the goods they offer (that is, to offer “lemons”), paired with the inability of buyers to distinguish between honest and dishonest sellers (that is, to determine which offers are “lemons”), will mean that prices will fall. As honest sellers disproportionately

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7 See David I. Levine, Just-Cause Employment Policies in the Presence of Worker Adverse Selection, 9 J. LAB. ECON. 294 (1991) (arguing that free market contracting may not lead to efficient levels of just-cause protection because of employee adverse selection problems); see also Mark Kelman, Could Lawyers Stop Recessions? Speculations on Law and Macroeconomics, 45 STAN. L. REV. 1215, 1252 n.131 (1993) (recognizing a signalling problem).

withdraw from a market that is undervaluing their offers (leaving a market with even more “lemons”), the price will fall further. In the end, a significant number of otherwise willing buyers and willing sellers will find it impossible to contract.9

An employee and employer contracting for employment fits Akerlof’s model: each possesses unique access to information—information regarding the quality of their offers—that the other party would find highly relevant, but which neither party can easily discover from the other. The employee, for example, has superior information regarding his likely work quality (including his skills and his propensity to shirk). The employer can only discover this information to a limited extent, and, fearing employee strategic behavior, the employer may have little reason to believe any representations of high work quality made by the employee. Similarly, an employer has superior information regarding the employer’s likely conformity to worker protective norms, but the employee has little reason to believe representations of “trustworthiness” made by the employer.

In this context, an employee who seeks an enforceable just-cause provision in the employment contract confronts a serious signalling problem regarding the quality of the employee’s likely work. At least two kinds of employees will disproportionately value just-cause protection. A relatively risk averse individual who desires long-term employment may seek just-cause protection as a form of insurance against future employer opportunism (of the very type discussed by Rock and Wachter), may be willing to pay a reasonable price for this insurance (in terms of a wage adjustment reflecting the added costs), and may nevertheless be at least equally likely to perform work of outstanding quality. Alternatively, an individual may value this protection precisely because she expects (or wishes to reserve an option) to perform deficiently at the job in question and therefore hopes to take advantage of the costs that a just-cause clause would impose on employer efforts to police against shirking. In Akerlof’s terms, the latter employee can be called a “lemon.”

The problem is that the employer cannot tell, in any given case, whether the employee who seeks the term is of the former or latter type, and the employee cannot effectively warrant as to which alternative she represents. Given these realities, employees will tend not to seek such a term through individual contracting, fearing that

9 See id. at 488-90.
any efforts to obtain the term will signal that they may be "lemon"—that is, shirkers or boundary-testers—whose costs to the employer will be more than the wage adjustment associated with the term. Any disclosure that they place a high value on the term will call into question their fitness for the job.

From the employer's perspective, the employee's signalling problem becomes a problem of adverse selection. Should the employer offer the just-cause term, the employer may become disproportionately attractive to those likely to shirk. Although the "trustworthy" employer might otherwise be quite willing to offer such a term in return for a wage differential (which would reflect that workers no longer require compensation for the risks of employer opportunism), the uncertainties associated with this adverse selection problem discourages the employer from making the offer without an additional wage adjustment to account for the associated uncertainty. Because an employee's acceptance of the term at the lower wage (higher price) would signal that the employee places an even higher value on the term, this might cause the employer to have an even greater concern for the quality of the employee. And this, of course, would make the employer less likely still to offer the term at that wage. Under such conditions, there might simply be no stable price for the term in question.

Given these realities, employers will tend not to offer such a term. The employer who desires a means of warranting his promise not to discharge without just-cause may still be unwilling to offer a binding term to any employee who discloses that she particularly values the term. In essence, the employer may be willing to offer such a term in the abstract, but not to any employee willing to pay for it. This is precisely the pattern documented by Akerlof in a host of situations, where—under circumstances of asymmetric information and unverifiable quality—private markets often generate a situation where "no . . . sales may take place at any price."10

The situation described by Rock and Wachter with respect to the just-cause term—that the term is generally never produced through non-union employment contracting—may simply reflect this "lemons

10 See id. at 493. Rock and Wachter recognize that employment contracting takes place under conditions of asymmetrical information and unverifiable quality, but they nonetheless argue that the resulting absence of any contracting for a just-cause term reflects the operation of an efficient market. Akerlof's point, however, is that such conditions will often constitute a market failure, where private contracting will not produce efficient results, and where private contracting may not even be capable of producing a desired contract term "at any price." See id. at 493-94.
problem.” If so, the absence of the term is absolutely no evidence that employees would not highly value the term if they could get it. In other words, the absence of the just-cause term does not disprove the provision’s efficiency. Employees may sufficiently fear employer opportunism that they would be more than willing to pay their share of the term’s cost. And this fear of opportunism may prevent optimal match investments in internal labor market human capital. Nevertheless, there may remain an insignificant number of just-cause provisions in individual employment contracts.

This “lemons problem” account is fully consistent with two other factors noted by Rock and Wachter. First, it is consistent with the contracting pattern in unionized employment, where just-cause provisions are as uniformly present as they are absent in non-union settings. When unions negotiate for employees, they can voice employee preferences without attributing these preferences to individual employees. Thus, while each individual employee may fear raising the issue of a just-cause term as an individual—lest she mark herself as one who is more likely to shirk and, thereby, competitively disadvantage herself in the eyes of the employer—the union can advocate the just-cause provision without disadvantaging any individual employee. In this way, the bargaining demands of a union may be far more accurate reflections of “true” employee preferences than the bargaining demands of individual employees.\(^1\)

Similarly, the employer may be less likely to fear an adverse selection problem when the term is sought by a union for the workforce as a whole, precisely because the term is unassociated with the particular preferences of individual employee applicants and, accordingly, says less about the likelihood of particular employees shirking.\(^2\)

\(^1\) See Richard B. Freeman & James L. Medoff, What Do Unions Do? 9 (1984) (stating that unions are often better able to represent the true preferences of employees because “workers who are tied to a firm are unlikely to reveal their true preferences . . . for fear the employer may fire them. In a world in which workers could find employment at the same wages immediately, the market would offer adequate protection for the individual, but that is not the world we live in”); see also id. at 7-16 (discussing other ways in which unionization may solve a variety of collective action problems associated with individual employment contracting, thereby more accurately reflecting employee preferences and generating more efficient contract terms).

\(^2\) I say “less likely” because an adverse selection problem may still be present for an employer in this situation. Having a just-cause term may mean that applicants with a predisposition to shirk will be disproportionately attracted to the firm. Although
Second, this "lemons problem" account is consistent with the use of disclaimers, noted by Rock and Wachter, in those jurisdictions where judicial decisions have implied an enforceable just-cause term from the existence of a just-cause norm.\textsuperscript{13} Put simply, reversing the default rule will not solve the "lemons problem." The problems of unverifiable quality and asymmetrical information remain, as do the resulting problems of signalling and adverse selection. To recognize this state of affairs, one need only hypothesize an employer presenting to applicants a boilerplate disclaimer which states that no legally enforceable just-cause term is intended by the statement of the just-cause norm. Should the employee propose deleting the disclaimer, asserting a strong preference for enforceable just-cause protection, the same signalling and adverse selection problems would arise: The employer, viewing any such employee as more likely than average to be a shirker or boundary tester, will be less likely to hire the employee at all. The employer is thus less likely to offer the option of individual just-cause protection and the employee is less likely to express the preference for any such protection.

Given these possible inefficiencies of individual contracting, state intervention may, in this context, enhance efficiency by solving the "lemons problem." Thus, if a just-cause term were efficient—such that its benefits in limiting employer opportunism outweigh its costs—state imposition of the term might be justified, given that the private market will tend not to produce it. As David Levine explains:

If all firms had [just-cause] policies, then the efficiency gains of just cause might outweigh the burden of [any increased problem of] shirkers. If only a subset of firms have just-cause policies, these firms will be faced with an applicant pool of workers with a concentration of workers who do not work hard but cannot be fired.

As is usual when externalities are present, government policies can increase national income. In this case, laws . . . that move toward just-cause employment policies can increase efficiency. If all companies were required to use just cause, the poor workers unionized employers overwhelmingly accept contractual just-cause provisions in collective bargaining agreements, such an employer concern may nevertheless explain some part of employer opposition to unionization. In any event, the fact that contracting difficulties persist in unionized employment gives no support to the proposition that non-union employment contracting is efficient.

\textsuperscript{13} See Rock & Wachter, \textit{supra} note 1, at 1935 n.44.
would be evenly distributed, and the efficiency gains could
dominate the loss of productivity from shirkers.\textsuperscript{14}

Accordingly, the failure of nonunion individual employment
contracting to expressly provide for enforceable just-cause protec-
tion hardly demonstrates that legal intervention to provide such
protection would be inefficient.\textsuperscript{15}

\textsuperscript{14} Levine, \textit{supra} note 7, at 295. This is the same point that Akerlof made using
Medicare as an illustration. Before Medicare, insurers feared that any individual
seeking health insurance at an age over 65 might be doing so because the individual
possessed private health information indicating her greater likelihood of needing the
insurance. With any upwards adjustment in price, those least likely to have such
information would exit the market, leaving the market even riskier to insurers. The
result was that such health insurance was hard to obtain at any price. \textit{See} Akerlof,
\textit{supra} note 8, at 491-92. This inefficiency provides a "major argument in favor of
medicare," that is, a state-mandated program:

\begin{quote}
On a cost benefit basis medicare may pay off: for it is quite possible that
every individual in the market would be willing to pay the expected cost of
his medicare and buy insurance, yet no insurance company can afford to sell
him a policy—for at any price it will attract too many "lemons."
\end{quote}

\textit{Id.} at 494.

\textsuperscript{15} Rock and Wachter dispute the plausibility of this "lemons problem" account of
nonunion employment contracting, arguing that neither an employee's request for
a just-cause term nor an employer's offer of a just-cause term should raise any fears
regarding shirking. This is so, they assert, because "[i]n a just-cause regime, low
productivity employees are no more protected than they are in a norm-governed
relationship." Rock & Wachter, \textit{supra} note 1, at 1939 n.52. But this assertion seems
at odds with Rock and Wachter's overall thesis. They argue against the efficiency of
a just-cause regime on the basis that, when just-cause must be proved to third parties,
employers must incur costs in terms of having to develop stronger cases and live with
erroneous results. \textit{See id.} at 1932-38. Obviously, such a regime makes discharge of
employees whose productivity is at the margin at least somewhat more difficult.
Indeed, if this were not the case, it is hard to understand the argument against
rendering the just-cause norm legally enforceable.

The case in favor of enforceability, of course, need not deny this phenomenon;
rather, it rests on the proposition that this cost is likely outweighed by the benefit of
granting employment security to those employees who adhere to the relevant
employment norms (and thereby constraining employer opportunism that could
hinder firm-specific employee investment).

A recent article defending the employment-at-will rule raises two other
arguments against the applicability of the "lemons problems" discussed in the text.
\textit{See} J. Hoult Verkerke, \textit{An Empirical Perspective on Indefinite Term Employment Contracts:
Resolving the Just Cause Debate,} 1995 Wis. L. Rev. 837, 902-05. Both arguments,
however, are flawed.

First, Professor Verkerke argues that employers and employees may face similar
signalling problems that may cancel each other out. \textit{See id.} at 903 (arguing that
employers may fear that opposition to just-cause terms might signal untrustworthiness
and, accordingly, harm recruitment). But it is not at all clear that two sets of such
problems would act to cancel each other out, rather than to enhance the seriousness
of the contracting problems at issue (for example, by further reducing the parties'
willingness to initiate discussions of the issue). An assertion that there are multiple
III. THE HIGH TRANSACTION COSTS ASSOCIATED WITH INDIVIDUAL CONTRACTING FOR EFFECTIVE JUST-CAUSE PROTECTION

In addition to the "lemons problem" described above, many employees who might value "insurance" against opportunistic discharges face other major impediments—in the form of high transaction costs—that make any contracting for just-cause protection quite costly, and thus, again, call into question the efficiency of current arrangements. Rock and Wachter acknowledge the high transaction costs problem but fail to recognize that state intervention in this area may reduce the costs at issue.

Rock and Wachter emphasize that any efforts to adjudicate just-cause cases would present significant costs associated, first, with proving difficult factual issues involving workplace performance, and, second, with defining the just-cause norm in a judicial system whose culture is quite distant from the diverse worlds of particular workplaces. The authors principally discuss these costs in terms of employer fears of litigation (presumably resulting in employer demands for greater wage adjustments in return for the contract term). Yet these costs may be of far more direct consequence from the employees' perspectives, rendering impractical the possibility of effective public enforcement of the norms at issue through the existing system of court litigation.

Unjust discharge claims are likely to be quite modest by the standards of our litigation system, especially for relatively nonelite contracting problems is hardly a demonstration that current arrangements reflect efficient contracting.

Second, Verkerke argues that any employee signalling problems would likely disappear after some significant period of employee performance, that is, after the employer has gathered information regarding the employee's work quality. See id. at 904. Because contracting for just-cause protection occurs no more frequently among employees who have worked for significant periods than it does among new employees, Verkerke concludes that employee signalling problems are not significant. See id. But this argument ignores that, at all times during an employee's career, there is some risk that seeking a just-cause term may signal a desire to be able to lessen productivity in the future, so that the "lemons problem" always persists to some extent. Moreover, the passage of a significant period of time may make the employee less likely to seek (and less able to obtain) just-cause protection. As the internal labor market model shows, employees become more dependent on their firm over time, and, as senior employees become less able to leave the firm, they become less able to influence contract terms. Thus, contract terms are less likely to reflect senior employees' particular needs. See supra note 11; infra note 20.
employees. Moreover, such claims will often be fact intensive and costly to litigate. Limited to contract damages (measured by lost earnings less any amounts earned in mitigating employment), workers of modest means will rarely expect a monetary recovery of sufficient size to justify the significant costs associated with the full litigation of their claims (attorney fees, court costs, risks of eventual loss, and risks of reputational injury that might adversely affect future employment). Thus, the very real costs of seeking the contract term at issue (in terms of signalling as well as in terms of wage reduction) would generate too few practical benefits as long as any contract right would be enforceable only through costly litigation in court.\textsuperscript{16}

This analysis does not, however, support the efficiency of current arrangements or prove the inefficiency of state intervention. Rather, the above reasoning illustrates the need to tailor any enforcement scheme to the particular nature of the disputes at issue. In fact, most serious proposals for reforming the employment-at-will regime have sought both a mandatory just-cause term and the creation of low cost alternative dispute resolution systems for the enforcement of the term, often viewing the latter as indispensable to the efficacy of the former.\textsuperscript{17} The legal systems of

\textsuperscript{16} Clyde Summers, after reviewing data concerning the patterns of litigation in those states that have been most liberal in implying contractual just-cause protection, concluded as follows:

Where recovery [in wrongful discharge cases] is limited to contract damages, prospective litigation costs may easily exceed potential recovery, except for high salaried employees. Therefore, even if the dismissal is clearly wrongful and success in litigation certain, the lawyer may not be able to take the case on contingency, if the employer is likely to force the case to trial. . . .

Because of litigation costs, all but middle and upper income employees are largely foreclosed from any access to a remedy for wrongful dismissal. This is apparent from the reported cases. Relatively few plaintiffs are hourly wage or clerical workers; the large majority are professional employees or are in middle and upper management. Middle income employees with contract claims . . . who cannot make a substantial payment in advance will be discouraged by lawyers from pursuing their claims. Lower income employees . . . will have difficulty finding a lawyer.


most other industrial democracies not only adopt standards regarding "unjust" discharge, but enforce the standards through specialized systems of labor courts, works councils, or other lower cost tribunals, separate from those nations' normal litigation systems. Of course, there can be no clearer illustration of the inadequacy of normal litigation fora for these disputes than the pattern in unionized employment, where, as Rock and Wachter recognize, the parties have almost uniformly established jointly administered grievance and arbitration systems to enforce their prohibitions on unjust discharge.

The clear inadequacy of normal litigation processes for the resolution of the disputes at issue obviously presents serious additional contracting problems for parties seeking to render the just-cause norm enforceable, for the question arises whether such parties can easily establish through private contracting a mutually acceptable, lower cost, and specialized alternative dispute resolution system.

An individual employee attempting to obtain such a system of adjudication through individual contracting obviously faces a number of daunting hurdles which would undermine the value of any adjudication system the employee could obtain and, thus, would call the efficiency of the contract results into serious question.

First, the employer will clearly have far greater access than any individual employee to the expertise and sophistication necessary to design or evaluate a private adjudication system. Not only will the employer have greater overall resources, but it will also gain greater expertise about such systems (at a far lower cost) because it will be a repeat user of any such system.

REV. 885, 908-10 (emphasizing that a low cost arbitration system should be the "first basic ingredient" of any proposed reform of the employment-at-will doctrine); Summers, supra note 16, at 533 (arguing that any meaningful employment law reform measures must be accompanied by the creation of administrative or arbitral systems containing "simplified procedures which reduce litigation costs, particularly legal fees").

See Estreicher, supra note 2, at 320 ("With the exception of Japan and Italy, the statutes in question [Canada, Great Britain, Germany, and France] all utilize specialized labor tribunals that, at least in theory, are thought to dispense a cheaper, quicker, more accessible and expert justice.").

See Rock & Wachter, supra note 1, at 1941; cf. Summers, supra note 16, at 537 (noting that "[t]he litigation costs for arbitration under collective agreements are only about one-tenth of the litigation costs for judicial proceedings").

This information asymmetry is particularly serious because the individual bargain envisioned by Rock and Wachter would need to occur early in the employee's life cycle, before the employee's exit option (external market position) declines as the
Second, the employer’s “repeat player” status—paired with the fact that few individual employees will themselves be repeat players in the employer’s wrongful termination dispute system—may call into question the fairness of the most essential component of any adjudication system: the impartiality of the judge. Although one of the principal advantages of an arbitration system is the ability to obtain judges with expertise in a particular workplace or kind of workplace dispute, the impartiality of any such privately selected judge may depend on the judge’s equal dependence on both sides for the reward of continued employment. Such equal dependence is the case in the unionized setting, where both employer and union have a permanent institutional presence. But it is harder to obtain in the nonunion setting, where no employee-side institution is likely to be present to counterbalance the employer. Given this asymmetry, there is a serious danger that any arbitrator who desires repeat business may have a self-interest in favoring the employer, because employers (but not individual employees) will be repeat selectors of arbitrators.  

employee becomes bound to the firm in reliance on the very internal labor market norms whose enforcement is at issue. At this early point, of course, the employee is at her most vulnerable regarding the risks of signaling poor work quality to the employer (because there is little prior history to the relationship). Moreover, the early career employee also may be undervaluing the need to police late career employer opportunism and may be particularly lacking in knowledge regarding the particular employer and the particular workplace norms. In other words, at this point, the employee’s information and sophistication disadvantages with respect to evaluating and bargaining over issues relating to eventual employer opportunism would be at their height. See Paul C. Weiler, Governing the Workplace: The Future of Labor and Employment Law 74-76 (1990). See generally Freeman & Medoff, supra note 11, at 9-10 (“In a nonunion setting, where exit-and-entry is the predominant form of [contract] adjustment, the signals and incentives to firms depend on the preferences of the ‘marginal’ worker, the one who might leave because of (or be attracted by) small changes ... [and] who is generally young and marketable; the firm can to a considerable extent ignore the preferences of typically older, less marketable workers, who . . . are effectively immobile.”). 

21 See National Academy of Arbitrators, Final Report of Committee to Consider the Academy’s Role, If Any, with Regard to Alternative Labor Dispute Resolution Procedures 6-7 (Apr. 17, 1992) (on file with author) (Steven B. Goldberg, dissenting) (“Regardless of the procedural protections that may be built into [a nonunion arbitration] plan ... the fact remains that one party, the employer, will be a steady customer of arbitrators under the plan, and the other party, the employee, will not. The effect of a difference between the parties in their ability to bring future business to the neutral on the neutral’s decisional process has been a source of concern in the entire dispute resolution field. ... [T]he risk of unconscious bias is inevitably present in employer promulgated arbitration programs.”); see also Michele M. Buse, Contracting Employment Disputes Out of the Jury System: An Analysis of the Implementation of Binding Arbitration in the Non-Union Workplace and Proposals to
Third, both of these first two contracting problems will be rendered even more serious by the persistence of the "lemons problem."22 Thus, to the extent that an employee openly seeks information in order to be better able to evaluate an employer’s proposed dispute resolution scheme, an employer may be more likely to question the quality of (and less likely to hire) the employee. The same would be true of an employee who seeks to alter the terms of the proposed system, including the method of selecting the arbitrator. Obviously, these impediments will discourage employee information gathering and hinder the flow of information to employers regarding employee preferences. It will also increase employee distrust of employer-designed systems.

Finally, to the extent that any private adjudication system would have to be offered to all employees (as it would, in order for employers to gain economies of scale and minimize the "lemons problem"), the system would take on the characteristics of a "public good." Individual employee contracting would thus be burdened by significant "free rider" problems, making more serious the problems of employee underinvestment in information gathering and misrepresentation regarding true preferences.

Employees could at least partially overcome many of these obstacles if they could join together, pool their resources, and attempt to solve their various collective action problems. This, of course, would be no easy task. But this is precisely how one can understand the growth of union internal labor markets, governed by collectively negotiated contract terms and policed by collectively administered grievance-arbitration systems. Thus, again, the existence of the union internal labor market model is more consistent with the existence of unsatisfied employee preferences in

Reduce the Harsh Effects of a Non-Appealable Award, 22 PEPP. L. REV. 1485, 1510 (1995); Samuel Estreicher, Arbitration of Employment Disputes Without Unions, 66 CHI.-KENT L. REV. 753, 764-65 (1990) (recognizing the “repeat player” problem as a possible “built-in asymmetry favoring the employer,” but hypothesizing that the problem could be resolved if a “claimants’ bar” emerges to provide an employee-side institutional presence); Matthew W. Finkin, Commentary on "Arbitration of Employment Disputes Without Unions", 66 CHI.-KENT L. REV. 799, 811-12 (1990) (recognizing the problem and doubting that such a claimants' bar will emerge, because most employees will be unable to obtain adequate legal counsel in such systems); cf. Note, The California Rent-A-Judge Experiment: Constitutional and Policy Considerations of Pay as You Go Courts, 94 HARV. L. REV. 1592, 1608 (1981) (discussing same danger of bias towards “steady customers” in other privately designed dispute resolution systems).

22 See supra notes 8-14 and accompanying text.
the non-union sector than it is with a pattern of efficient non-union employment contracting.\textsuperscript{23}

Of course, these problems might alternatively be solved through state intervention, with the state not only prescribing the enforceable just-cause term, but also designing and warranting a system of "fair" and lower cost dispute resolution for the workplace.\textsuperscript{24}

IV. IMPLICATIONS OF THE UNIONIZATION OPTION

Rock and Wachter admit that employees may choose unions as a means of obtaining enforceable employer promises regarding internal labor market norms. They find encouragement in the availability of a union option for employees, which may constrain employers, compelling them to honor internal labor market norms. But the authors avoid the import of this admission, which is, once again, to call into serious question the efficiency of non-union employment contracting.

Unfortunately, in our system unionization can only be obtained, to put it mildly, at immense transaction costs. Putting aside the debate regarding whether unionization is associated with gains or costs in terms of social efficiency, the process of unionization under our system requires employees to incur vast costs. Not only does unionization require the coordination of large numbers of employees, and thus the overcoming of major collective action problems, but it also must be done in an atmosphere of widespread fear of employer coercion. Employees supporting unions run a high risk of retaliatory discharge and the remedial scheme that is supposed to protect against that threat is widely viewed as ineffective.\textsuperscript{25}

\textsuperscript{23} The presence of unsatisfied employee preferences that are difficult contractually to solve in the non-union internal labor market is also consistent with the controversial efforts of some non-union employers to design non-union grievance and/or arbitration systems that purport to provide employees with reassurances regarding possible employer opportunism that would somewhat approximate those that a collectively bargained grievance-arbitration system would provide. See supra note 18. This tendency has generated substantial controversy precisely because such systems are perceived by many as employer-designed and employer-dominated, so that many doubt that they can (or will) be relied upon by workers as "fair." See FREEMAN & MEDOFF, supra note 11, at 108-09; see also supra note 18 and accompanying text.

\textsuperscript{24} See supra note 13 and accompanying text.

Given the substantial costs of unionization, if, as Rock and Wachter believe, the availability of unionization provides a needed limit on employer opportunism—and I would agree that it does—then one would expect either of two scenarios: (i) if private contracting is too costly to offer any practical solution, then employers should be able to engage in opportunism up to the point where costs to employees approach the substantial costs of unionization; or, (ii) if the threat of such opportunism is subject to private contractual solutions, then the threat of such significant opportunism would generate a pattern of contracting in this area. Thus, the bipolar contracting pattern recognized by Rock and Wachter—the near-universal absence of contracts in the non-union setting and near-universal presence in the union setting—would certainly provide evidence of contract failure in the non-union employment context and of the presence of significant opportunities for employer opportunism.  

CONCLUSION

Ultimately, Rock and Wachter assume that currently prevailing contract patterns reflect efficient results and explain this conclusion by positing the effectiveness of reputational costs as an adequate constraint on employer opportunism; but they do not seriously examine the possibility that other, less optimistic, scenarios may equally or better explain the patterns of employment contracting at issue. Other scenarios do, however, present equally, if not more,

26 Rock and Wachter's view that unionization is a necessary constraint on employer opportunism presents two other important policy implications.

First, this recognition should call for a vast increase in the severity of sanctions for employer coercive conduct undermining the unionization option. As the authors repeatedly emphasize, severe sanctions are necessary to deter breaches of rules that are difficult to monitor. See Rock & Wachter, supra note 1, at 1924-25. Given the widespread pattern of employer anti-union coercive conduct, and the even more widespread employee perception of such conduct, the current remedial limitations of the National Labor Relations Act should be altered. See supra note 21.

Second, Rock and Wachter ignore the fact that the very prevalence of the at-will legal rule drives up the costs of National Labor Relations Act enforcement. To the extent that employers are seen as having a legal "right" to discharge "unreasonably," those seeking to enforce the motive-based prohibition against anti-union discharge must incur far higher proof costs, as courts are that much less willing to infer prohibited motive from seemingly "unreasonable" employer conduct. See, e.g., Mueller Brass Co. v. NLRB, 544 F.2d 815, 819-20 (5th Cir. 1977) (rejecting, in light of employer right to "discharge for good cause, or bad cause, or no cause at all," NLRB inference of anti-union motive when employer discharged union activist "unreasonably" (quoting NLRB v. McGAhey, 233 F.2d 406, 412-13 (5th Cir. 1956))).
plausible explanations of current patterns, and the public policy implications of these other scenarios could not be more different. 27

27 Although this Comment has not examined in detail the effectiveness of reputational costs in policing internal labor market opportunism, there are certainly strong reasons to suspect that such reputational costs—although providing some constraining force—would likely be highly imperfect. See generally Schwab, supra note 3, at 26–27.

Reputational costs would only effectively constrain employers to the extent that (i) the employer will be recruiting additional employees into its internal labor market, (ii) those employees can easily determine the facts regarding the employer’s past behavior, and (iii) those employees can predict the extent that this past behavior is an indication of the employer’s future behavior with respect to them. But the timing of serious employer opportunism will likely be relatively late in an employer’s work life (when backloaded compensation promises become due, employee external market options have declined, and employee productivity may also have declined). See supra notes 3-5 and accompanying text. In contrast, the contracting process would presumably need to take place relatively early in the employee’s work life, before the employee becomes bound to the particular firm and thus loses an effective exit option. Thus, contract terms would be set at precisely the point at which the employee’s information position is weakest, and the prospect of employer opportunism is most remote. See supra note 20 and accompanying text.

In addition, just as Rock and Wachter recognize that monitoring employee performance is difficult and that proving the fairness of employer actions to third parties is even more difficult, the discovery by employees of the reasonableness of each employer action would also be quite difficult, especially given that the employer has unique access to relevant information regarding market conditions, firm decisionmaking processes, and work force performance, as well as unique power within the workplace which, to at least some degree, can be used to influence the flow of information. See Rock & Wachter, supra note 1, at 1924–25.

Finally, intervening events may significantly lessen the reputational costs of a discharge. For example, technological or market changes may mean that new recruits will come from a very different population than the more senior employees being terminated; changes in corporate management may mean that the firm may more safely disavow prior promises (or prior discharges); and shifts in firm structure or workplace location may (as is true of disciplinary power itself) influence the spread of information.

Given these factors it is highly unlikely that reputational costs will leave employers with little room for opportunism against late career employees, especially given a point emphasized by Rock and Wachter—that hard-to-detect opportunism must be subject to quite severe sanctions if it is to be effectively deterred. See id.