Judicial Interpretation of Employee Handbooks:
The Creation of a Common Law Information-Eliciting
Penalty Default Rule

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Under the common law doctrine of employment at will, employees who do not have a contract for a fixed term may be discharged at any time and for any reason, or for no reason at all.¹ More than forty states now recognize employment at will as the default rule governing employee discharge in their jurisdictions,² and with the steady decline of unionization in the American workforce,³ the vast majority of private sector workers in America are currently at-will employees.⁴ Despite the long-standing prevalence of the at-will rule, however, at least two recent empirical studies show that most employees believe that they enjoy legally protected job security and that they may be terminated only for good cause.⁵ These studies have caused the employment-at-will default rule to come under intense criticism.⁶


³ See John Sullivan, Unions Decline in Membership Continued in 2003 to 12.9 Percent of Workforce, BLS Reports, Daily Labor Rep (BNA) AA-1 (Jan 22, 2004) (showing that less than 13 percent of the total American workforce and only 8 percent of the private sector workforce are currently unionized, and that overall union membership steadily declined between 1983 and 2003); Samuel Estreicher, Labor Law Reform in a World of Competitive Product Markets, 69 Chi Kent L Rev 3, 3 (1993) (stating that private sector nonagricultural unionization reached a high of 35.7 percent in 1953 and declined to 11.5 percent by 1993).
⁴ See Pauline T. Kim, Bargaining with Imperfect Information: A Study of Worker Perceptions of Legal Protection in an At-Will World, 83 Cornell L Rev 105, 107 (1997) (stating that the vast majority of nonunion, private sector workers are employed at will).
⁵ See Richard B. Freeman and Joel Rogers, What Workers Want 118-20 (Russell Sage Foundation 1999) (detailing a survey in which 83 percent of workers surveyed indicated their belief that an employer could not legally terminate an employee for no reason); Kim, 83 Cornell L Rev at 110-11 (cited in note 4) (detailing the results of an empirical study indicating that employees consistently overestimate their right not to be fired without good cause and that 89 percent of workers questioned in the study believed that the law forbade an employer from discharging an at-will employee out of personal dislike).
⁶ See, for example, Cynthia L. Estlund, How Wrong Are Employees About Their Rights, and Why Does It Matter?, 77 NYU L Rev 6, 34–35 (2002) (arguing in favor of switching the default rule to for-cause protection); Cass R. Sunstein, Human Behavior and the Law of Work,
In the 1980s, states began to rigorously apply common law exceptions to the at-will rule. Today, most states apply as many as three judicially created exceptions to the at-will rule: (1) implied covenants of good faith and fair dealing, (2) public policy exceptions, and (3) implied contracts. The third exception has been the most dynamic, and forty-three at-will jurisdictions allow some form of implied contract to restrict an employer's absolute right to terminate its employees.

Courts frequently recognize employee handbooks containing discipline and discharge procedures as implied contracts. When binding employers to the terms of their employee handbooks, courts typically find that the handbooks themselves are unilateral contracts. Under this analysis, courts construe discipline and discharge procedures contained in handbooks as contractual offers by employers to limit their ability to discipline and discharge their employees, notwithstanding the employment-at-will default. Employers communicate these offers to their employees through the employee handbook, and employees accept them through the commencement or continuation of work.

There are, however, significant discrepancies between how courts traditionally apply contract law in commercial unilateral contract
cases and how they apply it in employee handbook decisions. This conflict is most evident in the willingness of some courts to find objective manifestations of mutual intent to make and accept an offer.\textsuperscript{16} Specifically, certain jurisdictions have been very liberal in discounting handbook disclaimers that explicitly attempt to preserve an employment-at-will relationship between employers and employees.\textsuperscript{17} Courts have also relaxed the level of actual knowledge an employee must have in order to prove acceptance of an employer's "offer."\textsuperscript{18} Taken together, these discrepancies suggest that there is more at play in the employee handbook decisions than the simple application of traditional contract law.

This Comment argues that while contract law provides a necessary framework for understanding the employee handbook decisions, it is not a sufficient explanation for why some courts are so aggressively construing ambiguous language and action to turn employee handbooks into binding contracts. This Comment argues that some of the employee handbook decisions, rather than using classical contractual analysis, create a penalty default rule that forces employers to inform their employees of certain critical information regarding the employment relationship. This "information-eliciting" penalty default rule mandates that employers that wish to benefit from the use of handbooks must educate their employees about the realities of at-will termination.\textsuperscript{19} While this rule does not switch the default employment relationship from at-will to for-cause, it is more protective of employees than an unadulterated at-will rule such as existed prior to the 1980s.

This Comment further asserts that such an information-eliciting penalty default rule is desirable given the results of recent empirical studies indicating that American workers are overwhelmingly igno-

\textsuperscript{16} See, for example, Butterfield v Citibank of South Dakota, NA, 437 NW2d 857, 859 (SD 1989) (finding that a manual containing progressive disciplinary procedures or a detailed list of exclusive grounds for employee discharge and discipline may manifest the employer's intent to be bound by the procedures).

\textsuperscript{17} See, for example, Durtsche v American Colloid Co, 958 F2d 1007, 1010–11 (10th Cir 1992) (holding invalid a disclaimer buried in an amended glossary).

\textsuperscript{18} See, for example, Kinoshita v Canadian Pacific Airlines, 68 Hawaii 594, 724 P2d 110 (1986) (holding that employees may rely on employee manuals that they have not read).

\textsuperscript{19} Default rules govern contracts unless explicitly contracted around. Penalty default rules are purposely created to be undesirable to the contracting parties in order to create an incentive for the parties to reveal information to one another and then to bargain to a mutually beneficial contract. See Ian Ayres and Robert Gertner, Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules, 99 Yale L J 87, 95–107 (1989).

The idea of using information-eliciting default rules in the employment law context originated with Cass Sunstein's pivotal article on the behavioral economics of the American workplace. See Sunstein, 87 Va L Rev at 231–32 (cited in note 6) (briefly discussing an information-eliciting default rule in the context of the at-will versus for-cause debate).
rant of the laws governing their employment relationships. These statistics make a compelling case for offering workers more protection than that offered by a strict at-will regime, which provides workers with very little protection while simultaneously allowing employers to benefit from their employees' ignorance. While some in the field of employment law have advocated for a switch to a for-cause default rule, this approach has the potential to cause negative economic repercussions in the American labor market. An information-eliciting penalty default rule is attractive because employers are relatively better informed of the law than are their employees and can most efficiently educate employees about their rights. It is only when both parties know what the law is that they can bargain to the most efficient terms governing the employment relationship. Although some courts currently appear to be applying a penalty default rule in practice, no court has explicitly invoked it. This Comment argues in favor of a widespread application of penalty default rules in employee handbook interpretation, as well as an open discussion of these rules on the part of deciding courts.

Part I of this Comment briefly discusses the doctrine of employment at will in order to provide a background with which to analyze the employee handbook cases. Part II examines the employee handbook decisions in light of traditional unilateral contract law, showing how courts have aggressively interpreted somewhat ambiguous handbook language in favor of employees. It then discusses the use of default rules in contract law and suggests that some courts are actually applying a penalty default rule that punishes employers who do not convey essential information to their employees. Part III discusses the benefits of a widespread and explicit information-eliciting penalty default rule in judicial interpretations of employee handbooks.

I. AN INTRODUCTION TO EMPLOYMENT AT WILL

Understanding the employee handbook decisions requires an understanding of the background laws governing employment at will. This Part aims to provide a basic understanding of the laws regulating employment at will, beginning with a description of the origin of the employment-at-will default rule, and ending with a description of some of the primary exceptions to the rule.

20 See text accompanying notes 157–60.
21 See Estlund, 77 NYU L Rev 6 (cited in note 6); Sunstein, 87 Va L Rev 205 (cited in note 6); Issacharoff, 74 Tex L Rev 1783 (cited in note 6).
Judicial Interpretation of Employee Handbooks

A. Origin of Employment at Will: Wood's Rule

Employment at will has been the default rule governing termination of employment since at least 1877, when H.G. Wood published his influential treatise on the laws of master and servant. According to Wood’s rule, “a general or indefinite hiring is prima facie a hiring at will, and if the servant seeks to make it out a yearly hiring, the burden is on him to establish it by proof.” Whether or not Wood’s formulation was an accurate description of the state of the law at the time of the publication of his treatise, virtually every state soon adopted his version of the rule governing employment relationships. To date, only Montana has statutorily precluded the use of an employment-at-will default. In 1991, the National Conference of Commissioners of Uniform State Laws promulgated the Model Uniform Employment Termination Act based on Montana’s for-cause statute. The significance of the Uniform Act is limited, however, as no state has yet adopted it.

B. Exceptions to Employment at Will

The at-will doctrine is only a presumption, however, and both individual employment contracts and general statutory and judicial

24 H.G. Wood, A Treatise on the Law of Master and Servant § 134 at 271–74 (John D. Parsons, Jr. 1877) (pointing out that American courts considered a general hiring to be a hiring at will while English courts held that a general hiring constituted a hiring for a year).
25 Id at 272 (suggesting that American courts’ presumption that an indefinite hiring is a hiring at will is inflexible).
26 For an American case endorsing the English rule that a hiring for an unstated term is presumed to be for a year, see Adams v Fitzpatrick, 125 NY 124, 26 NE 143 (1891) (holding that when an employee working under a contract for one year holds over and continues that service after the expiration of the year, there is a presumption that the parties assent to the continuance of the contract for another year).
27 See, for example, Martin v New York Life Insurance Co, 148 NY 117, 42 NE 416, 417 (1895) (stating that the at-will doctrine was “correctly stated by Mr. Wood” in holding that a general or indefinite hiring is prima facie a hiring at will and that the employee has the burden of demonstrating that such a hiring was yearly if he wants to make it out as such); McCullough Iron Co v Carpenter, 67 Md 554, 11 A 176, 179 (1887) (calling Wood an “authority of high repute” in concluding that the presumption was that the parties, by failing to renew an employment contract when the employee continued to work after the contract’s expiration, agreed to continue the original contract).
28 See Wrongful Discharge from Employment Act, Mont Code Ann §§ 39-2-901 to -915 (2003) (defining a discharge not for good cause as a wrongful discharge and setting forth an exclusive remedy). See also Peter O. Hughes, 10 Labor and Employment Law § 259.04 at 259-22 (Matthew Bender 2004) (“Montana’s [for-cause] statute is unique . . . and no state has undertaken quite so broad a revision of the employment at will doctrine.”).
31 Since the 1930s, an increasing number of federal statutes prohibit employers from considering certain specified factors such as union membership, disability, age, race, and sex in ter-
exceptions may overcome it. The majority of states recognize implied-in-fact contracts as exceptions to the at-will default rule. These contracts can arise whenever an employer implies a promise not to fire his employees at will, whether the communication was written, verbal, or merely implied by the context of the employment relationship as a whole. This Comment focuses on employee handbooks as a subset of the implied-in-fact contract exception to the at-will default.

II. THE EMPLOYEE HANDBOOK EXCEPTION TO EMPLOYMENT AT WILL

This Part discusses the discrepancies between traditional contract law and contract law as applied in employee handbook cases. It focuses on two particular areas: (1) judicial interpretations of the objective intent of employers to make an offer, and (2) judicial interpretations of actual knowledge of the offer by an employee. The discussion demonstrates how, in relaxing their usually rigorous evaluation of these requirements for contract formation, courts have made a significant break from traditional applications of unilateral contract law.

Part II.A describes the origin of the employee handbook exception to employment at will. Part II.B then discusses analytic difficulties created by judicial mappings of employee handbooks onto the rubric of unilateral contract law. This Part begins with a brief overview of relevant principles of unilateral contract law in order to provide a context for looking at the employee handbook cases. Finally, Part II.C demonstrates how the theory of information-eliciting penalty default rules explains the discrepancies between traditional applications of unilateral contract law and contract law as used in the interpretation of employee handbooks.

32 See generally Cihon and Castagnera, Employment and Labor Law at 5-20 (cited in note 1).
33 See Autor, Donohue, and Schwab, The Costs of Wrongful-Discharge Laws at 6 (cited in note 2).
34 See id at 6-7 (indicating that factors such as longevity of service, history of promotion or salary increase, treatment of other employees, and typical industry practice may imply contractual rights within the employment law framework).
A. Origin of the Employee Handbook Exception

Employee handbooks are documents containing general personnel and benefits policies prepared by employers for use by their employees. They range in scope from vague statements of company policy to detailed descriptions of discharge, discipline, grievance, promotion, vacation, compensation, and benefits procedures. Prior to the 1980s, courts did not generally enforce employer compliance with statements made in employee manuals.

Beginning in the early 1980s, however, virtually every state supreme court reconsidered its treatment of employee handbooks and concluded that under the right conditions a handbook could be transformed into a unilateral contract. Some courts denied that their decisions to recognize employee handbooks as contracts were departures from prior precedent and attempted to fit their analyses into that of earlier cases. Other courts explicitly acknowledged that their decisions constituted an evolution of the common law doctrine of em-

35 Merrick T. Rossein, 1 Employment Law Deskbook for Human Resources Professionals § 5.1 (West 2003).


37 See, for example, Johnson v National Beef Packing Co, 220 Kan 52, 551 P2d 779 (1976) (holding that a manual published after the employee had commenced working for the employer is a unilateral expression of company policy and does not constitute a contract because its terms were not bargained for and any benefits conferred are merely gratuities); Sargent v Illinois Institute of Technology, 78 Ill App 3d 117, 397 NE2d 443 (1979) (holding that guidelines set forth in a personnel manual given to an employee do not constitute a contract because they were not bargained for and, by agreeing to follow the guidelines, the employee agreed to perform the duties of his employment and nothing more). But see Carter v Kaskaskia Community Action Agency, 4 Ill App 3d 1056, 322 NE2d 574 (1974) (holding that a manual adopted by an employer and its employees became part of the employment contract and that the employees’ continued work constituted assent to and consideration for the modification).


39 See, for example, Pine River State Bank v Mettille, 333 NW2d 622, 629–30 (Minn 1983) (concluding that employee handbook provisions are enforceable without the need for consideration beyond the employee’s continued performance of services); Toussaint v Blue Cross & Blue Shield of Michigan, 408 Mich 579, 292 NW2d 880, 892 (1980) (holding that employer statements of company policy contained in manuals can give rise to contractual rights without evidence that the parties mutually agreed that the policy statements created such rights); Forrester v Parker, 93 NM 781, 606 P2d 191 (1980) (holding that policies laid out in an employee manual constitute an implied employment contract).

40 See, for example, Hoffman-La Roche, Inc v Campbell, 512 S2d 725, 728–29 (Ala 1987) (indicating that the conclusion that provisions in an employee handbook constitute an employment contract does not abrogate the employment-at-will doctrine because courts have never held that provisions in an employee handbook cannot constitute a contract).
ployment at will." For example, in Woolley v Hoffmann-La Roche, Inc, the Supreme Court of New Jersey stated:

This Court has long recognized the capacity of the common law to develop and adapt to current needs. . . . The interests of employees, employers, and the public lead to the conclusion that the common law of New Jersey should limit the right of an employer to fire an employee at will."

In order to accomplish this task, the Supreme Court of New Jersey recognized for the first time that an employee handbook can create a binding employment contract.

B. Interpreting Employee Handbooks as Implied Unilateral Contracts

Under the standard analysis, there are three distinct steps in the transformation of an employee handbook into a unilateral contract: (1) the employer makes a promise limiting its right to fire at will, (2) the employer communicates that promise to its employee through a handbook, and (3) the employee accepts the offer by commencing or continuing to work for the employer. These requirements map nicely onto the general contractual requirements of offer and acceptance in the context of unilateral contracts. First, the employer's statements in the handbook constitute the contractual offer. Second, the employer's communication of the offer to the employee through the handbook ensures the knowledge of the offer that is a prerequisite to the accep-
tance of a unilateral contract. Finally, the employee accepts the offer through commencing or continuing to work for the employer.

1. The law of unilateral contracts.

Before deciding whether the employee handbook decisions really are straightforward applications of traditional contract law (as the language of the opinions might suggest), it is first necessary to understand the basics of unilateral contract law.

While there is no universally agreed upon definition of a "contract," according to well-established legal principles contracts are initiated by one party, the promisor-offeror, making a promise to a second party, the promisee-offeree. Regardless of the technical definition of a contract, however, offer and acceptance are two components universally viewed as essential to contract formation.

An offer is commonly defined as a conditional promise to do or refrain from doing something in the future if the other party accepts the offeror's conditions. A promise, in turn, is defined as "a manifestation of intention to act or refrain from acting in a specified way, so made as to justify a promisee in understanding that a commitment has been made." Promises may be either express or implied. It is important to distinguish offers from mere statements of intention, hope, or desire, none of which is transformable into a binding promise. There is no difference between the role of an offer in unilateral and bilateral contracts.

49 See Mark Pettit, Jr., Modern Unilateral Contracts, 63 BU L Rev 551, 552 (1983) (describing traditional contract doctrine and noting that unilateral contracts are distinguishable from bilateral contracts because the promisee-offeree does not accept by giving a return promise).
50 See, for example, Calamari and Perillo, The Law of Contracts § 1.1 at 1, § 2.1 at 25 (cited in note 48); Pettit, Modern Unilateral Contracts, 63 BU L Rev at 552 (cited in note 49). For a general discussion of promise as the principle for contract formation, see Charles Fried, Contract as Promise: A Theory of Contractual Obligation (Harvard 1981).
52 Restatement (Second) of Contracts § 2 (1979). See also Peter Meijes Tiersma, Reassessing Unilateral Contracts: The Role of Offer, Acceptance and Promise, 26 UC Davis L Rev 1, 20–21 (1992) (arguing that an unaccepted offer is not a promise as that term is used in modern speech theory).
53 See, for example, Roebling v Anderson, 257 F2d 615, 619 (DC Cir 1958) (stating that the legal effect of express and implied contracts is identical and that the distinction between the two types of contracts is simply based on the way that the parties manifest mutual assent).
54 See Peters v Bower, 63 S2d 629 (Fla 1953) (holding that an affidavit of intent to grade streets in a subdivision did not amount to a binding contract); Bowman v Hill, 45 NC App 116, 262 SE2d 376 (1980) (holding that a document stating that vendors desired to construct a building adjacent to the building of the purchaser at some future time was a statement of wishes and desires and not a contractual promise).
An offer is understood to invite acceptance. An offeree accepts an offer, the original promise becomes a contract. In a bilateral contract, the promisee binds the promisor to his original promise by making her own promise to perform: that is, each party is both promisor and promisee. Unilateral contracts differ from bilateral contracts in that the second party does not accept by making a promise in return. Rather, the second party must bind the promisor to his promise by another method of consideration, usually the performance of a requested action.

Mutual manifestation of assent is a prerequisite to the formation of a contract. Thus, whether a promise will actually become a binding contract is dependent both on the intention of the promisor to make an offer and on the intention of the promisee to accept the offer. Rather than relying on an actual subjective "meeting of the minds," however, courts have long looked to objective standards such as the words and actions of the parties. Such objective manifestations of

55 See, for example, League General Insurance Co v Tvedt, 317 NW2d 40, 43 (Minn 1982) (indicating that an offer empowers an offeree to create a contract by accepting the offer and that a completed contract does not arise until the offer is accepted).
56 See, for example, Philadelphia Newspapers, Inc v Commonwealth, Unemployment Compensation Board of Review, 57 Pa Commw 639, 426 A2d 1289, 1290 n 3 (1981) (stating that an offer "is a manifestation of willingness to enter into a bargain, which would justify another person in understanding that his assent to that bargain is invited and will conclude it" and creates a power of acceptance in the offeree to transform the offeror's promise into a contractual obligation).
57 Restatement of Contracts § 12 (1932) (defining bilateral and unilateral contracts).
58 See Pettit, 63 BU L Rev at 552 (cited in note 49) (indicating that modern courts bind the offeror without inferring an implied promise by the offeree). See also Richard A. Lord, ed, 1 Williston on Contracts § 1:17 at 41 (Lawyers Cooperative 4th ed 1990) (describing the distinction between bilateral and unilateral contracts and its history).
59 See, for example, SouthTrust Bank v Williams, 775 S2d 184, 188 (Ala 2000) (stating that in a unilateral contract, the offeror makes an offer or promise that invites performance by the offeree, and that such performance constitutes both acceptance of and consideration for the offer).
60 See, for example, Christenson v Billings Livestock Commission Co, 201 Mont 207, 653 P2d 492 (1982) (holding that a proposed settlement between a workers' compensation claimant and a liability carrier that was not approved by an official with the authority to bind the liability carrier did not constitute a binding settlement contract because there was no mutual assent); Quality Sheet Metal Co v Woods, 2 Hawaii App 160, 627 P2d 1128, 1131 (1981) (stating that "to create a binding contract, there must be a mutual assent or a meeting of the minds"); Brown v Considine, 108 Mich App 504, 310 NW2d 441, 443 (1981) (stating that the requirement that there be mutual assent to a contract is basic to contract law and that a contract arises when both parties have executed and accepted it, not before).
61 See Restatement (Second) of Contracts § 2 comment b (cited in note 52) (indicating that the phrase "manifestation of intention" adopts an external or objective standard for interpreting conduct such that a party manifests an intention if he believes or has reason to believe that the other party will infer that intention from his words or conduct).
62 See Ricketts v Pennsylvania Railroad Co, 153 F2d 757, 760-62 (2d Cir 1946) (Frank concurring) (noting that some courts use objective in lieu of subjective standards in analyzing
intent should generally be "viewed from the vantage point of a reasonable person in the position of the other party." It is, at least theoretically, possible to form a bilateral contract even if the offeree did not actually know about the existence of the offer at the time of "acceptance." In order for a unilateral contract to be formed, however, the offeree must always actually know of the existence of the offer at the time of performance of the act that constitutes acceptance.

2. Employee handbooks as unilateral contracts.

The Supreme Court of Illinois' statement in *Duldulao v Saint Mary of Nazareth Hospital Center* is a standard explication of the three elements commonly thought necessary to transform a handbook into a unilateral contract:

First, the language of the policy statement must contain a promise clear enough that an employee would reasonably believe that an offer has been made. Second, the statement must be disseminated to the employee in such a manner that the employee is aware of its contents and reasonably believes it to be an offer. Third, the employee must accept the offer by commencing or continuing to work after learning of the policy statement. When these conditions are present a valid contract is formed.

Under the *Duldulao* standard, in order for a handbook to be binding there must be (1) a clear statement of intent on the part of the

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63 *USA Cable v World Wrestling Federation Entertainment*, 2000 Del Ch LEXIS 87, *54 (stating that the offeree's intention to accept an offer is unimportant except insofar as it is overtly manifested). See also *Shields v Keystone Cogeneration Systems, Inc*, 620 A2d 1331, 1334 (Del Super 1992) ("An intent which remains unexpressed and is not manifest to others cannot prevail."); *Sands v Sands*, 252 Md 137, 249 A2d 187, 191 (1969) ("[T]he test of a true interpretation of an offer or acceptance is not what the party making it thought it meant or intended it to mean, but what a reasonable person in the position of the parties would have thought it meant."); *Embry v Hargadine, McKitterick Dry Goods Co*, 127 Mo App 383, 105 SW 777 (1907) (holding that only intention as indicated by the words or acts of the parties is relevant to the question of whether the parties created a contract and that the parties' inner intentions cannot make a contract or prevent one from arising).

65 See Calamari and Perillo, *The Law of Contracts* § 2.13 at 73–74 (cited in note 48) (indicating that subjective intent to accept is usually irrelevant when the offer pertains to a bilateral contract and that unless the offeror knows or has reason to know that the offeree did not intend to accept, a bilateral contract is formed when the offeree makes the requested promise even if the offeree did not subjectively intend to accept).

66 *Id at 74.*

67 *Id at 318.*
employer, (2) actual dissemination of the handbook to the employee, and, possibly, (3) subjective knowledge of the offer on the part of the employee. While Duldulao may have reflected the state of the law at the time of its decision, it is no longer obvious that any of these three conditions continues to be necessary in order for a court to find that an employee handbook is a contract. Many courts have relaxed these requirements, suggesting that current judicial interpretations of employee handbooks have gone beyond the simple application of classic unilateral contract law.

a) Intent to make an offer. Usually, a promisor must make a statement with specificity sufficient to justify a promisee's understanding that a commitment was made before a statement can constitute an offer. Thus, handbooks explicitly stating that employees will not be fired without good cause, and lacking disclaimers reserving the at-will rule, can easily be construed as promises even under the most traditional understanding of contract law. In practice, however, courts have used a far more liberal standard in binding employers to statements made in their handbooks, and have routinely held that lists of discipline and discharge procedures, so-called “internal due process” procedures, are objective offers extended by employers.

Handbooks frequently contain internal due process provisions laying out progressive discipline procedures that management is supposed to follow preceding the termination of an employee. Courts frequently hold that such handbook provisions create a contractual obligation for the employer to comply with the procedural steps prior to the discharge of an employee. The rationale of these decisions re-

68 Id at 318–19.
69 But see Woolley, 491 A2d at 1264–66 (holding that a manual constitutes a binding contract unless no one could reasonably have thought that it was intended to create legally binding obligations, and that although the manual was distributed only to some employees, it still constitutes a binding contract for employees who did not receive it).
70 See Sunstein, 87 Va L Rev at 219 (cited in note 6) (noting that courts have used highly ambiguous commitments from employers—and even handbooks containing express disclaimers—to infer contractual terms of job security).
71 See Day v Amax, Inc, 701 F2d 1258, 1263 (8th Cir 1983) (indicating that providing mere descriptions of merchandise and purchase terms is not sufficient to constitute a legally valid offer).
72 See, for example, Cannon v National By-Products, Inc, 422 NW2d 636, 640 (Iowa 1988) (binding an employer to handbook language reading, “No employee will be . . . dismissed without just and sufficient cause”).
73 See, for example, Duldulao, 505 NE2d at 319–20; Preston v Claridge Hotel & Casino, Ltd, 231 NJ Super 81, 555 A2d 12, 15–16 (1989).
74 See, for example, Butterfield v Citibank of South Dakota, NA, 437 NW2d 857, 859 (SD 1989) (indicating that a “for cause only” agreement may be implied where a handbook contains either a mandatory and specific procedure that the employer agrees to follow prior to any employee's termination, or a detailed list of grounds for employee discipline and discharge); Duldulao.
lies on the understanding that the very listing of these discharge procedures is promissory in nature, regardless of subjective employer intent. Thus, in the words of the Supreme Court of Illinois, if "[a]n employee reading the handbook would . . . reasonably believe that . . . he or she would not be terminated without prior written warnings," then the employer makes a judicially enforceable offer even without any subjective intention to do so.

Courts have also found so-called "laundry lists" of dischargeable offenses to be binding on employers. These lists consist of examples of employee behavior that will result in termination. If a handbook's language at all suggests that the list is exclusive, courts will construe it as a promise by the employer to discharge employees only for the stated reasons. In Mobil Coal Producing, Inc v Parks, the Supreme Court of Wyoming found that the statement, "Some of the actions that will not be condoned at the Caballo Rojo Mine are as follows," in conjunction with an advisory, "The above general rules cannot possibly cover all situations that arise," was insufficient to preserve the at-will default when coupled with the listing of twenty-one separate actions.
for which an employee could be fired. Under traditional unilateral contract law, the advisory would have been enough to prevent the extension of an offer, notwithstanding the listing of examples.

Courts have also found lists categorizing types of termination to be binding on employers. In Hunter v Board of Trustees of Broadlawns Medical Center, the Supreme Court of Iowa held that an employee manual listing seven specific categories of termination of employment limited the employer’s ability to fire an employee for any other reason. Unlike the extremely detailed list in the manual under consideration in Parks, the manual at issue in Hunter simply stated:

XII. Separation of Employment

A. Policy: Broadlawns Medical Center strives to provide an orderly exit process for employees who are separated from employment through resignation, retirement or who are discharged for cause. The employee’s last day worked is the effective date of separation. Broadlawns Medical Center regrets the loss of services of an employee, but it is understandable that separations of employees occur. The types of separation are:

1. Voluntary Resignation: employee-initiated resignation with proper notice.
2. Voluntary Quit: employee-initiated separation without proper notice.
3. Retired: at employee’s or Broadlawns Medical Center’s request.
4. Three (3) Day Quit: employee failed to report to work for three consecutive days without notifying immediate supervisor, therefore, employee is considered to have abandoned position.
5. Expired Leave: failure of employee to report to work at the end of an authorized unpaid leave of absence.

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80 Id at 705. See also id at 706-07 (concluding that handbook provisions reflecting for-cause discharge constitute a contract and negate the at-will default because they create an expectation that they will be followed and induce employees to continue employment with the employer, while the employer secures a more orderly, cooperative, and loyal workforce as consideration).

81 See, for example, Burnside v Simpson Paper Co, 123 Wash 2d 93, 864 P2d 937, 943-44 & n 8 (1994) (concluding that a handbook’s list of “Types of Terminations,” which seemed exhaustive and indicated terminations only for cause, could contractually modify the at-will relationship); Hunter, 481 NW2d at 515-16. See also Osterman-Levitt v MedQuest, Inc, 513 NW2d 70, 74 (ND 1994).

82 481 NW2d 510 (Iowa 1992).

83 Id at 515.
6. Discharge: Broadlawns Medical Center initiates separation for cause.

7. Staff Reduction: Broadlawns Medical Center initiates employee lay off to reduce staff when deemed necessary.

Even such a modest list, however, was enough for the court to find manifest intent on the part of the employer to create a contract promising to terminate employees only for cause.

As demonstrated by these cases, at least some courts have repeatedly interpreted ambiguous handbook language in favor of finding an offer. It would be more in line with traditional applications of contract law if courts interpreted progressive discipline procedures contained in handbooks as mere expressions of an employer’s intent, hope, or desire for a well-functioning and amicable workplace rather than as an objective offer. Rather than adopting the approach that handbooks are not offers absent the explicit use of promissory language, however, courts in the last two decades started to regularly construe handbooks as offers, often treating the existence of an offer as the default presumption. While an explicit and unambiguous disclaimer stating that disciplinary procedures are merely suggested rather than mandated—or that the list of offenses is illustrative rather than exhaustive—may be able to preserve the at-will presump-
tion, the assumption that an offer exists unless proved otherwise is an aggressive application of contract law. As will be discussed in Part III.C, this understanding penalizes employers who do not inform their employees that, despite discharge and discipline procedures, they remain terminable at will.

b) The role of disclaimers in preventing offers. A promise will lead to a binding contract only if it is the intent of the promisor to extend an offer. As discussed above, courts judge this intent objectively through the words and actions of the party.

When courts first began to recognize employee manuals as implied unilateral contracts, they explicitly reserved the right of employers to include disclaimers stating that employment remained at will. In Woolley, one of the earliest decisions on the issue, the New Jersey Supreme Court stated in dicta:

All that need be done is the inclusion in a very prominent position of an appropriate statement that there is no promise of any kind by the employer contained in the manual; that regardless of what the manual says or provides, the employer promises nothing and remains free to change wages and all other working conditions without having to consult anyone and without anyone's agreement; and that the employer continues to have absolute power to fire anyone with or without good cause.

In deciding actual disclaimer cases, however, later courts have applied a stricter standard than that suggested in Woolley. In their determinations of the efficacy of disclaimers in preventing contract formation, courts have focused primarily on (1) the clarity of the

1043 (Idaho App 1987) (concluding that a handbook stating that a list of prohibited conduct is not "all-inclusive" does not modify the at-will default).

90 See Restatement (Second) of Contracts §§ 1–2, § 2 comment b (cited in note 52).

91 See Ricketts, 153 F2d at 761 (Frank concurring).

92 See, for example, Small v Springs Industries, Inc, 292 SC 481, 357 SE2d 452, 455 (1987) (holding that a jury may consider a handbook in deciding whether there was an agreement limiting the employee's at-will status, but suggesting that through the use of conspicuous disclaimers, employers can issue manuals that do not create reasonable expectations in employees and thus do not alter the at-will contract); Leikvold v Valley View Community Hospital, 141 Ariz 544, 688 P2d 170, 174 (1984) (suggesting that a manual that clearly and conspicuously tells employees that the manual is not part of the employment contract and that their jobs are terminable at will would not induce reasonable reliance on the part of employees); Toussaint, 292 NW2d at 894–95 (asserting that employers can inform their employees that personnel policies, such as those included in handbooks, are subject to the employer's unilateral changes).

93 491 A2d at 1271. The handbook under consideration in Woolley itself did not contain a disclaimer, so the court's discussion was merely dicta. See id at 1258–59, 1269–70.
disclaimer's language, (2) the placement and visibility of the disclaimer, and (3) employer behavior inconsistent with the disclaimer.

The disclaimer decisions are particularly important to an analysis of judicial interpretations of employee handbooks for two reasons. To begin with, there are significant discrepancies in how courts have treated individual disclaimers, leading to much uncertainty in the law. Additionally, courts have often seemed to go out of their way to prevent the enforcement of disclaimers, even to the point of going against precedent and the internal logic of a case.

Thus, in *McDonald v Mobil Coal Producing, Inc* (99) the Supreme Court of Wyoming invalidated a disclaimer stating, "READ CAREFULLY BEFORE SIGNING: I agree that any offer of employment, and acceptance thereof, does not constitute a binding contract of any length, and that such employment is terminable at the will of either party, subject to appropriate state and/or federal laws." Although the disclaimer was placed at the front of the handbook, was introduced in capitalized letters, and was written in plain English, the court held that

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94 See, for example, *Hanson v New Technology, Inc*, 594 S2d 96, 99 (Ala 1992) (holding that no employment contract was created by an employee handbook containing a statement expressly disclaiming that the handbook constituted an employment contract and restating that employment was at will); *Palmer v Women's Christian Association*, 485 NW2d 93 (Iowa App 1992) (holding that a handbook containing an unambiguous disclaimer prominently displayed on the first page did not create an employment contract).

95 See, for example, *Durtsche v American Colloid Co*, 958 F2d 1007, 1010-11(10th Cir 1992) (refusing to honor a disclaimer because it was buried in the handbook glossary and nothing drew the employees' attention to the disclaimer); *Sanchez v Life Care Centers of America, Inc*, 855 P2d 986 (Wyo 1991) (holding that disclaimers in employee manuals must be conspicuous to be effective against employees and that a disclaimer that was not set off by a border or larger print, was not capitalized, and was contained in a general welcoming section of the handbook was not conspicuous enough to be effective against employees); *Kumpf v United Telephone Co*, 311 SC 533, 429 SE2d 869 (SC App 1993) (holding to be insufficient a disclaimer inconspicuously placed on the last page of a handbook and not capitalized or set apart with a distinctive border, contrasting type, or contrasting color).

96 See, for example, *Marr v City of Columbia*, 307 SC 545, 416 SE2d 615 (1992) (holding that a handbook did not create an employment contract when the disclaimer was prominently displayed and there was no evidence that either the employer or the employee treated the handbook as a contract, but suggesting that a contract could be created if the employer had treated the handbook as a contract notwithstanding the disclaimer).

97 Compare *McDonald*, 820 P2d 986 (holding an inconspicuous disclaimer to be insufficient as a matter of law), with *Robinson v Christopher Greater Area Rural Health Planning Corp*, 207 Ill App 3d 1030, 566 NE2d 768 (1991) (holding a disclaimer to be sufficient to maintain employment at will without addressing its conspicuousness).

98 See *McDonald*, 820 P2d at 988-89 (concluding that a disclaimer explicitly stating that a handbook was not an employment contract was unclear as to its effect on the employment relationship).


100 Id at 988.
it was insufficient to prevent a handbook from becoming a contract. Despite the outcome seemingly dictated both by precedent and by adherence to the legal rules stated in the case, because the disclaimer was "not set off by a border or larger print, was not capitalized, and was contained in a general welcoming section of the handbook," it was not sufficient to maintain the at-will employment relationship.  

Disclaimers must be comprehensible to "persons untutored in contract law." Where courts find the language of the disclaimer to be ambiguous and capable of different interpretations, it will not be taken as a sign of the employer’s intention to preserve employment at will. Given the liberal judicial constructions of discipline and discharge procedures described earlier, an ambiguous disclaimer coupled with arguably promissory language to alter the employment-at-will relationship will usually result in a decision favorable to the employee.

Even more noteworthy, however, is the fact that even disclaimers written in unambiguous language may be unsuccessful in preventing the employee handbook from creating a contract. Numerous courts have held that employers must place disclaimers in such a way as to attract the attention of employees. In determining whether disclaimers have been displayed prominently enough, courts have looked to print size, typeface (including capitalization), borders, placement of the

101 Id at 989.
102 Id. See also Wait v Beck’s North America, Inc, 241 F Supp 2d 172, 185 (ND NY 2003) (holding that a handbook containing conspicuous plain language disclaiming the creation of a contract does not constitute a binding employment contract because an employee cannot reasonably rely on handbook policies that purportedly create contractual rights where the handbook’s plain language states that it does not create such rights).
103 See McDonald, 820 P2d at 989.
104 See, for example, Jones v Central Peninsula General Hospital, 779 P2d 783 (Alaska 1989) (holding that an ambiguous and inconspicuous disclaimer will not absolve employers from following a manual that creates the impression that employees are provided with certain job protections); Long v Tazewell/Pekin Consolidated Communication Center, 215 Ill App 3d 134, 574 NE2d 1191 (1991) (holding that ambiguities in disclaiming language must be held against the drafter and that an employee manual containing clearly stated policies regarding employment in mandatory terms created an enforceable contract despite its disclaimer).
105 See, for example, Fitch v Continental Casualty Co, 2002 US Dist LEXIS 24269, *27–28 (ND Ill) (concluding that a disclaimer written in small print at the bottom of a blank page at the end of an employee guide was not conspicuous enough to deny the creation of a contract); Lincoln v Wackenhut Corp, 867 P2d 701 (Wyo 1994) (holding a disclaimer to be effective where its text was approximately twice the size of the lettering used in the remainder of the handbook); Kumpf, 429 SE2d 869 (holding that a disclaimer that was inconspicuously placed on the last page of a handbook and was not capitalized or set apart with a distinctive border, contrasting type, or contrasting color was ineffective); McDonald, 820 P2d 986 (holding that a disclaimer was insufficient as a matter of law when it was not in larger print than the rest of the text, was not capitalized or set off by a border, and was contained in a general welcoming section); Hannah v United Refrigerated Services, Inc, 312 SC 42, 430 SE2d 539 (SC App 1993) (holding that a disclaimer was inconspicuous when factors such as larger or other contrasting type or color were not present).
disclaimer within the text of the handbook, and length of the disclaimer compared with the length of the handbook as a whole. As seen above, however, courts will sometimes go to extreme lengths to invalidate disclaimers. For example, the McDonald court invalidated a disclaimer because, among other reasons, the section containing the disclaimer was only partially capitalized.

Even disclaimers that are unambiguous and prominently placed in the handbook may be inadequate, however, if they are inconsistent with an employer's subsequent behavior. Many of the cases discrediting disclaimers revolve around literature distributed to employees after the distribution of the original handbooks. If subsequent literature is ambiguous or misleading, it may actually override the original unambiguous disclaimer.

For example, the original disclaimer involved in Leahy v Starflo Corp was conspicuously placed and unambiguously worded. In what was a near-textbook example of correct form and substance, the disclaimer was both printed in capital letters at the front of the manual and stated in plain English that the manual did not constitute a contract. After distribution of the manual, however, the employer's personnel manager circulated a letter to employees, stating, "If you are not aware of it we have had a disclaimer in our Employee Handbooks since about 1981. A disclaimer in the Employee Handbook is one

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106 See, for example, Fejes v Gilpin Ventures, Inc, 960 F Supp 1487, 1495 (D Colo 1997); Kumpf, 429 SE2d at 872; McDonald, 820 P2d at 989; Hicks v Methodist Medical Center, 229 Ill App 3d 610, 593 NE2d 119 (1992) (holding that an employment contract existed where the handbook language disclaiming such a contract was not highlighted, capitalized, or prominently displayed).

107 See, for example, Fejes, 960 F Supp at 1495; Kumpf, 429 SE2d at 872; McDonald, 820 P2d at 989.

108 See, for example, Fitch, 2002 US Dist LEXIS 24269 at *27-28; Kumpf, 429 SE2d at 872; McDonald, 820 P2d at 989.

109 See, for example, Jones, 779 P2d at 788 (indicating that a one-sentence disclaimer followed by eighty-five pages of detailed text does not unambiguously and conspicuously inform the employee that the manual is not part of an employment contract).

110 820 P2d at 989.

111 Leahy v Starflo Corp, 314 SC 546, 431 SE2d 567 (1993) (concluding that a disclaimer is invalid when subsequent language used by the employer creates ambiguity by suggesting that the employer intended to waive the disclaimer); Swanson v Liquid Air Corp, 118 Wash 2d 512, 826 P2d 664, 674-75 (1992) (noting that an employer's inconsistent statements can negate and override a disclaimer because ambiguous contract terms are resolved against the party choosing the ambiguous terms); Brown v United Methodist Homes for the Aged, 249 Kan 124, 815 P2d 72, 83 (1991) (indicating that an employer's oral statements of policies that are inconsistent with a written handbook disclaimer may negate the disclaimer).

112 See, for example, Swanson, 826 P2d at 676 (holding that a memorandum distributed subsequent to the distribution of the handbook was inconsistent with—and thus negated—the handbook's disclaimer).


114 Id at 569.
thing but what does the Company Policy say?? Read Policy #120-01 or Procedure #A04-003." Rather than cementing the legal effect of the original disclaimer, however, as was clearly the employer's intent, the Supreme Court of South Carolina held that the subsequent letter was ambiguous and waived the original disclaimer altogether. In sharp contrast to the decisions just discussed, other decisions have found the mere existence of a disclaimer enough to preserve the at-will relationship. These decisions acknowledge the presence of the disclaimer without closely examining language, placement, or additional employer behavior.

In Moore v Illinois Bell Telephone Co, the Appellate Court of Illinois upheld a disclaimer written in the broadest language, "The Plan is a statement of management's intent and is not a contract or assurance of compensation," without any discussion of the context or length of the disclaimer in relation to the handbook as a whole. In Anderson v Douglas & Lomason Co, the Supreme Court of Iowa recognized the validity of a two-sentence disclaimer at the end of a fifty-three-page employee manual. According to the Anderson court, other judicial interpretations of disclaimers had been far from straightforward applications of contract law, and had resulted in much uncertainty about the efficacy of any given disclaimer.

The Anderson court acknowledged that "[a]lthough in theory disclaimers protect employers, many courts have imposed requirements that make it more difficult to give effect to them." The court found that the case before it was "yet another case ... in which an employer has tried to satisfy the court's secret concept of an adequate dis-

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115 Id.
116 Id.
117 See, for example, Conaway v Control Data Corp, 955 F2d 358, 361 (5th Cir 1992) (noting that the at-will employment relationship is unaltered when an employee manual explicitly states that it is not intended to create a contract). See also Alameda v Martin Marietta Corp, 6 IER Cases (BNA) 95, 97 & n 4 (D DC 1990); Petersen v Sioux Valley Hospital Association, 486 NW2d 516, 520 (SD 1992); Smith v Union Labor Life Insurance Co, 620 A2d 265, 269 (DC App 1993); Robinson, 566 NE2d at 772.
118 See, for example, Conaway, 955 F2d at 361.
120 Id at 520-21.
121 540 NW2d 277 (Iowa 1995).
122 Id at 288. The disclaimer read, in its entirety: "This Employee Handbook is not intended to create any contractual rights in favor of you or the Company. The Company reserves the right to change the terms of this handbook at any time." Id.
123 Id at 287-88.
claimer in an employee handbook." In upholding the disclaimer, the court said:

We think such uncertainty is unnecessary. A disclaimer should be considered in the same manner as any other language in the handbook to ascertain its impact on our search for the employer's intent. Therefore, we reject any special requirements for disclaimers; we simply examine the language and context of the disclaimer to decide whether a reasonable employee, reading the disclaimer, would understand it to mean that the employer has not assented to be bound by the handbook's provisions.

Decisions such as those in Moore and Anderson act as foils to those decisions where courts closely examine disclaimers. These employer-friendly decisions may cause observers to query whether extremely close scrutiny of disclaimers is really appropriate under traditional applications of contract law. It appears that in the case of disclaimers, as with lists of disciplinary and discharge procedures, some courts are aggressively construing ambiguous language to bind employers to handbook statements that are protective of employees.

c) Acceptance of the offer. Under traditional principles of contract law, the promisee's actual knowledge of the offer is an essential prerequisite to acceptance of a unilateral contract. As with promissory language and disclaimers, however, courts have generously construed actual knowledge of an offer in the context of employee handbooks. Courts have allowed employees to rely on handbooks that the employees themselves have never read and in some cases did not even know existed until after their termination. These decisions, similar to those discussed in the previous two Parts, have been very protective of employees.

A number of cases have concluded that an employee need not have actually read the handbook in order to prevail under a unilateral contract claim. In Anderson, the Supreme Court of Iowa explicitly

125 Anderson, 540 NW2d at 288, quoting Sanchez, 855 P2d at 1260 (Cardine dissenting) (suggesting that a disclaimer that is clear, explicit, and adequate to inform a reasonable employee that the at-will relationship should be preserved is legally sufficient).
126 Anderson, 540 NW2d at 288, citing Bolling v Clevepak Corp, 20 Ohio App 3d 113, 484 NE2d 1367, 1373 (1984) (indicating that a reasonable person must be justified in believing a commitment was made for an employment handbook to constitute a contract).
127 See, for example, Kinoshita v Canadian Pacific Airlines, Ltd, 68 Hawaii 594, 724 P2d 110 (1986) (holding that an employee's rights under a handbook do not turn on whether the employee received the handbook because employment contracts do not always follow the traditional model in which contractors bargain over terms and courts seek to implement individual intentions).
128 See, for example, Anderson, 540 NW2d at 285; Nicosia v Wakefern Food Corp, 136 NJ 401, 643 A2d 554, 559 (1994); Kinoshita, 724 P2d at 117; Woolley, 491 A2d at 1268 & n 10.
acknowledged that it was departing from standard applications of contract law in holding that employees could rely on a handbook even if they had not read it. The court explained, "Although this holding is a departure from traditional . . . contract analysis, we think it produces 'the salutary result that all employees, those who read the handbook and those who do not, are treated alike.'"

The Supreme Courts of New Jersey and Hawaii have gone even further than the Anderson court. In Woolley and Kinoshita v Canadian Pacific Airlines, Ltd, the courts found that employees may sue for breach of contract even when they had not received the handbooks. The Kinoshita court expressly stated that when an employer creates an atmosphere "instinct with an obligation," it cannot avoid liability just because a particular employee had not received the handbook. The Kinoshita court was relying on the rationale of Toussaint v Blue Cross & Blue Shield of Michigan, which held that no individual employee need show reliance on a handbook because

[i]t is enough that the employer chooses, presumably in its own interest, to create an environment in which the employee believes that, whatever the personnel policies and practices, they are established and official at any given time, purport to be fair, and are applied consistently and uniformly to each employee. The employer has then created a situation "instinct with an obligation."

Under the Toussaint analysis, actual dissemination of the handbook is not necessary so long as the policies somehow "inform" the workplace environment. It is important to realize that the Toussaint court itself did not find that the handbook involved was a unilateral contract. Decisions such as Anderson and Kinoshita, however, have grafted the Toussaint analysis onto the unilateral contract framework.

129 540 NW2d at 285.
131 68 Hawaii 594, 724 P2d 110 (1986).
132 Woolley, 491 A2d at 1265; Kinoshita, 724 P2d at 117.
133 724 P2d at 117, quoting Toussaint, 292 NW2d at 892.
134 408 Mich 579, 292 NW2d 880 (1980). Although Toussaint did not itself discuss unilateral contracts per se, it was the first case in the 1980s to reconsider the binding nature of an employer's statements and is thus seminal to the employee handbook decisions.
135 Id at 892, quoting Wood v Lucy, Lady Duff-Gordon, 222 NY 88, 118 NE 214 (1917).
136 292 NW2d at 892.
137 Id.
138 Anderson, 540 NW2d at 285; Kinoshita, 724 P2d at 117.
C. CurrentApplications of the Penalty Default Rule

Default rules are those rules that fill the gaps in incomplete contracts and govern the contractual relationship unless explicitly contracted around. In the words of Richard Posner, default rules “should economize on transaction costs by supplying standard contract terms that the parties would otherwise have [adopted] by express agreement.” In contrast to regular default rules, however, penalty default rules are purposely set according to terms that the parties would not have wanted, in an attempt to induce the parties to reveal information to one another and then to affirmatively bargain to their preferred contractual relationship. By setting the right penalty default rules, courts can reduce strategic behavior on the part of better informed parties to purposely set inefficient contract terms at the expense of lesser informed parties. In particular, courts are in the position, as the ultimate arbitrators of contracts, to choose penalty default rules that induce knowledgeable parties to reveal information to their less informed counterparts. Penalizing the better informed party can thus be justified as a way of encouraging the production of information. Penalty default rules are especially attractive in situations where the second party is uninformed about the default rule itself because there is then a reduced likelihood of strategic behavior on its part.

In his influential article on common law employment contracts, Samuel Issacharoff argued that “employment is a prime arena for the use of penalty default rules in contract” because “they preserve an important element of individual voluntarism and guard against significant disparities in bargaining ability.” Sunstein suggests, in his article on the behavioral economics of the American workplace, that in the face of uncertainty about whether an at-will or for-cause default would best mimic the market, “we might seek a background rule that operates . . . to elicit information—that imposes on one or another of the parties the obligation to provide the crucial information to the other side (and also to [the court]).” This Comment argues that in
light of how courts have interpreted employee manuals since 1980, such an information-eliciting default rule is already partially in place, although it is still far from uniformly applied.

As demonstrated above, some state supreme courts are departing from strict application of contract law in their findings both of employers' objective intent to make an offer through the handbook and of employees' objective intent to accept the offer. This departure is most obvious in the area of handbook disclaimers, where a few courts have been extraordinarily exacting in their interpretations of disclaimers.\textsuperscript{148} In addition to strict requirements regarding disclaimers, courts have been very liberal in their findings of acceptance of offers contained in handbooks. Courts have been willing to assume acceptance by employees who did not read the promissory language, and have assumed reliance by employees who may never have even received the handbook itself.\textsuperscript{149} The result of these decisions, in their respective jurisdictions, has been to turn the existence of an employment contract into the default assumption in cases interpreting handbooks that contain discipline and discharge procedures. It is important to remember, however, that not all jurisdictions have taken these approaches. Most jurisdictions recognize employee handbooks as binding under at least some circumstances,\textsuperscript{150} but courts have differed radically in their particular requirements and interpretations.

While it is true that not all courts have been solicitous of employees in their decisions regarding implied employment contracts,\textsuperscript{151} the cases that have emerged as landmarks in this evolving field "share a penchant for protecting long-term employees despite a lack of clear doctrinal reasoning."\textsuperscript{152} In the employee handbook cases, courts seem to have extended this protective penchant beyond the interests of long-term employees to cover all workers governed by handbooks. One can understand these decisions as forcing those employers who wish to benefit from the use of employee manuals to also share with their employees vital information about the realities of termination in an at-will world.

\textsuperscript{148} See notes 105-09 and accompanying text.

\textsuperscript{149} See, for example, Anderson, 540 NW\textsuperscript{2}d at 285; Kinoshita, 724 P\textsuperscript{2}d at 117.

\textsuperscript{150} See Autor, Donohue, and Schwab, The Costs of Wrongful-Discharge Laws at 6 (cited in note 2).

\textsuperscript{151} See, for example, Conaway, 955 F\textsuperscript{2}d at 361.

\textsuperscript{152} Issacharoff, 74 Tex L. Rev at 1804 (cited in note 6) (gauging the sentiments underlying courts' holdings in employment cases, and pointing out that courts demonstrate solicitude for late-career employees regardless of the doctrinal explanation given to support their holdings).
III. EXPANDING THE USE OF PENALTY DEFAULT RULES IN JUDICIAL INTERPRETATIONS OF EMPLOYEE HANDBOOKS

This Part begins by outlining the two major arguments against retaining the current at-will regime regulating employment termination. An explicit and widespread application of penalty default rules in handbook interpretation would address both of these arguments. Part III.B focuses on the possibility of switching the default rule from employment at will to for-cause protection. Such a switch would obviate the need for penalty default rules in the interpretation of employee manuals. The Part then lays out three counterarguments to judicial creation of a for-cause rule. The Part ends with an argument in favor of retaining the at-will regime but encouraging the use of explicit and uniformly applied information-eliciting penalty default rules by all jurisdictions that currently recognize employee handbooks as unilateral contracts.

A. Criticisms of the Current Termination Regime

There are two pervasive problems with the current legal regime regulating termination of employment. First, recent studies have highlighted significant injustices caused by an at-will default rule.153 Second, increased judicial application of common law exceptions to employment at will has caused the law surrounding employment termination to become increasingly confused and unpredictable. According to one study, this confusion and unpredictability leads to negative economic effects in the form of increased unemployment.154

1. Present problems with the employment-at-will default rule.

The United States' employment-at-will presumption is unique in the industrialized world.155 Predictably, there has been much debate over the continued use of the employment-at-will default rule.156 Those

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153 See text accompanying note 167.
154 See note 176 and accompanying text.
156 See, for example, Pauline T. Kim, Norms, Learning, and Law: Exploring the Influences on Workers' Legal Knowledge, 1999 U Ill L Rev 447, 451 (reporting that workers consistently overestimate their legal rights in the context of at-will employment contracts and believe that the law affords protections akin to just-cause contracts); J. Hoult Verkerke, An Empirical Perspective on Indefinite Term Employment Contracts: Resolving the Just Cause Debate, 1995 Wis L Rev 837, 842-44 (arguing in favor of an at-will rule on the grounds that market participants favor it); Stewart J. Schwab, Life-Cycle Justice: Accommodating Just Cause and Employment at Will, 92 Mich L Rev 8, 10-12 (1993) (discussing the competing risks of opportunist firings by unfettered employers and shirking employees with job security, and arguing in favor of an intermediate approach that provides contract protection for employees at the beginning and end of their
in favor of retaining an at-will rule argue that it is a market-mimicking default: that employment at will is the relationship that employers and employees would most likely seek if left to bargain on their own.\textsuperscript{157} Any claim that employment at will is a market-mimicking rule, however, is dependent on two practical prerequisites: (1) that workers know their rights, and (2) that workers have enough power to bargain effectively with their employers. Without these two elements, it is difficult to guess what the outcome of fair and equal bargaining between employees and employers would be.

There is much evidence that suggests that employment at will cannot be claimed to be an accurate market-mimicking rule because employees are uniformly unaware of their rights, or lack thereof, in the current at-will regime. In the late 1990s a number of studies ascertained workers' perceptions of their rights and protections in the at-will workplace.\textsuperscript{158} One nationwide study found that 83 percent of respondents believed it was unlawful to fire an employee for no reason.\textsuperscript{159} A more limited study showed that 90 percent of employees thought that their employers could not terminate them based simply on the personal preference of a manager. Even when shown an explicit disclaimer of job security, up to 70 percent of respondents thought it was illegal to fire a worker in order to hire another person willing to do the same job for less money.\textsuperscript{160}

In order for there to be proper bargaining power, all parties involved must know the terms and conditions they are to bargain over.\textsuperscript{161} Given the results of the above studies, it may be erroneous (or at least premature) to assume that employment at will reflects the result that employees would seek if left to bargain on their own.

The fact that employers receive considerable benefits from dissemination of employee handbooks only exacerbates the potential for injustice associated with employee ignorance of the law. Given the careers while maintaining a presumption of at-will employment for midcareer employees in order to minimize opportunism); Richard A. Epstein, \textit{In Defense of the Contract at Will}, 51 U Chi L Rev 947, 947–51, 955 (1984) (arguing in favor of an at-will rule because an employer should be able to fire an employee who is able to quit at any time and concluding that an at-will default is "the efficient solution to the employment relation").

\textsuperscript{157} See, for example, Epstein, 51 U Chi L Rev at 951, 956–57 (cited in note 156).

\textsuperscript{158} See Freeman and Rogers, \textit{What Workers Want} at 118–22 (cited in note 5); Kim, 83 Cornell L Rev at 110 (cited in note 4).

\textsuperscript{159} Freeman and Rogers, \textit{What Workers Want} at 119 (cited in note 5).

\textsuperscript{160} Estlund, 77 NYU L Rev at 9 (cited in note 6), citing Kim, 1999 U Ill L Rev at 459, 464 (cited in note 156).

\textsuperscript{161} See Sunstein, 87 Va L Rev at 229–31 (cited in note 6) (arguing that since employees are generally unaware that they work in an at-will world and that even if they are aware they are unlikely to know exactly what it means, it is both inaccurate and unjust to assume that employment at will is a true market-mimicking default rule that accurately captures the shared understanding of the parties).
number and scope of decisions holding that manuals can alter employees' at-will status notwithstanding employers' assertions to the contrary, one might have reasonably predicted that employers would simply cease drafting and distributing manuals altogether. Yet employers continue to utilize employee manuals and in so doing strongly suggest that they benefit from them. 162

One of the reasons that employers continue to utilize employee manuals is that they remain the most cost-effective method of disseminating information to employees, especially for large and relatively complex organizational employers. 163 By distributing handbooks, employers ensure that both employees and managers inhabit a "level playing field" regarding knowledge of company policies and procedures. 164 Conventional corporate wisdom holds that this sense of shared knowledge boosts workplace morale and workplace productivity by giving employees confidence that employers uniformly apply company policies. 165 In addition, employers sometimes issue manuals containing job security policies in an attempt to defeat unionization of the workforce. 166

The benefits gained by employers who use handbooks, coupled with the discrepancy between actual and perceived employee protections, militate against the application of an unadulterated at-will default rule. This is so because "[t]he problem with erroneous employee beliefs about the law is that they allow employers to have it both ways: Employers enjoy the considerable benefits of employee beliefs that they are legally protected against unjustified discharge while escaping the costs of that legal protection." 167 In other words, the problems associated with employees' misperceptions of their rights are only heightened when employers distribute handbooks that potentially mislead their employees about protection from termination at will.

163 Id at 229.
164 Id at 229-30. These benefits exist as long as a substantial number of employees read the manuals; as is clear from both common sense and case law, not all employees read the manuals all the time.
165 Id.
166 See, for example, Swanson v Liquid Air Corp, 118 Wash 2d 512, 826 P2d 664, 679 (1992) (indicating that employers attempt to defeat unionization by setting out certain policies and making certain representations to employees). It is worth noting that for-cause protection is typically included in collectively bargained contracts. See Kim, 83 Cornell L Rev at 107 (cited in note 4).
167 Estlund, 77 NYU L Rev at 10 (cited in note 6) (emphasis omitted).
2. Inconsistencies in application of the at-will default.

An additional problem with the current state of the law governing employment termination is that it has become, at least at first glance, "chaotic, a set of cases with little internal coherence or rationale." In the words of one commentator, there is a veritable "doctrinal fog ... engulfing the common law of employment." At least one empirical study suggests that such uncertainty in the law results in negative economic effects in the labor market.

While it is true that employee handbook cases are generally brought in state court, and thus decided under individual states' laws, there remains a need for general uniformity across jurisdictional lines since most institutional employers no longer employ workers in only one jurisdiction. State courts have clearly influenced one another in the handbook decisions already: the great majority of courts reconsidered the handbook issue within a very short time period, and many of the cases referenced one another even when they were decided in different jurisdictions. The use of fairly uniform penalty default rules by states already recognizing the handbook exception to employment at will would not, therefore, be inconsistent with precedent and would promote predictability in the law, thus addressing rule of law concerns.

B. Possible Counterarguments

Many critics of employment at will propose switching the default rule to allow termination only for good cause. There are at least

169 Issacharoff, 74 Tex L Rev at 1804 (cited in note 6) (arguing that the application of legal doctrine in the regulation of the workplace is helter-skelter because some decisions purport to rest on formal contract theory by presuming that all of the elements of a contract exist while others rely on contestable interpretations of societal values to find public policy-based torts, and suggesting that decisions in at-will termination cases, which include employee handbook cases, tend to be exceptionally sympathetic to late-career employees regardless of the doctrinal explanation for the decision given by the court).
170 See Autor, Donohue, and Schwab, The Costs of Wrongful-Discharge Laws at 6–7 (cited in note 2) (suggesting that the uncertainty surrounding a potential judicial finding that an employer's words or actions have created an unintended implied employment contract might "pervasively affect" the employer's personnel practices). For a discussion of the relationship between job security and unemployment, see Part III.B.2.
171 See, for example, Kinoshita, 724 P2d at 116 (citing Toussaint (Michigan) and Thompson v Saint Regis Paper Co, 102 Wash 2d 219, 685 P2d 1081 (1984)); Woolley, 491 A2d at 1263 (citing Toussaint and Mettille (Minnesota), among others).
172 For commentary articulating these concerns, see Schwab, 92 Mich L Rev at 9 (cited in note 156), and Issacharoff, 74 Tex L Rev at 1783 (cited in note 6).
173 See, for example, Estlund, 77 NYU L Rev at 8, 34–35 (cited in note 6); Sunstein, 87 Va L Rev at 207–08 (cited in note 6).
three problems associated with a change from at-will to for-cause: endowment effects, disemployment effects, and questions of judicial competence.

1. Endowment effects.

Empirical studies suggest that, the Coase Theorem notwithstanding, there are real costs involved in switching default rules. Because people overvalue rights they already have, and undervalue rights they do not, changing default rules can actually cause people to change their valuations of specific rights. It may, therefore, be inadvisable to switch from at-will to for-cause without further study of the potential costs.

2. Disemployment effects.

A paper released by the National Bureau of Economic Research in December 2002 found that the implied contract exception to employment at will had a modest negative impact on employment-to-population rates in state labor markets. The study also found that the implied contract exception had a weakly positive association with wages. Rather than attributing the upward trend in wages to employees' increased bargaining power, however, the authors asserted that the lowest-wage workers in any given demographic group were the ones most likely to bear the impact of negative employment rates, thus leading to an upward composition bias in overall wages.

At first glance, if the study argues for any change from the current state of the law, it would appear to be for a return to a rigid employment-at-will regime and against switching to a for-cause default. This seemingly straightforward solution is unsatisfactory, however, for three distinct reasons.

First, most legal scholars agree that there are major injustices associated with sticking to an unadulterated at-will rule. Indeed, it is reasonable to view the common law exceptions to the at-will rule as a

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175 Cass R. Sunstein, *Switching the Default Rule*, 77 NYU L Rev 106, 110-12 (2002) ("When the endowment effect is at work, those who initially receive a legal right value it more than they would if the initial allocation had given the right to someone else.").
176 Autor, Donohue, and Schwab, *The Costs of Wrongful-Discharge Laws* at 3 (cited in note 2) (noting a 0.8 to 1.6 percent decrease in employment-to-population rates for all education and gender groups).
177 Id (observing a 0.5 to 1.5 percent increase in worker wages after recognition of the implied contract exception to the employment-at-will doctrine).
178 Id at 3, 19 (finding that wrongful discharge laws have a disproportionately adverse effect on the employment rate of female, less-educated, and younger workers).
judicial acknowledgement of the inequities inherent in a strict application of employment at will. According to this argument, the costs would be too high to tolerate a return to a regime that did not recognize exceptions to the at-will rule. Rather than rejecting the study, this argument depends on a simple risk-risk analysis, which finds that any disemployment effects are less costly than a rigid at-will rule.

Second, the study does not differentiate between employee handbook decisions and cases relying on other types of implied contracts. The study does not, therefore, necessarily argue against a liberal trend in binding employers to statements made in handbooks as opposed to in other implied agreements.

Third, the authors noted that the implied contract decisions “generated substantial uncertainty surrounding termination, resulting in numerous cases where courts found that employees held implied-contractual employment rights that employers had not subjectively intended to offer.” If it is uncertainty that is creating the disemployment effect, courts may be able to solve this problem by applying explicit penalty default rules in their employee handbook decisions. This solution would serve to remove most uncertainty because employers could simply choose not to issue handbooks, or, if they deemed a handbook desirable, employers could include disclaimers that were sufficiently understandable and conspicuous.

3. Questions of judicial competence.

Even if switching the default rule would be efficient, however, there is a potential institutional argument against judicial abnegation of the at-will standard. Despite both severe criticism lobbied by academics and employee advocates against the at-will default rule, and the promulgation of the Uniform Employment Termination Act in 1991, only Montana has statutorily switched from at-will to for-cause protection. It may not be within courts’ institutional competence to change the default rule in the face of social controversy coupled with overwhelming legislative silence. One must question whether it is appropriate for the judiciary, the least politically accountable branch of government, to unilaterally decide to make a change that might have far reaching and unanticipated economic consequences in the form of rising unemployment. Studies showing that strengthening wrongful

180 See Sunstein, 77 NYU L Rev at 126 (cited in note 175) (suggesting that switching the default rule from at-will to for-cause might decrease employment); Autor, Donohue, and Schwab, The Costs of Wrongful-Discharge Laws at 3 (cited in note 2) (finding that adoption of the im-
discharge laws can lead to increased unemployment only heighten these concerns.\textsuperscript{181}

Cynthia Estlund is correct in asserting that courts could use the common law to switch the default.\textsuperscript{182} After all, courts created the handbook exception after decades of refusing to recognize implied agreements in the employment context. A penalty default rule has one great advantage over switching to for-cause protection, however: the penalty default rule is already in use in numerous jurisdictions, so there are already common law precedents for courts to follow. One would expect more uniformity among individual courts and jurisdictions in applying a preexisting rule than in individual formulation of new rules. The existence of precedent may also serve to lessen concerns among those worried about judicial activism. Although the very recognition of employee handbooks as unilateral contracts was arguably a radical departure from precedent, there now exists over two decades of case law on which courts can rely in applying a penalty default rule in handbook interpretation.

C. Arguments in Favor of Expanding the Use of Penalty Default Rules

Given the current disarray in the laws regulating employee handbooks and the potential economic costs associated with such uncertainty, it seems that some change is required. The above arguments show, however, that neither a strict at-will nor a strict for-cause default may be desirable. Application of penalty default rules in judicial interpretations of employee handbooks would unify the current case law, and offers two potential advantages over either an at-will or for-cause regime.

First, an information-eliciting penalty default rule presents a way of addressing some of the inequities associated with an at-will rule without incurring the economic risks and uncertainties associated with switching the default rule to for-cause protection. As demonstrated above, employment at will can be an accurate market-mimicking rule only if both employers and employees actually know what they are bargaining for. As numerous studies show, however, employers know much more about the law than do their employees. Penalty default

\textsuperscript{181} See Autor, Donohue, and Schwab, The Costs of Wrongful-Discharge Laws at 3 (cited in note 2).

\textsuperscript{182} See Estlund, 77 NYU L Rev at 32 (cited in note 6) (indicating that the current at-will rule is a common law background rule, and arguing that the case for its judicial abandonment has much in common with the reasoning the judiciary used to abandon the "caveat lessee" rule).
rules are well suited for such situations, as they force the better informed party to reveal the actual terms of the bargain by creating "incentives for information revelation through bargaining."[^1] In this respect, penalty default rules make perfect sense as tools for handbook interpretation as they would force employers to educate their employees about the realities of at-will discharge, thereby helping to place employees in a position to fairly and effectively bargain over the conditions of job termination.

According to this analysis, courts would begin with the assumption that by distributing handbooks discussing discipline and discharge procedures, employers change the at-will default in their work environments. While employers may retain the employment-at-will default through a disclaimer, they can do so only if they make their intentions clear to employees. In order to succeed in retaining the at-will default, a disclaimer would need to meet two requirements. First, it would need to be written in plain English so as to be easily understood by laypersons reading the handbook. Second, it would need to be placed in such a way as to maximize the likelihood that an employee would both actually read it and realize that it applied to the handbook as a whole.

The second advantage of a penalty default rule is that while courts may not wish to mandate that employers undertake a massive educational campaign *sua sponte*, a penalty default rule would at the very least begin to ensure that employers do not "have it both ways." Employers who wish to use employee manuals should be required to take extra care in making sure that they do not benefit from the manuals by deceiving their employees about the actual level of job security offered. If employers who use employee manuals wish to retain an employment-at-will standard, they must inform their employees of that intention in an explicit disclaimer within the four corners of the manual and in such a way as to maximize both the number of employees who will read the disclaimer and the number of employees who understand what it means. The fact that courts are drawing inferences of contractual job security on the basis of the "highly ambiguous commitments" contained in employee manuals displays "an implicit

[^1]: Jason Scott Johnston, *Strategic Bargaining and the Economic Theory of Contract Default Rules*, 100 Yale L.J. 615, 625 (1990) (indicating that default rules should promote efficient outcomes by creating incentives for information disclosure that allow the parties to take proper precautions to avoid inefficient outcomes rather than always reflecting the rule that most parties would want). See also Ayres and Gertner, 99 Yale L.J. at 99–100 (cited in note 19) (suggesting that efficient defaults will sometimes diverge from the rules that the parties would have contracted for and that penalty defaults are purposely set at what the parties would not want in order to promote efficiency by encouraging the parties to reveal information to each other or to third parties).
behavioral rationality in the law, rooted in an understanding of what workers actually think."\textsuperscript{184} By penalizing employers who use manuals without clearly informing their employees about the possibility of at-will termination, a penalty default rule would increase the rationality of the current law.

CONCLUSION

Adopting an explicit and uniform information-eliciting penalty default rule would provide two salutary effects. First, it would explicate seemingly puzzling decisions in employee handbook cases and provide a consistent and analytically sound theory to undergird these decisions. Second, it would educate a workforce that appears to be overwhelmingly ignorant of the current legal realities surrounding job termination.

\textsuperscript{184} Sunstein, 87 Va L Rev at 219 (cited in note 6).