

## FOREWORD

# THE ROLE OF CONTRACT IN THE MODERN EMPLOYMENT RELATIONSHIP

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A central premise underlying modern employment law is that workplace relationships, at bottom, are contracts.<sup>1</sup> Those contracts usually begin something like this: A manager interviews an applicant. She is pleased with the applicant's credentials and offers him a position. A salary is named. The parties haggle, or they don't. They discuss benefits and job responsibilities, or they don't. At the end of the interaction, one thing is clear: the worker has "accepted" the "offer" of employment—either by explicitly saying so or by showing up for work directly thereafter. At a minimum, they have agreed to the following: For as long as the worker performs (and the employer suffers him to do so), he will receive his wages.

Of course, it is never that simple. Modern employment is a multifaceted relationship comprised of far more than the exchange of money for labor. Employers typically make other commitments to workers besides the promise of pay. They offer opportunities for extra-wage compensation and benefits, such as pensions, bonuses, and health insurance, which are administered through written policies that create expectations, if not legal entitlements, among participating

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1. See, e.g., Alan Story, *Employer Speech, Union Representation Elections, and the First Amendment*, 16 BERKELEY J. EMP. & LAB. L. 356, 406 (1995) ("Within both American labor and employment law doctrine, the traditional baseline conception of the employment relationship is that it is a voluntary (i.e. non-coercive) contractual relation.").

workers.<sup>2</sup> They also make informal promises through their managers and other agents who may provide assurances of long-term work, opportunities for training and development, and future promotions or advancements.

Similarly, employees know that they must do more than simply show up to work to receive the benefits of employment. Many employers issue personnel handbooks that promulgate disciplinary rules, company procedures, and policies on everything from tardiness to conflicts of interest. Some employers also require entering workers to sign formal documents, such as noncompetes and arbitration agreements, that attempt to contractualize discrete aspects of the relationship. Beyond these official rules, employees understand that they must comply with other implicit company standards. Employees anticipate that their work obligations will develop and change over time, and they know they must oblige instructions and assignments that may exceed the bounds of any static job description.<sup>3</sup> In return, they expect employers to abide by the letter and spirit of their official and unofficial promises, exercising managerial discretion equitably and making exceptions to the company policy where appropriate.

Given the multiple sources of obligation and expectation in the workplace, it is often difficult to determine what should happen in the event of a dispute. Which of the parties' promises are gratuitous and which carry the force of law? In answering those questions, American courts have historically turned to the rules of private contracts, although they often apply that body of law with some difficulty. Contract law requires mutual assent and the exchange of consideration for the creation of a binding agreement.<sup>4</sup> Many workplace promises, however, lack these formalities. The substance of whatever commit-

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2. Indeed, key employment benefits, such as health insurance, are often more important to workers than the amount of their take home pay in making decisions to accept or remain in a particular job. See *Center for Survey Research: Health Pulse of America*, Stony Brook University, at <http://www.stonybrook.edu/surveys/HPAAug03.htm> (Aug. 19, 2003) (noting that 71% of non-retired Americans responded that if they had to look for a job in the coming year, they would prefer a job with health coverage and lower salary to one with no health coverage and higher salary).

3. In contrast, unions have been able to successfully exploit the inevitable gap between written rules and implicit obligations in times of labor-management conflict through the "work-to-rule" job action. See *Local 702, International Brotherhood of Electrical Workers v. Nat'l Labor Relations Bd.*, 215 F.3d 11, 14 (D.C. Cir. 2000) (describing electrical worker's "work-to-rule" job action, which included employees "adhering strictly to all company safety and other rules; doing exactly and only what they were told; reporting to work precisely on time and parking work trucks at company facilities at day's end (thus precluding employees from responding to after-hours emergencies); presenting all grievances as a group; advising non-employees to report unsafe conditions; and advising customers of their right to various company information and of their right to have their meters checked annually for accuracy").

4. RESTATEMENT (SECOND) OF CONTRACTS § 17 (1981) ("[T]he formation of a contract requires a bargain in which there is a manifestation of mutual assent to the exchange and a consideration.").

ment is in dispute may be vague and indefinite, particularly if it is made orally.<sup>5</sup> Indeed some workplace “promises” are not even statements, but are simply implicit in the parties’ understanding of how things work between them.<sup>6</sup> Such understandings may even be at odds with more formal policies of the employer.

Of course, some employer promises are sufficiently specific to suggest an intent to be bound, as where the obligation derives from a handbook or written policy. In such cases, however, courts may question whether the promise is supported by consideration. At the outset of a relationship, consideration for employer promises is provided by the employee’s commencing work; the problem lies in unilateral efforts to alter the understanding or impose new obligations after the fact. Where the employer and employee form a bilateral agreement for a fixed term of employment, the employer’s promises are contractually enforceable and cannot be modified without new consideration. By default, however, employment is terminable at will, and the relationship is therefore more frequently understood as a unilateral agreement.<sup>7</sup> From this perspective, promises endure only so long as the employer refrains from changing its mind, for the execution of each unit of work by the employee marks the commencement of a new agreement under new terms.<sup>8</sup> Any long-term commitment is deemed illusory, negated by the shared understanding that either party can walk away at any time.<sup>9</sup>

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5. See, e.g., *Varney v. Ditmars*, 111 N.E. 822, 823 (N.Y. 1916) (finding conversation in which employer offering employee a “fair share of my profits” if employee addressed backlogged jobs too vague to evidence required meeting of minds).

6. Scholars often refer to such understandings as “implicit” or “social” contracts of employment as distinguished from the legally enforceable obligations of the parties. See Denise M. Rosseau, *Psychological and Implied Contracts in Organizations*, 2 EMPLOYEE RESP. & RTS. J. 121, 123–29 (1989) (articulating differences between social and emotional expectations of individuals in contract relationships and the legal and equitable principles under which courts enforce select aspects of such relationships).

7. The doctrine of employment “at will” is generally attributed to Nineteenth Century treatise writer Horace Wood, and though his analysis has been subject to dispute, employment at will continues to be the modern default rule of the employment relationship in every jurisdiction except Montana. See MARK A. ROTHSTEIN ET AL., EMPLOYMENT LAW, at 1–4 (2d ed. 1999) (discussing evolution of Wood’s “at will” concept of employment relationships). For the exception to the general rule, see MONT. CODE ANN. § 39-2-904(1) (2003), which creates “just cause” protection for employees who have completed an employer’s probationary period of employment.

8. See, e.g., *Pine River State Bank v. Mettelle*, 333 N.W.2d 622, 627 (Minn. 1983) (“[W]here an at-will employee retains employment with knowledge of new or changed conditions, the new or changed conditions may become a contractual obligation . . . . The employee’s retention of employment constitutes acceptance of the offer of a unilateral contract; by continuing to stay on the job, although free to leave, the employment supplies the necessary consideration for the offer.”); accord *Johnson v. Morton Thiokol, Inc.*, 818 P.2d 997, 1002 (Utah 1991).

9. But see W. David Slawson, *Unilateral Contracts of Employment: Does Contract Law Conflict with Public Policy?*, 10 TEX. WESLEYAN L. REV. 9 (2003) (criticizing this interpretation and arguing that the law of unilateral contracts requires employers to

Whatever the correct interpretation of contract law in such circumstances, courts often resist the conclusion that a disputed employment promise is gratuitous, particularly in cases involving employers renegeing to the detriment of employees. And no wonder. Given the economic significance of work to the individual, as well as the centrality of work in our society, the promises and commitments of those we work for play a crucial role in shaping our lives. For many people, personal happiness, sense of purpose, and sense of success, in addition to financial security, all depend significantly on their experiences in their jobs.<sup>10</sup> Employers, likewise, view their relationship with their workers differently from other exchange obligations they take on in the course of business. In the contemporary service economy, the success of a company is heavily dependent on the quality of its workforce, and many employers invest accordingly.<sup>11</sup> Thus, parties on both sides of the equation are likely to see their connection to one another as a relationship of mutual dependence—what the law might call a “status”—that exceeds the bounds of its discrete components.

The result is that the law of employment contracts is highly idiosyncratic. Courts frequently find binding obligations in cases where contract formalities are absent, while avoiding enforcement of signed documents carrying all of the trappings of enforceable instruments. For instance, courts have intuited binding promises of job protection based on industry practice and informal assurances and have recognized a cause of action for breach of an implied-in-fact contract for long-term employment.<sup>12</sup> At the same time, they frequently hold covenants not to compete unenforceable for overreaching<sup>13</sup> and agree-

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abide by promises of job security made in consideration of employees' remaining on the job).

10. As Vicki Schultz puts it, “For most people, working . . . is a way to contribute something to the larger society, to struggle against their limits, to make friends and form communities, to leave their imprint on the world, and to know themselves and others in a deep way . . . . [W]ork isn't simply a sphere of production. It is also a source of citizenship, community, and self-understanding.” Vicki Schultz, *The Sanitized Workplace*, 112 *YALE L.J.* 2061, 2069–70 (2003). See also H.G. KAUFMAN, *PROFESSIONALS IN SEARCH OF WORK* 53–55 (1982) (discussing psychological changes resulting from professionals' unemployment and impacts on individual and family).

11. Illustrative of this idea is the recent emergence of an extensive business management literature on the importance of developing and maintaining human capital. See PATRICK H. SULLIVAN, *VALUE-DRIVEN INTELLECTUAL CAPITAL* 13–16 (2000) (describing origin and development of concept of intellectual capital in business management field from 1980s to present); KARL ERIK SVEIBY, *THE NEW ORGANIZATIONAL WEALTH* 3–8 (1997) (demonstrating high proportion of intangible corporate assets to market value for major global companies).

12. See, e.g., *Pugh v. See's Candies, Inc.*, 171 Cal. Rptr. 917, 927 (Cal. Ct. App. 1981) (recognizing implied-in-fact contract for job security based on duration of plaintiff's employment, commendations and promotions he received, lack of direct criticisms of his work, assurances given to him by employer, and employer's acknowledged policies).

13. Most courts evaluating the enforceability of a noncompete contract apply the general rule that such agreements are void unless they are reasonably limited in scope

ments to arbitrate void for lack of consideration.<sup>14</sup> This seeming inconsistency in enforcement can be explained to some extent by judicial concern for the well-being of workers, particularly those whose skills do not permit them to diversify the risk of job loss and who lack bargaining power compared with their employer.<sup>15</sup> The formalized contracts signed by most workers tend to be non-negotiable form agreements drafted by their employer that curtail or eliminate workers' rights. On the other hand, employer promises that benefit workers often are made extra-contractually, sometimes intentionally so. Assuming that such concerns constitute an appropriate focus of judicial decision-making, they are problematic in that they fail to yield a unifying theory of how courts should apply contract law to employment relationships. The result is that the law of employment contracts remains a puzzle, unresolved on key issues that greatly affect workers' lives.

Given this landscape, it is necessary for legal scholars to identify and tackle the broad theoretical questions that plague the doctrine. An overriding issue is how to integrate the pieces of a multi-dimensional employment agreement, both with one another and, perhaps more importantly, with the holistic relationship that they purport to define. This concern implicates many questions. On the level of contract law, how do written contract terms intersect with oral terms? With implied understandings of the parties? With external norms? On the level of social policy, which freedoms should employment law aim to protect? Freedom of competition for employers? Freedom from oppression for employees? Or freedom of contract for all parties? On a pragmatic level, how do existing and proposed legal rules affect the decisions of courts? The strategies of employers and their attorneys? The real lives of workers? And, on perhaps the most fundamental level of all, what do our responses to the questions posed

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and necessary to protect a legitimate interest of the employer. See RESTATEMENT (SECOND) OF CONTRACTS § 188 (1981) ("A promise to refrain from competition . . . is unreasonably in restraint of trade if: (a) the restraint is greater than is needed to protect the promisee's legitimate interest, or (b) the promisee's need is outweighed by the hardship to the promisor and the likely injury to the public.").

14. See, e.g., *Hooters of Am., Inc. v. Phillips*, 39 F. Supp. 2d 582, 617–18 (D.S.C. 1998) (finding employer's return promise to arbitrate disputes illusory where employer retained discretion to modify or cancel agreement), *aff'd*, 173 F.3d 933 (4th Cir. 1999).

15. See, e.g., *Orkin Exterminating Co. v. Foti*, 302 So. 2d 593, 596 (La. 1974) (noting public policy rationale against enforcing noncompete agreements based on "disparity in bargaining power" between employee and employer, where employee, "fearful of losing his means of livelihood . . . contract[s] away his liberty to earn his livelihood in the field of his experience"); *Arthur Murray Dance Studios of Cleveland, Inc. v. Witter*, 105 N.E.2d 685, 704 (Ohio 1952) (noting that an employee "is often in urgent need of selling [his labor] and in no position to object to boiler plate restrictive covenants placed before him to sign . . . . His individual bargaining power is seldom equal to that of his employer").

here tell us both about the nature of contract law and the nature of employment as a contract?

Such questions call for robust theorizing at the intersection of two areas of legal scholarship that have a great deal to offer one another. Contract theory seeks to understand the way in which private parties structure consensual relationships, including how parties decide what to include and what not to include in their agreements. It contains what is now a developed literature on “relational” contracts, long-term or recurrent agreements in which the parties’ desire to protect and preserve their relationship impacts how they perform or respond to non-performance.<sup>16</sup> This inquiry is of significant import to employment contracts, which are highly personal, yet the majority of relational contract literature concerns ongoing commercial transactions between businesses.<sup>17</sup> For its part, much of recent employment law scholarship has focused on the regulatory aspects of the employment law regime, in particular on the scope of federal discrimination laws and other statutes that dictate threshold terms of employment. Somewhat less attention has been given to the private dimension of the employment relationship, including how parties and courts determine terms and conditions that exceed legally proscribed minimums or fall outside the scope of public regulation. Employment law scholarship that does address these aspects of the employment relationship does not always draw on contract theory.<sup>18</sup>

The Articles in this Symposium Issue bring together the scholarship of contract law and employment law, bridging the gap between these two bodies of theory and doctrine. Several of the pieces respond to court efforts to reconfigure the rules of contract law to better suit the problems of employment relationships. David Slawson’s contribution, for instance, focuses on employer modification of personnel manuals.

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16. Relational contract theory refers principally to the idea that the behavior and expectations of contracting parties are heavily influenced by a desire to preserve their relationship and foster cooperative behavior. *See generally* IAN MACNEIL, *THE RELATIONAL THEORY OF CONTRACT* (David Campbell ed., 2001); Jay M. Feinman, *Relational Contract Theory in Context*, 94 NW. U. L. REV. 737 (2000); Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089 (1981).

17. *But see* Paul J. Gudel, *Relational Contract Theory and the Concept of Exchange*, 46 BUFF. L. REV. 763, 769–74, 788–92 (1998) (discussing cases involving implicit promises of employee job security and employer duty of good faith in illustrating principles of relational contract theory); Edward B. Rock & Michael L. Wachter, *The Enforceability of Norms and the Employment Relationship*, 144 U. PA. L. REV. 1913, 1929–38 (1996) (using example of employers’ voluntary compliance with “for cause” discharge practices, despite background rule of employment “at will,” to illustrate relationship between internal norms and legal rules).

18. The consistent exception, of course, is the large body of writing that applies law and economic principles to the employment relationship. *See, e.g.*, Richard A. Epstein, *In Defense of the Contract at Will*, 51 U. CHI. L. REV. 947 (1984) (arguing for contract at will based on fairness, utility, and distributional concerns). This well-developed discourse could be enriched by scholarship that considers employment contract issues from other ideological perspectives.

Professor Slawson examines court decisions establishing “new” rules of contract that permit employers to revoke promises of job security by revising their employee handbooks. Professor Slawson criticizes this approach, arguing that basic contract law, properly understood and applied, can both protect employee expectations and preserve employer discretion, while at the same time enabling employers who so chose to make binding promises of job security.

In contrast, Frank Snyder’s contribution attributes court manipulation of contract law to a lack of fit between contract principles and employment relationships. Professor Snyder points out that, historically, employment was considered a legal status, not a private agreement, and that it continues to be a status relationship today despite modern emphasis on self-determinism. Because of this, employment decisions sounding in contract law offer only partial solutions to the problems of employment relationships; at the same time, they create exceptions of general applicability that make business transactions costly and unpredictable. Debora Threedy’s contribution responds to Professor Snyder, calling into question the theory that employment cases negatively impacted the development of contract law. Closely examining the chestnut case *Alaska Packers’ Ass’n v. Domenico*, Professor Threedy concedes that the court’s strict application of the pre-existing legal duty rule in that decision did little to advance the cause of the plaintiff employees, cannery workers who sought to exert concerted pressure on management. Professor Threedy notes, however, that the court applied extant contract principles that were not rejected until the development of uniform commercial law some sixty years later. In addition, she points out that *Alaska Packers’* has been recast as a decision involving the doctrine of economic duress, an area of contract law in which the decision remains relevant despite the advent of modern labor law.

Other articles in this Symposium look at the contractual nature of employment from a multi-party perspective. Michael Green’s contribution considers a possible role for unions in addressing the problem of employer-mandated arbitration agreements. While critics of arbitration have generally sought a regulatory response prohibiting agreements that limit employees’ statutory rights, Professor Green searches for a contract-based solution. He suggests that employees can enhance their bargaining power through collective action and calls on unions to take an active role in negotiating this aspect of employment on behalf of their constituencies. In contrast, Orly Lobel looks at the emergence of a new third party player in modern employment relationships—the temporary employment agency. Her contribution explores the various reasons for employer reliance on third party employers, which range from the desire to circumvent legal obligations to benign efforts to capitalize on flexibility. Professor Lobel critiques court decisions involving temporary workers for failing to

acknowledge the triangulated nature of the contingent employment relationship and calls for a new model of employment contract rights that enables managerial flexibility while preserving employer accountability.

The last three articles offer different perspectives on the enforcement of post-employment restraints on competition. Scott McDonald's contribution critiques the current legal framework, offering rich examples of how costly it is for both employers and employees to operate in an environment where noncompetes are not predictably enforceable. He questions the viability of contract-based solutions, demonstrating how drafting techniques have failed to overcome existing legal ambiguities, and calls instead for a statutory solution that creates uniform guidelines for enforcement. My own contribution looks at the formation of noncompetes rather than their enforcement and asks whether contract law can be used to close the floodgates that have unleashed an increasing number of these agreements on the labor market. Drawing on the rules of enforcement of premarital agreements, I propose enhanced rules of assent, consideration, and unconscionability that will encourage employers to use such agreements responsibly. Finally, Marlize van Jaarsveld's contribution offers a South African perspective on the competing policy concerns that complicate questions of noncompete enforcement. Professor van Jaarsveld demonstrates how competing influences from British and Roman-Dutch law converged to create a regime in which the ability to pursue one's occupation is constitutionally protected, but restraints on trade are *prima facie* enforceable, subject to basic public policy limitations.

To be sure, many questions about the relationship between contract and employment remain unanswered. The complexity of employment issues—the inherent tension between public regulation and private ordering, between legal agreements and moral obligations, between business interests and human need—will doubtlessly continue to challenge courts and legal scholars. The voices collected here offer a first step toward a richer understanding of the contractual dimension of employment and employment's influence on contracts in addressing some of the most pressing issues of the contemporary labor economy.