The Unjustified Absence of Federal Fraud Protection in the Labor Market

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Imagine a steel company struggling to stay afloat against strong national and international competition. The company has an outdated production facility in Youngstown, Ohio, and faces two related problems: the need for an infusion of capital to upgrade the facility and the need to maintain employee morale and productivity. A company official meets with people who are interested in making an equity investment in the company. One potential investor asks whether the company is currently profitable and whether the company plans to stay in business for the long term. The official answers, "The company has been profitable, and there are no plans for shutting down our operation." The investors make a sizable equity contribution. Later that day, the official meets with the employees of the Youngstown facility. Employees considering job offers at a new plant down the street ask whether the facility is currently profitable and whether the company plans to keep the plant operating for the long term. The official answers, "The Youngstown facility has been profitable, and there are no plans for shutting down our operation." The employees decline the job offers elsewhere and continue working at the Youngstown facility.

Now assume that the answers to both questions were lies. The official knew that neither the company nor the plant was profitable and that plans were in the works to shut down the plant and liquidate the company. The official lied to the potential investors in order to gain a capital infusion to satisfy other creditors holding short-term obligations. The official lied to the workers to keep them working diligently while the company went through its death throes. The company does eventually shut down, and the securities held by the investors lose a significant portion of their value while the workers lose their jobs.

Both the capital investors and the workers have suffered damage because of the official's lies. Can they do anything about it? For the capital investors, the answer is a resounding yes. Federal law offers significant protection against fraud in the capital market. In this hypothetical, the capital investors would likely have a claim against the official and the company under several provisions of federal law, including section 10(b) of the 1934 Securities Exchange Act and the Securities Exchange Commission's Rule 10b-5. The workers, however, are not the beneficiaries of any federal law protecting them from such fraud in the labor market and would be left without a federal cause of action against the company or the official. This Article argues that this

2. Manipulative and Deceptive Devices and Contrivances. 17 C.F.R. § 240.10b-5 (1997). For further discussion of section 10(b) and Rule 10b-5, see infra notes 48-66 and accompanying text.
3. For a discussion of the very limited remedies federal law provides, see infra notes 89-97 and accompanying text. Moreover, federal law actually throws up obstacles to such protection that the employees might otherwise receive under the common law. See infra Subsections IV B 1-2.
difference in treatment, previously unanalyzed, is unjustified.

This hypothetical is derived from an actual case arising from the closing of two United States Steel facilities in Youngstown in the late 1970s and early 1980s. The corporation had operated two large steel mills in Youngstown since the turn of the century. In the fall of 1977, the workers in these mills and the Youngstown community generally were worried about rumors that the two factories were to be closed. These rumors were not groundless. In later litigation, U.S. Steel itself introduced exhibits of never-mailed letters dated August 25, 1977, announcing the closing of both plants.

Nonetheless, management answered the rumors by assuring employees that shutdowns were not definite and stated on several occasions that the plants could be saved if the workers improved productivity. "Hotline" telephones were strategically placed in the two plants so that employees could listen to prerecorded messages from management. The first such message told the workers that there were "no immediate plans to permanently shut down" either factory and that the mills' "continued operation" was "absolutely dependent upon their being profit-makers." Randall Walthius, an agent of U.S. Steel, told the press that there were studies under way "aimed at making the Youngstown facilities profitable" and that it would be "on the basis of the plants' profitability that they will continue to operate."

4. The analogy between fraud in the labor market and fraud in the securities market has been largely invisible. No scholarship found during the course of writing this Article sought to compare a corporation's duty of truthfulness to investors to its duty of truthfulness to its employees. Perhaps the analogy has been largely unnoticed because of the power of categorization within the law. Labor law and corporate law are rarely studied together; few lawyers and legal academics claim expertise in both areas. Corporate law is seen as an abstract, serious, and usually "conservative" subject in law school; it typically has little or nothing to do with workers. On the other hand, labor and employment law are all about workers; they are probably viewed as much more peripheral to the current law school curriculum and as trivial, "liberal," and somewhat past their prime. This stark dichotomy obfuscates areas of analogous interests and shared analysis. The duty to tell the truth explored in this Article is only one example of this actual overlap; there are probably many more. For one article that explicitly draws comparisons between corporate law and labor law but does not focus on issues of fraud, see Daniel R. Fischel, Labor Markets and Labor Law Compared with Capital Markets and Corporate Law, 51 U. CHI. L. REV. 1061 (1984), which describes the similar incentives that workers and investors face when entering into contracts with firms. For a perhaps hopeful example of corporate and labor scholars coming together, see the papers presented at the Conference on Employees and Corporate Governance, Columbia Law School/Sloan Project on Corporate Governance (Nov. 22, 1996) (unpublished manuscript, on file with the Yale Law Journal). See also Katherine Van Wezel Stone, Labor and the Corporate Structure: Changing Conceptions and Emerging Possibilities, 55 U. CHI. L. REV. 73 (1988).


5. See Local 1330, United Steel Workers v. United States Steel Corp., 631 F.2d 1264 (6th Cir. 1980); Staughton Lynd, The Fight Against Shutdowns: Youngstown's Steel Mill Closings (1982); Singer, supra note 4, at 614-22.

6. See Local 1330, 631 F.2d at 1270 n.4.

7. Id. at 1270-71 (quoting William Ashton, Superintendent, U.S. Steel's Youngstown District) (internal quotation marks omitted).

8. Id. at 1271.
The steelworkers responded to these representations as the company must have hoped: They improved productivity and cut costs. In April 1978, plant superintendent William Kirwan stated on the hotline that his plant had made a profit during the previous month, thus showing that the goal of profitability was "attainable." Kirwan told the press later that month that the company would "be doing business here for some time to come." In both May and June 1978, Kirwan made similar profitability reports. By the end of 1978, Kirwan was able to record a statement on the hotline recounting the year's successes: "[E]arly in 1978 we initiated significant changes in our operations in order to make Youngstown Works profitable and once again a viable plant. . . . [W]e have attained our 1978 goal which was 'survival' and now we embark on the 1979 goal which is 'revival.'"

The company also made representations to the general public that the plants had righted themselves. For example, in a letter to the editor of the Wall Street Journal published in April 1979, company management boasted that a "complete turn-around has been achieved at Youngstown in the past year." The letter asserted that a report that the Youngstown plants were eroding corporate profits was "nonsense" and "fiction." These assurances continued throughout 1979. Indeed, the Chairman of the Board of U.S. Steel, David Roderick, emphasized in mid-June that, "[s]imply stated, we have no plans for shutting down our Youngstown operation."

The employees appeared to rely on the company's representations. They improved their productivity, allowed management to adjust seniority policy to save money, and waived grievances when management combined some jobs. Moreover, individual employees depended on the company's representations to make important personal decisions. One employee, Frank Georges, bought a new house on November 27, 1979, the day the Board of Directors of U.S. Steel met in New York and voted to close both Youngstown plants. The decision would put 3500 employees out of work. Georges heard the news as he was driving home from the bank.

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9. Id. at 1272.
10. Id.
11. See id. at 1274-75.
12. Id. at 1272.
13. Id. (quoting a letter from Kirwan; C.I. Richards, Jr., an agent of U.S Steel; and R.M Greer, also an agent of U.S. Steel) (internal quotation marks omitted).
14. Id. at 1272-73 (quoting a letter from Kirwan and R.M Greer) (internal quotation marks omitted).
15. In September 1979, Kirwan told a group of employees that the employees had "saved their jobs." Id. at 1276.
16. Id. at 1273. Only two things could cause a shutdown, Roderick said, "massive expenditures to meet environmental requirements" or an "unproductive plant operation." Id. But he reiterated that the Youngstown plant was "profitable" and "operating in the black." Id. In early November, another corporate representative, Frederick Foote, asserted that "[w]e've said all along the Ohio Works has been profitable and there are no plans for a shutdown." Id.
17. See id. at 1275-76.
18. See id. at 1277. Another employee admitted to his foreman that he was considering other employment because his pension had fully vested. The foreman advised him not to do so because he had
The employees and their labor union sought legal recourse. Joined by the Congressman from the affected district and the Attorney General of Ohio, the union sued to enjoin the closure. The employees argued that statements made by the company constituted an enforceable promise to keep the plants open as long as the plants were profitable. This claim was rejected by the courts, which accepted the company's argument that, despite its earlier comments to the contrary, the plants were not profitable. Even though there was some evidence that U.S. Steel had changed its definition of profit over time, neither the federal district court nor the Sixth Circuit was willing "to exchange its own view of the parameters of profitability for that of the corporation." The workers argued that, based on reliance interests, a "property right has arisen from the long-established relation between the community . . . and Plaintiffs, on the one hand, and Defendant on the other." After some initial statements admitting sympathy for this claim, the district court decided that there was no precedent for such a property right and that it lacked power to create such a legal claim. The Sixth Circuit affirmed the lower court's holding.

It is possible that David Roderick did not actually know of plans to close the Youngstown plants when he made his statement only six months before the announcement of the shutdown was made. Perhaps U.S. Steel used the same definition of profit when company officials claimed the facilities were profitable as when they closed them for lack of profitability. But it is also possible that officials of U.S. Steel either told their workers incomplete truths or complete untruths.

While it is common for chief executive officers to acknowledge that they and their companies have obligations to be honest to their employees, there a "secure future" with U.S. Steel. Id. at 1276. On the basis of this advice, the employee decided to stay with the company, bought a new car, and purchased a new house. See id. at 1276-77.


20. See Local 1330, 631 F.2d at 1279 (reviewing plaintiffs' argument that the definition of profitability the company used in setting goals for the employees was different from the one used in deciding to close the plants).

21. Id. at 1278 (quoting Local 1330, 492 F. Supp. at 7) (internal quotation marks omitted).

22. Id. at 1280 (quoting the amended complaint) (internal quotation marks omitted).


25. For example, Albert Dunlap, the former Chief Executive Officer of Scott Paper who cut 11,000 jobs in 1994, gained some public notoriety for his unabashed arguments that corporate layoffs were necessary for the health of the U.S. economy. Corporate executives are not villains, he said, but rather they are like doctors, healing sick companies and protecting the health of the economy. Even Dunlap recognized, however, that "a CEO has an obligation to communicate with workers and prepare them for the inevitable." Villains? Heck No. We're Like Doctors, NEWSWEEK, Feb. 26, 1996, at 48.
are abundant examples of companies that mislead their employees. These companies may cause their employees to believe, for instance, that their jobs are more secure than they in fact are, \(^{26}\) that their jobs will be better than they

\[\text{\textsuperscript{26}}\text{ While the problem of employer fraud is hardly limited to plant closings, such situations often present particularly poignant examples of possible employer fraud. Not only is corporate downsizing ubiquitous, but employers also have powerful incentives to keep the truth from their workers in such situations. About 10 times a week, a large factory closes down somewhere in the United States, with each closing throwing an average of 190 people out of work (these figures do not include mining, construction, and service companies). See Jon Nordheimer, \textit{Downsized, But Not Out: A Mill Town's Tale}, \textsc{N.Y. Times}, Mar. 9, 1997, at C12. Between 1991 and 1995, nearly 2.5 million Americans lost their jobs because of corporate restructuring. See \textit{Corporations Under Fire}, \textsc{N.Y. Times}, Feb. 25, 1996, at D14. Only about a third of those who lose their jobs find replacement work that pays at least as well as their former jobs. See Louis Uchitelle & N.R. Kleinfield, \textit{On the Battlefields of Business: Millions of Casualties}, \textsc{N.Y Times}, Mar. 3, 1996, at A26.}

Beyond U.S. Steel's experience in Youngstown, there are numerous and more recent instances of possible employer fraud. One will be described later in this text. See \textit{infra} Subsection 1\textsc{V}B \textsc{3a} (discussing White \textit{v. National Steel Corp.}, 938 F.2d 474 (4th Cir. 1991)). Another recent and particularly poignant example of possible fraud comes from the Hathaway shirt factory in Waterville, Maine, where a mostly female work force had been sewing Hathaway shirts for over 150 years. See Adam Zagorski, \textit{Short-Shirted in Maine}, \textsc{Time}, June 3, 1996, at 58. In early 1995, Linda Wachner, the Chief Executive Officer of the Warnaco Group, Inc., Hathaway's parent company, went to Waterville to quell fears of an imminent plant closing. Sales were booming in Warnaco's various brands, and the stock price was soaring. See \textit{id. see also Shareholder Scoreboard: Industry-by-Industry, Who Leads the Field in Shareholder Returns, \textsc{Wall St. J.}, Feb. 27, 1997, at R4 (table titled “Apparel-Clothing & Fabrics”) (showing Warnaco stock’s five-year average return to be the second best within its industry group). According to one account, Wachner assured Waterville workers that she “would not close the plant” if the employees “would do quality work and bring the cost of the shirt down.” Sara Rimer, \textit{Fall of a Shirtmaking Giant Shakes Its Hometown}, \textsc{N.Y. Times}, May 15, 1996, at A14. Afterward, the plant’s employees forfeited a raise to help pay for productivity consultants for the plant, and the employees’ union persuaded the company to adopt a joint labor-management program to address workplace problems and improve productivity. See \textit{Union Efforts To Increase Productivity Not Enough To Keep Warnaco Plant Open}, \textit{Daily Lab. Rep} (\textsc{BNA}) No. 98, at D-9 (May 21, 1996) [hereinafter \textit{Union Efforts}].

By March 1996, the plant’s employees had significantly increased the factory’s productivity. See Rimer, \textit{ supra} (stating that productivity had doubled); see also \textit{Union Efforts}, \textit{ supra}, at D-9 (stating that output had increased by 33%). The productivity consultant claimed that the employees had “turned the plant around.” Rimer, \textit{ supra}. Warnaco, in the meantime, recorded unprecedented profits. See \textit{Union Efforts}, \textit{ supra}, at D-9. On May 6, 1996, however, Wachner announced that Warnaco would quit making the Hathaway line and either sell or scrap the Waterville plant. Hathaway shirts were not keeping up with Warnaco’s other, more profitable product lines. See Rachel Spevack, \textit{Warnaco Pulling Plug on the Patch}, \textsc{Daily News Rec.} (\textsc{New York}), May 7, 1996, at 1. The Waterville workers were shocked. The chief steward of the local union said that the announcement of the closing was “totally, totally unexpected.” Joe Rankin & Darla L. Pickett, \textit{Hathaway Jobs in Jeopardy}, \textsc{Cent. Me. Morning Sentinel}, May 7, 1996, at A1. According to the company, however, the plant closing “shouldn’t have been a surprise” to the Hathaway employees. \textit{Union Efforts, \textit{ supra}}, at D-9 (quoting Michael Freitag, spokesperson for Warnaco).

Other examples of plant closings may have involved employer fraud. For example, in \textit{Milne Employees Ass’n v. Sun Carriers, Inc.}, \textit{960 F.2d} 1401 (9th Cir. 1991), after the defendant corporation bought Milne, an independent trucking company, Sun Carriers’s management allegedly made speeches and showed videotapes promising the Milne employees job security and asked them to refrain from seeking other employment. Several months later, Sun Carriers closed all of the Milne plants. See \textit{id}. at 1405. Similarly, in \textit{Washington v. Aircap Industries, 860 F. Supp. 307 (D S C 1994)}, the company decided in May to close a factory but, even after this decision had been made, told the workers that the plant would continue operating through the summer. The plant closed six weeks after this announcement with no advance notice to the employees. See \textit{id}. at 310-11. Even more recently, British Petroleum (BP) closed a profitable refinery in Lima, Ohio, after soliciting bids but refusing to sell it to potential buyers. The Mayor of Lima claimed that BP had not dealt “honestly” with the town and its employees. Marc Cooper, \textit{A Town Betrayed: Oil and Greed in Lima, Ohio}, \textsc{Nation}, July 11, 1997, at 11, 13.

Entities other than employees and shareholders have also accused corporations of making misrepresentations to them. For example, in \textit{Charter Township of Ypsilanti v. General Motors Corp.}, \textit{506 N.W.2d} 556 (Mich. Ct. App. 1993) (per curiam), the city of Ypsilanti sued General Motors after it closed
actually turn out to be,\textsuperscript{27} or that their health benefits are assured after retirement when in fact they can be revoked at the will of the company.\textsuperscript{28} In these cases, would the law have something to say about the companies' actions? Should it?

Part I of this Article begins the analysis of these questions by sketching the common law background of the tort of deceit and by comparing the differences in the (high) level of protection against fraud in the capital market and the (low) level of protection in the labor market. With a description of the differences set out, Parts II through IV examine possible justifications for the differences between the two levels of protection. Part II argues that economic theory cannot explain the failure to offer fraud protection to workers. Truthful information is important in all kinds of markets, including the labor market, in order to allow people to allocate resources to those uses that offer the greatest return. Part III explains why the market is unlikely to provide adequate protection from fraud on its own. In Part IV, the Article claims that the common law has not been, and will not likely be in the near future, an adequate substitute for national, statutory protection against fraud in the workplace. Common law remedies are insufficient because of meddlesome procedural obstacles workers face in bringing common law fraud claims that capital investors do not face in bringing claims under federal law. Moreover, even when employee claimants succeed in overcoming these procedural impediments, they appear to lose out disproportionately because courts apply what amounts to a presumption against using common law tort to aid workers defrauded by their employers.

In Part V, the Article explores the costs and benefits of national statutory fraud protection for workers. The analysis shows that the net benefits of fraud regulation are likely to be at least as high in the labor market as in the capital markets. Ultimately, this Article concludes that there are no persuasive justifications for having a federal statute that protects the capital market from fraud but not having federal fraud protection in the labor market. The final

\textsuperscript{27} See, e.g., Diane E. Lewis, Tenn. Workers Say Firm Owes Back Pay, BOSTON GLOBE, May 1, 1997, at A1 (revealing that workers were lured to travel from Tennessee to Massachusetts with apparently false promises of lucrative work).

Labor Fraud

section of Part V therefore sketches the contours of a possible federal statute protecting the labor market from fraud.

I. A COMPARISON OF FEDERAL ANTIFRAUD PROTECTION IN THE CAPITAL AND LABOR MARKETS

Federal law provides a high level of protection against fraud in the capital market but offers a comparatively low level of such protection in the labor market. This part describes these differences. Section I.A outlines the common law tort of deceit, which provides the basis for the antifraud provisions of federal securities law. Section I.B then describes the nature of, and the rationale for, the fraud protection contained in federal securities law. Section I.C illustrates the much more limited protection federal law offers to employees who have been misled by actual or potential employers.

A. The Common Law Background

Most students preparing for the bar exam are able to set out the common law elements of fraud: There must be a material misrepresentation of fact made with some degree of scienter, and the hearer must have reasonably relied on the misrepresentation and suffered damage as a result. Although it has been expanded significantly in both the United States and Great Britain over the centuries, it has remained rooted to its core idea: It is wrong for a participant in the marketplace to tell a lie in order to take value from another in a market transaction.

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29. The level of scienter required is usually knowledge or recklessness but, at times and in some jurisdictions, has been extended to include negligence. See Louis Loss, Fundamentals of Securities Regulation 713 (2d ed. 1988).
30. In the words of the Restatement:
   One who fraudulently makes a misrepresentation of fact, opinion, intention or law for the purpose of inducing another to act or to refrain from action in reliance upon it, is subject to liability to the other in deceit for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation. Restatement (Second) of Torts § 525 (1977); see also W. Page Keeton et al., Prosser and Keeton on the Law of Torts § 105, at 728 (5th ed. 1984); Loss, supra note 29, at 712
31. See Keeton et al., supra note 30, § 105, at 727
32. Much of this central idea was originally captured in the remedy of recision. The defensive employment of the law of recision entailed resisting a seller's action for breach of a contract when the seller had made a misrepresentation to induce the buyer's purchase. Recision was also available as an offensive tool by the buyer in an action for restitution. See id. at 729-30, Louis Loss & Joel Seligman, Fundamentals of Securities Regulation 971 (3d ed 1995)
In 1789, English courts severed the previously necessary connection between misrepresentation and the existence of a contract. See Pasley v. Freeman, 100 Eng. Rep. 450 (K.B. 1789). In Pasley, the tort was held to lie where the plaintiff had no dealings with the defendant but had been induced by his misrepresentations to sell goods on credit to a third person, who subsequently defaulted. A dissenting judge argued that the precedents would not allow the action when there was no privity of contract between the parties, and the defense claimed that recognizing such a cause of action would bring about "mischiefs and
One of the most important expansions of this idea concerned what constitutes an untruth. Because courts now view the significance attached to words or communicative conduct according to their effect, under the circumstances, on the "ordinary" mind, a half-truth is as actionable as an outright lie. Statements that are reasonably capable of both a true and false meaning will amount to misrepresentation if the plaintiff accepts the false meaning and the defendant intends this result or knows that it will occur. Statements that are literally true may also be actionable if they create a false impression in the mind of the hearer. As one old state law case commented, "A fraud may be as effectually perpetrated by telling the truth as a falsehood; by calling things by their right names as by their wrong names."

Moreover, the common law now imposes liability in some circumstances for partial or even complete silence. To be sure, courts did not traditionally consider silence to be actionable deceit, but they have made important exceptions. Silence does not protect someone who has a duty to speak because of a fiduciary or other confidential relationship. Also, complete silence does...
not protect a party to a business transaction who "by concealment or other action intentionally prevents the other from acquiring material information." Any representation that creates a false impression, that covers up the truth, or that removes an opportunity that might otherwise have led to the discovery of a material fact is classed as misleading and is just as actionable as a verbal assurance that the fact is not true. Examples include floating a ship to conceal the defects in its bottom, sending one who is in search of information in a direction where it cannot be obtained, and even falsely denying knowledge when in possession of the facts.

An additional exception to the general common law rule that silence is immune from legal attack is the principle that if one does speak, she must disclose enough to prevent her words from misleading. Half of the truth may amount to a lie if the listener understands it to be the whole truth. Furthermore, one who makes a statement and subsequently acquires new information that makes her previous statement misleading or untrue cannot remain free from legal liability by staying quiet. She has an affirmative duty to disclose such new information to anyone she knows still to be acting on the basis of the original statement. This rule has been applied, for example, in cases in which there is a significant decline in the profits of a business whose sale is pending. The common law has historically provided numerous protections for fraud in business relationships, protections that have undergone significant expansion over the course of this century.

(Mass. 1942). Yet this rule has been under attack in recent years. The Restatement now requires disclosure of facts basic to the transaction, if [the defendant] knows that the other is about to enter into it under a mistake as to them, and that the other, because of the relationship between them, the customs of the trade or other objective circumstances, would reasonably expect a disclosure of those facts. The Restatement (Second) of Torts § 551(2)(e). This provision is illustrated as follows: "A sells to B a dwelling house, without disclosing to B the fact that the house is riddled with termites. This is a fact basic to the transaction." Id. § 551 illus.3.

As one commentator has observed, "[U]nder the modern law of misrepresentation, the existence of a duty to disclose is not limited to situations involving preexisting fiduciary relationships." Alison Grey Anderson, Fraud, Fiduciaries, and Insider Trading, 10 Hofstra L. Rev. 341, 351 (1982). Indeed, "there has been a rather amorphous tendency on the part of most courts in recent years to find a duty of disclosure when the circumstances are such that the failure to disclose something would violate a standard requiring conformity to what the ordinary ethical person would have disclosed." Keeton et al., supra note 30, § 106, at 739.

39. Restatement (Second) of Torts § 550.
40. See Keeton et al., supra note 30, § 106, at 737.
42. See Chisolm v. Gadsden, 32 S.C.L. (1 Strob) 220 (1847).
44. See Keeton et al., supra note 30, § 106, at 738.
45. See Restatement (Second) of Torts § 551(2)(c) (1977).
46. See Loewer v. Harris, 57 F. 368 (2d Cir. 1893).
B. Federal Fraud Protection in the Capital Markets

1. The Basic Legal Framework

Federal protection against fraud in the capital markets grew out of the common law, and numerous federal statutory provisions give animation to the core idea that market participants should not lie in a market transaction in order to take value from others. If a company induced purchase of its securities with fraudulent misrepresentations, it would be susceptible to suit under section 10(b) of the Securities and Exchange Act of 1934 and the Securities Exchange Commission's Rule 10b-5, the most famous and often used antifraud provisions. But these are not the only provisions that protect against fraud in the capital markets by imposing on companies the obligation to be accurate and complete in their communications to actual or potential investors. For example, section 12(2) of the Securities Act of 1933 states that

47. See LOSS, supra note 29, at 712. The elements of a misrepresentation claim under the federal securities laws are aligned with the elements of the common law tort claim. The analyses under the common law and the federal statutes are sufficiently related that Loss has stated that "it seems reasonable to assume at the very least that the most liberal common law views on these questions should govern under these statutes." Id. at 716. While courts have said repeatedly that the fraud provisions of the Securities Acts, as well as the mail fraud statute, are not limited to circumstances that would give rise to a common law action for deceit, see, e.g., Charles Hughes & Co. v. SEC, 139 F.2d 434, 437 (2d Cir. 1943) (SEC Acts); United States v. Groves, 122 F.2d 87, 90 (2d Cir. 1941) (mail fraud), it is difficult to say precisely how much further the federal provisions extend, see LOSS, supra note 29, at 716.

48. 15 U.S.C. § 78j(b) (1994). Section 10(b) reads as follows:

   (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Id.

49. Manipulative and Deceptive Devices and Contrivances, 17 C.F.R. § 240.10b-5 (1997). The Rule reads as follows:

   (a) to employ any device, scheme, or artifice to defraud,
   (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
   (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

Id.

50. See SEC v. National Sec., Inc., 393 U.S. 453, 465 (1969) (noting that section 10(b) and Rule 10b-5 "may well be the most litigated provisions in the federal securities laws"); FEDERAL SECURITIES EXCHANGE ACT OF 1934 § 5.05[1], at 5-46 & n.4 (Matthew Bender's Sec. Regulation Series, 1997) (noting that section 10(b) and Rule 10b-5 have become "the most important of the causes of action under the federal securities laws"); LOSS, supra note 29, at 728 (discussing the "revolution" in Rule 10b-5 litigation).
any person who ... offers or sells a security ... by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements ... not misleading ... shall be liable to the person purchasing such security from him.\textsuperscript{51}

Section 11(a) of the 1933 Act also animates the core common law idea. It creates a cause of action for those who purchase a company’s security after the company has issued a registration statement that “contain[s] an untrue statement of a material fact or omitted to state a material fact ... necessary to make the statements therein not misleading.”\textsuperscript{52} Moreover, the company would also potentially face suit under section 17(a) of the 1933 Act, which makes it unlawful for a seller of securities “to employ any device, scheme, or artifice to defraud, or ... to obtain money or property by means of any untrue statement of a material fact.”\textsuperscript{53}

A company’s duty to be truthful to actual or potential investors stretches beyond the official registration statements a company is required to file with the Securities Exchange Commission (SEC).\textsuperscript{54} A company and its insiders can


\textsuperscript{52} 15 U.S.C. § 77k. Section 11 makes issuers strictly liable for material misstatements, and the purchaser can recover her trading loss without proving reliance. See Paul G. Mahoney, Precaution Costs and the Law of Fraud in Impersonal Markets, 78 VA. L. REv. 623, 632-33 (1992), see also LOSS & SELIGMAN, supra note 32, at 1003. The causes of action under both section 12(2) and section 11(a) vary somewhat from what the common law would have required. See LOSS & SELIGMAN, supra note 32, at 984-87, 1008-13.

\textsuperscript{53} 15 U.S.C. § 77q(a)(1)-(2). Other pertinent provisions include section 9(a)(4) of the 1934 Act, which makes it unlawful for any dealer or broker ... to make, regarding any security registered on a national securities exchange, for the purpose of inducing the purchase or sale of such security, any statement which was at the time and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, and which he knew or had reasonable ground to believe was so false or misleading.

15 U.S.C. § 78(a)(4). See generally LOSS, supra note 29, at 699-711 (identifying federal statutory protection including section 17(a) of the 1933 Act, 15 U.S.C. § 77q(a), section 15(c) of the 1934 Act, 15 U.S.C. § 78o(c), and the mail and wire fraud statutes, see 18 U.S.C. §§ 1341, 1343 (1994)). Before the Securities Act of 1933, the federal government could deal with securities fraud only through criminal prosecution for violations of the mail fraud statute, see 18 U.S.C. § 1341, or for conspiracy to violate it, see 18 U.S.C. § 371, or through the Postmaster General’s administrative ability to enter a so-called “fraud order” under which all mail directed to the respondent or his agent would be returned to the sender, see 39 U.S.C. § 3005(a) (1994). See LOSS, supra note 29, at 699.

\textsuperscript{54} The federal securities laws require companies to file certain current, quarterly, and annual reports with the SEC. See J. ROBERT BROWN, JR., THE REGULATION OF CORPORATE DISCLOSURE AT VI (2d ed Supp. 1 1997). For example, filings are required under the 1933 Act in “registration statements for public offerings or distributions or in circulars to be furnished in the case of ‘exempt’ offerings under Regulation D, 17 C.F.R. § 230.501-506 (1980), or Rule 144, 17 C.F.R. § 230.144 (1988).” Victor Brudney, A Note on Materiality and Soft Information Under the Federal Securities Laws, 75 VA. L. Rev. 723, 726-27 n 11 (1989). Also, the 1934 Act mandates filings under “the registration and continuous disclosure requirements of §§ 12 and 13(a) and the rules thereunder; the proxy rules promulgated under § 14(a), the ‘going-private’ rules promulgated under § 13(e); the tender offer and takeover rules promulgated under §§ 13(d), 13(e), and 14(d); and the insider trading rules under § 16.” Id.
violate federal law by disseminating false or misleadingly incomplete information in some informal context such as a report, press release, or director’s speech, even if the communication is voluntary. Federal antifraud law enforces, in this context, what is essentially a requirement of completeness. Factual accuracy will not insulate a company’s communication from possible liability if the statement is nevertheless materially misleading. Said another way, “[A] duty to speak the full truth arises when a defendant undertakes to say anything.” Again, this duty of completeness attaches even when the communication is completely discretionary.

Moreover, accuracy and completeness at the moment of the disclosure do not necessarily prevent liability. Companies may have an obligation to ensure

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The focus of this Article is whether the duty to refrain from fraud should be applied to the labor markets through a federal law. Whether the additional duty to make certain affirmative disclosures should apply to the labor market is not considered here. Some, however, have attacked mandatory disclosure requirements. See, e.g., RICHARD POSNER, ECONOMIC ANALYSIS OF LAW 444-45 (4th ed. 1992) (stating that prospectuses are “[w]ritten in a forbidding legal and accounting jargon” that are “of no direct value to the unsophisticated stock purchaser” and that it is “widely accepted by economists” that “regulation of new issues does not help investors”). But see Frank H. Easterbrook & Daniel R. Fischel, Mandatory Disclosure and the Protection of Investors, 70 VA. L. Rev. 669 (1984) (concluding that the economic case against mandatory disclosure is equivocal). This debate, however, is beyond the scope of the more basic protection that this Article proposes.

55. In SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), for example, the company voluntarily distributed a misleading press release about a huge ore strike. The Second Circuit concluded that “[i]t does not appear to be unfair to impose upon corporate management a duty to ascertain the truth of any statements the corporation releases to its shareholders or to the investing public at large.” Id. at 861-62. Rule 10b-5, said the court, is violated whenever assertions are made . . . in a manner reasonably calculated to influence the investing public, e.g., by means of the financial media . . . if such assertions are false or misleading or are so incomplete as to mislead irrespective of whether the issuance of the release was motivated by corporate officials for ulterior purposes.

56. First Va. Bankshares v. Benson, 559 F.2d 1307, 1317 (5th Cir. 1977); see also Heil v. Lebow, No. 91 Civ. 8656 (JFK), 1994 WL 637686, at *7 (S.D.N.Y. Nov. 14, 1995) (“[A] statement which is literally true, if susceptible to quite another interpretation by the reasonable investor . . . may properly . . . be considered a material misrepresentation . . . .” (citations omitted) (internal quotation marks omitted)).

57. See BROWN, supra note 54, § 5.03[1], at 3-8 n.26 (citing cases). Actionable communication can include an overstatement of revenue, a misleading press release about a new product, misstatements about the product’s stage of development, references about a production date that turn out to be false, untrue suggestions that a new product will be shipped soon or will be shipped in substantial quantities, overly optimistic statements about the impact of a product on the market, statements incompletely characterizing the results of new product testing, and the failure to disclose known difficulties with a product. See id. § 1.01[1], at 1-3; id. § 5.03[2][d], at 5-17 to -29; id. § 5.03[3][b-c], at 5-31 to -41; see also In re Apple Computer Sec. Litig., 886 F.2d 1109 (9th Cir. 1989) (denying the defendant summary judgment where it had made overly optimistic statements about a new product).
When an earlier statement has become misleading in a material respect, an affirmative duty to disclose may arise. While this duty might not exist when confusion in the market stems from inaccurate rumors or information circulating among the investing public, a response from the company may become necessary if "the issuer is the source of the inaccuracies or is responsible for their dissemination." In any event, the federal requirement to avoid false or materially incomplete statements sometimes creates, in effect, an affirmative duty to disclose when a company's earlier statement has become materially misleading.

Federal securities laws have made actionable a range of fraudulent activities that lie outside the paradigmatic case. As at common law, no requirement of contractual privity exists in the affirmative misrepresentation case. An affirmative misrepresentation or material omission may be actionable even though neither the company nor a company insider actually engages in any trades; a company that knowingly or recklessly disseminates false information will be liable to those who buy or sell securities on the basis of the false information. This expansion from the core case protects traders in the secondary markets from fraud, even though the securities they purchase or sell were issued by the company much earlier and even if the other parties to the transactions are private individuals.

A second expansion from the paradigmatic case is the explosion of liability for insider trading, which occurs when a corporation or its insiders trade in the corporation's securities without disclosing material information unavailable to the public. In this context, liability does not depend on an affirmative misstatement. Instead, federal law imposes an affirmative duty on the corporation or insider to disclose material information or to abstain from trading. This affirmative duty of disclosure arises from the presence of a

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60. See Brown, supra note 54, § 3.02, at 3-6; Brudney, supra note 54, at 749 n.72 (citing cases and scholarship).
61. The SEC believes that, depending on the circumstances, there is a duty to correct statements made in any filing . . . if the statements either have become inaccurate by virtue of subsequent events, or are later discovered to have been false and misleading from the outset, and the issuer knows or should know that persons are continuing to rely on all or any material portion of the statements. Loss, supra note 29, at 737 (quoting Securities Act Release No. 6084, 17 SEC Doc. 1048, 1054 (July 10, 1979)); see also Butler Aviation Int'l, Inc. v. Comprehensive Designers, Inc., 425 F.2d 842, 843 (2d Cir. 1970) (finding liability for failure to correct a press release); SEC v. Shattuck Denn Mining Corp., 297 F. Supp. 470, 475-76 (S.D.N.Y. 1968) (same); Loss, supra note 29, at 737 n.57 (citing cases).
62. Loss, supra note 29, at 738 (citing John M. Sheffey, Securities Law Responsibilities of Issuers To Respond to Rumors and Other Publicity, 57 Notre Dame Law 755 (1982)), see also Loss, supra note 29, at 738 n.58 (citing cases).
64. See, e.g., SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 861-62 (2d Cir. 1968), Brudney, supra note 54, at 737 n.44. In addition, under the "misappropriation" doctrine of 10b-5, which the Supreme Court recently validated, the duty to disclose or abstain attaches to others who have access to information unavailable to the market generally and who would violate a fiduciary duty "or other similar relationship of trust and confidence" by using the information, without disclosure to the principal, to gain an advantage
fiduciary duty between the insider or corporation and the other transacting party.65 Thus, if a corporation wants to trade in its own securities (say, through the distribution of securities to the public or through corporate repurchase of its own stock in freezeouts or self-tenders), it has a duty to disclose any information that would be material to the party buying or selling the stock.66

In short, the securities acts have protected investors from fraud since their inception. In the years since 1933, courts and the SEC have greatly expanded the scope of this protection beyond the paradigmatic fraud case. Under the current regime investors are provided with a high level of protection covering a wide range of additional situations.

2. The Rationales for, and Continuing Importance of, Federal Protection

The requirements that corporate communications be truthful and complete are premised on the belief that an increase in the quantity, and an improvement in the quality, of information available to investors will facilitate intelligent investment decisions and improve the efficiency of securities markets in pricing securities and in allocating financial capital to real capital.67 The

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66. See Chiarella, 445 U.S. at 232-33; see also United States v. Chestman, 947 F.2d 551, 575-76 (2d Cir. 1991) (Winter, J., concurring in part and dissenting in part) (discussing the development of insider trading case law by the Supreme Court). In the misappropriation context, the fraud is seen as arising from the failure of the misappropriator to disclose to the principal that she intends to trade on the basis of the information. See O'Hagan, 117 S. Ct. at 2211.

67. See Brudney, supra note 54, at 736.

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65. See id. at 735-36; see also H.R. REP. NO. 73-1383, at 11 (1934) (stating that with accurate information the competing judgments of buyers and sellers will lead to a price that reflects as nearly as possible a hypothetical just price), reprinted in 1 SECURITIES L. COMM., FEDERAL BAR ASS'N, FEDERAL SECURITIES LAWS: LEGISLATIVE HISTORY 1933-1982, at 793, 804 (1983) [hereinafter SECURITIES LAWS: LEGISLATIVE HISTORY]; Alison Grey Anderson, The Disclosure Process in Federal Securities Regulation: A Brief Review, 25 HASTINGS L.J. 311, 314 (1974) (noting that disclosure promotes accurate investment analysis and protects unsophisticated investors from unfair treatment); Brudney, supra note 65, at 334 (suggesting that the goal of disclosure is to make price reflect value). This is also the rationale for the affirmative duties of registration and disclosure. See supra note 54; see also Brudney, supra note 54, at 741.

In the insider trading cases, reference is often made to the importance of maintaining "fair and honest markets." E.g., O'Hagan, 117 S. Ct. at 2209 (quoting the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1994)). The market rationale cannot be the principal basis for the insider trading rules, however, because the requirement that the trader violate a fiduciary duty means that only a subset of traders with greater-than-market information will be prohibited from trading. Indeed, as the Supreme Court said in Dirks and reiterated in O'Hagan, "There is no "general duty between all participants in market transactions to forgo actions based on material, nonpublic information."' Id. at 2212 (quoting Dirks, 463 U.S. at 655).
mechanism through which this occurs is relatively straightforward. When fraud is not penalized, the price of a company's security is not likely to reflect accurately the underlying ability of the firm to create wealth. Financial capital then moves from higher-valuing to lower-valuing users. But if fraud is illegal and accurate information about firms is otherwise available to people looking to invest, the market prices of the securities of those firms will better reflect the relevant characteristics of those firms. If the securities are priced below (or above) what informed investors are willing to pay, the informed investor will purchase (or sell) the securities until the price rises (or falls) to the price the informed investor is willing to pay. Thus, when information—untainted by fraud—is available, the market price will automatically adjust as a result of the activity of the informed investors.

Importantly, only some investors need to be informed for prices to adjust. In an efficient market, uninformed investors can obtain the information they need from the price itself. Thus antifraud laws protect even those investors who do not directly hear the fraudulent or misleading statement because antifraud laws help ensure that market prices accurately reflect the relevant characteristics of particular firms. When security prices are accurate, even an uninformed investor cannot make what is ex ante a bad deal. "By accepting the market price, investors are protected."

Indeed, in O'Hagan, the Court made clear that if the misappropriator of information disclosed to her principal (as opposed to the other party in the securities transaction) that she intended to trade on the information, there would be no liability under section 10(b), even though the market would be as deceived as if there had been no disclosure to the principal. See id. at 2211 n 9, id. at 2225 (Thomas, J., concurring in the judgment in part and dissenting in part).

The principal rationale for the insider trading rules is the notion that it is "desirable to deny persons having exclusive possession of certain kinds of information an advantage over others with whom they effectively transact, but who cannot lawfully get such information." Brudney, supra note 54, at 735, see also Brudney, supra note 65, at 334. This rationale is related to another justification that animated Congress in adopting the acts, that the public interest would be served by recognizing and equalizing "the gross inequality of bargaining power between the professional securities firm and the average investor." Loss, supra note 29, at 716. As the Second Circuit explained in an early case under the securities acts, "The essential objective of securities legislation is to protect those who do not know market conditions from the overreachings of those who do." Charles Hughes & Co. v. SEC, 139 F.2d 434, 437 (2d Cir. 1943). Another court has stated that the securities laws were enacted "for the very purpose of protecting those who lack business acumen," United States v. Monjar, 47 F. Supp. 421, 425 (D. Del. 1942), aff'd, 147 F.2d 916 (3d Cir. 1944); see also Norris & Hirshberg, Inc. v. SEC, 177 F.2d 228, 233 (D.C. Cir. 1949) (stating that "the investing and usually naive public needs special protection in this field"). Loss, supra note 29, at 719 (noting that the purpose of securities laws was to protect unsophisticated investors) But even these explanations overstate the rationale for the insider trading rules because inequality in knowledge is not enough; there must be a breach of fiduciary duty as well.

68. See Mahoney, supra note 52, at 631.
69. See F.A. Hayek, The Use of Knowledge in Society, 35 AM. ECON. REV 519, 526-27 (1945). For a general review of the efficient capital market hypothesis, see Ronald J. Gilson & Bernard S. Black, The Law and Finance of Corporate Acquisitions 135-81 (2d ed. 1995), for an analysis of the informational content of prices in other markets, see Mahoney, supra note 52, at 641-44
70. Fischel, supra note 4, at 1066. Uninformed investors may, of course, lose somewhat if they purchase or sell securities during the period of time that the market price is adjusting to the activity of the informed investor (indeed, they may be selling to the informed investor). But prices in the capital market typically adjust very quickly, so the uninformed investor will be protected in the great majority of cases. See Daniel R. Fischel, Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded
These rationales are strongest with regard to fraud in the initial distribution of securities. As Frank Easterbrook and Daniel Fischel have pointed out, "There is no good reason for . . . telling lies in the issuance of stock."

Fraud in these situations causes the greatest misallocation of resources. When resources are diverted into businesses that are less efficient than competing businesses, there is genuine loss. The penalties available for this type of "core" fraud are thus typically greater than when the fraud is committed in the secondary market.

The strength and importance of the rationales underlying these protections are emphasized by their federal scope and mandatory nature in an area otherwise dominated by state law and generally subject to contractual defeasance. Generally, firms are free under modern corporate statutes to structure themselves however they choose. Most state statutes establish standard forms for corporations, but these terms can be altered through amendment of a corporation's charter or bylaws. The antifraud rules embodied in the federal securities laws, however, are national in scope and impose mandatory obligations that cannot be varied by agreement. Shareholders cannot opt out of the disclosure and antifraud protection of the securities laws. This reflects Congress's implicit determination that, even if individual shareholders and directors would choose to opt out of the federal securities laws, the harmful effects on the market of such opting-out would be sufficiently severe to justify the public's interest in enforcing the law's protection and obligations.

It bears notice as well that the federal securities laws have largely avoided the fate of many other New Deal programs that have been overruled, rescinded, or repudiated. They continue to enjoy both implicit and explicit public support. To be sure, some federal antifraud provisions have been subject to criticism, primarily for providing a basis for strike suits any time a

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71. EASTERBROOK & FISCHEL, supra note 51, at 336.
72. See id.; see also Mahoney, supra note 52, at 633 (arguing that "the wealth transfer to the defendant is a good proxy for the net social cost of primary-market frauds").
73. See EASTERBROOK & FISCHEL, supra note 51, at 335-36.
74. See Fischel, supra note 4, at 1063.
75. Companies can contract around the registration requirements of the securities laws in certain limited circumstances if the securities to be sold are offered only to a small number of sophisticated investors. See, e.g., Rule 144A, 17 C.F.R. § 230.144A (1996). The antifraud rules, however, cannot be contracted around even in these circumstances. See id. preliminary note 1 ("This section relates solely to the application of section 5 of the [1933] Act and not to antifraud or other provisions of the federal securities laws.").
76. The mandatory nature of the antifraud rules also reflects Congress's determination that investors should not have to rely on common law remedies in tort or contract. See infra Part IV.
77. See, e.g., Easterbrook & Fischel, supra note 54, at 669; see also infra note 85 and accompanying text.
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company's stock price falls.\textsuperscript{78} These criticisms provided the impetus for the Private Securities Litigation Reform Act of 1995,\textsuperscript{79} which made changes vis-à-vis certain duties of managers to be truthful to shareholders. One of the most important pertained to the creation of two "safe harbors" for forward-looking statements.\textsuperscript{80} One safe harbor protects a person making a putatively misleading statement about the future if it is accompanied by "meaningful" cautionary statements identifying "important factors" that could cause actual results to differ materially from those in the forward-looking statement.\textsuperscript{81} The second requires the plaintiff to prove the speaker made the forward-looking statement with actual knowledge (rather than recklessness) that the statement was false or misleading.\textsuperscript{82}

Even with these changes, however, capital investors continue to have significant federal protection against fraud. First of all, the safe harbors do not preclude the SEC, as opposed to individual plaintiffs, from bringing actions against a corporate official who makes a putatively misleading statement about the future. Second, the safe harbors are attempts to limit litigation costs arising from strike suits. They can hardly be seen as a retreat from the key principle that fraud in the capital market is inefficient and unfair. Misleading statements about the future will still provide the basis for a private cause of action if they are made knowingly and are not accompanied by sufficient cautionary language to give the listener pause.

Indeed, much of the criticism of the present state of federal fraud law—as well as the recent changes animated by these criticisms—goes to the expansions of federal protection and does not reach the heart of the federal protection against fraud.\textsuperscript{83} There seems to be a remarkable consensus that, on

\textsuperscript{78} See, e.g., Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 741 (1975) (recognizing the social costs of strike suits); Elliott J. Weiss, The New Securities Fraud Pleading Requirement: Speed Bump or Road Block?, 38 Ariz. L. Rev. 675, 678-79 (1996); see also Mahoney, supra note 52, at 624-25 (criticizing the expansion of federal fraud protection that came about through the adoption of the "fraud-on-the-market" theory of reliance); Roberta Romano, Directors' and Officers' Liability Insurance—What Went Wrong?, in New Directions in Liability Law 67, 69 (Walter Olson ed., 1988) (describing the increase in the number of claims filed against directors).


\textsuperscript{80} The SEC had previously provided other safe harbors. For 45 years, the SEC discouraged firms from making any projections of profits or other forward-looking disclosures on the ground that this kind of information was inherently misleading. In 1979, however, the SEC issued Rule 175, 17 C.F.R. § 230.175 (1996), permitting the disclosure of projections and forecasts provided they are adequately supported. See Easterbrook & Fischel, supra note 54, at 696; James R. Repetti, Management Buyouts, Efficient Markets, Fair Value, and Soft Information, 67 N.C. L. Rev. 121, 140-41 (1988).

\textsuperscript{81} Private Securities Litigation Reform Act of 1995 § 27A(c)(1)(A)(i), 109 Stat. at 750; see also Avery, supra note 79, at 355.

\textsuperscript{82} See Private Securities Litigation Reform Act of 1995 § 27A(c)(1)(B), 109 Stat. at 750-51. No cautionary language is necessary under this safe harbor. See Avery, supra note 79, at 355.

\textsuperscript{83} See, e.g., Mahoney, supra note 52, at 625, 630-31. Though Mahoney criticizes the Supreme Court for loosening the reliance element that was previously essential under the common law, he does not retreat from the notion that legal protection from fraud is necessary.
the whole, the benefits of rules against fraud outweigh their costs.84 No serious movement exists either in politics or in academe calling for the end of government protection against securities fraud.85 Even in the recent statutory changes, the “core” of federal fraud law was untouched: If a company or a corporate official knowingly or recklessly makes a material misrepresentation about existing facts in order to take value from another in a securities transaction and the other party to the transaction relies on the misrepresentation to her detriment, the company or official will be liable. This tenet remains unquestioned.86

C. Federal Fraud Protection in the Labor Market

Like investors, workers contribute an essential input to companies’ creation of wealth through the production of goods and services. Also like investors, workers have a difficult time acquiring and evaluating the information necessary for them to decide whether and how they should make their contribution.87 Like investors who have to evaluate factors including the complexity of financial documents, market risk, and expected returns, workers have to analyze the financial strength of employers, market risk, working conditions, and the like.88

84. Without a detailed empirical analysis, it is difficult to prove absolutely that the costs of a rule against fraud outweigh the benefits. Lynn Stout has pointed out, however, that if the absence of federal fraud protection caused the value of the securities market to be discounted only one percent, that would be equivalent to a $100 billion dollar decline in the value of outstanding corporate securities. See Lynn A. Stout, Type I Error, Type II Error, and the Private Securities Litigation Reform Act, 38 ARIZ. L. REV. 711, 714-15 (1996). As Stout suggests, it is difficult to imagine the costs of strike suits outweighing the benefit of avoiding such a decline. See id.

85. See id. at 713 (stating that there is a “consensus” among securities scholars that fraud is “very, very bad”). In a forthcoming article, Roberta Romano calls for the end of mandatory federal regulation of securities in favor of “a market-oriented approach of competitive federalism” that would allow states to compete with each other on the basis of their systems of securities regulation. Roberta Romano, Empowering Investors: A Market Approach to Securities Regulation, 107 YALE L.J. (forthcoming June 1998) (manuscript at 2, on file with the Yale Law Journal). She bases her argument on what she calls the “successful experience of the U.S. states in corporate law, in which the 50 states and the District of Columbia compete for the business of corporate charters.” Id. While Romano questions the efficiency of mandatory fraud protection at the federal level, she does not argue that fraud law itself is inefficient or improper. Whether the proper situs for fraud protection in the capital market is at the state or federal level is beyond the scope of her article. Nevertheless, Romano appears to be expressing a minority view, and there are a number of grounds on which to question her argument. As Joel Seligman has pointed out, the federalization of antifraud protection took place because of a “widely held belief” that a web of state laws could not provide adequate checks on fraud in the capital market. Joel Seligman, The Historical Need for a Mandatory Corporate Disclosure System, 9 J. CORP. L. 1, 18 (1983). With the growing sophistication and size of the capital markets, it is worth questioning how one could expect states to be more successful at fraud regulation in the 1990s than in the 1930s. See Stephen J. Choi & Andrew T. Guzman, National Laws, International Money: Regulation in a Global Capital Market, 65 FORDHAM L. REV. 1855, 1882-83 (1997) (arguing that, in most countries, including the United States, it is more efficient for there to be a single national securities regime than a multitude of state regimes). In the context of fraud protection for workers, this Article discusses below whether a federal antifraud scheme for workers would be more efficient than state protection. See infra notes 182-184, 303-312 and accompanying text.

86. See, e.g., EASTERBROOK & FISCHEL, supra note 51, at 336 (“There is no good reason for not registering stock required to be registered or for telling lies in the issuance of stock.”).

87. See infra notes 120-123 and accompanying text.
conditions, benefits, wages, termination policies, promotion practices, grievance procedures, and hours. Moreover, the decisions workers make in choosing employers tend to have long-term implications, probably to a greater extent than for investors choosing among investment vehicles. Unlike investors, however, workers are not protected by a federal statute comparable to those protecting capital investors. No generally applicable federal protection exists, even for statements that would seemingly be at the core of antifraud protection.

To be sure, workers enjoy a range of federal protection in the workplace, and some federal statutes require employers to disclose information. For example, the Worker Adjustment and Retraining Notification (WARN) Act generally obliges employers of one hundred or more employees to give employees or their union sixty days notice of a plant closing or mass layoff. An employer who violates the notice provisions is liable for penalties equal to back pay for each day of the violation, up to sixty days. In addition, certain statutes require employers to disclose information about workplace risks to which employees are exposed, and federal labor law requires that companies negotiating with unions hand over certain relevant information. Moreover, to the extent that much of the need for protection from employer fraud arises in the context of possible plant closings, the National Labor Relations Act (NLRA) provides some protection by allowing unions to bring charges against an employer before the National Labor Relations Board for unfair labor practices. Unfair labor practices may include the refusal to bargain about the

88. See infra notes 139-142 and accompanying text.
90. See id. § 2102.
91. See id. § 2104(a)(1); see also North Star Steel Co v. Thomas, 515 U.S. 29, 31-33 (1995) (providing an overview of WARN Act); cf. Washington v. Aircap Indus., 860 F. Supp. 307 (D.S.C. 1994) (holding that employees were entitled to back pay only for “work days” within the violation period)
92. See, e.g., Occupational Safety and Health Act of 1970 (OSHA), 29 U.S.C. §§ 651-678 OSHA regulations provide that “employees have both a need and a right to know the hazards and identities of the chemicals they are exposed to when working.” 29 C.F.R. § 1910.1200 app. E (1996). Pursuant to OSHA, employers must provide all employees with access to Material Safety Data Sheets that contain vital information about the health hazards associated with chemicals present in the workplace. See id. OSHA also established the Records Access Rule, 29 C.F.R. § 1910.1020, which requires employers to provide their employees with access to records voluntarily created by the employer that contain the medical and exposure histories of other employees who have been previously exposed to toxic substances or other physically harmful agents.
93. See NLRB v. Trauit Mfg. Co., 351 U.S. 149, 153 (1956) (ruling that it is an unfair labor practice for a company to claim financial inability to pay a wage increase and then to refuse to allow the union to see the company’s books to verify the claim); Oil, Chem. & Atomic Workers Local 6-418 v. NLRB, 711 F.2d 348, 358-59 (D.C. Cir. 1983) (holding that the employer’s duty to bargain in good faith with a labor union includes a duty to supply the union with “‘requested information that will enable [the union] to negotiate effectively and to perform properly its other duties as bargaining representative’” (quoting Local 13, Detroit Newspaper Printing & Graphic Communications Union v. NLRB, 598 F.2d 267, 271 (D.C. Cir 1979))). This duty to provide relevant information typically includes matters central to the bargaining process, such as wages and work hours, and can extend to details of chemical exposure and other work hazards. See Oil, Chem. & Atomic Workers Local, 711 F.2d at 359, 361.
effects of a plant closing. To the extent that the need for fraud protection arises in the context of employee benefits, the Employee Retirement Income Security Act of 1974 (ERISA) may provide some limited protection.

None of these statutes, however, provides a general remedy to protect workers from employer fraud. Indeed, not only are employees afforded fewer statutory protections than shareholders, but federal law also makes it more likely that employers will not be held liable for any untrue statements to their employees. It does so by making it more difficult for employees to take advantage of fraud remedies they might have otherwise received under the common law. Section 301 of the Labor Management Relations Act (LMRA) grants federal jurisdiction over suits for violations of collective bargaining agreements. Under section 301, courts must determine whether the collective bargaining agreement preempts claims an employee has brought under other statutes or the common law. Because this preemption doctrine is interpreted quite broadly, it often stands as a significant obstacle to unionized employees seeking to sue their employers over putative misstatements pertaining to plant closings or job security. ERISA similarly includes a broad preemption doctrine. If the employee fraud suit pertains to alleged misstatements about employee benefits, a number of courts have held that federal law preempts such claims. In addition, the remedies that ERISA provides are less protective of workers than those offered by the common law. Thus, not only do workers have less federal statutory


There are significant loopholes in the NLRA's protective scheme. Most crucially, companies are not required to bargain over whether a plant should be closed in the first place. See First Nat'l Maintenance, 452 U.S. at 686; United Food & Commercial Workers Int'l Union Local 150-A v. NLRB, 880 F.2d 1422, 1430 (D.C. Cir. 1989); Stone, supra, at 388. Moreover, according to Stone, effects bargaining generally takes place after the employer has made and implemented a decision, when the union no longer has leverage to protect its members. If the employer violates its obligation to engage in effects bargaining, the remedy for the violation is limited to back pay and is typically calculated from five days after the date of the court or board order until the time the parties reach either agreement or impasse. This time period is not to exceed the time the employee actually was out of work but cannot be less than two weeks. See In re Transmarine Navigation Corp., 170 N.L.R.B. 389, 390 (1968). In effect, "this means that when a violation is found, the employer quickly bargains to impasse and is liable for back pay for only two weeks." Stone, supra, at 589 n.52 (citing as an example Yorke v. NLRB, 709 F.2d 1138, 1144-46 (7th Cir. 1983)).

99. See Stone, supra note 95, at 593-96.
100. See id. at 577.
101. See infra note 213 and accompanying text.
102. These preemption doctrines are considered in more detail below. See infra Subsections IV.B.1-2.
protection from fraud than capital investors, they also face obstacles in pursuing common law fraud claims that equity investors do not.

This difference between the high level of federal protection against fraud in the capital markets and the low level of federal protection in the labor markets might be justified on a number of public-regarding grounds. Perhaps truthful information is not important in the labor market, or not as important in the labor market as in the capital market. Or even if truthful information is important, perhaps private mechanisms would insure it. Perhaps the labor market will self-correct without government regulation; or perhaps the common law already provides adequate protection. Perhaps states can act on their own initiative to provide a solution. Perhaps, finally, the costs of regulation would be higher or the benefits of regulation lower in the labor market than in the capital market. The remainder of this Article will examine whether any of these possible justifications are persuasive in explaining the existing situation.\(^{103}\)

103. As a descriptive matter, the difference between the level of fraud protection may be explained not by public-regarding reasons but by the interplay of pressure groups on the legislative and regulatory process. See, e.g., MURRAY EDELMAN, THE SYMBOLIC USES OF POLITICS 56 (1964) ("Administrative agencies are to be understood as economic and political instruments of the parties they regulate and benefit, not of a reified 'society,' 'general will,' or 'public interest.'"); Sam Peltzman, Toward a More General Theory of Regulation, 19 J.L. & ECON. 211 (1976) (arguing that government officials are vote maximizers who arbitrate among competing interests that seek to use the government to redistribute resources); Richard A. Posner, Taxation by Regulation, 2 BELL J. ECON. & MGMT. SCI. 22 (1971) (arguing that one function of regulation is the performance of distributive and allocative chores usually associated with the taxing branch of the government); George J. Stigler, The Theory of Economic Regulation, 2 BELL J. ECON. & MGMT. SCI. 3, 3 (1971) ("[R]egulation is acquired by the industry and is designed and operated primarily for its benefit."). Because they are a result of pressure group politics, the argument would go, regulations serve the broader public interest only by accident. See Easterbrook & Fischel, supra note 54, at 671. In this view, the difference between the high level of protection against fraud available to capital investors and the low level of protection available to workers is explained simply by the greater ability of capital investors to affect the political process.

There may be much to this story that is correct. But even if this explanation is factually accurate, it serves only as a positive explanation rather than a normative justification for the difference between the two levels of legal protection. Justifications ought to matter. See, e.g., ARISTOTLE, POLITICS 69 (Benjamin Jowett trans., The Viking Press 2d prtg. 1959). As Aristotle wrote:

The true forms of government, therefore, are those in which the one, or the few, or the many, govern with a view to the common interest; but governments which rule with a view to the private interest, whether of the one, or of the few, or of the many, are perversions.\(^{Id.}\)

To the extent that justifications do matter (to public servants, legislators, judges, lawyers, or academics, among others), the pressure group description is incomplete and dissatisfying. Indeed, some scholars have argued that, even as a descriptive matter, regulatory politics are not completely about power and that justifications are important in the formulation of legislative and regulatory initiatives. See, e.g., James Q. Wilson, The Politics of Regulation, in THE POLITICS OF REGULATION 357, 370-72, 393 (James Q. Wilson ed., 1980) (arguing that the power of ideas often shapes regulation, even in the face of concentrated political opposition); see also Robert L. Rabin, Federal Regulation in Historical Perspective, 38 STAN. L. REV. 1189, 1293-94 (1986) (arguing that the National Environmental Policy Act and the Clean Air Act, among other initiatives, were not products of interest group politics); cf. JERRY L. MASHAW, BUREAUCRATIC JUSTICE 13 (1983) (discussing observations of administrative agencies that operate independently and sensibly, even in the face of varied political pressure). To the extent that these scholars have a point, justifications would matter not only in helping one discover what the right outcome should be but also in helping one achieve it.

One might also pose a historical hypothesis for the difference between the levels of fraud protection in the capital and labor markets. Stability of and truthfulness in the capital market were to be protected by the Securities Act of 1933, 15 U.S.C. § 77 (1994), and the Securities Exchange Act of 1934, 15 U.S.C. § 78. Stability of and truthfulness in the labor market, on the other hand, were to be ensured by labor unions.
II. THE IMPORTANCE OF ACCURATE INFORMATION IN THE LABOR MARKET

One possible justification for the lack of federal fraud protection for workers is that information is not important, or not as important, in the labor market as in the securities market. This part responds to that possible justification by outlining the basic economic importance of information in ensuring efficient markets and by applying these insights to the labor market. This part then highlights why some of the costs of fraud are even greater in the labor market. Because of this, one must reject the idea that the reason for the absence of an antifraud law protecting workers is a reduced need for information in this sphere.

A. The Basic Model

The idea that truth is a good thing, and falsity a bad one, is hardly new. Truth is a central principle in many ethical systems, and falsehood is generally condemned. But truthfulness as a principle is borne out by economic, as well as moral, theory. It is routine, in fact, when one speaks in economic terms, to maintain that accurate information is essential to a competitive market and to "efficient" outcomes.

operating under the protection of the NLRA, an initiative "that recognized organized labor as a countervailing force to big business." Rabin, supra, at 1252; cf. Oil, Chem. & Atomic Workers Union Local 6-418 v. NLRB, 711 F.2d 348, 358-59 (D.C. Cir. 1983) (discussing the duty of unions to represent intelligently and effectively employees in collective bargaining with employers). As the strength of unions has declined, workers have been able to rely on them less to protect themselves from employer fraud. Meanwhile, as legal and nonlegal protection against fraud has increased in the capital markets, see supra notes 54-66 and accompanying text, the differences between the protection available to workers and those available to investors have grown as well.

104. See, e.g., SISSELA BOK, LYING 18 (1978) ("[S]ome level of truthfulness has always been seen as essential to human society . . . ").

105. This Article does not attempt to make a moral argument for an antifraud statute for workers. This is not to say that moral arguments are meaningless in the public sphere but simply to acknowledge that this Article focuses on legal, economic, and public policy arguments.

106. E.g., BRUCE E. KAUFMAN, THE ECONOMICS OF LABOR MARKETS 241-42 (4th ed. 1994). Some basic principles will help illustrate this argument. A competitive market allocates goods, services, labor, and capital through variations in prices. When something (whether a tomato, a car, or an engineer) is highly desired but in short supply, its price (or wage, in the case of the engineer) will rise, decreasing the quantity demanded until the market clears. If something is in surplus, or not greatly desired, its price will fall until the quantity demanded rises sufficiently to clear the market of any surplus goods. When the market clears, it is in equilibrium because the quantity demanded of the item equals the quantity supplied.

This equilibrium state is seen as efficient because it allows both suppliers and buyers to allocate their resources to uses that produce the most utility. This is one of the basic principles of economics: If voluntary exchange through a market is permitted, resources will tend to gravitate toward their most valuable uses. As Judge Posner writes, "By a process of voluntary exchange, resources are shifted to those uses in which the value to consumers, as measured by their willingness to pay, is highest." POSNER, supra note 54, at 11.

A widget manufacturer is willing to spend more for labor and materials than other potential users of those resources only if she thinks she can use those resources to obtain a higher price for her finished widgets than could the other users. Similarly, Company A is willing to pay an engineer a higher wage than Company B only if his services are worth more to Company A than to Company B, meaning that A can use him to produce a more valuable output, as measured by the prices consumers are willing to pay.
Labor Fraud

In the labor market, jobs differ from one another in many characteristics: the prestige of the position, the dangerousness of the work, the pleasantness of the surroundings, the security of the job, and the level of the wages, to name just a few. Workers do not choose which job to accept on the basis of wages alone but on the whole package of attributes, both good and bad. For equilibrium to occur in the labor market, the wage rate in jobs with more desirable attributes must fall, and the wages in the less desirable jobs must rise, until the total of advantages and disadvantages are equalized across jobs available to a particular worker.\textsuperscript{107} Differences in rates of pay—"compensating wage differentials"—equalize the net attractiveness of jobs that offer different sets of attributes.\textsuperscript{108}

For the sake of simplicity, it is useful to isolate two attributes of work that are likely to be important to workers choosing among possible jobs—wages and job security. Job security is important to workers because a worker is not likely to make her choice between jobs on the basis of which firm has the highest present wage rate but rather on which provides the best future income stream. If one company offers employment that is seasonal or less secure for some other reason, the worker may choose to accept a position with a firm that pays less but provides more security.

Now assume two firms are identical in every respect, except that Company A is able to offer relatively secure employment and Company B is able to offer only less secure employment.\textsuperscript{109} Assume also that the people in the labor market, building widgets or for some other use, and engineers will be foiled in choosing between Companies A and B. If, for example, both companies were prohibited from disclosing to the engineer the amount they would pay him, the engineer would be unable to choose between them with certainty, and there would be no assurance that the engineer’s labor would be dedicated to the use that society valued the most (as measured by the market valuation of his labor). It is important to note, however, that in some contexts the benefits of the disclosure of information are outweighed by other values, such as the importance of privacy. Cf. \textit{e.g.}, Paul M. Schwartz, \textit{Privacy and the Economics of Personal Health Care Information}, 76 Tex. L. Rev. 1, 4-5 (1997) (arguing that the unlimited disclosure of personal health care data is not economically efficient).

\textsuperscript{107} See, \textit{e.g.}, KAUFMAN, supra note 106, at 372. For a similar analysis of the securities markets, see Easterbrook & Fischel, supra note 54, at 673.

\textsuperscript{108} Admittedly, this is a simplistic assumption, but it is helpful in comparing jobs that are similar. In jobs that require radically different skills, the effect of the labor supply on wages will likely swamp the effect of the compensating wage differential. That is why major league baseball players earn more than coal miners even though mining coal is less desirable work. See, \textit{e.g.}, KAUFMAN, supra note 106, at 377-78, cf. JOHN STUART MILL, \textit{PRINCIPLES OF POLITICAL ECONOMY} 235 (Longmans, Green & Co 1900) (1848) (noting the simplicity of assumptions with regard to wage differentials).

\textsuperscript{109} In this portion of the analysis, the level of job security each company offers is assumed to be an exogenous variable. This assumption will be relaxed in the following section.
market know which firms offer secure employment and which do not. If the wage rate per hour were the same in both firms, everyone would want to work for Company A because it offers equal pay and better job security. The surplus of labor for Company A and the shortage of labor for Company B would cause the wages at Company A to fall and those at Company B to rise until workers were indifferent between the two companies. The wage in Company B would have to be higher than the wage in Company A by an amount sufficient to compensate for the greater probability that there would be layoffs, plant closings, or other job discontinuities.\textsuperscript{110} In a competitive labor market (and holding other factors equal), the company with better job security will be able to offer a lower wage rate than the company with poor job security because the latter company will have to pay a higher wage to entice workers to accept the higher risk of job loss.\textsuperscript{111}

This makes intuitive sense. Those employees working for the insecure employment firm have to run the risk that they will suffer the costs of job discontinuity. These costs will depend on such factors as the expected length of time between jobs, the availability of information about other jobs, the location (and indeed existence) of other work, and whether a replacement job will pay the same.\textsuperscript{112} The difference between the wages offered by the secure employment firm and the wages offered by the insecure one will therefore differ greatly in different markets. One would expect that a firm offering secure employment in Youngstown, where alternate employment is probably scarce, would be able to pay a significantly lower wage than insecure employment firms in the same area or secure employment firms elsewhere. This situation might explain why the management of U.S. Steel thought it so

\textsuperscript{110} See John M. Abowd \& Orley Ashenfelter, Anticipated Unemployment, Temporary Layoffs, and Compensating Wage Differentials, in STUDIES IN LABOR MARKETS 141, 143-45 (Sherwin Rosen ed., 1981); see also KAUFMAN, supra note 106, at 373 (discussing the effect of seasonal employment on wage compensation).\textsuperscript{111} See Abowd \& Ashenfelter, supra note 110, at 144-45. Note that this analysis would essentially be the same for any two conditions of employment. To the extent that Company A offers a non-wage benefit (whether safer working conditions or better cafeteria lunches), Company B must increase its wages to compensate.\textsuperscript{112} Another complexity should be noted here as well. One additional factor in the difference between the wages at the secure employment firm and the insecure employment firm will be the elasticity of the labor supply, i.e., the variance in the laborer's preference for work over leisure and other uses of time as the wage increases. The more "elastic" the labor supply, the more the supply of labor will change for any given change in the wage rate. See, e.g., KAUFMAN, supra note 106, at 59-62 \& n.10. Many studies show that the labor supply curve for both men and women is very inelastic, that is, for every one percent wage increase, the hours worked will increase considerably less than one percent. See, e.g., id. at 60-62. The more inelastic the labor supply, the greater the compensating differential will be between the wage rate at the secure employment firm and the insecure employment firm. See Abowd \& Ashenfelter, supra note 110, at 147. This is because the insecure employment firm will have to increase its wages significantly in order to entice a sufficient number of workers to join it. In other words, let us assume that if the insecure employment firm paid no wage differential it would have a labor shortage of 10%. If the supply of labor were elastic, the firm would be able to increase its work force sufficiently by increasing its wages by less than 10%. If the supply were inelastic, it would have to increase its wages by more than 10%.
important to assure its employees that their employment was secure;\textsuperscript{113} with secure employment, the workers would demand a markedly lower wage than if their jobs were insecure.

It is important to recognize that it is a good (read "efficient") thing from society's point of view that insecure employment firms must offer higher wages to fill their jobs than secure ones because different individuals have various tastes for security and risk.\textsuperscript{114} Some workers will prefer to have a secure job rather than an insecure one that offers a wage that is fully compensatory of the expected financial losses arising from any future job loss. Others will prefer the riskier job with a higher possible payoff. Even if the expected financial benefit of both jobs were the same (that is, if the probability of the payoff multiplied by the amount of the payoff were equal in both firms) and even if everything else were equal, some people would still prefer the risky job and others would prefer the secure job.

That different people have different preferences for risk and security is an important part of this story because it helps explain why a competitive, fully informed market makes everybody better off. If a worker prefers job security more than her fellow workers (that is, if she is risk averse), she can choose to work for a company that offers more secure employment, though with lower wages. In effect, she can purchase job security with a portion of her wages. If a worker does not need or want job security as much as her fellow workers, she is free to accept a job with the firm with less security but with higher wages. In effect, she can sell her preference for risk (or lack of desire for job security) in exchange for a higher wage. Both workers are able to maximize their job satisfaction, or utility, by giving up what they value less (for example, the extra dollar in wage) for what they value more (the extra amount of job security). The workers have achieved allocational efficiency; they have allocated their labor in such a way as to maximize their utility, within the constraints of the market.\textsuperscript{115}

Not only is this result better for workers, but firms also become more efficient when a competitive market requires truthful information. Secure employment firms will want to sell their security in the labor market by offering lower wages, and insecure employment firms will need to purchase (through higher wages) workers' willingness to be subject to job discontinuities. If workers can learn which firms provide secure employment and which do not, the operation of the competitive labor market will mean that

\textsuperscript{113} See notes 6-16 and accompanying text.


\textsuperscript{115} Again, the analysis would be the same if we were comparing wages and workplace safety (or lunchroom food, or size of office space, or any other condition of employment) rather than wages and security. Some workers will value any one of these factors more than their coworkers, and the market will ensure that workers who value those things more will allocate themselves to the firms that offer them at lowest cost.
risk preferrers will end up in the firms providing risky employment and risk avoiders will end up in the firms offering secure employment. The market ensures that each firm satisfies its needs at minimum cost. Because secure employment firms can sell their security to risk-averse workers, they will be able to decrease their labor costs more than they would if workers did not know which firms were risky and which were secure. Similarly, because insecure employment firms can purchase a willingness to be subject to risk from risk preferrers, their labor costs will be less than if they had to purchase the same amount of risk bearing from a cross section of workers. Another way to say this is that the market will induce a sorting process that will match firms with employees and attain the appropriate mix of labor and job security at minimum cost to the firm.

The analogy to capital markets is straightforward. With accurate information, risk-averse investors can place their investment funds in financial vehicles that offer a secure return and low volatility. Businesses in secure, low-volatility market sectors can entice capital investment at lower cost from these risk-averse investors than they can from a broader group of investors because the risk-averse investors will pay a portion of their returns in exchange for security. Risk-prone investors will similarly be able to find investment vehicles that offer their preferred mix of expected return and risk. Businesses in highly volatile industry sectors will have a lower cost of capital than they would if they had to seek capital from a larger group of investors. Without accurate information, the market price will not reflect the value of the underlying securities. As the drafters of the 1934 Securities Exchange Act stated in the House Report on the Act, “There cannot be honest markets without honest publicity.”

116. There is a complexity that should be noted here although it is discussed further below. See infra notes 122-123 and accompanying text. If the risky company is able to mislead the workers in the labor market into believing that the company is less risky than it in fact is, the company is robbing society of a portion of its allocational efficiency. Some of the difference is deadweight loss, and some is redistributed to the company that lies.

117. See, e.g., Abowd & Ashenfelter, supra note 110, at 149-50. Similarly, if workers differ in the elasticity of their supply of labor, the workers with the highest elasticity will be sorted into firms that have the greatest amount of job discontinuities (for example, seasonal employment). This allows the firm to achieve its demanded employment flexibility at the lowest cost.


119. See H.R. REP. NO. 73-1383, at 11 (1934), reprinted in 1 SECURITIES LAWS: LEGISLATIVE HISTORY, supra note 67, at 793, 804. The full passage reads:

No investor, no speculator, can safely buy and sell securities . . . without having an intelligent basis for forming his judgment as to the value of the securities he buys or sells. The idea of a free and open public market is built upon the theory that competing judgments of buyers and sellers as to the fair price of a security brings about a situation where the market price reflects as nearly as possible a just price. Just as artificial manipulation tends to upset the true function of an open market, so the hiding and secreting of important information obstructs the operation of the markets as indices of real value. There cannot be honest markets without honest publicity.

Id.
What happens when we assume the labor market does not enjoy "honest publicity"? As we have seen, when workers know which firms offer secure employment and which offer insecure employment, the market induces wage adjustments so that each firm is able to hire the number and type of workers it demands. These equilibrium points are seen as optimal from a societal point of view because any movement away from them imposes more costs than benefits. For example, if employment in the insecure employment firm is forced up artificially, the social costs of providing the extra work are greater than the social benefits gained through the extra work. Analogously, if the employment levels in the firm providing secure employment are held artificially low, society is losing potential benefits. At any point below the equilibrium amount of hours worked, the benefits of employing a worker for an additional hour are greater than the costs of providing the extra hour.

Fraudulent information in the labor market tends to cause this very effect. Consider what happens when firms are able to lie about the security of the employment they offer. When lying is allowed, workers will not be able to tell the difference between a secure firm that is telling the truth and an insecure firm that is lying. Hence workers will be unable to demand a wage differential from insecure firms because they will not know from which firms to demand it. Similarly, secure firms will be unable to offer lower wages than insecure firms because workers will not be able to tell if the secure firms are telling the truth about the security of the jobs offered. Instead, workers will be forced to calculate their willingness to work based on assumptions about the relative proportion of secure versus insecure jobs in the marketplace. In other words, they will view all firms as average and make their decisions about where to work accordingly.\textsuperscript{120} The supply of labor for both firms will be somewhere between what would have been the supply for the secure and the insecure employment firms and would reflect the workers’ beliefs about the probability that the firm they work for is secure or insecure. Moreover, one would expect that the cost of labor for the economy as a whole would rise because workers would have to be compensated for being subject to fraud by their employers.

False information thus has serious consequences. Firms that offer insecure employment are able to decrease the wages they pay their employees, even though the underlying insecurity of the employment they offer has not changed. Also, because they no longer have to pay a wage differential, insecure employment firms will demand more workers. Secure employment firms, on the other hand, are forced to pay a higher wage, even though the underlying security of the employment they offer has not changed. Because they are forced to pay a higher wage, the secure employment firms will tend

\textsuperscript{120} Cf. Easterbrook & Fischel, supra note 54, at 673 (noting that securities investors lacking sufficient information will view all securities as average) Some workers might be able to search out and discover which employers are lying, but such search is unlikely to be cost-free These costs could be avoided by a rule against fraud. See infra notes 292-294 and accompanying text
to employ fewer workers. At the end of the day, too many people (from the societal perspective) are working for the insecure employment firm, and too few are working at the secure employment firm; the wages at the secure employment firm are too high, and the wages at the insecure employment firm are too low.\textsuperscript{121}

Of course, while this scenario is inefficient overall, the skewing of the information available in the market is favorable to some. The workers who retain their jobs in secure employment firms will be making a higher wage. The shareholders of insecure employment firms, or more precisely, the shareholders of insecure employment firms that lie about the riskiness of the employment they offer, will benefit from the opportunity to employ more workers at a lower wage. But people suffer in this scenario as well. Because wages at secure employment firms will be (artificially) increased, they will not be able to employ as many workers. Some of their employees will be thrown out of their jobs. If these laid-off workers find jobs at untruthful, insecure employment firms, they will be working for less than they would demand if they knew about the insecurity of their employment. Workers at untruthful, insecure employment firms will have their wages cut. Quite a number of investors will lose as well. Truthful, insecure employment firms will suffer financially because they bear an unfair competitive disadvantage vis-à-vis untruthful, insecure employment firms. Shareholders of secure employment firms will also lose because those firms will no longer be able to offer lower wages because of the security of the employment they offer. Although this scenario creates some "winners," the losers have lost more than the winners have won. Incomplete information has moved us away from the socially optimal equilibrium.

Over time, the harmful effects multiply. Because the profits of secure employment firms will tend to fall and the profits of (untruthful) insecure employment firms will tend to rise, some secure employment firms will go out of business (or, said another way, will become insecure employment firms). The market will begin to be dominated by insecure employment firms. The lies of the insecure employment firms not only will have hurt their own workers but will have dragged down the market as a whole.\textsuperscript{122}

Lack of accurate information about job security (or, for that matter, about any other employment condition valued by employees) will cause workers to allocate their labor to inefficient uses and will force employers offering secure employment to pay more in wages than they would need to if workers had

\textsuperscript{121} For a similar analysis applied to the securities markets, see Easterbrook & Fischel, supra note 54, at 673-74.

\textsuperscript{122} Cf. George A. Akerlof, The Market for "Lemons": Quality Uncertainty and the Market Mechanism, 84 Q.J. ECON. 488, 495 (1970) (describing how dishonest dealings "tend to drive honest dealings out of the market"); Farber & Matheson, supra note 24, at 928 (relating a similar analysis as an explanation for the need to enforce promissory estoppel doctrine).
correct information. Fewer workers will be employed by firms offering secure employment, and more workers will be employed by firms offering insecure employment. The story thus far is sufficient to show that, as in the capital market, the need for correct information is important to ensure allocative efficiency in the labor market.\textsuperscript{123}

B. \textit{Job Security as an Endogenous Variable}

There is an additional reason that the law should seek to ensure accurate information in the labor market by prohibiting fraud against employees. Up to this point, this analysis has assumed that the level of risk of job discontinuity is a fixed, exogenous variable, something which each firm accepts as given and which is unaffected by company policy or practices.\textsuperscript{124} This assumption is certainly correct in many respects because companies are subject to market forces they cannot control and some industries are inherently more risky in this sense than others. Yet this assumption is incorrect in other ways because the incidence of job discontinuity is partially a function of planning, company policy, management, capital investment, and marketing.\textsuperscript{125}

Thus the amount of job security that a company provides is something that the company can affect. Some efforts to reduce the incidence of job discontinuities will impose costs on the firm.\textsuperscript{126} But they need not be large costs; indeed, the company may be able to decrease the incidence of job discontinuity cheaply by, for example, planning production schedules more carefully or buying more advertisements. But it is to be expected that the cost of reducing job discontinuities will increase as the rate of job discontinuities falls and it becomes increasingly difficult to find simple and low-cost methods of reducing job risk. In other words, a firm faces increasing marginal costs of preventing job discontinuities.

Significantly, however, a firm does not only incur additional costs with improvements in job security. It also realizes the monetary benefit based on the wage differential for secure employment firms. When a company decreases the incidence of job discontinuity its workers must suffer, it will be able to attract a work force at a lower wage rate. As we have seen, the threat of job discontinuity is something that, other things being equal, workers would rather

\textsuperscript{123} One cannot, however, say on the basis of the discussion thus far whether the need for regulation is necessary in the labor market or whether the need for such regulation is as great or greater than in the securities market. See infra Section II.C.

\textsuperscript{124} See supra note 109.

\textsuperscript{125} For example, the layoffs in the steel mills of Youngstown came in part because of the failure of U.S. Steel to invest in the modernization of its facilities. See \textit{Lynd}, supra note 5, at 16 By some accounts, the potential closure of Warnaco's Hathaway shirt factory, see supra note 26, came in part because of the failure of the company to dedicate resources necessary to market the shirts effectively. See Rimer, supra note 26 (noting that Warnaco "had long since all but stopped advertising Hathaway shirts nationally")

\textsuperscript{126} The following discussion is analogous to that provided in \textit{Kaufman}, supra note 106, at 392-98, on the provision of health and safety protection.
avoid. As the incidence of job discontinuity increases, informed workers demand a higher risk premium for each additional amount of risk.\textsuperscript{127} Thus, as the rate of job discontinuity increases, firms will have to pay a higher and higher wage premium. As they decrease the risk of job discontinuity, they receive a benefit by way of the lower wages they can pay to attract workers.\textsuperscript{128}

When deciding how much to spend on preventing job discontinuities, a firm must consider both the monetary cost and monetary benefit of reducing such discontinuities. The optimal level of expenditures is at the level where the cost of prevention and the marginal cost of discontinuity are equivalent. Consider the possibility that firms will mislead workers about the security of their employment. If firms can lie with impunity, all firms will have incentives to mislead their workers into believing that their jobs are more secure than they are. With such widespread mendacity, workers likely would not demand a fully compensatory risk premium in wages. They will probably assume that their jobs are more secure than they are in fact and thereby demand less of a wage differential to compensate them for that additional risk.\textsuperscript{129} In such a case, the company’s marginal cost of job discontinuity would be falsely deflated. Because the costs of job discontinuity would be held falsely low, a firm would tend to spend less on the prevention of job discontinuities. The false equilibrium brought about by fraud would thus tend to involve a higher level of job insecurity than if fraud were not present. Incomplete information, therefore, not only takes us away from allocational efficiency but plausibly results in a greater number of job discontinuities such as layoffs and plant closings. Allowing fraud in the labor market decreases the benefits firms gain from offering security and decreases the costs firms bear from providing insecurity, which makes insecurity more likely.

\textsuperscript{127} This is because, in the aggregate, most people are assumed to be risk averse, i.e., they have an increasing aversion to additional increments of risk. See id. at 394-95.

\textsuperscript{128} Cf. id. (discussing, in the context of health and safety provisions, that if firms are required to reduce injury rates below an optimal level they must offer workers lower wages in order to stay in business). If a firm has a greater level of discontinuity than that represented by its optimal point, it will increase its preventative expenditures because the benefit of lower labor costs will outweigh the costs of prevention. If a company has a level of discontinuity that is less than optimal, an increase in wages to compensate workers for additional insecurity will cost less than the savings in prevention costs.

\textsuperscript{129} This would at least be the short term effect and would last until workers learned that they could not rely on any statement from their employer pertaining to job security. The length of time in which this is likely to occur begs reference to Keynes’s famous aphorism that “[i]n the long run, we are all dead.” JOHN MAYNARD KEYNES, A TRACT ON MONETARY REFORM 80 (1923). In the long run, workers’ willingness to accept lower wages in return for representations about job security would decrease as well. The demands of workers would then depend in part on workers’ evaluations of the likely number of firms offering secure employment and firms offering insecure employment. One might even observe that in firms that offer secure employment, workers will require higher wages per incidence of job discontinuity because they can no longer rely on their company’s representation of continued job security. In the long term, therefore, the continuance of the effects mentioned in the text will depend on whether there are more insecure employment firms that would benefit from a rule allowing fraud or more secure employment firms that would lose from such a rule.
C. Some Additional Costs of Fraud in the Labor Market

Much that has been said thus far about the importance of information in the labor market is also true in the capital market, but there are differences as well. Several distinctions provide justifications for concluding that antifraud rules are more important in the labor market than in the capital market.

It is important to note at the outset of the discussion, however, that the capital market's greater national scope and efficiency might appear to argue for greater protection than in the labor market. The national exchanges facilitate a highly efficient and very important system for security sales and purchases. If a company issues stock using misleading statements, the fraud will be incorporated into the prices of the company's stock, wherever the purchaser might be. Moreover, if fraud is not punished effectively, investors will eventually lose confidence in the securities market and will tend to shift to alternative methods of investing. Because the health of, and confidence in, national exchanges is vital to a strong national economy, fraud protection for such markets is seen as essential.

Labor markets, on the other hand, are less efficient and less national. If a company fraudulently assures workers in Ohio that their jobs are secure, such fraud is unlikely to affect workers in California greatly. Labor fraud is likely to have local, or perhaps regional effects, rather than national ones. In addition, one might argue, confidence in the labor market is less essential to the health of the national economy. Labor markets do not depend on a national labor "exchange," the success of which turns on the confidence of workers that it is not tainted by fraud. While investors have more alternatives and could throw the markets into a tailspin if fraud were quotidian, workers have to work. It is more important, one would say, to erect national fraud protection for the capital market than for the labor market.

This argument goes too far. Because it is less efficient and fluid, the labor market certainly is less sensitive to changes in worker "confidence" than the capital market is to investor confidence. But the sensitivity of the capital market also makes it more likely that fraud will be found out without the intervention of legal rules, as the incentives for monitoring the validity of company statements are quite high. Much money can be made by sniffing out fraud and either using such information to inform one's own trades or selling the information to other investors.\(^\text{130}\) It is less likely that private monitors for fraud will spring up in the labor market; the opportunities for arbitrage do not exist.\(^\text{131}\)

\(^{130}\) See infra notes 296-298 and accompanying text. Yet, even with these private mechanisms, legal protection against fraud in the capital markets is still seen as essential.

\(^{131}\) See infra notes 301-302 and accompanying text.
Furthermore, even if the labor market is less national than the capital market, it is certainly national enough to provide the basis for federal fraud protection. Employer fraud often creates an interstate effect, more obviously at some times than at others. Its national effect would be at least as high as other aspects of the employment relation subject to federal control. Indeed, the Supreme Court has noted that the law surrounding labor agreements and collective bargaining "is 'peculiarly one that calls for uniform law'" because "the possibility that individual contract terms might have different meanings under state and federal law would inevitably exert a disruptive influence upon both the negotiation and administration of collective agreements." The concern that words—the terms of understanding between employers and employees—be allowed to have a consistent meaning across jurisdictional boundaries would argue for a national fraud law just as strongly as for a national collective bargaining law.

One basis for concluding that the need for fraud protection is particularly strong in the labor market is that, from a macroeconomic perspective, fraud in the labor market arguably creates more allocative inefficiency than much of the fraud that occurs in the capital market. As was explained above, the securities laws make actionable not only the deceit that occurs in the initial distribution of securities, but also fraud that affects trades in the secondary market. As Paul Mahoney has explained, "Lies told in secondary markets have smaller allocative effects than those told in primary markets." Deceit in the secondary market does not cause the misdirection of financial capital to the issuer but rather the misdirection of shares among traders. Because the shares are not themselves the productive asset, "the overall efficiency consequences of putting noncontrolling shares of stock in the hands of one investor rather than another [are] small." In contrast, the fraud of concern in the labor market—employers misleading employees to entice them to stay in or accept a job—is in the primary market. The workers' labor is itself the productive asset, and a

132. Allegedly fraudulent employer representations have at times lured workers across state lines. See, e.g., Lazar v. Superior Ct., 909 P.2d 981 (Cal. 1996) (examining whether an employer fraudulently enticed a potential employee to move from New York to Los Angeles to accept a job), discussed infra note 271; Charter Township of Ypsilanti v. General Motors Corp., 506 N.W.2d 556 (Mich. Ct. App. 1993) (per curiam) (rejecting a fraud claim against General Motors for moving its plant production capacity from Michigan to Texas), discussed infra note 272; Lewis, supra note 27 (examining a case in which workers were lured to move from Tennessee to Massachusetts with apparently false promises of lucrative work).


135. See supra text accompanying note 63.

136. Mahoney, supra note 52, at 633.

137. Id. at 633-34.
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misallocation of that asset from a higher-value use to a lower-value use inflicts deadweight loss on society in every case. This deadweight loss can be severe. If we make the reasonable assumption, for example, that the kind of deceit that allegedly occurred in U.S. Steel’s Youngstown facilities was not unique in the declining steel industry of the late 1970s and early 1980s, or in manufacturing generally during that time period, it is easy to see that such fraud could have had significant macroeconomic effects. Labor resources were hindered from moving efficiently from steel to more productive pursuits, and when the inevitable eventually occurred, the massive plant closings caused economic shocks that sent state and regional economies reeling.138

That financial capital is more fluid than human capital means that fraud in the labor market hurts workers in ways that capital investors need not suffer. As Daniel Fischel has observed, “Investors in capital markets are protected by the virtually infinite number of investment substitutes.”139 Companies compete for capital investment, and if an investor is dissatisfied with the performance of a particular investment, she can usually sell it with little difficulty and at little cost. If a firm has misled capital investors with regard to, say, potential for investment gains, investors can generally find substitute investment vehicles in short order. They will have suffered loss, to be sure, but their loss can be minimized by rapidly transferring the funds from the defrauding firm to a truthful firm.

On the other hand, as Fischel states, “fewer substitutes exist for labor opportunities.”140 Being unemployed or even self-employed is a less efficient substitute for a steel worker who loses her job than placing money in the bank is for an investor who must sell her stock in the steel company. An investor can find a multitude of alternative uses for disposable cash; a steel worker has many fewer alternatives for her skills. Cash does not need to be “retrained” before it can be used profitably again, but an unemployed steelworker might need such retraining.

Moreover, while investors in the securities markets typically can leave the market completely at little cost, the “exit option” is much more costly for workers. Workers simply cannot move as quickly as capital; think of the costs of a worker leaving Youngstown and relocating to Texas, or for that matter Indonesia, compared to moving an amount of capital between the same locales. The exit option may in fact become more costly the longer the employee stays in her job. To the extent that the worker develops firm-specific skills or

138. Econometric studies reveal that advance notice of layoffs tends to reduce the length of unemployment workers suffer after the layoff. See, e.g., John T. Addison & Pedro Portugal, Advance Notice and Unemployment: New Evidence from the 1988 Displaced Worker Survey, 45 INDUS. & LAB. REL. REV. 645, 658 (1992) (concluding that advance notice is associated with a reduction in joblessness for most categories of workers); see also id. at 660 tbl.A1 (discussing other econometric analyses on point).
139. Fischel, supra note 4, at 1065.
140. Id. at 1066.
develops other links to a particular job or place, she becomes more dependent on the firm for continued employment. Thus, workers’ ability to leave firms tends to become more constrained the longer they work for particular employers. The costs of employer fraud will therefore tend to be quite high when the employees affected are long-term employees.

There is yet another way in which fraud in the labor market is more costly than in the capital market. Capital investors can protect themselves ex ante from fraud by placing their funds in a number of different investment vehicles. From the standpoint of the individual investor, the risk of fraud can be seen as simply another risk of the market. While one firm might commit fraud on its investors, it is unlikely that many will do so at any one time. The costs of being victimized by fraud will be less when only a portion of one’s investments are in the defrauding firm. Workers are much less able to protect themselves ex ante through diversification. Investors can put their eggs in many different baskets; full-time workers have only one egg and must place it in only one basket. In more economic terms, human capital is difficult to diversify because employees are unable to divide their labor resources—efforts and knowledge and skill—among a large number of firms. Employees are thus especially vulnerable to fraud by their employers because any cost they suffer is felt across their human capital “portfolio” rather than merely in one portion of it.

There is one final way in which fraud in the labor market is particularly costly. By definition, capital investors use savings to purchase stock. In addition, for most investors the income and capital gains from investments are not typically necessary for subsistence. A job, on the other hand, is much more closely tied to survival. For most, work is the method by which one gathers the necessities of life. One could generalize, then, and say that when a company defrauds an investor about an investment, the damage is to savings. When a company defrauds a worker about her work, the damage is to subsistence.

In the labor market as in the capital market, information matters. The damage of false or incorrect information is severe to workers, employers, and society in general. In addition, costs are present in the labor context that are absent from the securities one. Thus, unless some other factor is present, the

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141. See id. at 1067.

142. These two points, that fraud is particularly costly in the labor market because of the scarcity of adequate substitutes and that it is particularly costly because of workers’ inability to diversify their risk, apply much more persuasively on the employee’s side of the equation than on the employer’s. An employer need worry about fraud from employees much less than vice versa because employers are typically better able to find adequate substitutes and are generally better able to diversify away the risk that some employees are deceiving them in some material way. The case for federal fraud protection in the labor market is thus much stronger vis-à-vis employers’ deceit of employees than vis-à-vis employees’ fraud of employers. The statute proposed infra in Part V, therefore, makes only the former actionable.
conclusion that statutory protection is a good thing in the securities market is sufficient to demonstrate that it should exist in the labor market. Whether any such contrary factor exists is the question to which this Article now turns.

III. THE POSSIBILITY OF MARKET SELF-CORRECTION

The insights set out in Part II do not necessarily provide a rationale for regulation, much less for regulation on the federal level. Government regulation of fraud may be unnecessary because the market will self-correct; perhaps competitive pressures will penalize fraud sufficiently that a rule against it is unnecessary. This argument is based on the insight that sellers of a good cannot lie costlessly about the qualities of the good. Some purchasers will seek to verify the representations before purchase, and, to the extent the representations were misleading, the potential purchaser will likely go elsewhere. Even if the purchaser fails to verify the seller’s statements at the time of purchase, any misrepresentation will decrease the probability of repeat purchases. Moreover, “Many sellers have competitors anxious to expose misstatements.” Finally, firms that genuinely offer superior products will seek ways to bond their statements (with warranties, for example), to provide purchasers the opportunity to verify the seller’s representations (through inspection or trial use periods, for example), or to allow third parties (outside accounting firms or consumers’ groups) to check the truthfulness of the sellers’ statements.

But, as Easterbrook and Fischel remind us, these market corrections will not work perfectly. Sellers of low-quality products can partly frustrate verification by “mimicking the disclosure of ascertainable facts while making bogus statements about things buyers cannot verify.” Some sellers will not care about repeat transactions. Itinerant vendors, for example, “have no brand name to protect and seldom engage in multiple transactions with the same buyer, so they have strong incentives to misrepresent the quality of their wares in order to obtain a higher price.”

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143. See supra Section I.B.
144. See Easterbrook & Fischel, supra note 54, at 674 (“One cannot leap from the difficulties of a market with asymmetric information to the conclusion that there is need for regulation—even such mild regulation as a prohibition of fraud.”).
145. Even if the market does not self-correct, one would also need to argue that regulation would be less costly than the continuation of nonregulation. Moreover, to the extent that the proposed antifraud law for the labor market would be federal in scope, one would have to provide a basis to believe that a federal remedy would be more effective than protection rooted in state law. These issues are discussed infra in Part V.
146. Easterbrook & Fischel, supra note 54, at 674 n.7.
147. See id. at 675.
148. Id. at 674.
149. EASTERBROOK & FISCHEL, supra note 51, at 95.
Even with the possibility of repeat purchases, sellers of low-quality items may often find that, as Easterbrook and Fischel put it, "the gains from one-shot deception [are] greater than the reputational loss"; that is, "some firms will find fraud to be the project with the highest net present value." In addition, certain products are simply not subject to accurate verification. Many securities, for example, constitute an interest in unique projects; in such case, "neither competitors' statements nor the prospect of repeat purchases will impose restraints, and it is very hard for a buyer to verify statements before the sale." Market corrections are difficult in the labor market as well. Many workers will find it difficult, if not impossible, to verify employers' or potential employers' statements with regard to the safety of the workplace, job security, or certain employment benefits. Moreover, the labor market enjoys less protection from private monitors than does the capital market. While the capital market could rely on a number of private mechanisms to monitor fraud, unions are labor's best hope for ferreting out employers' misstatements. Unions, however, are in a period of historical weakness.

Even when verification and bonding are possible, they impose costs on the market transactions, and these costs are not always borne by the fraudulent party. These costs decrease the aggregate amount of commercial activity—if a widget purchaser has to spend five percent of the purchase price to verify the quality of the widgets she buys, she can purchase fewer widgets. If the high-quality supplier of widgets has to offer a warranty that adds five percent to the cost of providing the widget, then she too will sell fewer widgets. Moreover, to the extent that these verification and bonding devices are imperfect, sellers will begin to lose confidence in the market as a whole; they will tend to discount the quality of all the widgets in the market. Buyers will no longer be willing to spend as much as previously, even on good widgets, because they will be less sure that they are in fact buying good widgets. The makers of good widgets will tend to exit the market because they cannot get a fair price for their product. The market will then come to be dominated by makers of poor widgets.

150. Easterbrook & Fischel, supra note 54, at 675.
151. Id.
152. Id. at 674 n.7; see also Nicholas L. Georgakopoulos, Frauds, Markets, and Fraud-on-the-Market: The Tortured Transition of Justifiable Reliance from Deceit to Securities Fraud, 49 U. MIAMI L. REV. 671, 695 (1995) (arguing that verification costs are particularly high in financial markets). Indeed, only a limited amount of information can be verified at all in the securities markets. Investors cannot deduce future profits or risks of a business venture and would not want to spend their resources doing that even if they could. See Easterbrook & Fischel, supra note 54, at 674-75. Employees face the same difficulties when evaluating the prospects of a potential employer's business.
153. See infra notes 203-205, 301-302 and accompanying text.
154. See infra notes 295-302 and accompanying text.
155. See infra notes 299-300 and accompanying text.
156. This analysis tracks that offered in Stout, supra note 84, at 713.
157. See Akerlof, supra note 122, at 495.
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One would expect that this effect would also occur in the labor market. Honest employers will have to expend resources to bond their statements, making it more expensive for them to hire any given amount of labor. To the extent that bonding and verification are imperfect, employees will tend to lose confidence in the labor market as a whole, making them less likely to enter the labor market in the first place and to demand higher wages if they do.

A rule against fraud can mitigate these effects. As Easterbrook and Fischel explain, a penalty for fraud makes it more costly for firms providing low-quality products (or employment, one might add) to use false disclosures to mimic firms providing high-quality products or employment; the fraud penalty, meanwhile, imposes no or low costs on honest firms providing high-quality products or employment.\(^{158}\) In fact, the rule against fraud decreases the costs that firms providing high-quality products or employment need to expend to certify their products. The costs of providing high-quality products or employment will fall while the costs of passing off low-quality products or employment will increase.

Of course, antifraud rules will themselves not operate perfectly, and they will impose costs of their own. To the extent that they are underenforced, or that the penalties imposed are too low to deter fraudulent conduct, firms providing high-quality products or employment may still need to use some additional certification devices.\(^{159}\) In order to enforce the rule, the government will have to dedicate resources to investigating, prosecuting, adjudicating, and punishing fraudulent activity. If the rule is overenforced or enforced inaccurately, honest firms will incur expenses protecting themselves from possible liability.\(^{160}\) Without a detailed empirical analysis, it is difficult to prove conclusively that the costs of a rule against fraud outweigh the benefits.\(^{161}\) But rules against fraud are indeed ubiquitous.\(^{162}\) They have been a concern of the common law for centuries,\(^{163}\) and they are presently found in the laws of all fifty states and of the federal government.\(^{164}\) If the costs of such rules outweighed their benefits, one would expect to see at least some jurisdictions without such rules.

\(^{158}\) See Easterbrook & Fischel, supra note 54, at 677.

\(^{159}\) Cf. id. (noting that verification expenses go down for high quality securities if informational warranties are generally enforced).

\(^{160}\) See id. at 678; cf. Brudney, supra note 54, at 733 n.31 (noting that hindsight often exposes corporate enterprises to liability if projections are unfulfilled); Stout, supra note 84, at 715 (admitting that securities fraud “[s]uit[s] may . . . be imposing significant costs on United States firms”)

\(^{161}\) For a “back of the envelope” calculation that the benefits of a rule against fraud in the securities markets far outweigh the costs of such a rule, see Stout, supra note 84, at 714-15

\(^{162}\) See supra Section I.A.

\(^{163}\) See supra notes 31-32 and accompanying text.

\(^{164}\) See JONATHAN SHELDON, UNFAIR AND DECEPTIVE ACTS AND PRACTICES 31 (3d ed 1991) (“Every state and the District of Columbia have enacted at least one statute with broad applicability to most consumer transactions, aimed at preventing consumer deception and abuse in the marketplace.”), see also id. app. A at 527-42 (providing a state-by-state analysis of each statute).
Of course, too much can be made of this descriptive point, especially since this Article's argument would collapse if the absence of an effective fraud remedy in the labor market could be taken to provide a normative argument not to have such a remedy. Perhaps the better way to proceed is to note that one sees little evidence of a move away from fraud protection in general. Notwithstanding some recent moves to reduce the costs to businesses of defending against strike suits and to provide corporate officials some safe harbors for future-regarding statements, there remains a consensus in the academy and in politics that, on the whole, antifraud law is beneficial. It would seem reasonable, then, for a proponent of protection against fraud in the labor market to take as a starting point not the justification of fraud law generally but the accounting of likely costs and benefits of fraud protection for the labor market in particular.

IV. THE DIFFICULTIES OF RELYING ON COMMON LAW REMEDIES

Perhaps the lack of federal statutory protection against fraud in the labor market can be explained on the basis that it is simply duplicative of existing remedies. One might suppose, for example, that contract law would be an adequate safeguard against employer deceit. Workers could claim that the employers' statements were legally binding promises or negotiate with their employers to ensure that they had enforceable agreements. Another possible source of protection could come from the common law of tort. One might suggest, then, that the lack of federal statutory protection for workers requires them to depend on a different source of protection from investors, that is, the common law, but that the actual amount of protection is unlikely to be much different. To the extent contract or tort law provides adequate protection against fraud, a federal statute is unnecessary. This part analyzes whether either of these common law remedies provides the efficient level of fraud protection.

A. Why Contract Law Is Not Enough

Many of the types of representations that are important to workers pertain to the future and appear to be promises: "We will not close the plant as long as it is profitable," or, "You will have medical insurance for life." One might naturally propose, therefore, that contract law provides the necessary protection for workers even if tort law does not. There are a number of reasons, however, that workers should not be forced to depend solely on contract law to guard against deceitful practices by their employers.

165. See supra text accompanying notes 79-82.
166. See supra notes 84-86 and accompanying text.
First, the tort of deceit has been seen to add something separate from contract law for over two centuries. It is odd to ask workers, then, to depend on contract remedies when other market participants such as capital investors need not limit their avenues of redress. Contract law is essential for workers and other market participants, of course, but one should not fall into an unconsidered assumption that it is all that is essential. Contract law is essentially about promises. The tort law of deceit is about false statements that induce reliance. Some false statements that induce reasonable reliance will be promissory in nature (e.g., “We will not close the plant if it remains profitable”); others will not be (e.g., “The plant is now profitable”). Statements of the latter variety are not enforceable promises, and those of the former variety may not be either, even given their forward-looking natures. But both kinds of false statements might indeed induce someone reasonably to rely on them. Therefore, if contract law were the only option for workers, they would be underprotected from employer fraud.

Also, if workers could depend on contract law alone, they and employers would be forced to bargain about their relationship to a much greater extent, increasing the costliness of agreements. If default contract rules do not protect employees, then employers might be forced to write their commitments into the employment contract or otherwise warranty their statements. Unless they can depend on legal fraud protection, employees will be unlikely to rely on

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167. See Pasley v. Freeman, 100 Eng. Rep. 450 (K.B. 1789) (severing the previously necessary connection between misrepresentation and a contract); see also supra note 32

168. See E. ALLAN FARNSWORTH, CONTRACTS 9 (1982) observing that, “From the perspective of society as a whole, the function of the law of contracts might have been seen as furthering the general economic good by encouraging parties to enter into . . . transactions” based on an exchange of promises, and that it “was essential to provide a general basis for the enforcement of promises”

169. Remember the Youngstown case in this context. See supra notes 5-24 and accompanying text Many of the statements there were promissory in nature, yet the plaintiffs lost their promissory estoppel claim in the district court on the grounds that the statements did not constitute promises. See Local 1330, United Steel Workers v. United States Steel Corp., 631 F.2d 1264, 1277 (6th Cir. 1980) Also consider in this context the many cases arising under ERISA concerning company statements about “lifetime” benefits. Many of these cases, decided on contract reasoning, hold that such statements do not rise to the level of enforceable contracts, usually because of “reservation of rights” clauses. See, e.g., Sprague v. General Motors Corp., 92 F.3d 1425, 1434 (6th Cir. 1996); In re Umsys Corp Retiree Med Benefit “ERISA” Litig., 58 F.3d 896, 902-03 (3d Cir. 1995); Moore v. Metropolitan Life Ins. Co., 856 F.2d 488, 489 (2d Cir. 1988). But see Armistead v. Vernitron Corp., 944 F.2d 1287, 1299-300 (6th Cir. 1991) (using equitable estoppel doctrine to protect employees from the effects of misleading representations concerning retiree benefits). When courts in these kinds of cases apply tort reasoning, however, reasoning which is available when employees bring a fiduciary duty claim against the plan administrator, see infra notes 215-219 and accompanying text, the reservation clauses are not determinative. The outcome is instead determined in part according to whether it was reasonable for the employees to rely on the statements notwithstanding the reservation clauses. See, e.g., Varity Corp. v. Howe, 116 S.Ct. 1065, 1073 (1996)

170. Reliance might be reasonable even with certain disclaimers or cautionary statements made within the same communication or elsewhere. The key question would be whether the disclaimers or cautions were sufficiently influential as to make reliance unreasonable. Cf Dale v. Rosenfeld, 229 F.2d 855, 858 (2d Cir. 1956) (“Availability elsewhere of truthful information cannot excuse untruths or misleading omissions in the prospectus.”); Loss, supra note 29, at 892 n.19 (recognizing the possibility that under section 12(2) of the 1933 Act, 15 U.S.C. § 77i (1994), true statements in one communication would not necessarily deny recovery if statements appearing in another communication were false).
employer statements unenforceable in contract. The inadequate level of protection and increased cost of this approach indicate that it is not a complete solution.

B. The Level of Protection in Tort

Some commentators have suggested that the common law provides lesser substantive protection against fraud than the securities laws. To the extent this is true, the argument for statutory fraud protection in the labor market would be strengthened. But as was outlined above, the level of protection from fraud under the common law is quite high and is increasing. Under common law tort, complete silence does not protect a party to a business transaction who by concealment intentionally prevents the other from acquiring material information; any representation that creates a false impression and thus covers up the truth is classified as misleading and is just as actionable as a verbal assurance that the fact is not true; if a party to a transaction communicates, she must disclose a sufficient amount to keep her words from being misleading, and "half of the truth may obviously amount to a lie, if it is understood to be the whole." These expanding protections could possibly provide an adequate remedy.

One is unable to say with certainty, then, whether the substance of the common law provides a noticeably lower level of fraud protection than is available statutorily in the capital markets under the securities laws. If and to the extent fraud protection seems stronger under the securities laws, such apparent strength may depend simply on the fact that the securities laws in effect federalized common law protection. The ensuing judicial broadening of fraud protection under the securities laws might simply be the continuance of an expansion that had been occurring, and would have continued, in the common law.

171. See Loss, supra note 29, at 716.
172. See supra Section I.A.
174. See KEETON ET AL., supra note 30, § 106, at 737.
175. See id. § 106, at 738.
176. Id.
177. Professor Georgakopoulos has argued that securities laws are stricter than common law deceit because of the relaxation of the reliance element on the basis of the fraud-on-the-market theory. See Georgakopoulos, supra note 152, at 711-19. He contends convincingly that a relaxation of the reliance requirement makes sense in the financial markets. But there is nothing about the fraud-on-the-market theory that limits it to the federal securities context and excludes common law courts from using it in common law deceit actions involving securities. In other words, the use of the fraud-on-the-market theory says less about the difference between federal and common law than about the market for securities and the market for real goods. One can support an antifraud statute for workers and remain agnostic with regard to whether the fraud-on-the-market theory should apply in actions brought under such a statute. For a discussion of the fraud-on-the-market theory in the capital markets, see infra notes 282-286 and accompanying text.
Yet one should not conclude that a federal statute for workers is unnecessary. Indeed, fraud was illegal in every state of the union in 1933, yet Congress nevertheless felt it necessary to enact fraud protection for the capital markets on the national level. Also, the core antifraud protection of the securities acts continues to command broad public support, implying that the acts offer some benefit.

Indeed, a national statutory rule is preferable to the common law on several grounds even if the underlying substantive law is more or less the same. Under the common law, the legal rules will vary somewhat across jurisdictions and will tend to vary more than they would if all courts were interpreting a common statutory text. When rules vary across jurisdictions, it is more difficult for companies and investors (as well as employers and employees) to know what the law requires. Similarly, even within a jurisdiction, a common law rule will tend to have more elasticity than a rule based on a statute. Such elasticity in a rule will impose uncertainty costs on those seeking to abide by it. The fact that a party often cannot know, until long after the fact, whether she will be found to have violated the law will make the law less efficient in deterring harmful activity and will increase the costs of obedience. A clearer legal rule avoids these costs. In addition, some companies engage in business across a number of jurisdictions. It is simply more efficient to litigate claims in one federal court than in several state courts. These reasons apply as easily to a labor market fraud rule as they do to a capital market fraud rule.

In fact, there are reasons to be particularly skeptical about the ability of the common law to remedy fraud in the labor market. Ironically, aspects of federal law throw up obstacles to employees bringing fraud claims against their employers through possible preemption by federal labor law or ERISA. These preemption doctrines do not apply to capital investors and impose significant obstacles to employees’ abilities to vindicate common law rights. Even when employees are able to overcome these constraints, the common law fraud remedy has provided, at best, limited assistance.

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179. See Easterbrook & Fischel, supra note 54, at 670
180. See Seligman, supra note 85, at 18.
181. See supra notes 85-86 and accompanying text.
182. For an analysis of whether the proper locus of statutory protection is at the state or federal level, see infra Section V.B.
183. See Easterbrook & Fischel, supra note 54, at 699.
1. The Section 301 Preemption Problem

One of the largest obstacles to workers successfully using common law tort remedies is federal labor law, specifically the labor law doctrine of section 301 preemption. Section 301 of the LMRA grants federal jurisdiction over suits for violations of collective bargaining agreements. Under section 301, “courts determine whether the collective bargaining agreement preempts claims an employee brings under [other statutes or the] common law.” Because many instances of employer fraud pertain to matters—such as job security, working conditions, or employment benefits—that collective bargaining agreements typically cover, a section 301 preemption question is presented whenever a unionized employee attempts to bring a fraud claim in a judicial forum. When a claim is preempted, its preemption is complete: “[I]t is converted into a section 301 claim from its inception, even if alternative causes of action are pleaded in the complaint.”

This limitation is a significant obstacle to workers’ attempts to vindicate their common law rights because the Supreme Court has given section 301 a broad preemptive scope on the ground that the law surrounding labor agreements “is peculiarly one that calls for uniform law.” Moreover, even though section 301 pertains to labor contracts, the Supreme Court has allowed the section’s broad preemptive scope to bar employees’ tort claims as well. In Allis-Chalmers Corp. v. Lueck, the Court held that section 301 preempted an employee’s state law tort claim in a case in which the plaintiff alleged that the employer had harassed him because of an insurance claim he had filed. The Court made clear that section 301 would preempt any claim that is “substantially dependent upon analysis of the terms of an agreement made between the parties in a labor contract,” whether pleaded in contract or tort. Thus many courts have held that section 301 preempts workers’

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185. See Labor Management Relations Act (LMRA), 29 U.S.C. § 185 (1994); see also Stone, supra note 95, at 577.
186. Section 301 states in relevant part:
Suits for violation of contracts between an employer and a labor organization representing employees in an industry affecting commerce . . . may be brought in any district court of the United States having jurisdiction of the parties, without respect to the amount in controversy or without regard to the citizenship of the parties.
187. Stone, supra note 95, at 577.
188. Id. at 598 (citing Franchise Tax Bd. v. Construction Laborers Vacation Trust, 463 U.S. 1, 23-24 (1983)).
191. Id. at 220.
192. See id. at 211.
claims that their employers have defrauded them. Katherine Van Wezel Stone has noted two practical consequences of a state common law claim's preemption under section 301. First, "any claims for breach of a collective bargaining agreement that are even arguably subject to an arbitration clause must be decided in arbitration, rather than by a court." Courts have "also adopted an extremely narrow standard for judicial review of the arbitration decisions." In practice, this means that an employee whose claim is preempted under section 301 may pursue private arbitration only. As a result, by virtue of the combination of section 301 preemption rules and their collective bargaining agreements, unionized workers find that they do not have access to any court to assert their state law claims.

Second, when a claim is preempted under section 301, the state law rights are extinguished. The arbitrator applies the law of the collective agreement, not the external state law that the employee initially sought to invoke. The unionized employee whose state law claim is preempted thus receives neither the benefit of a judicial forum nor the advantage of the substantive provisions of the state common law right.

To be sure, section 301 preemption does not bar all common law fraud claims arising in the context of the employment relation. Most basically, section 301 pertains only to collective bargaining agreements, so any employee unrepresented by a union would not face these problems. Even unionized workers can avoid the preemption problem if the underlying claim does not depend on the collective bargaining agreement but on individual oral employment agreements. But, even with these exceptions, the point

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194. See Stone, supra note 95, at 394-96.

195. Id. at 595; see also United Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574, 584-85 (1960) (announcing the presumption of arbitrability); United Steelworkers v. American Mfg Co., 363 U.S 564, 567-68 (1960) (ruling on a motion to compel arbitration that the judicial role is limited to determining whether the plaintiff has asserted "a claim which on its face is governed by the contract").

196. Stone, supra note 95, at 595; see also United Paperworkers Int'l Union v. Misco, Inc., 484 U.S. 29, 36 (1987) ("Courts are not authorized to reconsider the merits of an [arbitral] award even though the parties may allege that the award rests on errors of fact or on misinterpretation of the contract ").

197. See Warrior & Gulf Navigation, 363 U.S. at 581-81; Stone, supra note 95, at 595 & n 74.

198. An additional difficulty posed by section 301 is that the statute of limitations is six months while the limitations period under state common law fraud is usually greater. See, e.g., CAL. CIV. CODE § 338 (West 1982 & Supp. 1997) (three years); 735 ILL. COMP. STAT. ANN. 5/13-205 (West 1992) (five years); MASS. GEN. LAWS ANN. ch. 260, § 2A (West 1992) (three years), N.Y. C.P.L.R. 213 (Consol. 1997) (six years).

199. See Caterpillar, Inc. v. Williams, 482 U.S. 386 (1987), Stone, supra note 95, at 600-01. In some other cases, courts have held that section 301 did not preempt employees' common law fraud claims. See Milne Employees Ass'n v. Sun Carriers, Inc., 960 F.2d 1401 (9th Cir. 1991), Wells v. General Motors Corp., 881 F.2d 166 (5th Cir. 1989); Berda v. CBS Inc., 881 F.2d 20 (3d Cir. 1989), Varnum v. Nu-Car...
remains that section 301 preemption is a significant problem in the vindication of common law rights in the labor context and has no corollary in the capital market context. The fact that nonunionized workers do not need to worry about section 301 preemption may provide little solace because unions offer one of the few private mechanisms to monitor fraud in the labor market. Furthermore, the legal doctrine allowing plaintiffs to avoid section 301 preemption if their claims concern individual rather than collective matters is hardly a bright line rule. Because the uncertainty of such a rule increases the expected litigation costs for workers seeking to vindicate their common law right not to be defrauded, section 301 preemption weakens the common law's ability to protect against fraud in the labor market even in those cases in which the employee's claim ultimately avoids preemption. 

2. The ERISA Preemption Problem

Some of the most hurtful frauds occur when employers mislead employees with regard to employment benefits such as health insurance, disability plans, and pensions. Not only is this kind of fraud potentially devastating, but one would also expect it to be relatively common. As David Charny recently pointed out, workers are not typically well-informed about particular aspects of firms' benefit plans, and with ill-informed employees, firms will tend "to compete on salient aspects of jobs, like higher wages and job security, while cutting corners on less visible features, like the details of insurance coverage." Insurance, in particular, "becomes a particularly tempting arena for employer opportunism because workers may discover coverage limits or changes only after many years at the job."

A typical situation might involve an employee enticed to accept early retirement in part with statements that she would continue to receive full insurance coverage. Several months later, after the newly retired employee is diagnosed with a debilitating, costly illness, she also learns that her insurance was cut off on the date of her resignation. If this employee were to seek

Carriers, Inc., 804 F.2d 638 (11th Cir. 1986); Anderson v. Ford Motor Co., 803 F.2d 953 (8th Cir. 1986); Barske v. Rockwell Int'l Corp., 514 N.W.2d 917 (Iowa 1994).
200. See supra note 95 and accompanying text.
201. Because section 301 is part of a federal law, a federal statute would be required to avoid these preemption obstacles completely.
202. See Lewis, supra note 28; All Things Considered, supra note 28.
204. Id. at 1619.
205. Id. Charny cites a General Accounting Office study that determined that over 70% of retired workers misunderstood when they would be eligible for retirement benefits. See id. at 1619 n.48 (citing JOHN H. LANGBEIN & BRUCE A. WOLK, PENSION AND EMPLOYEE BENEFIT LAW 75 (1990) (citing U.S. GEN. ACCOUNTING OFFICE, PENSION PLANS: MANY WORKERS DON'T KNOW WHEN THEY CAN RETIRE 2 (1987))).
legal recourse against her employer, she would face a number of obstacles. First, if she brought a common law fraud claim, it is likely that a court would bar the claim as preempted by ERISA. Second, the remedies available under ERISA would be less than would have been available under the common law. This section discusses each of these problems in turn.

ERISA is an intricate statute that establishes a federal regulatory scheme for employee retirement plans, including both pension and benefit plans. Section 514(a) preempts "any and all State laws insofar as they may now or hereafter relate to any employee benefit plan" by any employer engaged in commerce or in any industry or activity affecting commerce. The "relate to" preemption language has been interpreted to be "clearly expansive," preempting any state law that "has a connection with or . . . reference to such a plan." Broad preemption is necessary, it is said, to further Congress's intent to "establish pension plan regulation as exclusively a federal concern." Thus, a number of courts have held that ERISA preempts common law fraud claims that concern some aspect of a covered employment plan. According to the First Circuit, for example, preemption is appropriate when the "existence of [an employee benefit plan is inseparably connected to any determination of liability under state common law of misrepresentation." Preemption would also be appropriate, presumably, if the determination of liability would require the court to inquire into the content of the plan, rather than merely its existence.

Thus ERISA may prevent workers from taking advantage of common law remedies that otherwise would be available to them. Whether ERISA preemption on balance erodes protection for workers depends, however, on the level of protection ERISA provides in the place of the common law. Here, the employee had accepted a severance package that stretched payments over six months, with the understanding that the insurance would continue during the payout period, but when the employee was subsequently diagnosed with multiple sclerosis, the employee found out that the insurance coverage had ceased on the final day of employment).

answer is that ERISA provides some, but less, protection against employer fraud than the common law would.

Recently, in Varity Corp. v. Howe, the Supreme Court authorized ERISA suits brought by individual workers against employers who had intentionally misled them regarding the security of their benefits. In Varity, the defendant company created a separately incorporated subsidiary into which it could place a number of the parent company's outstanding debts and commitments. The plan was to allow the subsidiary to fail and go into bankruptcy, eliminating the obligations. Among the obligations the parent company sought to eliminate were those arising from the benefit plan's promises to pay certain medical and other nonpension benefits to employees. The parent enticed about 1500 employees to move to the new subsidiary with various representations that their benefits would remain secure if they voluntarily transferred to the subsidiary. These representations were lies, as the parent company knew that the subsidiary was bound to fail. The subsidiary indeed collapsed after two years, and the employees lost their nonpension benefits.

Though ERISA does not have a specific provision making material misrepresentations actionable, the Court held that the employer's deliberate misrepresentations violated the fiduciary obligations ERISA imposes upon plan administrators. ERISA provides that "a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries," and the Court decided that "deceiving a plan's beneficiaries in order to save the employer money at the beneficiaries' expense" violated this requirement. Varity may thus supply a meaningful and important remedy for employees who have been defrauded by their employers, and it should be applauded.

But whatever protection Varity offers, important and significant gaps still exist. First, Varity protects employees only from employer fraud that is related to employee pensions and benefits. It does not protect against fraud relating to wages, job security, working conditions, promotion policies, or the like. The presence of fraud protection under ERISA highlights its absence elsewhere. Second, even if the employee does win a fiduciary duty claim under ERISA, only equitable relief, as opposed to damages, is available.

216. See id. at 1068-69.
218. Varity, 116 S. Ct. at 1074.
cases, therefore, a defrauded employee will be able to recover significantly less under ERISA than would be available under the common law, which allows for compensatory damages for deceit.\(^{221}\)

Third, *Varity* protects employees from employer fraud only if the employer is acting as the plan administrator when the misrepresentations occur. The duty to avoid misrepresentations arises because of the employer’s fiduciary duties under ERISA. The employer is a fiduciary "‘to the extent’ that he or she ‘exercises any discretionary authority or discretionary control respecting management’ of the plan, or ‘has any discretionary authority or discretionary responsibility in the administration’ of the plan."\(^{222}\) The Court found that the misrepresentations at issue in *Varity* were related to plan administration because *Varity* was "both an employer and the benefit plan’s administrator."\(^{223}\) In addition, statements about the company’s financial health were, according to the Court, “intentionally connected” to statements about the future of employees’ benefits,\(^{224}\) the statements were made by “those within the firm who had authority to communicate as fiduciaries,"\(^{225}\) and reasonable employees could have believed that the company was making the statements in its “capacity as plan administrator."\(^{226}\) It is hardly clear whether, and how, these criteria will be applied in future cases. Indeed, the Court went out of its way to limit the scope of its holding:

> We conclude . . . that the factual context in which the statements were made, combined with the plan-related nature of the activity, engaged in by those who had plan-related authority to do so, together provide sufficient support for the District Court’s legal conclusion that Varity was acting as a fiduciary.\(^{227}\)

In an ironic way, then, *Varity* underscores the default rule that an employer *qua* employer does not owe any duty under federal law to avoid deceiving its employees. The defendant in *Varity* had chosen to administer its own plan; such a choice is hardly required.\(^{228}\) Perhaps an employer could avoid the *Varity* duties simply by choosing some other entity, a professional plan administrator for example, to administer its employee benefit plan. If the employer thereafter deceived its employees about employee benefits, the

\(^{221}\) Cf., e.g., *Howe*, 36 F.3d at 756-57 (vacating a jury award of $7.6 million in compensatory damages to one group of plaintiffs and substituting equitable relief of less than $700,000, reinstatement into the plan, and restitution for accrued benefits).

\(^{222}\) *Varity*, 116 S. Ct. at 1071 (quoting 29 U.S.C. § 1002(21)(a))

\(^{223}\) Id.

\(^{224}\) Id. at 1074.

\(^{225}\) Id. at 1073.

\(^{226}\) Id.

\(^{227}\) Id.

\(^{228}\) See 29 U.S.C. § 1108(c)(3) (1994); *Varity*, 116 S. Ct. at 1071 (noting that the defendant was both employer and plan administrator, as ERISA "permits"); id. at 1084 (Thomas, J., dissenting) ("Under ERISA, an employer is permitted to act both as plan sponsor and plan administrator")
employees could be left completely without a remedy; ERISA would preempt the common law claim and fail to provide an alternative.\textsuperscript{229}

One final irony is worth noting. \textit{Varity} provides a limited remedy for employees who are defrauded by their employers about ERISA-covered benefits if the employer breaches its fiduciary duties as plan administrator when making affirmative misrepresentations. Yet, under the common law as well as under the federal securities laws, it is unlawful to make material misrepresentations even to those to whom one does not owe a fiduciary duty.\textsuperscript{230} For workers to receive analogous protection from affirmatively deceptive statements, the Court needed to find that the employer was breaching a fiduciary duty that would be unrequired in these other contexts. Absent a fiduciary duty, workers can be left without a remedy for affirmative misstatements, while for other market participants, the existence of fiduciary duty is immaterial.

3. \textit{The Apparent Presumption Against Workers Using Tort Law To Protect Themselves from Fraud}

Because of these obstacles, it is reasonable to assume that workers' fraud claims reach the merits less often than analogous fraud claims brought by other market participants. If this assumption is true, it would help belie the notion that the common law provides an adequate substitute to federal fraud protection for workers. The questions of whether the common law could provide adequate protection, if the preemption problems outlined above were somehow solved, demands a closer look at the relatively few cases that do reach the merits.\textsuperscript{231} Admittedly, the relative scarcity of cases makes it difficult to argue conclusively either way. One can, however, examine cases that have reached the merits and evaluate whether they are consistent with the view that the common law protects workers adequately from fraud.

For workers seeking to depend on the common law, the cases available for analysis are not particularly encouraging. The cases suggest the following as

\textsuperscript{229} Cf. Pohl v. National Benefits Consultants, Inc., 956 F.2d 126 (7th Cir. 1992). In \textit{Pohl}, the defendant, the employer's health benefits provider, told Mrs. Pohl that her husband's benefit plan would cover 80\% of the costs of treating their daughter's psychiatric illness. In fact, the plan limited payment to $10,000. The daughter underwent treatment, and the Pohls were billed a total of $19,000. They subsequently brought a misrepresentation claim. The district court preempted the common law claim. In an opinion by Judge Posner, the Seventh Circuit affirmed, holding that the plan administrator's function under the plan was ministerial only, rather than discretionary. The administrator was therefore not a fiduciary. The Pohls were left "remediless." \textit{Id.} at 127. Judge Posner emphasized that preemption was required by the statute even though "ERISA does not provide a substitute remedy." \textit{Id.} at 128.

\textsuperscript{230} See supra notes 29-30, 43-51 and accompanying text.

\textsuperscript{231} Even if common law courts dealt fairly with workers' claims, the proponent of a common-law-only regime would still have to demonstrate that a state remedy is better than a federal one. As noted below, \textit{see infra} Section V.B, drawbacks to this approach include possibly lower protection under the common law than under federal securities laws, variation across jurisdictions, and the costs associated with elastic legal rules.
a working hypothesis: Some courts apply what amounts to a presumption against using the common law to aid workers allegedly defrauded by their employers. Misrepresentations that would appear to be sufficient to support a fraud claim in other contexts are held to be insufficient in the employment context. To illustrate this hypothesis, one case in particular deserves careful attention.

a. White v. National Steel Corp.

Consider White v. National Steel Corp. Steel workers whose job security was protected by a collective bargaining agreement accepted “management” positions not covered by the bargaining agreement after National Steel allegedly made promises of job security for the new positions. These promises included the right to return to their former positions if they so wished. When the workers were nevertheless laid off, they brought suit for breach of contract and fraud. The claims of fraud were based on the allegation that National Steel actively misrepresented its policies and conditions of employment for management positions. The employees also brought a claim of “constructive” fraud, allowed under West Virginia law, arguing that National had an affirmative duty to disclose certain material facts that affected the employees’ jobs.

This case is worth focussing on for several reasons. First, the situation presented in the case contained the very kind of fraud at issue in this Article, fraud which would almost certainly be covered by any federal antifraud statute for workers. The alleged misrepresentations and omissions pertained to conditions or terms of employment, and they were sufficiently important to be material. Second, the case arose in a jurisdiction that appears to offer more than enough protection against fraud. Not only do West Virginia courts recognize suits for affirmative misrepresentations, they also provide through the doctrine of constructive fraud a way for courts to punish material omissions. Third, the case was litigated in federal court, and the appellate decision was written by Judge J. Harvie Wilkinson, a well-respected conservative jurist on the Fourth Circuit. Fourth, the court was considering the defendant’s motion for summary judgment, thus requiring it to rule for the plaintiffs if there was a genuine issue of material fact. One might reasonably suppose that if the employee plaintiffs could find a fair hearing in this case,

232. 938 F.2d 474 (4th Cir. 1991).
233. See id. at 488-90. The suit was originally filed in state court in West Virginia but was subsequently removed to federal district court pursuant to 28 U.S.C. § 1441(c) (1994), presumably because of the federal questions arising under the section 301 preemption doctrine. See White v National Steel Corp., 742 F. Supp. 312, 318 n.4 (N.D. W. Va. 1989), aff’d, 938 F.2d 474 (4th Cir. 1991); cf. Berda v CBS Inc., 881 F.2d 20, 21 n.1 (3d Cir. 1989) (explaining removal to federal court when federal law preempts a state cause of action).
234. See White, 938 F.2d at 489.
gaps in fraud protection for workers could be filled through state tort law rather than a federal statute. Conversely, if the common law did not provide adequate protection against fraud in the workplace in this case, there is further reason to believe that a statute would be necessary to provide real fraud protection to workers.

An analysis of the case provides evidence for the latter proposition. Judge Wilkinson’s opinion made quick work of the employees’ fraud allegations and upheld a grant of summary judgment to the defendant employer on those claims. The way the court rejected these claims illustrates the apparent presumption against workers’ common law fraud claims.

i. Constructive Fraud

The court disposed of the constructive fraud claim in just four paragraphs. In West Virginia, courts allow constructive fraud claims to be brought on the basis of a failure to disclose, rather than an affirmative misstatement. The West Virginia Supreme Court of Appeals had defined constructive fraud as “a breach of a legal or equitable duty, which, irrespective of moral guilt of the fraudfeasor, the law declares fraudulent, because of its tendency to deceive others, to violate public or private confidence, or to injure public interests.” This definition does not require the plaintiff to show a breach of a preexisting duty. Indeed, the “duty” can be the result of the court’s decision to require some kind of disclosure rather than its basis.

In White, the employee plaintiffs alleged that National Steel had committed constructive fraud when it enticed them to accept managerial positions but failed to inform them of certain company policies. National Steel had often promoted hourly rate employees to management positions at times of increased business when it needed more foremen and managers. The company’s practice was to return the workers, when business declined, to their former positions with their accumulated seniority restored. This time, however, the company laid off the plaintiffs from their management positions and refused to return them to their hourly jobs. National Steel asserted that its practice of returning recently promoted employees to their union jobs was a

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235. The court reached the merits after deciding that the plaintiffs’ claims were not preempted by section 301 or by other aspects of federal labor law because the claims were based on individual employment contracts and were “independent of any collective bargaining agreement.” Id. at 482.


237. See Stanley, 285 S.E.2d at 683 (“The law indulges in an assumption of fraud for the protection of valuable social interests based upon an enforced concept of confidence, both public and private.”).

238. See White, 938 F.2d at 478.

239. See White v. National Steel Corp., 742 F. Supp. 312, 339 n.31 (N.D. W. Va. 1989) (“In fact, there does not appear to be any evidence in the voluminous record before this Court of any former bargaining unit member who was not permitted to return prior to the layoffs giving rise to the claims in this litigation.”), aff’d, 938 F.2d 474 (4th Cir. 1991).
matter of discretion, and the plaintiffs claimed that the company had committed constructive fraud by failing to inform them that the practice could be discontinued.\textsuperscript{240} In addition, the employees based a constructive fraud claim on an allegation that, after they had been promoted to positions without seniority, the company entered into a collective bargaining agreement prohibiting their return to their old jobs.\textsuperscript{241} The employees alleged that it was constructive fraud when the company failed to inform them of such a change in policy.\textsuperscript{242}

Faced with these claims, both the district court and the Fourth Circuit declined to use the common law power West Virginia law gave them to hold National Steel liable for constructive fraud. The court of appeals upheld the district court's grant of summary judgment for National Steel on all of the employees' constructive fraud claims. It would have been one thing, and much more defensible, if the court had held that the facts of the case would not support a finding of constructive fraud. But the court went further, refusing even to apply the law of constructive fraud to the facts.

According to the Fourth Circuit, constructive fraud law does not apply to the employment relationship. The court's reasoning was made in three cursory steps. First, the court found unpersuasive the precedents brought to bear by the employees because "[t]he cases they cite[d] establish claims for constructive fraud in the context of property sales."\textsuperscript{243} Second, the court said that

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    \item[\textsuperscript{240}] See White, 938 F.2d at 479.
    \item[\textsuperscript{241}] See id. at 480.
    \item[\textsuperscript{242}] See id.
    \item[\textsuperscript{243}] Id. at 489. It could be argued that this reasoning reveals a presumption against using fraud law to assist workers. The court apparently believed that the employment context is sufficiently different from property sales that the precedents developed in the latter are not persuasive in the former. This is hardly self-evident, as courts for decades have used property imagery to help make judgments with regard to employment law and the relationship between laborers and their employers. See, e.g., State \textit{v} Goodwill, 33 W. Va. 179, 183 (1889) (striking down a labor law on due process grounds, saying a man's labor was his "most sacred" property); cf. Richard A. Epstein, \textit{The Mistakes of 1937}, \textit{Geo. Mason U L Rev}, Winter 1988, at 5, 19 ("At common law, all workers owned their labor and employers owned their capital").

Although many of the older cases making such an analogy have been overruled, see, e.g., Adkins \textit{v} Children's Hosp., 261 U.S. 525 (1923), overruled by West Coast Hotel Co \textit{v} Parrish, 300 U.S. 379 (1937) (upholding a minimum wage law for women), it remains true that property doctrine is often used to interpret and analyze the employment relation. For example, scholars have argued powerfully that property law is a helpful metaphor for explaining and categorizing certain problems that arise within the employment relation. See, e.g., Singer, \textit{supra} note 4, \textit{passim}. The Supreme Court, too, has recognized the powerful similarities between jobs and other kinds of property. See, e.g., Perry \textit{v} Sindermann, 408 U.S. 593, 601-02 (1972) (stating that a junior college teacher might have a property interest in continued employment under his school's informal tenure system).

One can disagree, of course, with specific holdings in cases and specific analyses in law journals and still accept the point that the analogy between property and employment can be a close one. The \textit{White} court, however, thought the differences between property and employment were so great that it was unnecessary to explain why constructive fraud precedents arising out of property sales were not persuasive when used in the employment context. The court simply stated that the cases cited by the plaintiffs came from the context of property sales. See \textit{White}, 938 F.2d at 489. In effect, the court was saying that when negotiating the conditions of a stock purchase (which, the court assumed, involves the sale of "property"), it is important that the parties not deceive each other, and fraud law will protect against such deception. When negotiating the conditions of employment, however, each party will have to assume the risk that the other is deceiving her. And, the court must have concluded, the situations are so different that the
constructive fraud "is generally reserved for those cases where a fiduciary relationship exists between the parties or the fraud violates an important public policy concern." Finally, the court concluded that to recognize constructive fraud in this situation would conflict with West Virginia's doctrine of at will employment. Each of these reasons is open to criticism, but the last is the one that best highlights the apparent presumption against using fraud law to benefit workers.

In stating its justification for refusing to extend the protection of constructive fraud law to employees, the court drew on images of judicial deference: "[A]ny court-imposed affirmative duty to inform employees of conditions of employment, particularly layoff policies and criteria, may lead to diminution of West Virginia's at will doctrine." The court reasoned that a duty to disclose such policies would leave employers with a Hobson's choice: not to disclose and be held accountable for constructive fraud or to disclose and then be bound by their representations in contract. This rationale provided sufficient reason for the court to refuse to import constructive fraud law into labor and employment law.

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244. White, 938 F.2d at 489-90 (citing Miller v. Huntington & Ohio Bridge Co., 15 S.E.2d 687, 695 (W. Va. 1941)). This reasoning is similarly open to attack. The court was correct to note that affirmative duties to disclose information arise most often in situations in which there is a fiduciary relationship between the parties, a relationship that did not exist in this case. But there are numerous exceptions, and the exceptions are growing. See supra notes 37-46 and accompanying text. Some of the cases cited by the court, in fact, involved factual circumstances in which the doctrine of constructive fraud was recognized even without the existence of a fiduciary relationship. See, e.g., Chamberlaine & Flowers, Inc. v. McBee, 356 S.E.2d. 626 (W. Va. 1987) (holding that a vendor has a duty to disclose substantial defects in housing to potential purchasers); Thacker v. Tyree, 297 S.E.2d 885 (W. Va. 1982) (holding that a builder-vendor has a duty to disclose to potential purchasers substantial defects in housing that would not be revealed by a reasonably diligent inspection).

The court did recognize that the absence of preexisting fiduciary duty does not end the inquiry. If "public policy" would be served, the doctrine of constructive fraud could be applied even without a fiduciary duty. But if the absence of fiduciary duty does not end the analysis, then the question becomes much more difficult than the court admitted. The key question the court had to resolve in analyzing the employees' constructive fraud claim was not whether there existed a fiduciary relationship between the employees and employer. Instead, the pivotal inquiry should have been whether an exception to that principle should be recognized in this case as it had been elsewhere. The court could have looked at the range of cases in which exceptions had been recognized and then determined in what ways they were similar to the case at hand, or the court might have taken its own language seriously and analyzed whether "important public policy concerns" were at stake. But the court hardly nodded toward either inquiry.

To be sure, the court did look beyond the fiduciary duty doctrine in one sense. It noted that the facts did not "show behavior so arbitrary and irresponsible as to be egregious," White, 938 F.2d at 490, an unsympathetic test that all but sealed the fate of the employees' claim. A basic problem with the court's use of this test was that it was derived not from the law of West Virginia but from that of Maine. See id. (citing Broussard v. CACI, Inc.-Federal, 780 F.2d 162, 164 (1st Cir. 1986) (citing Larrabee v. Penobscot Frozen Foods, 486 A.2d 97, 99-100 (Me. 1984); Terrio v. Millinocket Community Hosp., 379 A.2d 135, 137 (Me. 1977))). Instead of looking at the doctrine's exceptions or analyzing public policy concerns, as the law of West Virginia would seem to have dictated, the court borrowed from a First Circuit case.

245. White, 938 F.2d at 490.
246. Id.
247. See id. ("We see no indication that West Virginia would have us adopt a legal doctrine developed in the context of commercial sales and apply it within employment relationships.")
This rationale is unsatisfactory. Even if a tension between at will employment and fraud existed, it is not obvious (at least without a much more detailed argument) why the judicially created doctrine of at will employment should trump the judicially created doctrine of constructive fraud. But the tension is, in any event, less than the court proposed. "Employees could easily argue," the White court explained, that "disclosure of employment policies gives rise to binding oral contracts" requiring the employers to abide by the terms of those policies. The recognition of such rights would weaken the at will doctrine, and the court saw "no indication" that the West Virginia courts would accept such a weakening. But certainly the White court could be charged with the recognition that an employee's contract arguments are not unquestionably accepted by courts, even when made "easily." Instead, the court should have assumed that West Virginia courts would accept the employees' arguments that disclosures amounted to contracts only when the disclosures were stated in promissory terms. In such cases, there is no tension between the fraud and at will doctrines because, when there is a promise of continued employment, the at will doctrine is, and should be, set aside. The tension, if it exists at all, arises in determining whether a statement is a promise, not in deciding whether the statement should be disclosed.

Moreover, even if the tension were to exist in theory, it would rarely exist in practice. The statements that employers would need to make to avoid committing constructive fraud are the kind that would make employment policies seem less like a contract. In the White case itself, for example, the employees were arguing that the company should have said something like: "It is up to the company, not the employees, to decide which employees are able to go back to their old jobs." This is not the kind of statement that the employees would likely want to argue was a part of their contract. Indeed, the kind of statement that the employer typically keeps secret is something like, "I can lay you off for any reason or for no reason at all." The disclosure of such a statement would seem to bolster, rather than undermine, the at will doctrine. Contrary to the White court's insinuation, the reason for not disclosing such a statement has nothing to do with the desire to preserve the at will doctrine but is an attempt to maintain the illusion of offering secure employment without actually having to do so.

Instead of leaving the employers with a Hobson's choice, the court's logical error grants them the benefits of two legal rules. They can make representations that look like contracts, but because of employment at will they

248. Id.
249. Id.
250. See supra notes 120-122 and accompanying text (noting that absent a fraud law employers will have economic incentives to mislead employees to believe their jobs are more secure than they are, in order to entice workers to develop firm-specific skills).
are not forced to offer full disclosure, which would ensure that their statements were not misleading.251

ii. Actual Fraud

The Fourth Circuit's rejection of the employee plaintiffs' claims of actual fraud also illustrates the apparent presumption operating against workers' fraud claims in common law courts. The plaintiffs' complaint had included two counts of actual fraud. In the first count, the employees alleged that National Steel had told them that they had the right to return to their former positions when they chose to do so. Statements to this effect were false when made, alleged the plaintiffs, because National Steel's actual policy was that the company, rather than the employees, decided who could return.252 In the second count, the plaintiffs asserted that the company had made three false promises: (1) that it would transfer rather than lay off the new management employees who were no longer governed by a collective bargaining agreement; (2) that there would be no layoffs of these management employees; and (3) that layoffs would be based on company seniority rather than tenure in a specific position or job category.253

According to the court, the employees' first count for actual fraud—that the company had misrepresented to the employees that they had the right to return to their union jobs—was flawed in several ways. The "primary problem" was the "generality and vagueness" of the alleged misrepresentations,254 which made it impossible for the plaintiffs to prove fraud by the required "'clear and distinct evidence.'"255 The court made it difficult to evaluate its holding in this regard because it did not describe the actual representations that appeared in the record.256 Whatever the actual statements had been, the court said that they should not go to the jury because the representations were as consistent with truthfulness as they were with falsity, and "fraud 'is not deducible from facts and circumstances which would be equally consistent with honest intentions.'"257

251. The district court in White fell into the same logical trap. The district court stated, "It would appear that, in an 'at will' state, a holding that the employer had an affirmative duty to disclose to prospective at will employees terms and conditions under which the employee was to be laid off, would deprive the employer of his 'at will' rights." White v. National Steel Corp., 742 F. Supp. 312, 337 (N.D. W. Va. 1989), aff'd, 938 F.2d 474 (4th Cir. 1991). The only way the court's statement would be true, however, is if what the employer had failed to disclose was indeed some limit on the employer's ability to lay off the employee. And if there is indeed some limitation on termination, the employment relation is not in fact at will.

252. See White, 938 F.2d at 490.

253. See id. at 491.

254. Id. at 490.


256. But see White, 742 F. Supp. at 339 ("Usually the questions [asked by the employees] were general (e.g., could I go back if I didn't like the job?).").

257. White, 938 F.2d at 491 (quoting Steele, 295 F. Supp. at 1269).
That fraud should be proved by clear evidence, and that the plaintiffs should lose if the evidence is in equipoise, appear to have been straightforward applications of West Virginia law. What seems less straightforward is the court's use of these principles in the case at hand. According to the court, to satisfy the fraud standard the plaintiffs would have had to have shown that "National represented to them that they had the unilateral right to return to their former positions when, in fact, National at that time reserved that power for itself." While the court did not apply this standard to the company's alleged statements, the court implied that the statements were akin to an exchange that the court specifically said would not satisfy this standard. According to the court, even if before taking the management position the employee had asked, "Can I return if I don't like the job?", and even if the company had agreed, the employee's fraud claim still would be insufficient to go to a jury. Such an answer to the employee's question "is much more in the nature of a promise to return a worker than it is a misrepresentation of which party has the final authority over the decision." Such a representation was insufficient to constitute fraud because the company "might well have intended to return plaintiffs [to their previous jobs] upon an expression of displeasure but later changed its mind." Such a broken promise would be the "substance of contract law" and should not be "shoehorned" into an "ill-fitting" fraud suit.

Note how this description of the law of fraud held the employee plaintiffs in White to a much higher standard than most other plaintiffs bringing fraud claims. First, the court's dependence on some putatively clear line between contract and tort was simply wrong. If a party has been fraudulently induced to enter into a contract, she need not depend for redress on contract remedies alone but could look to the tort doctrine of promissory fraud.

Second, the court's focus on the question of authority is obfuscatory. Imagine a person trying to decide between buying an IBM computer and an Apple computer. He asks the IBM salesperson, "Can I return the IBM if I don't like it or if it does not work?", and the seller answers, "Yes." The buyer purchases the IBM on the basis of this representation. It breaks. The purchaser attempts to return the IBM the next day. The seller says, "When I said you could return the IBM if you did not like it, I did not mean to imply that I was...

259. White, 938 F.2d at 490.
260. Id. at 490-91.
261. Id. at 491.
262. Id.
giving up my authority to reject its return if I so chose. I was not representing to you my return policy; I was making a promise. Since yesterday, I have changed my mind. You cannot return the IBM. To the extent you have a claim against me, it is in contract, not fraud."

In this commercial context, the seller of the IBM seems obtuse because no reasonable person who answered "yes" to the buyer's question could believe that it would actually make a difference to the buyer whether "yes" constituted a false statement of the return policy or a false promise to accept the computer if returned. To the buyer, the question of authority is immaterial if the result under either interpretation is that the buyer can return the IBM if it does not work. There is little doubt that such an exchange could satisfy the elements of common law fraud because the significance attached to words is determined according to their effect on the ordinary mind; the speaker is held responsible if a false meaning is accepted by the hearer and the defendant knows that the hearer has accepted it as true.264

Thus there should have been little difficulty allowing the workers to reach the jury with their analogous claims. The key question was not whether the company waived its rights to reassign its employees but what reasonable employees would have understood the representations to mean. Like the computer buyer who cared little as to whether the seller's representations constituted a statement of policy or a promise, the employees probably cared little about questions of authority. What was important was whether they could rely on the company's representation that they could return to their old jobs. This should have been an opportunity for straightforward application of common law fraud doctrines, but the court refused.

The court was also quick to deny the plaintiffs' second count of actual fraud—that the company had made three false promises—relying on what appears to be two separate rationales. First, the court repeated its reasoning from the first count of actual fraud, asserting that the misrepresentations at issue were promises and "therefore not actionable as fraud."265 The court went on, however, seemingly to contradict itself by admitting that fraud could be shown if the promises were false when made.266 But the contradiction in theory was no problem in practice because the court drastically constrained the type of evidence it would admit to prove the fraud. To prove the allegation that the company committed fraud in promising that there would be "no layoffs" of management employees, the court said that it would accept only evidence showing that the company was "simultaneously making specific plans to lay off the very employees it was promising not to lay off."267 The evidence that the employees did produce, that the company had indeed begun

264. See supra text accompanying notes 33-35.
265. White, 938 F.2d at 491.
266. See id.
267. Id.
developing guidelines for layoffs among managerial employees, was deemed insufficient as a matter of law. Why evidence that the company was planning for layoffs was not relevant in proving the falsity of statements disavowing layoffs is unclear. In any event, such evidentiary parsimoniousness was a creation of the court rather than a reflection of the underlying doctrine.

With its second rationale the court added irony to injury. Apparently relying on the common law requirement that reliance on misrepresentations must be reasonable, the court observed that "the turmoil in the United States steel industry was widely known in the late 1970s and general preparations in those years for the possibility of layoffs should hardly have come as a surprise to employees at a steel plant." Given the instability of the industry, according to the court, the employees should have expected layoffs and should not have relied on representations to the contrary. Unable even to begin to view the situation from the standpoint of the plaintiffs, the court missed the point. The turmoil in the industry was the very reason that the workers needed to depend on their employer's representations of job security, not to mention a reason that National Steel might have had perverse incentives to lie. Under the court's rationale, the common law should become less powerful whenever truthfulness and completeness become more important but less likely.

b. **Grounds for Hope in the Common Law?**

What can one say, then, about the prospects of using the common law to provide workers an adequate substitute for statutory fraud protection? To be sure, *White* is only one case, and without a comprehensive survey of other like cases it is difficult to know for certain whether *White* is typical of a broader tendency of courts to apply what amounts to a presumption against the use of the common law tort of deceit to assist employees defrauded by their employers. The cases are not empty of victories for workers, but on
balance the cases do not appear to offer much encouragement. 272

It is worth considering the possibility that the comparative dearth of common law fraud cases is caused neither by the preemption problems outlined above nor some other failure of the legal system, but by the failure of employee plaintiffs to rely on fraud law as a source of redress. Recall the


272. Consider Charter Township of Ypsilanti v. General Motors Corp., 506 N.W.2d 556 (Mich. Ct. App. 1993) (per curiam). There, General Motors won a series of tax abatements for its Willow Run factory from the city of Ypsilanti. General Motors' plant manager had stated to the city that, "Upon completion of this project and favorable market demand, [the abatement] will allow Willow Run to continue production and maintain continuous employment for our employees." Id. at 558. After the corporation subsequently announced that it would be shutting down the plant, the city sued General Motors alleging, inter alia, promissory estoppel and misrepresentation. The trial court found for the city and enjoined the company from closing the plant, see Charter Township of Ypsilanti v. General Motors Corp., No. 92-43075-CK, 1993 WL 132385 (Mich. Cir. Ct. Feb. 9, 1993), but the court of appeals reversed on the grounds that the company's statement was "puffery," General Motors, 506 N.W.2d at 560, and "hyperbole," id. at 561, that the city should have expected. In the securities context, meanwhile, "the 'puffing' concept . . . has all but gone the way of the dodo." LOSS, supra note 29, at 717.

Numerous other decisions have come down against employees. See, e.g., Marsh v. Coleman Co., 774 F. Supp. 608, 610-11, 613-14 (D. Kan. 1991) (finding that an employee could not reasonably rely on an employer's statement that "there will always be a place" for the employee, that "everything's going to be all right," and that he should "relax [and not] worry"); Hindley v. Seltel, Inc., 672 F. Supp. 1093, 1094-96 (N.D. Ill. 1987) (applying Illinois law to find that employer representations that an employee would participate in upcoming management discussions and would be "rewarded" when the company's financial situation improved were insufficiently explicit to support a fraud claim); Rice v. Rent-a-Ctr. of Am., 664 F. Supp. 423, 429 (N.D. Ind. 1987) (holding that, under Indiana law, an employer's statement that an employee would probably receive his position back after a short time would not support a fraud claim); Salter v. Alfa Ins. Co., 561 So. 2d 1050, 1053-54 (Ala. 1990) (finding that, when an employee who had been told that she did not have to perform a certain act was then terminated for failing to perform that act, no actionable injury supported a fraud claim because the employee was employed at will); Merrill v. Crothall-Am., Inc., 606 A.2d 96, 100 (Del. 1992) (holding that a contract between an employer and an employee, stating that employment was at will, barred the employee's fraud claim based on the employer's assurances that the employee's position was "permanent"); Ikemiya v. Shibamoto Am., Inc., 444 S.E.2d 351, 352-53 (Ga. Ct. App. 1994) (finding a claim that an employer acted fraudulently in enticing an employee to enter an employment contract was not supportable because the underlying employment contract was at will); Wheeling v. Ring Radio Co., 444 S.E.2d 144 (Ga. Ct. App. 1994) (same); Romack v. Public Serv. Co., 499 N.E.2d 768, 775 (Ind. Ct. App. 1986) (finding that departure from another job did not constitute a sufficiently concrete detriment to support a constructive fraud claim); Bower v. Atlis Sys. Inc., 582 N.Y.S.2d 542, 544 (App. Div. 1992) (holding that, because a prospective employee would have been at will if hired, she could not have reasonably relied on assurances of prospective employment by the defendant); Brumbach v. Rensselaer Polytechnic Inst., 510 N.Y.S.2d 762, 764 (App. Div. 1987) (holding that the defendant's alleged misrepresentation that an employee professor's position was tenure-tracked was a representation of a possible future contingency and therefore insufficient to support a fraud claim); Grant v. DCA Food Indus., 508 N.Y.S.2d 327, 328 (App. Div. 1986) (finding that an employer's assurances of "secure" employment if the plaintiff relocated could not support a fraud claim because a failure to perform future acts is actionable only in contract and the employee was at will).
Youngstown Steel case, in which the employee plaintiffs raised claims in contract and promissory estoppel and fashioned a property claim out of the workers' reliance interests. The plaintiffs' lawyers were among the best in the business. Yet they failed to raise a fraud claim even though much of the employees' other claims depended squarely on interpretations of company statements. There is a hole in the case where a fraud claim should have been.

Again, this is only one example. The plaintiffs' attorneys in the Youngstown case may have had excellent reasons for not claiming fraud, and there is a significant likelihood that the union plaintiff would have had section 301 preemption problems if the same situation were to arise again. But the absence of a fraud claim in such a case provides support for remaining uncertain about why common law fraud actions rarely reach the merits. Perhaps if more actions were brought, courts would begin to learn how to deal with them carefully and well. One of the benefits of the common law is indeed such a facility to change and adjust to new factual situations. Perhaps, over time, courts could indeed provide effective protection against employer misrepresentation.

It is worth hoping for this progress within the common law, and it is essential that it be applauded if and when it occurs. But even assuming that courts will begin to apply fraud law as rigorously in the labor market as they do elsewhere, the common law is bound to be inferior to federal statutory protection. The preemption problems would remain, as would the other costs of depending on a state-based, elastic, and variably applied web of legal rules.

273. See supra notes 17-23 and accompanying text.
274. For a first-person account of the fight against the Youngstown closings from the perspective of the unions' lead attorney, see LYND, supra note 5.
275. In fact, the genesis of this Article was a seminar discussion at Boston College Law School where participants noticed and discussed the absence of a fraud claim in the Youngstown case.
276. Perhaps the attorneys believed that the promissory estoppel claim did the work of the fraud claim. The promissory estoppel claim is akin to a fraud claim, they are not, however, identical twins. A fraud claim would not have required the showing of a promise, and the company's changing definitions of "profitability" would have bolstered a fraud claim even though it doomed the promissory estoppel claim. Cf. supra note 32 (noting that a fraud claim does not require the existence of a contract). Concerns about remedy might also have provided a reason for relying on promissory estoppel rather than fraud. According to Daniel Farber and John Matheson, courts have tended to offer expectation, rather than reliance, damages in promissory estoppel cases. See Farber & Matheson, supra note 24, at 909-10. In the Youngstown case, expectation damages would presumably have been higher than reliance damages. The difference would not explain, however, why the plaintiffs failed to raise a fraud claim in the alternative.
277. Allis-Chalmers Corp. v. Lueck, 471 U.S. 202 (1985), the case that expanded the section 301 preemption doctrine to bar tort claims, was decided in 1985, several years after the Youngstown plant closings. So even if the Youngstown plaintiffs had been successful with a tort claim in 1980, it is hardly clear that they would be successful today.
278. See supra text accompanying notes 182-184. This elasticity would be especially troubling vis-à-vis the labor market, since "uniform law" is "peculiarly" of interest when it comes to labor agreements. Local 174, Teamsters v. Lucas Flour Co., 369 U.S. 95, 103 (1962) (quoting Pennsylvania R R v. Public Serv. Comm'n, 250 U.S. 566, 569 (1919)); see also supra text accompanying note 189.
There is one final concern. To the extent that courts have something of a blind spot on the issue of employer fraud, it is difficult to imagine precisely how the common law would rectify such an infirmity. Workers should not, in any event, expect the cure to come quickly. A statute passed by Congress and signed by the President, however, seeking to guarantee workers the same right to be free from fraud as enjoyed by capital investors could have an extraordinary effect. By revealing the incongruity between the levels of protection in the capital and labor markets, such a statute's direct effect would be magnified by its educational effect on common law courts. To the extent that the existing presumption against workers using common law fraud actions is unintentional, a national statute might cause even state law courts to apply the common law more generously and fairly.

V. EXPLORING A REGULATORY RESPONSE

That the common law does not now provide an adequate remedy against fraud for workers and is unlikely to provide one in the near future does not in itself provide a justification for statutory protection. Perhaps the costs of antifraud regulation in the labor market are particularly high or the benefits abnormally low. If either is true, the case for statutory antifraud protection would be weakened. This part begins by examining more carefully the costs and benefits of such statutory protection. The analysis shows that the net benefits of fraud regulation are likely to be at least as high in the labor market as in the capital market. This part then asks whether the necessary statutory protection has been or could be implemented at the state level. It concludes that states generally have not enacted strong antifraud regulation for the labor market and are unlikely to do so. Moreover, a regime of state statutory protection would impose uncertainty costs that would make it second best to a federal regime. Having justified a statutory response on cost-benefit grounds and having explained why a state regime is not likely or optimal, the final section of the part sketches the contours of a possible federal statute protecting the labor market from fraud.

A. The Costs and Benefits of Antifraud Regulation in the Labor Market

1. The Costs

To be sure, a statutory requirement of truthfulness imposes costs on the speaker and, because of enforcement and monitoring costs, on society as a whole. The relevant question here, however, is whether such a requirement would have relatively higher costs, compared to benefits, when applied in the

279. See, e.g., Brudney, supra note 54, at 733-34 nn.31-34 (discussing the social costs of truth-telling).
labor market than when applied in the securities market. A precise analysis is difficult without more empirical data, but there appears to be little reason to believe that the costs of statutory fraud protection would be significantly greater in the labor market than in the securities context.

One might contend that the enforcement and adjudication costs of fraud protection in the labor market would be exorbitant because the meaning of "materiality" would be extremely difficult for courts to define. The application of the legal rule would thus be impossible for employers to anticipate. And because employers communicate to employees constantly, and in countless ways, any looseness in the legal definition would force employers to bear exorbitant costs to ensure that they do not run afoul of the law. Alternatively, employers would simply stop communicating altogether to employees because of the risks of legal liability.

This is a powerful objection, but it provides an unsuccessful distinction between the labor market and the securities market. Companies engage in a wide range of communications to employees, but most of this communication does not pertain to the terms or conditions of employment. The communications that arguably could contain misrepresentations actionable under a law prohibiting fraud on employees would be some subset of all employee communication. It is hardly clear, then, that the absolute amount of communications at issue in the labor context would be greater than in the securities context; after all, companies communicate constantly to the public and to actual and potential investors. Even though the number of communications at issue in the securities market is quite large, the concept of materiality is still left to case-by-case analysis; thus, the concept is quite difficult to pin down ex ante. The costs of uncertainty, therefore, would be no greater in the labor market.

In fact, there is reason to believe that monitoring costs would be lower in the labor market. In the securities market, a fact is material if there is "a substantial likelihood" that a reasonable investor would consider it important in deciding whether to purchase or sell a security. In Basic Inc. v. Levinson, the Supreme Court essentially reduced this test to one that asks whether the market price of the security was affected by the alleged misstatement. Because of the efficiency and fluidity of the securities

280. See Basic Inc. v. Levinson, 485 U.S. 224, 250 (1988) ("Materiality depends on the facts and thus is to be determined on a case-by-case basis.").
281. Moreover, in the absence of a federal statute, the common law of fraud still applies. As noted above, see supra text accompanying notes 182-184, the common law imposes large costs because of the variation of legal rules across jurisdictions and the elasticity and uncertainty of the legal rules within each jurisdiction. A federal statute would minimize interjurisdictional differences and would decrease uncertainty costs.
284. In recognizing the fraud-on-the-market theory, the Court allowed plaintiffs who traded in reliance on the market price to establish a presumption that they relied on the alleged misstatement even if they
market, one would expect that prices would be very sensitive to company communications. Thus, the threshold for materiality would be quite low, and the costs of monitoring the range of communications that might include material statements quite high. If the definition of materiality in the labor market is analogous to that in the securities market, courts would seek to learn whether an employer's statement would tend to affect the market wage of the jobs it provided. Because the labor market is much less efficient and fluid than the securities market, one would expect that wages would be less susceptible to putative misstatements than would securities prices. The threshold for materiality would thus be higher in the labor market. That is, even if a little misstatement might affect the market price of a company's security, wages would be affected only by a somewhat larger lie. In this way, then, the labor market's inefficiency would actually make an antifraud statute less costly to administer. One could thus expect lower monitoring costs in the labor market than those already borne in the securities market.

Another cost of statutory antifraud protection in the labor market would be the potential for frivolous litigation brought by disgruntled workers. But it is doubtful that frivolous litigation would be as great a problem under a labor fraud statute as it is under the securities acts, for at least two reasons. First, as explained in Part I, antifraud protection in the capital market goes quite far beyond the "core" case to include fraud that affects the secondary market as well fraud through insider trading. Because the fraud of concern in the labor market is only "primary market" fraud—deceit by employers on employees—there would be fewer possible bases for frivolous suits than in the securities markets. Second, because the scope of the fraud will tend to be less national in the labor market and because the wage system is less fluid than the price system in the capital market, the damages awarded under labor law suits will tend to be less than under the securities acts. It is less likely, then, that lawsuits under the labor fraud statute will be instigated by an overly zealous plaintiff's bar motivated by a desire for quick, lucrative settlements.

never actually heard or read the misstatement. See id. at 245-47. This holding can be correct only if one assumes that changes in prices cause changes in investors' decisions.

285. See supra Section II.C.

286. As noted above, see supra Section II.C, the labor market's inefficiency in some ways makes the fraud that occurs more costly. Once again, a difference between the securities and labor markets cuts in favor of protection in the latter.

287. Cf. Romano, supra note 78, at 69-70 (discussing causes of the increased numbers of employee suits against corporate directors, including those filed by employers).

288. See supra notes 63-66 and accompanying text.

289. See supra Section II.C.

290. Cf. Elliott J. Weiss & John S. Beckerman, Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions, 104 YALE L.J. 2053, 2054 (1995) ("Controversy abounds about securities class actions, centering on the fact that attorneys operating on a contingent fee basis initiate most such suits in the name of 'figurehead' plaintiffs with little at stake."") (footnote omitted)).
Finally, one might worry that antifraud protection in the labor market will increase the cost of labor. This increased cost will make it more likely that companies will locate, or relocate, their facilities to countries where workers are not so protected. The response to such an argument also finds an analogy in the capital market. Indeed, strong antifraud rules make it more difficult for deceitful companies to gain access to capital in U.S. markets. This may have forced some companies to seek capital in other equity markets around the world. But their departure is not a subject of consternation. Instead, the departure of deceitful companies to other capital markets is applauded as it makes it cheaper for honest companies to gain the capital they need here in the United States. Only if one doubts that fraud is a drag on the economy can one mourn the exodus of fraudulent companies.

The same argument holds in the labor market. Over the long term, the presence of fraud in the labor market actually tends to make labor more—not less—expensive because workers must be compensated for being subject to deceit. If this economic story has some basis in reality, one should expect to see a decrease in labor costs after the passage of a strong antifraud law for the labor market. To the extent that labor costs for deceitful companies would increase, they should be more than offset by cost reductions for honest companies.

2. The Benefits

On balance, then, the relative costs of a labor antifraud statute would appear to be no higher, and possibly lower, than the analogous costs of enforcing fraud protection in the capital markets. But the key comparison, of course, should be between the costs of fraud protection and its benefits. A description of the benefits of a regulation of fraud in the labor market relative to the capital market would have to begin with a reminder that the costs of inaccurate information are plausibly much greater in the labor market. As discussed above, a worker's inability to find substitute jobs easily or to diversify her risks will make fraud more costly than if substitutes were readily available and her risks were diversified, as is the case with the typical capital investor.

A related point should be made here. The lack of diversification may make fraud more likely in the labor market than in the capital market. Workers are often more valuable to employers when they develop firm-specific skills (thus reducing the possibility of limiting risk through diversification). But employees need to be induced to develop such skills. Without such inducement, employees will be unwilling to dedicate resources to develop skills that cannot be transferred elsewhere and that therefore do not improve their ability to

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291. See supra notes 139-142 and accompanying text.
command an increased wage in the market. Moreover, rational employees realize that once they develop firm-specific skills, they are at risk of opportunistic behavior by firms. Firms can threaten workers with termination if they do not accept reductions in their compensation. To encourage firm-specific investment by their employees, employers will seek to assuage workers' concerns by making commitments about job security.\textsuperscript{292}

This helps to explain why strong incentives exist for misrepresentation in the labor market. It may be expensive to back up the representations of job security; employment contracts that are not terminable at will are more costly. But without strong antifraud laws in the labor market, employers will be able to represent that they provide employment contracts not terminable at will when in fact they provide just that. Employees will thus develop firm-specific skills, giving the employers the advantage of their increased value to the firm while the employees will still be subject to opportunistic behavior by employers. The more specifically skilled the employees become, the more they will ask for some assurances from their employers, and the more likely their employers will resort to fraud.

Of course, workers would eventually learn that they could not depend on their employers' representations. Employers who could in fact offer job security would have to bond their representations or offer some other way for workers to verify them. But these devices will impose costs of their own, costs that an antifraud rule would help avoid. Moreover, as noted above,\textsuperscript{293} these devices will be imperfect. And to the extent they are imperfect, workers will begin to doubt the entire labor market just as investors would begin to doubt the capital market. Over time, a labor market without fraud protection will tend to be dragged down toward the level of the firms providing insecure employment because secure employers will bear disproportionate costs. As secure employers suffer disproportionately, the jobs they offer will become relatively less secure. Perhaps we live in such a world now. A rule against fraud will provide the additional, important benefit of avoiding (or rectifying) this harmful effect. Put another way, a rule against fraud would allow secure employment firms that otherwise could not survive to establish a niche in the labor market.\textsuperscript{294}

While it should be clear that these benefits provide a strong argument for an antifraud rule in the labor market,\textsuperscript{295} it is less obvious whether these

\begin{footnotes}
\item[292.] See Fischel, \textit{supra} note 4, at 1074-75 (discussing the willingness of firms to make job security commitments).
\item[293.] See \textit{supra} notes 148-157 and accompanying text.
\item[294.] It would be interesting to test this hypothesis empirically. One would expect, holding other things equal, that in jurisdictions with strong antifraud protection, employers would tend to offer more secure employment than in those jurisdictions with weak protection.
\item[295.] It seems likely that the benefits would outweigh the costs. Wages and salaries for all nongovernmental employees in the United States during 1995 (the most current data available) totaled just under $2.8 trillion, and compensation of employees not included in wages and salaries totaled another $790
\end{footnotes}
benefits would be relatively greater in the labor market than in the securities market. It is worth noticing, however, that the capital market provides significant incentives for private monitoring of fraud while the labor market is much more dependent on government protection. For example, large institutional investors, which own over one half of equity holdings in the United States, have both incentives and resources to monitor companies in which they invest. Moreover, because capital is so fluid, arbitrageurs can make money in the market by discovering frauds that falsely inflate the value of securities and selling those securities short. In addition, investment advisors can make money by selling information about suspected frauds to investors.

On the other hand, none of these private monitoring devices exists to any meaningful extent in the labor market. Because labor is much less fluid than capital, arbitrageurs and advisors cannot make their fortunes by uncovering employer misstatements. Unions do have some incentives to detect employer fraud. But unions are relatively weak in the United States compared to other

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See U.S. DEP’T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES—1996, at 449 (1996). If we make the reasonable assumption that the absence of fraud protection has increased labor costs by one percent, a fraud rule would thus create a savings in the range of $36 billion dollars per year. Even if monitoring and enforcement costs are quite high, it is difficult to imagine that they would swamp this figure. Cf. Stout, supra note 84, at 713-14 (making a similar calculation for the securities market).


297. Cf. HOUSE COMM. ON INTERSTATE & FOREIGN COMMERCE, 95TH CONG., REPORT OF THE ADVISORY COMMITTEE ON CORPORATE DISCLOSURE TO THE SECURITIES AND EXCHANGE COMMISSION 620-21 (Comm. Print 1977) ("Competition among analysts results in security prices that reflect a broad set of information."); Ronald J. Gilson & Reinier H. Kraakman, The Mechanisms of Market Efficiency, 70 Va. L. Rev. 549, 571 (1984) ("In today's securities markets, the dominant minority of informed traders is the community of market professionals, such as arbitrageurs, researchers, brokers and portfolio managers, who devote their careers to acquiring information and honing evaluative skills.")

298. In the capital market, there also exists "a uniquely active and responsive financial press which facilitates the broad dissemination of highly timely and material company-oriented information to a vast readership." Proposed Comprehensive Revision to System for Registration of Securities Offerings, Securities Act Release No. 33-6235, 20 SEC. Docket. 1175, 1179 (Sept. 16, 1980). Moreover, the New York Stock Exchange (NYSE), the American Stock Exchange, and the National Association of Securities Dealers (NASD) require their member companies to disclose promptly all developments material to investors and to correct market rumors. See BROWN, supra note 54, § 3.02. See generally id. § 3.06 (describing self-regulatory organizations in the security markets). For example, the NYSE expects its listed companies "to release quickly to the public any news or information which might reasonably be expected to materially affect the market for its securities." NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL ¶ 202.05 (1996). To be sure, these self-regulatory organizations do not have the legal power to impose civil or criminal penalties. But violations of these rules can result in significant sanctions, including the suspension of trading, the delisting of a company, or, in the case of the NASD, a denial of access to the automated quotation system important for over-the-counter securities trading. See BROWN, supra note 54, § 3.06[5]. The oversight of these organizations, which have no analogy in the labor market, provides a significant brake on the incentive to mislead investors. See Jonathan R. Macey, Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC at Sixty, 15 CARDOZO L. REV. 909, 934-35 (1994) (arguing that the self-regulation of the various security exchanges provides significant protection for investors). It may not be correct to view these institutions as totally private monitoring devices, however, because it is unclear that they would exist absent the threat of regulation.
industrial nations, and their strength is in a historical period of decline. Fewer than one out of every five workers in the United States is now represented by a union. In no way can unions provide the powerful private monitoring in the labor market that large institutional investors provide in the capital market. Without effective private monitoring devices, the labor market stands to benefit significantly from statutory protection from fraud. It is reasonable to believe, in fact, that the net benefits would be greater in the labor market than in the capital market. And to the extent union strength is in a period of historical decline, legal protection is becoming even more important because employees have few self-help options.

The argument could be made, however, that monitoring institutions are unnecessary in the labor market. Employees might be able to investigate past corporate behavior fairly easily. When a prospective employee is considering two jobs, she can glean reputational information from numerous sources. When she is weighing whether to believe her employer vis-à-vis some representation to her, she is able to evaluate the likely truthfulness of the statement based on previous statements made by the company. Especially with regard to employer representations concerning the health of a specific factory, workers often have a very acute sense of how the plant is doing: They can monitor the level of inventories or whether management continues to invest in maintenance, for example. This is something that an investor cannot do very easily. One might say that the labor market is much more personal than the capital market and thus that a worker is better able to judge the credibility of any representation made.

But another, more plausible story can be told. For many workers, it is quite difficult to gather material information about working conditions, job security, and the like. And it is even more difficult for workers—whether they are presently working for the firm or are prospective employees—to gather the kind of information necessary to evaluate statements like those made in Youngstown. Whom would they ask? What would they ask? Indeed, with many kinds of jobs, and with many kinds of workers, getting sufficient information to evaluate whether one’s employer (or prospective employer) is lying is either impossible or exorbitantly costly. Moreover, in those cases in which the employer in fact is lying, the employer must believe that the deceit

299. See International Labor Office, World Labor Report 1993, at 34 tbl.3.1 (1993) (showing union density in the United States at 15% in 1989 compared to, for example, 32% in Germany, 39% in the United Kingdom, 45% in Australia, and 81% in Sweden).

300. See id.; see also Stone, supra note 95, at 578 (stating that, between 1980 and 1990, union membership declined from almost 25% of the nonagricultural work force to less than 17%).

301. See Paul C. Weiler, Governing the Workplace 74 (1990) ("The worker who is shopping for a job will find it very difficult to learn (and certainly will not want to ask) about the actual dismissal risks in the firms being interviewed."); Stewart J. Schwab, Life-Cycle Justice: Accommodating Just Cause and Employment at Will, 92 Mich. L. Rev. 8, 27 (1993) ("Young job entrants cannot easily assess an employer’s reputation for how it handles senior workers.").
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has a desirable effect, otherwise it would not risk the reputational consequences of being discovered.  

On the other hand, even though they may not have access to the plant floor, investors and their agents often have access to the company's decisionmakers in ways that workers do not. And without unions to play the role of a monitor, a company can lie to its employees in Ohio and suffer little reputational consequences among its workforce in California. In the capital market, the reputational injury of fraud speeds through phone lines and computer networks almost instantaneously. Thus the reputational costs firms suffer when they defraud investors are likely to be larger, and suffered over a broader geographical area, than the reputational costs from lying to workers.

B. The Possibility of State, Rather than Federal, Regulation

It is likely, therefore, that antifraud regulation for workers will be at least as cost-effective as existing regulation in the capital markets. Still, it is worth asking whether the regulatory response has already occurred or could occur at the state level. If state statutes could already guarantee accurate information, the affirmative case for a federal statute would be weakened. In addition, one might suggest that leaving the regulation of employer fraud to the states has affirmative benefits over and above what a national standard could offer. Federalism allows states to use their laws to compete for businesses and workers. The states that have the most efficient mix of legal rights and duties will attract the right mix of businesses and workers. If a state's law is too protective of workers, companies will locate elsewhere. If a state's law is too protective of businesses, workers will relocate. This argument would suggest that rules produced by this interplay are more likely to be efficient than rules promulgated by a nationwide regulatory regime.

The difficulty with this argument is that it does not seem to correlate with what one discovers when investigating various states' regulatory responses toward fraud in the workplace. As shown above, it is unlikely that the most efficient legal rule is to have no, or little, regulation of fraud in the labor market. Yet that is exactly what one finds at the state level. Few states offer any statutory protection against fraud in the workplace. Indeed, the

302. Moreover, the law already has a method to deal with those cases in which the employee in fact does have information that causes them to doubt the employer's representation. If the employee knows the employer is lying, reliance on those lies is unreasonable and recovery is barred. See supra note 30 and accompanying text.

303. See Easterbrook & Fischel, supra note 54, at 691; Macey, supra note 298, at 935-36; Romano, supra note 85 (manuscript at 6-7).

304. See supra Parts II & III.

305. Indeed, courts in Connecticut, Georgia, Massachusetts, Minnesota, and North Carolina have held that disputes arising out of the employer-employee relationship are not covered by those states' unfair trade practices statutes. See DEE PRIDGEN, CONSUMER PROTECTION AND THE LAW § 4 02[5](f) (1996) (collecting cases). California is an exception. See id.
absence of fraud protection for workers is made stark when one considers the wide range of protection states offer in other areas of commerce.\textsuperscript{306}

Why, given the well-known theory of competition among various states producing efficient sets of state laws, do we find most states without efficiency-promoting fraud protection? One possibility is that the states are competing to their collective detriment. Markets have defects, and to the extent states compete in what amounts to a market to produce laws, they may face defects akin to those suffered in other kinds of markets. Collective action problems are among the most familiar of market failures: Individually rational behavior may produce collective irrationality, and if everyone acts in her self-interest, serious harm will frequently result.\textsuperscript{307} In the context of state regulation, it is likely most efficient for all jurisdictions to have statutory rules against employer fraud, but each individual jurisdiction is unlikely to be willing to be the first to adopt such a rule. Each jurisdiction will need assurances that the others will go along. Without such guarantees, state legislators and regulators will worry that strong workplace antifraud rules in their jurisdiction will increase the costs to companies of doing business in the state, causing employers to relocate elsewhere.\textsuperscript{308} This worry is based on a simplistic view of the economics of fraud protection.\textsuperscript{309} Nevertheless, it is unlikely that individual state legislators will willingly bear the political risk of taking the lead on antifraud protection for the labor market.\textsuperscript{310} Regulation at the federal level can resolve this collective action difficulty among the states. Viewed this way, a federal law does not usurp state power. Instead, it is the method through which states fulfill their collective desire to protect the labor market from the inefficiencies of fraud. Without federal intervention, the states are left in a situation that none of them would prefer.

\textsuperscript{306} See, e.g., MASS. GEN. LAWS ANN. ch. 93A, § 2 (West 1997) ("Unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce are hereby declared unlawful."). Chapter 93A has been interpreted to exclude disputes arising from the employer-employee relationship. See Manning v. Zuckerman, 444 N.E.2d 1262, 1265 (Mass. 1983).

\textsuperscript{307} See CASS R. SUNSTEIN, AFTER THE RIGHTS REVOLUTION 49 (1990).

\textsuperscript{308} To be sure, workers will be willing to relocate to such a jurisdiction because of the added protection the state offers. In times of labor surplus, however, there would be little benefit from such an effect. In fact, additional workers in the labor force, linked with fewer jobs, will increase unemployment and decrease wages.

\textsuperscript{309} See supra Part III.

\textsuperscript{310} This "race to the bottom" analysis parallels the analysis sometimes offered as an explanation for the trend in corporate law toward more permissive state incorporation statutes. In the corporate context, the literature is extensive and somewhat contentious. See, e.g., EASTERBROOK & FISCHEL, supra note 51, at 212-15 (describing the debate over whether a race to the bottom exists); MORTON J. HORWITZ, THE TRANSFORMATION OF AMERICAN LAW 1870-1960, at 84 (1992) (describing competition among states on the basis of allowances for corporate consolidations); William L. Cary, Federalism and Corporate Law: Reflections upon Delaware, 83 YALE L.J. 663 (1974) (arguing that competition among states occurs on the basis of which state best allows managers to exploit investors); Roberta Romano, The State Competition Debate in Corporate Law, 8 CARDozo L. REV. 709 (1987) (claiming that Delaware is the preferred state of incorporation because of its body of legal precedents and sophisticated corporate bar); Ralph K. Winter, Jr., State Law, Shareholder Protection, and the Theory of the Corporation, 6 J. LEGAL STUD. 251 (1977) (arguing that competition among states is driven by investor interests).
This is not to say that a state should not, or could not, have strong antifraud protection for workers. The collective action problem suggested above is almost certainly more of a political problem than an economic one. A state enacting a fraud statute for the labor market may be able to generate a comparative advantage vis-à-vis other states in competing for firms that provide (for example) secure employment. Because the absence of fraud protection imposes relatively greater costs on firms providing secure employment, such firms will prefer to locate in jurisdictions that penalize fraud. Unfortunately, states do not appear to have chosen to compete on such a basis. Perhaps legislators are unconvinced by the economic arguments or worry that the short-term harmful effects of insecure employers leaving the state will swamp the positive effects of secure employers entering the state. Perhaps state legislatures simply have not considered the issue or have been captured by those who would be hurt by an antifraud statute for the labor market.

Even in the best-case scenario, however, a web of state statutes would take second place to a federal statute. As the common law imposes costs because of the variability and uncertainty of legal rules across jurisdictions, a regime of state statutes would suffer from the same defects. A national statute is much more likely to provide uniformity and certainty, lessening the aggregate costs of enforcement and compliance.

C. The Contours of a Proposed Model Statute

If the arguments thus far are convincing, it would be useful to think about what a statute protecting against fraud in the labor market might look like. Consider the following, based on Rule 10b-5:

It shall be unlawful for any employer engaged in interstate commerce, (a) to employ any device, scheme, or artifice to defraud, (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) to engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any person, in connection with the offering or provision of employment, the negotiation of the terms of an employment relation, or the offering or continuing provision of employment benefits.

311. See supra notes 120-122 and accompanying text
312. See supra text accompanying notes 182-184
313. Cf. supra note 49 (reprinting Rule 10b-5)
This statute would make actionable employer misrepresentations and material omissions in connection with those things that workers consider important in deciding between jobs: job security, employee benefits, and the terms and conditions of the employment relationship. It would have offered the possibility of a federal remedy to the steel workers in Youngstown and West Virginia.\(^{314}\)

Though based on Rule 10b-5, it is worth noting that this statute would be narrower than 10b-5 in an important respect. Under 10b-5, a corporation and its insiders are under an affirmative duty to disclose inside information whenever they wish to trade in the securities market. If this requirement were to be transferred to the labor and employment context, the company would be under a virtually constant duty to disclose material information to its employees because the company, in an important sense, is trading in the labor market every time it hires or fires an employee or negotiates the terms of an employment contract.

This aspect of 10b-5 law would not transfer automatically to the labor context because, according to the Supreme Court, the underlying rationale for the duty to disclose or abstain under 10b-5 is the existence of a fiduciary duty between the insider or corporation and the other transacting party.\(^{315}\) In the labor context, however, courts do not generally recognize a fiduciary duty running from the employer to the employee.\(^{316}\) Therefore, it seems unlikely

314. Note also that the statute as proposed focuses only on employer fraud. This can be justified on a number of grounds. As discussed above, see supra note 142, the costs of employer deceit of employees is likely to be greater than the reverse because employers can easily diversify their risk of employee deceit and can substitute honest employees for deceitful ones at lower cost. In addition, the scale of the harm to the efficiency of the labor market is likely to be greater when an employer deceives employees than when an employee deceives her employer. That is, an employer’s misrepresentations will tend to affect a number of workers, and thus the labor market as a whole, while an individual worker’s deceit is unlikely to have significant impact beyond her own employment relationship. In addition, employers would not face the preemption problems that workers are likely to face because any employee fraud is unlikely to concern collective bargaining agreements or ERISA plans.

Finally, the focus on employer, rather than employee, deceit finds an analogy in the securities laws. As discussed above, see supra Subsection I.B.1, a number of antifraud provisions of the securities laws focus only on the “issuer” or “seller” of securities: Section 12(2) of the 1933 Act applies to “any person who . . . offers or sells a security”; section 11(a) of the 1933 Act focuses on “issuers” of securities; and section 17(a) concentrates on fraud by “any person in the offer or sale of any security,” which has always been interpreted to mean sellers. See also LOSS & SELIGMAN, supra note 32, at 743 (discussing sections 9(a)(4) and 10(b) of the 1934 Act, 15 U.S.C. § 78i(a)(4), j(b) (1994), which also focus on the issuer). The core idea that market participants should not lie in a market transaction in order to take value from others was thus first, and most firmly, applied against those who sought fraudulently to induce others to invest their resources in a venture, i.e., when the justifications for antifraud protection are at their highest. See supra note 32 and accompanying text. The analogy in the labor market is to employer fraud. When a company uses fraud to induce workers to invest their resources—that is, their labor—in a venture, the justifications for antifraud protection in the labor market are similarly at their highest.

315. See supra note 65 and accompanying text. In the misappropriation context, the obligation to disclose or abstain from trading arises out of a fiduciary duty to the source of the inside information. See supra note 65.

316. There are powerful arguments to the contrary. See O’Connor, supra note 26 (arguing that courts should expand directors’ fiduciary duties to require them to mitigate disruptions caused by corporate changes); Marleen A. O’Connor, Restructuring the Corporation’s Nexus of Contracts: Recognizing a Fiduciary Duty To Protect Displaced Workers, 69 N.C. L. REV. 1189 (1991) (same).
that courts would transplant the duty to disclose or abstain into the labor law context, even given a statute that closely aligns with Rule 10b-5. Thus the duties required under the labor antifraud statute would likely be less than those under Rule 10b-5, even though the operative language would be the same. Without a disclose-or-abstain rule, employers would not have an affirmative duty to disclose all material inside information anytime they engage in a "trade" in the labor market.

Instead, courts interpreting the above statute would likely look for analogous duties arising under the securities laws (and common law) in non-insider trading contexts. Duties in these contexts depend not on a fiduciary duty between the parties but on the need to protect the underlying market from falsehoods and incomplete statements. 317 Thus, the duties of truthfulness and completeness would likely arise whenever a company made statements, even voluntarily, about matters that would be material to employees or potential employees. Materiality would likely be defined analogously as well. As materiality under Rule 10b-5 is determined by asking whether a piece of information would be important to a reasonable shareholder in deciding whether to buy or sell a security, 318 materiality under the labor market fraud statute could be determined by asking whether the piece of information would be important to a reasonable person in deciding whether to enter into or continue an employment relationship.

This statute, like Rule 10b-5, would also enforce a requirement of completeness. 319 Factual accuracy—"We have no immediate plans to shut down our facility"—will not insulate a company's communication from possible liability if something is left out—"but we plan to shut down next quarter"—that makes the statement materially misleading. Or, if a company represented to an incoming employee that she would receive certain benefits, it would be deemed actionable if the employer intentionally failed to state conditions on such benefits and if the failure to state the conditions made the representation misleading. Moreover, this statute would likely be construed analogously to Rule 10b-5 as imposing a duty on employers to correct and update past statements that have become materially misleading because of changed circumstances. 320 So construed, this statute would be a powerful shield against inefficiencies and unfairness caused by fraud in the labor market. 321

317. See supra note 67 and accompanying text. 318. See TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). 319. See supra notes 56-59 and accompanying text. 320. See supra notes 60-62 and accompanying text. 321. The calculation of damages under such a statute would in some circumstances entail much complexity. In the securities context, however, several observers do not find the system to be as chaotic as it initially appears. See, e.g., Easterbrook & Fischel, supra note 51, at 315-16. For a further discussion of damages in the securities context, see Mahoney, supra note 52, at 627 & n 13. The details of this issue, however, are beyond the scope of this Article. It is worth noting, in any event, that damages
VI. CONCLUSION

Fraud is theft. In the context of the securities markets, this straightforward proposition undergirds very strict statutory protection. When workers are concerned, however, the proposition has not been taken nearly as far. In fact, under existing doctrine, if company management lies to shareholders in order to benefit employees (say, by understating employee benefits in an annual report in order to avoid shareholder protests), management will have violated federal law. If, on the other hand, management lies to workers in order to benefit shareholders (say, by misleading employees about the security of their jobs to keep them working diligently up until a plant closing), there is no federal statute that would make such fraud actionable.

This Article has argued that there are no compelling justifications for such a difference. First, the difference cannot be justified on economic grounds. The labor market, like the capital market, depends on the free flow of information to ensure allocational efficiency. Fraud regulation, in fact, may be more important in the labor market because workers cannot easily minimize the risk of fraud through diversification. Moreover, there are fewer incentives for private monitoring to take the place of government regulation.

Second, the absence of statutory fraud protection in the labor market cannot be explained by the availability of common law remedies. The common law is insufficient because of the troublesome preemption problems posed by section 301 of the LMRA and by ERISA. Section 301 preempts many claims that relate to collective bargaining agreements, and ERISA bars many state law fraud claims that relate to employee benefits. Moreover, when employee claimants succeed in overcoming these procedural impediments, some courts seem to apply what amounts to a presumption against using common law tort to aid workers defrauded by their employers. This apparent presumption is illustrated by the White case,\(^3\) in which the court seemed to hold the employee plaintiffs to a higher standard than would be applied to other market participants. Furthermore, even setting aside these obstacles, the common law is less efficient than statutory protection and is unlikely to be an adequate substitute for it in this context.

Finally, the absence of statutory fraud protection cannot be justified on the basis of a cost-benefit analysis. While there certainly would be monitoring, enforcement, and other costs associated with statutory protection, it is unlikely that such costs would be greater than those already borne in the capital market.

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The actual reasons that workers do not enjoy the same level of protection as capital investors may have more to do with politics than with the details of a cost-benefit analysis or the availability of common law remedies. But to the extent justifications matter, it is important to note that workers in the United States are exposed to the risk of employer misrepresentations about subjects that are crucial to their lives and that they have little legal protection from such risk. Such exposure imposes costs not only on the workers but also on society as a whole.