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RESTRAINTS ON ALIENATION OF HUMAN CAPITAL

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INTRODUCTION

ALTHOUGH it is by no means essential to a system of property law, free alienability of entitlements is a generally accepted principle in much of American law. For example, courts have long invalidated restraints on alienation of land,[1] and freedom of contract remains an organizing principle for much corporate and commercial law. In recent years, influential scholars have even argued, with some success, for increased alienability of rights derived from public law, such as the right to pollute.[2] Susan Rose-Ackerman has captured the low regard in which economists hold inalienability rules by describing inalienability as the "stepchild of law and economics,"[3] but the common law's antipathy to inalienability long predates the emergence of law and economics.[4]

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[1] For an early case expressing common law opposition to restraints on alienation of land, see Sir Anthony Mildmay's Case, 6 Co. Rep. 40a, 41b, 77 Eng. Rep. 311, 315 (K.B. 1606). For more recent discussions of the policy favoring alienability of property, see Richard E. Manning, The Development of Restraints on Alienation Since Gray, 48 Harv. L. Rev. 373, 401-06 (1935); Glen O. Robinson, Explaining Contingent Rights: The Puzzle of "Obsolete" Covenants, 91 Colum. L. Rev. 546, 568 (1991) ("[A]lienation is essential to promote efficient use of property—notably, but not exclusively, land.").

[2] See Bruce A. Ackerman & Richard B. Stewart, Reforming Environmental Law: The Democratic Case for Market Incentives, 13 Colum. J. Envtl. L. 171, 171-72, 178-88 (1988); Bruce A. Ackerman & Richard B. Stewart, Reforming Environmental Law, 37 Stan. L. Rev. 1333, 1341-51 (1985); Cass R. Sunstein, Administrative Substance, 1991 Duke L.J. 607, 634-37.

[3] Susan Rose-Ackerman, Inalienability and the Theory of Property Rights, 85 Colum. L. Rev. 931, 931 (1985) ("Inalienability is the stepchild of law and economics. Too often, economists note the existence of restrictions on transferability, ownership, and use, only to dismiss them as obviously inefficient constraints on market trades.").

[4] See, e.g., John C. Gray, Restraints on the Alienation of Property § 258 (2d ed. 1895) ("[I]nalienable rights of property are opposed to the fundamental principles of the common law . . . .").

The common law's preference for free alienability rests on a number of foundations. First, permitting trade and sale of entitlements assures that those entitlements will flow to persons whose market behavior suggests that they value the entitlements most.[5] Of equal importance, free alienability of entitlements serves as the foundation for a price system that minimizes both overproduction of goods and services that economic actors do not want, and underproduction of goods in great demand. Moreover, free alienability promotes personal autonomy by increasing the choices individuals enjoy about how to live their lives.[6]

Free alienability of entitlements has not, however, been a universal principle in American law. In recent years, a number of scholars have sought to identify and explain legal rules that make particular entitlements inalienable.[7] Susan Rose-Ackerman and Richard Epstein, for example, have each offered efficiency justifications for some inalienability rules.[8] Margaret Radin has, in more sweeping terms, endorsed some restraints on alienation of entitlements as necessary to protect personal integrity.[9] She and others have argued against free trade in

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[5] See, e.g., Richard A. Posner, Economic Analysis of Law 31 (2d ed. 1977) ("If a property right cannot be transferred, resources will not be shifted from less to more valuable uses through voluntary exchange.") (footnote omitted); Richard A. Epstein, Why Restrain Alienation?, 85 Colum. L. Rev. 970, 972 (1985).

[6] Much scholarly debate in recent years has focused on the effects of forced alienation of property rights, with a number of scholars arguing that autonomy concerns justify leaving property owners with choices about whether to transfer their rights. See, e.g., Richard A. Epstein, Notice and Freedom of Contract in the Law of Servitudes, 55 S. Cal. L. Rev. 1353, 1367 (1982) ("To say that ordinary ownership presents a holdout problem is not to identify a defect in the system; it is to identify one of its essential strengths. If a holdout is adamant, no private party can *force* him to sell the land in question at any price."); Carol M. Rose, Servitudes, Security, and Assent: Some Comments on Professors French and Reichman, 55 S. Cal. L. Rev. 1403, 1412 (1982) (noting that the holdout "has a genuine interest in his property right, however irrationally inflated that interest may seem to the world at large").

[7] See Guido Calabresi & A. Douglas Melamed, Property Rules, Liability Rules, and Inalienability: One View of the Cathedral, 85 Harv. L. Rev. 1089, 1111-15 (1972); Epstein, supra note 5, at 970 ("This Article first seeks to explain why the right of alienation is a normal incident of private ownership. Thereafter it seeks to examine the principled reasons for limiting the right."); Margaret J. Radin, Market-Inalienability, 100 Harv. L. Rev. 1849, 1850 (1987) ("In this Article I explore nonsalability, a species of inalienability I call market-inalienability."); Rose-Ackerman, supra note 3.

[8] Epstein, supra note 5, at 970 ("The proper office for restraints on alienation is to provide indirect control over external harms when direct means of control are ineffective to the task."); Rose-Ackerman, supra note 3, at 932 ("[E]conomic efficiency itself may require restrictions on property.").

[9] Radin, supra note 7, at 1903-14, 1936-37.

particular personal attributes: blood,[10] reproductive capacity,[11] and sex,[12] for instance.

The legal literature, however, has largely ignored a more universal point: a variety of well-established legal rules impede the transfer of human productive capacities, often called "human capital." Employment law's reluctance to enforce employee covenants not to compete, combined with its flat prohibition on specific enforcement of personal service contracts, safeguards an employee's income potential against an employer's claims.[13] Bankruptcy's "fresh start" policy similarly insulates a debtor's future earning potential from creditor claims.[14] Family law's general refusal to treat advanced degrees and licenses as "property" for equitable distribution purposes protects an individual's earning potential against claims by a spouse.[15]

These restrictions on alienation of human capital have been accompanied by a variety of justifications, ranging from economic efficiency to an asserted concern for avoiding any vestige of "involuntary servitude." These justifications, however, currently provide a questionable foundation for the legal rules that distinguish, in significant ways, between human capital and traditional forms of property. In justifying these restraints, moreover, courts and scholars have rarely considered an important distributional effect of these restraints on alienation: the persons most likely to benefit from rules that keep future earning capacity in the hands of its original holder are those persons best endowed with the talents, skills, and knowledge that contribute to that earning capacity.

Parts I, II, and III of this Article examine restraints on alienation of human capital in three doctrinal areas: employment law, debtor-creditor law, and family law. I hope to demonstrate that the law's restraints on alienation of human capital contrast sharply with the free alienation policies that underlie traditional property law, and to establish that the justifications advanced for this difference in treat-

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10 See Richard M. Titmuss, The Gift Relationship: From Human Blood to Social Policy 158-72, 195-208 (1971).

11 Radin, supra note 7, at 1928-36.

12 Id. at 1924 (arguing for an "incomplete commodification" of sex that would permit prostitution, but prohibit pimping).

13 See infra Part I.

14 See infra Part II.

15 See infra Part III.

ment are questionable at best. In Part IV, I examine in more detail one particular justification—that alienation of human capital smacks of involuntary servitude—and conclude that the only conception of servitude against which restraints on alienation might protect is very much an upper-middle class conception. In Part V, I explore the distributional consequences of the special treatment accorded human capital and conclude that they are positively perverse. As I argue in Part VI, these conclusions suggest a significant rethinking of doctrinal rules surrounding human capital, a rethinking that better accounts for the emerging importance of human capital as a source of wealth.

I. The Employment Context

The principal market for human capital is the labor market. Individuals endowed with human capital sell the right to use that capital to employers who combine human capital with other resources to produce a variety of goods and services. The market affords potential employees a range of choices: they may generally choose among trades or professions and among employers, or they may choose to forgo the employment relationship altogether in favor of a livelihood as an entrepreneur.

Although in many respects one's freedom to dispose of human capital in this "market" resembles freedom to alienate more traditional property rights, there is one significant difference: holders of human capital may dispose only of limited rights in that capital. A potential employee cannot sell an employer the right to specific performance of an employment contract.[16] Moreover, legal doctrine limits the employee's right to provide a potential employer with other devices to secure performance of a long-term contract; in particular, doctrine restricts the enforcement of covenants not to compete with the employer in the future.[17] These limitations contrast sharply with legal treatment of more traditional property rights. An owner of land or physical capital is generally free to rent her assets for a defined term or to sell them outright, relinquishing all future rights in the assets.

This Part examines doctrinal limitations on an employee's right to alienate human capital, especially the limitation on enforcement of covenants not to compete. As this examination reveals, existing doc-

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[16] See infra note 21 and accompanying text.
[17] See infra Part I.C.

trinal limitations on enforceability of assignments of human capital threaten to discourage employer investment in employees. Courts have recognized that problem, and have mitigated potential inefficiencies by enforcing at least "reasonable" employee covenants not to compete with employers. The principal justifications for refusing to enforce "unreasonable" covenants not to compete, however, are insufficient. Both the efficiency-based justifications—that such covenants are necessary to restrain the exercise of monopoly power or to correct informational imbalances in negotiations between employers and employees—and the moral objections stemming from a concern with involuntary servitude are generally unfounded. Hence, this Part concludes that the existing doctrinal structure, which requires fact-specific judicial evaluation of covenants for reasonableness, rests on foundations that are problematic at best.

A. Protection of Buyers' Rights: Mandatory Injunctions, Restrictive Injunctions, and Damages

Before examining the legal regime surrounding employment contracts, consider the alienability of more traditional forms of property: land, tangible personal property, and securities. The owner of traditional property rights may transfer them by contract. The transfer may be time-limited, as in a lease, or permanent, as with transfer of a fee interest in land. Upon transfer, the transferee acquires an entitlement protected by a "property rule": if the transferor or anyone else seeks to interfere with the transferee's use or possession of that property, the transferee is not limited to a damage claim, but may instead enjoin interference with or demand specific performance of the contract.[18]

Human capital, too, is transferable by contract, but the rights an employer-transferee may acquire are more circumscribed. Consider the protection available to an employer who would buy an employee's human capital. The Thirteenth Amendment's protection against involuntary servitude prevents the employer from obtaining specific

[18] See, e.g., Sakansky v. Wein, 169 A. 1 (N.H. 1933) (holder of right of way over neighboring land entitled to enjoin construction over that right of way, even when neighboring servient owner offered to leave an eight foot high opening at location of easement, and to lay out a new way giving dominant owner alternative access).

performance of an employment contract.[19] Moreover, even before adoption of the Thirteenth Amendment, common law courts had refused to permit specific performance of personal service contracts on the ground that judges could not adequately supervise an unwilling employee's job performance.[20] It has long been established, then, that an employer cannot secure complete "property rule" protection against an employee's refusal to perform his obligation to devote his human capital to the employer.[21]

Protection of the employer's interest in an employee's human capital, however, is not inevitably limited to liability rules providing for monetary damages in the event of breach. Even without an explicit covenant in the employment contract, an employer may be entitled to restrain the employee from accepting similar employment from a competitor.[22] And the employer may, by insisting upon a restrictive covenant in the employment contract,[23] make protection against competitive employment more explicit. When courts issue injunctions against violation of anticompetitive covenants, they provide the employer with a modicum of "property rule" protection: the employer at least knows that the employee may not sell her human capital to a competitor without the employer's permission.

From the employer's perspective, this limited property-rule protection has two advantages over liability-rule protection. First, an employee faced with enforcement of a restrictive covenant has a greater incentive to honor the employment agreement than does an employee faced only with money damages. If the employer can

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19 See, e.g., Woolley v. Embassy Suites, Inc., 278 Cal. Rptr. 719, 727 (Cal. Ct. App. 1991) (specific performance of personal services contracts contrary to Thirteenth Amendment); Restatement (Second) of Contracts § 367(1) (1981) ("A promise to render personal service will not be specifically enforced."); id. cmt. a (indicating that one reason for refusing to grant specific performance is concern about imposing involuntary servitude).

20 See Restatement (Second) of Contracts § 367 cmt. a (refusal to specifically enforce personal service contracts based in part "upon the difficulty of enforcement inherent in passing judgment on the quality of performance"); 11 Samuel Williston, A Treatise on the Law of Contracts § 1423 (Walter H.E. Jaeger ed., 3d ed. 1968 & Supp. 1992) (same).

21 See Williston, supra note 20, § 1423.

22 Lumley v. Wagner, 42 Eng. Rep. 687 (Ch. 1852), remains the leading case. For a discussion of the rationale behind the rule, see Edward Yorio, In Defense of Money Damages for Breach of Contract, 82 Colum. L. Rev. 1365, 1375-76 (1982).

23 These covenants, which I will frequently refer to as "anticompetitive covenants," are promises that the employee will not compete with the employer, either on her own or in the service of an existing competitor of the employer, if she breaches her employment contract.

obtain a restrictive injunction, the employer can deprive the employee of the principal benefit associated with human capital.[24] By contrast, ordinary contract damages would limit the employer to the loss the employer suffers as a result of the breach—a loss that may be smaller than the gain the employee will realize if she breaches. As a result, enforcing a restrictive covenant may increase the employer's leverage over a breaching employee.

Second, enforcing a restrictive covenant avoids the valuation problem that would otherwise face an employer seeking damages for an employee's breach of an employment contract. In the typical case where the employee breaches a covenant not to compete with the employer, the employer who seeks damages must establish that the breaching employee is a greater threat to the employer's business than another potential competitor in the employer's market would be. That in itself is not an easy task. On top of this difficulty, to collect damages the employer would also have to prove the difference in value in dollar terms. That difficulty could be almost insurmountable. If the employer must prove damages for breach not of a restrictive covenant but of a long-term employment contract, her position is even worse: the employer must now convince a court that the employee is worth more than the employer has agreed to pay her and that the employer should be entitled to the difference between the employee's value and the agreed-upon wages. If the employer can obtain even limited property-rule protection through judicial enforcement of restrictive covenants, the employer avoids these significant valuation problems.

B. *Why Enforce Restrictive Covenants? Optimizing Employer Investment in Employees*

The previous Section establishes that enforcement of restrictive covenants in all employment contracts would provide effective protection to employers concerned with employees who might breach employment contracts by leaving the employer to work elsewhere. But why should the law be concerned with such employee breach? When employment contracts are at issue, the principal question is whether employers will invest optimally in their employees without

[24] See Paul H. Rubin & Peter Shedd, Human Capital and Covenants Not to Compete, 10 J. Legal Stud. 93, 98 (1981).

some assurance that employees will remain with the employer for a substantial period of time.

1. General Training

Economic theory suggests that contract enforcement is not necessary to assure optimal investment in generalized job training because ultimately the employee pays, albeit indirectly, for the employer's contributions to her human capital.[25] Consider an employee with two job alternatives, one that will provide training that will increase her expected future earnings by ten percent per year after the first year and another that will have no effect on future earnings. If the jobs are otherwise equally attractive to the employee, she will choose the job that increases future earnings. But *every* similarly-situated prospective employee will choose that job, enabling the employer to pay less in salary to applicants and creating a salary differential between the two jobs. An employee who chooses the job without training will receive a positive salary differential equal to the present value of the expected increase in future earnings of an employee who chooses the job that provides training.[26]

In effect, then, an employee pays for her own generalized job training. As with other investments, the employee must decide whether the cost of the training—lower present income—is worth the expected return in human capital.[27] If the employee chooses to make the investment in human capital, the employee reaps the benefits of the investment. Whether any particular employee makes the investment in human capital is a matter of indifference to employers because the employee, not the employer, bears the costs and reaps the benefits of the investment in human capital. As a result, enforcement of employment contracts is not necessary to assure optimal investment in generalized job training.

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[25] See Gary S. Becker, Human Capital: A Theoretical and Empirical Analysis, with Special Reference to Education 15-44 (2d ed. 1975).

[26] Id.

[27] Indeed, the willingness of many people to work in low-paying or nonpaying internships and apprenticeships supports the proposition that the employee, not the employer, bears the cost of generalized job training. To the extent that the employer provides portable, generalized job training, the employer need not pay much to the employee who receives such training because the employee attaches great value to the training. This analysis explains, in some measure, the apparent paradox that "you can't get a job without experience, and you can't get experience without a job."

2. Development of Firm-Specific Human Capital

Suppose, however, that the employer provides training that makes the employee valuable to the particular employer but not to others. Suppose, that is, that the training produces firm-specific human capital. How will the cost of such training be distributed between employer and employee?

Firm-specific training is less valuable to the employee than generalized training because the training is marketable only to a single employer. As Gary Becker has demonstrated, the employee who invests in firm-specific human capital is not at the mercy of his employer.[28] True, firm-specific capital is, by definition, valuable to only one firm. But once a particular employee has developed firm-specific human capital, the firm can ouly derive the benefit of the capital from that one employee—to duplicate the capital would require an additional investment in another employee. The monopoly, therefore, is bilateral, and if the employer wishes to retain the benefit of its investment in human capital, the employer will have to pay the employee more than an employee without firm-specific human capital. Because the employee who acquires firm-specific human capital will enjoy this leverage over her employer, potential employees will accept somewhat reduced initial wages in return for training that will produce firm-specific human capital.[29]

However, the bilateral monopoly relationship between employee and employer also gives leverage to the employer who, by definition, provides the only market for the employee's firm-specific capital. This leverage will make it difficult for the employee to reap all of the benefits associated with the employee's firm-specific human capital. As a result, the employee will be unwilling to reduce her initial wage demand to reflect all of those benefits. The employer, who is likely to share some of the benefits associated with firm-specific human capital, will also have to share in the cost of its development.

If all parties were risk-neutral, employee and employer might well be willing to share in the cost of developing firm-specific human capital without any assurance about the distribution of future benefits derived from that capital. Because each party would have leverage

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[28] Becker, supra note 25.

[29] See id. at 30; Rubin & Shedd, supra note 24, at 95.

over the other, each party might be willing to take its chances on future negotiations to distribute those gains.

Suppose, however, that employees are generally risk averse. If so, they may be unwilling to gamble on their future ability to bargain with the employer over a distribution of the gains produced by firm-specific training. They may also be unwilling to bear the risk that the firm itself will disappear, leaving the employee with worthless human capital.[30] Employees unwilling to take these risks will be unwilling to contribute substantially to the cost of developing firm-specific human capital. If so, the result will be underinvestment in firm-specific human capital unless the employer bears a relatively large percentage of the cost.

To induce the employer to bear the cost of developing this firm-specific human capital, the employer must be assured a return on those development costs. Long-term contracts provide a mechanism—although not the only mechanism—for assuring that return.[31]

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30 As Professor Coffee astutely observed:

> Firm-speeific human capital consists not only of specialized training or knowledge, but also the ability to work within an existing corporate cnlture and organizational structure. For present purposes, its existence implies that the senior manager may be left in an exposed position, because to the extent he has invested heavily in firm-specific human capital, he typically has little lateral mobility. . . . If the firm is taken over, his investment may be lost, either because a different firm-specific expertise may now be necessary to operate within the acquiring firm, or because his position duplicates that of a similar manager within the acquiring firm (and hence he is likely to be replaced).

John C. Coffee, Jr., Shareholders Versus Managers: The Strain in the Corporate Web, 85 Mich. L. Rev. 1, 74-75 (1986) (footnotes omitted).

31 Of course, optimal investment in firm-specific human capital might also be achieved if employers conld provide employees with sufficient incentive to bear the cost of developing firm-specific human capital. Recent corporate law literature has suggested that "golden parachutes," i.e., severance payments upon "premature" termination of employment, might be used to induce employees to bear the cost of firm-specific training. See id. at 24; Jonathan R. Macey, Externalities, Firm-Specific Capital Investments, and the Legal Treatment of Fundamental Corporate Changes, 1989 Duke L.J. 173, 186.

But the golden parachute is at best a dubious device for encouraging development of firm-specific human capital. First, the golden parachute does not provide the firm with reasonable insurance that the parachute's beneficiary will develop firm-specific capital. Beeause the payoffs on golden parachutes are not typically tied to future performance, the parachute provides the manager with no incentive to invest in firm-specific capital. The parachute provides no reward for developing firm-specific capital because even if a manager proves inadequate, he remains entitled to the parachute. Indeed, some of the most ardent takeover proponents have argued that managers in a position to collect golden parachutes—those whose firms have become takeover targets—are in that position because their companies have been poorly managed. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, Auctions and Sunk

Without the protection of long-term contracts, an employer faces an increased risk that the employee, armed with the monopoly power her training has produced for her, will seek and obtain additional compensation for firm-specific human capital that the employer has already paid for. Moreover, the employee might, for nonpecuniary reasons, seek alternative employment even at the risk of forfeiting firm-specific human capital, leaving the employer uncompensated for its investment in the employee.[32] Therefore, without some assurance that employees will perform long-term employment contracts, employers might well underinvest in development of firm-specific human capital.

3. *Trade Secrets and Customer Information*

Employer investment in employees extends beyond job training. First, an employer may trust the employee with information critical to the employer's business—trade secrets or customer lists, for instance. Without this information, the employee may be useless to the employer. With possession of this information, however, the employee represents a threat to the employer. If the employee leaves to start her own business or to work for a competitor, and brings with her information acquired from her former employer, the former employer's business may suffer. Similarly, the employer may want the employee to work with clients the employer has cultivated over time. But if the employee, once she develops a working relationship with the clients, is free to leave the employer and take the clients with her, the employer may be less willing to encourage contact between the employee and clients.

In some ways, information and client contacts resemble generalized job training. Employees might choose to take lower salaries in return for exposure to information and clients, thus eliminating the need for the employer to invest in the employee. There are, however, problems with the analogy. First, an employee is unlikely to know the value of

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Costs in Tender Offers, 35 Stan. L. Rev. 1, 1 (1982); Frank H. Easterbrook & Daniel R. Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, 94 Harv. L. Rev. 1161, 1168-74 (1981).

32 Of course, even if employment contracts are enforced by restrictive injunctions, an employer must bear the risk that the employee will leave the employer for nonpecuniary reasons. But the injunction increases the pain the employee will suffer if she leaves the employer, substantially reducing the risk the employer will bear.

a secret before it is revealed to her. Once it is revealed, she would have no incentive to pay for it. This asymmetry of information would make negotiations difficult. Second, even if informational problems could be surmounted, the employee is unlikely to be in a financial position to bid for a valuable secret.[33] Long-term contracts, enforceable by restrictive injunction, provide a mechanism for insuring against such losses and thus for assuring that employees acquire optimal levels of information and client contact.

4. *Unique Employees*

When particular employees possess unique skills or talents, employers may find investment in one employee warranted only if the employer can assure that another employee will remain bound to the employer. Professional team sports provide an obvious example. Team owners invest in players, at least in part, in order to achieve a financial return through gate receipts and television and radio revenue. That return depends heavily on fan interest in the team. It is hard to imagine fans having a rooting interest in a team, however, if players were free to switch uniforms every day or every week.[34]

In addition, fan interest, and ultimately team revenue, depends in some measure upon the team's success. With that in mind, consider the owner of a baseball team trying to build a pennant winner. If the owner believes her team is one pitcher away from the pennant, how much will she invest in the pitcher if she fears that one of her other key players will jump to another team? If the owner cannot be sure of keeping the talent she has under contract, she may be less willing to invest in other players. Some level of stability, then, is almost certainly needed to guard against underinvestment in players and in other aspects of the professional sports enterprise.

Employers and agents also invest in employees (or principals) by providing promotional services. Suppose, for instance, a record com-

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[33] See Rubin & Shedd, supra note 24, at 96.

[34] I do not mean to argue that professional team sports would collapse were it not for judicial willingness to enforce restrictive covenants. Indeed, even if players were entirely free to move from team to team on a daily basis, most would not find it worthwhile to do so. First, personal and family reasons might make it undesirable to move unless a competitive offer were particularly lucrative. Second, endorsement contracts are undoubtedly more available to a player who establishes an identification with a particular team or geographical area, at least for some period of time. But even if most players were to opt for stability, underinvestment in players would likely result if even a few "unique" players were to hop from team to team.

pany enters into a long-term exclusive recording contract with a singer. If the company promotes the singer's reputation, much of the effort spent on the singer's behalf will be wasted, from the company's perspective, if the singer is free to record for another company. The possibility of such losses may induce the company to underinvest in the singer, causing efficiency losses. Moreover, if the singer does not have enough personal assets to engage in effective self-promotion—a common phenomenon with artists who have yet to develop a reputation—the record company may be the only entity capable of investing in the singer.

Thus, in the case of unique employees, as with employees who will receive firm-specific training or trade secrets, a legal regime that allows employers to use anticompetition covenants to reduce the risk that employees will breach long-term contracts operates to encourage optimal investment in employees. Let us turn, then, to the legal regime that does in fact govern long-term employment contracts.

C. *Enforceability of Restrictive Covenants: The "Reasonableness" Requirement*

For centuries, English and American courts have carefully scrutinized restrictive covenants between employers and employees as "restraints on trade." Professor Harlan Blake, in a much-cited article, traced this suspicion of restrictive covenants to early cases in which employers had used covenants to evade traditional rules governing apprenticeships.[35] Early English courts did not invariably invalidate restrictive covenants, however. By the time the landmark case of *Mitchel v. Reynolds*[36] was decided in 1711, the court was able to articnlate the eighteenth century version of a "rule of reason," distinguishing between enforceable "particular" restraints and invalid "general" restraints.[37]

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[35] Harlan M. Blake, Employee Agreements Not to Compete, 73 Harv. L. Rev. 625, 631-37 (1960).

[36] 24 Eng. Rep. 347 (1711).

[37] The court wrote:

> [W]herever a sufficient consideration appears to make it a proper and an useful contract, and such as cannot be set aside without injury to a fair contractor, it ought to be maintained; but with this constant diversity, *viz.* where the restraint is general not to exercise a trade throughout the kingdom, and where it is limited to a particular place; for the former of these must be void, being of no benefit to either party, and only oppressive . . . .

The reasonableness requirement of *Mitchel v. Reynolds* remains the law in most states today. In assessing reasonableness, courts purport to balance the interests of the employer, the employee, and the general public.[38] General covenants not to compete are invalid;[39] courts enforce only covenants limited in duration and in area.[40] Some states do statutorily prohibit enforcement of covenants not to compete.[41] Even these statutory prohibitions, however, are not absolute.[42] Statutory exceptions, like "reasonableness" rules in the majority of states, recognize the inefficiencies that would result if courts refused to enforce all restrictive covenants. This Section examines these legal protections against inefficiency.

Id. at 348; see generally Blake, supra note 35, at 629-37 (analyzing the *Mitchel* decision).

38 See All Stainless, Inc. v. Colby, 308 N.E.2d 481, 485 (Mass. 1974) ("In determining whether a covenant will be enforced, in whole or in part, the reasonable needs of the former employer for protection against harmful conduct of the former employee must be weighed against both the reasonableness of the restraint imposed on the former employee and the public interest."); Reed, Roberts Assocs., Inc. v. Strauman, 353 N.E.2d 590, 593 (N.Y. 1976) ("[A] restrictive covenant will only be subject to specific enforcement to the extent that it is reasonable in time and area, necessary to protect the employer's legitimate interests, not harmful to the general public and not unreasonably burdensome to the employee . . . .").

39 See cases cited supra note 38.

40 Sometimes, when enforcement of the strict terms of the covenant would be "unreasonable," courts nevertheless enjoin competition—but only in an area smaller than that specified in the parties' covenant. See, e.g., Sidco Paper Co. v. Aaron, 351 A.2d 250, 254 (Pa. 1976) ("However, where the covenant imposes restrictions broader than necessary to protect the employer, we have repeatedly held that a court of equity may grant enforcement limited to those portions of the restrictions which are reasonably necessary for the protection of the employer.").

41 See, e.g., Cal. Bus. & Prof. Code § 16600 (West 1987 & Supp. 1992), which provides that "[e]xcept as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void." See also Ala. Code § 8-1-1 (1975 & Supp. 1992); Colo. Rev. Stat. § 8-2-113 (1986 & Supp. 1992); Fla. Stat. Ann. ch. 542.33 (Harrison 1992); Haw. Rev. Stat. § 480-84 (1985 & Supp. 1991); La. Rev. Stat. Ann. § 23:921 (Supp. 1992) ; Mont. Code Ann. § 28-2-703 (1991); N.D. Cent. Code § 9-08-06 (1987 & Supp. 1991); Okla. Stat. Ann. tit. 15, § 217 (West 1966 & Supp. 1992).

42 The statutes usually except anticompetitive covenants incident to a sale of goodwill or corporate shares, see Ala. Code § 8-1-1(b); Cal. Bus. & Prof. Code § 16601; Colo. Rev. Stat. § 8-2-113; Fla. Stat. Ann. ch. 542.33(2); Haw. Rev. Stat. § 480-4(c); La. Rev. Stat. Ann. § 23:921(B); Mont. Code Ann. § 28-2-704; N.D. Cent. Code § 9-08-06(1); Okla. Stat. Ann. tit. 15, § 218; or anticompetitive covenants incident to dissolution of a partnership. See Ala. Code § 8-1-1(c); Cal. Bus. & Prof. Code § 16602; Colo. Rev. Stat. § 8-2-113; Fla. Stat. Ann. ch. 542.33(3); Haw. Rev. Stat. § 480-4(c); La. Rev. Stat. Ann. § 23:921(D); Mont. Code Ann. § 28-2-705; N.D. Cent. Code § 9-08-06(2); Okla. Stat. Ann. tit. 15, § 219.

1. Introduction: Restrictive Covenants Incident to the Sale of a Business

Upon the sale of closely held businesses or professional practices, the purchaser frequently extracts from the seller a covenant not to compete. The purchaser's need for such a covenant is apparent. Much of what the purchaser is buying is the "goodwill" built up by the seller. Because existing customers of the business may identify that goodwill with the seller, if the purchaser could not preclude the seller from competing with the business, that goodwill might be worthless to the buyer. In that case, the buyer might be unwilling to invest in the business, even if she values the business more than the seller does.

Courts are generally more willing to enforce covenants not to compete incident to the sale of a business than they are to enforce covenants between an employer and employee.[43] As Judge Fuld noted in summarizing the New York case law, "a buyer of a business should be permitted to restrict his seller's freedom of trade so as to prevent the latter from recapturing and utilizing, by his competition, the good will of the very business which he transferred for value."[44] Even in states where, by statute, anticompetitive covenants are generally void,[45] the statutes usually except such covenants incident to the sale of a business,[46] or to the dissolution of a partnership.[47]

Even covenants incident to the sale of a business, however, must be "reasonable" to be enforceable. For instance, if the covenant restricts the seller from entering geographical areas or lines of business in which the firm has not operated, a court might find the covenant to be

[43] See, e.g., Reed, Roberts Assocs., Inc. v. Strauman, 353 N.E.2d 590, 593 (N.Y. 1976) ("[W]here an anticompetition covenant given by an employee to his employer is involved a stricter standard of reasonableness will be applied.").

[44] Purchasing Assocs., Inc. v. Weitz, 196 N.E.2d 245, 247 (N.Y. 1963).

[45] See Ala. Code § 8-1-1; Cal. Bus. & Prof. Code § 16600; Colo. Rev. Stat. § 8-2-113; Fla. Stat. Ann. ch. 542.33; Haw. Rev. Stat. § 480-4 (c); La. Rev. Stat. Ann. § 23:921; Mont. Code Ann. § 28-2-703; N.D. Cent. Code § 9-08-06; Okla. Stat. Ann. tit.15, § 217.

[46] See Ala. Code § 8-1-1(b); Cal. Bus. & Prof. Code § 16601; Colo. Rev. Stat. § 8-2-113; Fla. Stat. Ann. ch. 542.33(2); Haw. Rev. Stat. § 480-4(c); La. Rev. Stat. Ann. § 23:921(b); Mont. Code Ann. § 28-2-704; N.D. Cent. Code § 9-08-06(1); Okla. Stat. Ann. tit. 15, § 218.

[47] Ala. Code § 8-1-1(c); Cal. Bus. & Prof. Code § 16602; Colo. Rev. Stat. § 8-2-113; Fla. Stat. Ann. ch. 542.33(3); Haw. Rev. Stat. § 480-4(c); La. Rev. Stat. Ann. § 23:921(b); Mont. Code Ann. § 28-2-705; N.D. Cent. Code § 9-08-06(2); Okla. Stat. Ann. tit. 15, § 219.

"unreasonable."[48] Indeed, the California statute permits enforcement of restrictive covenants incident to the sale of a business only when the sales agreement specifies particular counties in which the seller has actually engaged in that business.[49]

At first glance, these limitations on enforcement of restrictive covenants should have little impact on a purchaser's investment planning. So long as the seller has established no goodwill in the area, his competition in that market does not deplete the value of the goodwill the buyer purchased and therefore should have minimal impact on the purchaser's investment decision. Similarly, to the extent that a covenant would restrict the seller past the time the purchaser needs to transfer customer loyalty to the firm under new ownership, the covenant should have little effect on the purchaser's investment planning.[50] The personal element of the "good will" the seller has sold dissipates as his customers grow accustomed to the new management of the sold firm.

This analysis, however, ignores the uncertainty engendered when a court decides to draw lines between enforceable and unenforceable agreements. The reasonableness requirement threatens the prospective purchaser with litigation over the permissible scope of any covenant not to compete and with the possibility that a court, without complete understanding of the purchaser's business needs, might ultimately refuse to enforce a covenant necessary to protect good will.

When courts impose a "reasonableness" requirement on employee covenants not to compete, they may do so, in part, out of a sense that

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48 See, e.g., Purchasing Assocs., 196 N.E.2d at 248, where the court declined to enforce an anticompetition covenant because the seller of the assets of a business had not engaged in the same line of business the buyer ultimately pursued. But see Wells v. Wells, 400 N.E.2d 1317, 1320-21 (Mass. App. Ct. 1980) (enforcing covenant to prevent competition even in areas where seller had not previously conducted business).

In a number of jurisdictions, however, courts will reduce the scope of otherwise invalid restrictions and enforce the restrictions as modified. See, e.g., Mich. Comp. Laws § 445.774(a) (1989 & Supp. 1992) (authorizing courts to rewrite restrictions to make them reasonable); Amex Distrib. Co. v. Mascari, 724 P.2d 596, 601 (Ariz. Ct. App. 1986) ("Arizona will follow the blue-pencil rule . . . .").

49 Cal. Bus. & Prof. Code §§ 16601-16602.

50 Of course, if the firm enjoys monopoly power in the market, the investor may hope to reap monopoly profits from the investment—profits that might be jeopardized if seller were to reenter the market in the future. Once customer loyalty has transferred from the seller to the purchaser, however, competition from the seller would be no more harmful—and no more likely—than competition from any other potential entrant into the market.

the parties to the covenant possessed unequal bargaining power.[51] Such concerns, however, appear unwarranted when the disputed covenant arises out of the sale of a business, a transaction almost certain to be accompanied by negotiations between equally sophisticated parties. Thus, in this context, there does not seem to be any reason to permit courts to rewrite the parties' bargain.

2. *Restrictive Covenants in Employment Contracts: Trade Secrets and Customer Information*

Courts routinely enforce restrictive covenants when convinced that enforcement is necessary to protect an employer against his former employee's use of trade secrets or customer information acquired from the employer.[52] Indeed, courts have recognized that trade secrets encompass more than secret formulas or other technical data, and have enforced restrictive covenants against employees in possession of information about the employer's new product lines and expansion plans.[53] Courts also strive to protect employers against salespeople who threaten to exploit customer contacts established during the period of employment.[54]

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[51] See infra note 86.

[52] See Novelty Bias Binding Co. v. Shevrin, 175 N.E.2d 374 (Mass. 1961) (trade secrets and customer information); Raven v. A. Klein & Co., 478 A.2d 1208, 1210 (N.J. Super. Ct. App. Div. 1984) (trade seerets); Farmers Ins. Exch. v. Fraley, 720 P.2d 770, 771 (Or. Ct. App. 1986) (customer information).

[53] See, e.g., Kroeger v. Stop & Shop Cos., 432 N.E.2d 566, 570 (Mass. App. Ct. 1982). By contrast, in cases where the employer can cite only the employee's general familiarity with the firm's operations, courts do not generally enforce anticompetition covenants. Thus, in Reed, Roberts Assocs. v. Strauman, 353 N.E.2d 590 (N.Y. 1976), the New York Court of Appeals refused to enforce an anticompetition covenant against a senior vice-president of Reed, Roberts who sought to form a competing firm, despite Reed, Roberts' allegations that the vice-president had, during the course of his employment, acquired valuable information about Reed, Roberts' operations. The departing vice-president had been responsible for operations, not sales, and the court concluded that knowledge of the firm's operations would not suffice to justify an injunction:

> Apparently, the employer is more concerned about Strauman's knowledge of the intricacies of their business operation. However, absent any wrongdoing, we cannot agree that Strauman should be prohibited from utilizing his knowledge and talents in this area. A contrary holding would make those in charge of operations or specialists in certain aspects of an enterprise virtual hostages of their employers.

Id. at 594 (citation omitted).

[54] See, e.g., John G. Bryant Co. v. Sling Testing & Repair Inc., 369 A.2d 1164, 1167-69 (Pa. 1977); Sidco Paper Co. v. Aaron, 351 A.2d 250, 257-58 (Pa. 1976).

Moreover, courts have not limited enforcement of restrictive covenants to salespeople. Customer contact is valuable to professional people as well, and courts have enforced restrictive covenants even against physicians who seek to compete with their former employers. *Karpinski v. Ingrasci*[55] is illustrative. Karpinski had built up an oral surgery practice and then hired Ingrasci to treat some of his patients. Ingrasci agreed that he would not practice oral surgery in the five-county area of Karpinski's practice except in association with Karpinski. At the end of the contract period, the two doctors could not agree on the nature of their continued association, and Ingrasci opened up his own practice in the area. Karpinski, concerned that the dentists who had referred clients to his office would now refer them to Ingrasci out of habit, sought to enforce the restrictive covenant. The New York Court of Appeals enforced the covenant, even without a time limit, to protect Karpinski against loss of the customer base he had developed.[56]

The *Karpinski* court's willingness to enforce this broad restrictive covenant, however, is not typical. Although courts generally enforce restrictive covenants to protect against abuse of customer contact acquired during the period of employment, they typically hold such covenants unenforceable if they are not limited to a "reasonable" period of time.[57] Moreover, courts often limit enforcement to the geographical area in which the former employee had worked.[58]

In addition to limiting the geographic area and duration of anticompetition covenants, courts also second guess the employer's "need" for protection. For instance, in *National Hearing Aid Centers v. Avers*,[59] an employee contracted to sell his employer's hearing aids

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55 268 N.E.2d 751 (N.Y. 1971).

56 See also Hayes v. Altman, 225 A.2d 670, 670-72 (Pa. 1967) (enforcing restrictive covenant against optometrist). But cf. Cohen v. Lord, Day & Lord, 550 N.E.2d 410, 410-12 (N.Y. 1989) (suggesting professional responsibility problems in enforcing restrictive covenants against lawyers).

57 See All Stainless, Inc. v. Colby, 308 N.E.2d 481, 485-87 (Mass. 1974) (limiting enforcement of covenant to area that had been salesman's territory during the period of employment); Boldt Mach. & Tools v. Wallace, 366 A.2d 902, 904, 907 (Pa. 1976) (enforcing restraint only in territory where employee actually sold); *Sidco*, 351 A.2d at 254-56 (affirming chancellor's decision limiting the scope of injunction enforcing restrictive covenant).

58 See, e.g., Reading Aviation Serv. v. Bertolet, 311 A.2d 628, 629-31 (Pa. 1973) (holding covenant unlimited in duration invalid on its face and refusing to reform covenant to make it reasonable).

59 311 N.E.2d 573 (Mass. App. Ct. 1974).

on a commission basis and agreed that he would not sell hearing aids or accessories within Maine, New Hampshire, Vermont, or six counties of Massachusetts for two years after termination of the contract. When that employee terminated the contract and began to sell hearing aids in violation of the covenant, National Hearing Aid Centers sought an injunction. The Appeals Court of Massachusetts reversed the trial court's grant of an injunction, finding insufficient evidence that the employee had appropriated any confidential customer information and concluding that such information would not, in any event, have been useful to the employee in the sale of hearing aids.[60] The court indicated that there were few repeat customers in the hearing aid business, and that customer contact was therefore of little value to employer or employee. Because the employer had demonstrated no "need" for protection from the employee's competition, the court refused to enforce the covenant.[61]

Thus, although recognizing the need to protect trade secrets and customer information, courts have been unwilling to permit employers and employees to define the scope of their own protection by contract. Instead, courts have scrutinized restrictive covenants carefully and have enforced them only when the threat to the employer's interests was apparent.

3. *Unique Employees*

Some courts have held[62] and others have suggested[63] that employers are entitled to enforce restrictive covenants against unique or extraordinary employees—those whose unique skills make them diffi-

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60 Id. at 576-78.

61 Similarly, in New Castle Orthopedic Assocs. v. Burns, 392 A.2d 1383 (Pa. 1978), the Pennsylvania Supreme Court refused to enforce a two-year restrictive covenant in a physician's employment contract on the ground that the physician's employer had demonstrated insufficient harm. Because the employer had plenty of patients and a backlog, the court concluded that the employer did not need protection against competition from the former employee.

62 See Houston Oilers v. Neely, 361 F.2d 36, 40 (10th Cir.), cert. denied, 385 U.S. 840 (1966); Nassau Sports v. Peters, 352 F. Supp. 870, 875-76 (E.D.N.Y. 1972); King Records, Inc. v. Brown, 252 N.Y.S.2d 988, 990-91 (App. Div. 1964); Dallas Cowboys Football Club v. Harris, 348 S.W.2d 37, 42-44 (Tex. Civ. App. 1961).

63 See American Broadcasting Cos. v. Wolf, 420 N.E.2d 363, 367-68 (N.Y. 1981); Purchasing Assocs. v. Weitz, 196 N.E.2d 245, 247-49 (N.Y. 1963).

cult to replace.[64] The courts have generally applied this "unique employee" doctrine to enforce restrictive covenants against members of two particular professions—athletes and entertainers.

In the leading English case, *Lumley v. Wagner*,[65] an opera singer contracted to sing for the proprietor of an opera company and agreed not to appear in any other theater or concert without the proprietor's written permission. The proprietor successfully enjoined the singer from performing for a competitor.

Although the court in *Lumley* did not focus on the uniqueness of the singer's services, the leading American case, *Philadelphia Ball Club, Ltd. v. Lajoie*,[66] did emphasize the unique talents of the employee involved.[67] Napoleon Lajoie, a baseball player later elected to the Hall of Fame, had entered into a contract that gave his team an option to renew each year for three years. The contract prohibited Lajoie from playing for any other team. In holding that Lajoie's team could enjoin him from playing for a competitor, the Pennsylvania Supreme Court observed that "[Lajoie] has become thoroughly familiar with the action and methods of the other players in the club, and his own work is peculiarly meritorious as an integral part of the team work which is so essential."[68] Thus, the court not only recognized

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[64] Even in California, where, by statute, covenants not to compete are generally unenforceable, see supra notes 41-42, 45-47 and accompanying text, injunctions may be granted to prevent breach of personal service contracts by unique employees. The California Civil Code reads as follows:

> An injunction can not be granted:
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> . . . .
>
> . . . To prevent the breach of a contract, other than a contract in writing for the rendition or furnishing of personal services from one to another where the minimum compensation for such service is at the rate of not less than six thousand dollars per annum and where the promised service is of a special, unique, unusual, extraordinary or intellectual character, which gives it peculiar value the loss of which can not be reasonably or adequately compensated in damages in an action at law . . . .

Cal. Civ. Code § 3423 (West 1970 & Supp. 1992); see also Cal. Civ. Pro. Code § 526 (West 1979 & Supp. 1992); Cal. Lab. Code § 2855(a) (West 1989 & Supp. 1992).

[65] 42 Eng. Rep. 687 (Ch. 1852).

[66] 51 A. 973 (Pa. 1902).

[67] Id. at 974. In a recent article, Professor VanderVelde suggests that the *Lumley* doctrine was not fully accepted by American courts until the *Lajoie* case was decided. Lea S. VanderVelde, The Gendered Origins of the *Lumley* Doctrine: Binding Men's Consciences and Women's Fidelity, 101 Yale L.J. 775, 795-99, 821 (1992). Specifically, VanderVelde notes that until the *Lajoie* case was decided, the *Lumley* doctrine had never been applied to issue a permanent injunction against a male performer. Id. at 821.

[68] *Lajoie*, 51 A. at 974.

and emphasized Lajoie's uniqueness, but understood that the employer would have a reduced incentive to invest in other players without some assurance that players under contract would not depart for other teams.

Since the *Lajoie* decision, a number of other courts have enforced restrictive covenants against players who sought to switch teams (or leagues) between seasons[69] or even, in some cases, after sitting out a season.[70] In some of these cases, courts have emphasized investments a team had made in reliance on the particular player.[71]

The uniqueness doctrine has not been limited to team sports. Courts have used the doctrine, for instance, to enjoin professional boxers from fighting in violation of exclusive management contracts,[72] and singers[73] and television personalities[74] from recording or performing in violation of their agreements.

Although it has served to protect some employers, the uniqueness doctrine has been costly for the judiciary and thus for society. The doctrine has often left courts embroiled in deciding whether a particular performer's skills were unique,[75] and has also required courts to address claims that employees other than entertainers—fashion models or hairdressers, for instance—should be treated as "unique"

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69 See, e.g., Nassau Sports v. Peters, 352 F. Supp. 870 (E.D.N.Y. 1972); Central New York Basketball Club v. Barnett, 181 N.E.2d 506 (Ohio Ct. C.P. 1961).

70 See, e.g., Lemat Corp. v. Barry, 80 Cal. Rptr. 240, 243-44 (Cal. Ct. App. 1969) (holding that NBA contract prevents player from jumping to ABA after sitting out a season); Dallas Cowboys Football Club v. Harris, 348 S.W.2d 37, 46 (Tex. Civ. App. 1961) (affirming that NFL contract prevents player from jumping to AFL even after sitting out a season).

71 See, e.g., *Lemat Corp.*, 80 Cal. Rptr. at 243 (noting that the trial court "found that because the Warriors had primarily built their style of play and public image around Barry, and the special, unique, unusual and extraordinary character of Barry's services, the loss to the Warriors of his services for a second year could not be adequately compensated for in money").

72 See, e.g., Arias v. Solis, 754 F. Supp. 290, 295 (E.D.N.Y. 1991); Madison Square Garden Boxing v. Shavers, 434 F. Supp. 449, 452 (S.D.N.Y. 1977).

73 See, e.g., MCA Records, Inc. v. Newton-John, 153 Cal. Rptr. 153, 155 (Cal. Ct. App. 1979).

74 See, e.g., Zink Communications v. Elliott, No. 90 Civ. 4297, 1990 WL 176382, at *25 (S.D.N.Y. Nov. 2, 1990); Clooney v. WCPO Television Div. of Scripps-Howard Broadcasting Co., 300 N.E.2d 256 (Ohio Ct. App. 1973).

75 See, e.g., *Zink Communications*, 1990 WL 176382, at *17 (noting "considerable body of state and federal cases . . . on the point of whether a defendant was furnishing unique services. . . . The most instructive cases involve performers of one kind or another, actors, singers, athletes, radio and television personalities. The inquiry is intensely fact oriented."); Chapin v. Powers, 73 N.Y.S.2d 854 (Sup. Ct. 1947).

employees.[76] This uncertainty about the scope of available protection, like the uncertainty over which restrictive covenants will be "reasonable" in other contexts, is likely to cause inefficient waste of judicial resources and may cause underinvestment in unique employees.

4. *Job Training*

One of the rationales offered by employers to justify anticompetition covenants is that the employer needs protection against loss of its investment in training an employee. Testimony offered by the vice-president of a paper company in *Clark Paper & Manufacturing Co. v. Stenacher*[77] expresses the employer position:

> I can recollect several men, at this time, who are now in the employ of competitors, salesmen, that we have spent our good time and our good money breaking in, men that we have taken and drilled and that we have gone through a period of no profit to the time when they commenced to make themselves worth while, simply to leave us and go with some one else.[78]

In other words, employers argue that without anticompetition covenants, employees will take advantage of employer-financed training only to reap the benefit while working for a competitor. The argument suggests that failure to enforce anticompetition covenants would result in underinvestment in job training.

Nevertheless, courts have generally rejected employer arguments based on investments in training. In *Clark*, for instance, the court refused to enforce a covenant preventing a wrapping paper salesman from entering the employ of a competitor for eight years.[79] As the New York Court of Appeals has put it, "no restrictions should fetter

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[76] See, e.g., Russell-Stewart, Inc. v. Birkett, 201 N.Y.S.2d 687, 689 (Sup. Ct. 1960), appeal dismissed, 215 N.Y.S.2d 215 (N.Y. App. Div. 1961) (finding that a fashion model who is one of many that could render a similar service is not a unique employee); cf. Donnybrook Hairdressers v. Schachter, 223 N.Y.S.2d 424, 426-27 (Sup. Ct. 1961) (leaving the question of a hairdresser's uniqueness for trial).

[77] 140 N.E. 708 (N.Y. 1923).

[78] Id. at 711.

[79] The court wrote of the covenant:

> The fact is, the plaintiff sought in this indirect way to prevent by such an agreement its employee from leaving its service, and did not primarily seek to enjoin him from imparting information which might do it harm. It anticipated no other harm than might come from a trained salesman carrying his acquired skill elsewhere.

Id. at 710. See also Richmond Brothers, Inc. v. Westinghouse Broadcasting Co., 256 N.E.2d 304, 307 (Mass. 1970) (refusing to enforce three-year restrictive covenant against radio an employee's right to apply to his own best advantage the skills and knowledge acquired by the overall experience of his previous employment. This includes those techniques which are but 'skillful variations of general processes known to the particular trade.' "[80] The employer's investment in training has generally furnished a basis for enjoining competition only in those cases where the employer has shared trade secrets or customer lists with the employee.

This legal framework, which does not treat employer investment in job training as a "reasonable" basis for enforcing restrictive covenants, is consistent with the economic analysis discussed earlier.[81] If, as economic theory suggests, the cost of general job training is borne by the employee, not the employer, refusal to enforce restrictive covenants will not lead to inefficient underinvestment in training.

D. *Objections to Enforcement of Restrictive Covenants*

The preceding Section demonstrates how courts have shaped legal doctrine to prevent underinvestment in human capital. By enforcing restrictive covenants against former employees who possess trade secrets, customer information, unique talents, or who personify in some measure the firm's good will, courts have enforced anticompetition clauses in employment contracts in those cases where that clause is most essential to protect against inefficiency. At the same time, however, judicial use of a "reasonableness" standard—rather than a rule requiring enforcement of all restrictive covenants—has caused some inefficiency. The standard has encouraged litigation over the enforceability of particular covenants and has resnlted in replacing the contracting parties' judgment about the "need" for the covenant with the judgment of courts removed from the problems faced by the particular employer and employee.

When courts decline to enforce restrictive covenants, they generally advance one or more of three justifications (if they advance any justification at all). First, they contend that enforcement would stifle competition.[82] Second, they cite inequality of bargaining power between

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announcer, rejecting radio station's argument that announcer had become valuable because of station's investment in him).

80 Reed, Roberts Assocs. v. Strauman, 353 N.E.2d 590, 593 (N.Y. 1976) (quoting Restatement (Second) of Agency § 396 cmt. b (1957)).

81 See supra text accompanying note 25.

82 See, e.g., Duffner v. Alberty, 718 S.W.2d 111, 113-14 (Ark. Ct. App. 1986).

employers and employees as a reason to ignore restrictive covenants that appear to disfavor the employee.[83] Finally, they conclude that enforcement would be akin to impermissible involuntary servitude.[84]

1. The Anticompetitive Effect of Restrictive Covenants

When courts cite stifling of competition as a rationale for refusing to enforce restrictive covenants, they rarely explain exactly how enforcing the covenant will restrain competition. All covenants not to compete restrain competition in one sense: the number of potential entrants into the market is reduced by one. In a competitive market, however, elimination of one competitor will have at most a trivial effect. Covenants not to compete would become pernicious only if they created or increased monopoly power in some market.

One concern might be that the covenant restrains competition in the market for the employee's services. That is, the covenant prevents the employee from soliciting offers from other potential employers and arguably prevents the employee's human capital from flowing to the user who would value it the most. Upon further reflection, however, this concern is unfounded, for nothing prevents the employee from bargaining with his employer for release from the covenant. If either the employee himself or other prospective employers value the employee's services more than his current employer does, the employee should be willing to pay the employer to release him from the contract. Hence, enforcing the covenant should have no anticompetitive effect in the market for the employee's services.

Alternatively, courts may worry that restrictive covenants would stifle the market for the employer's products or services.[85] If the employer can prevent the employee from striking out on his own, the employer may be able to eliminate a competitor from the market. As a practical matter, however, elimination of one potential competitor

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[83] See, e.g., Arthur Murray Dance Studios v. Witter, 105 N.E.2d 685, 703-04 (Ohio Ct. C.P. 1952).

[84] See, e.g., Lynch v. Bailey, 90 N.Y.S.2d 359, 363 (App. Div. 1949) ("In the light of what appears to be the real purpose of the restrictive clause we may say of it what this court said of another restrictive clause that was held to have a similar purpose, namely, that it 'savored of servitude.' ").

[85] See generally Maureen B. Callahan, Comment, Post-Employment Restraint Agreements: A Reassessment, 52 U. Chi. L. Rev. 703, 712-18 (1985) (noting that both the market for employee services and the market for employer's product must be considered in assessing claim that enforcement of restrictive covenants will lead to monopoly).

will have no effect on competition unless, first, there are barriers to market entry and, second, the employee is in a better position to surmount those barriers to entry than other potential competitors. Without barriers to entry, competitors would enter the employer's market until the employer had no market power, with or without the presence of her former employee. Even with barriers to entry, restricting the employee would have no effect on the employer's market position unless the employee, because of familiarity with the market or customer contacts, was in a better position to enter the market than other potential competitors.

Suppose, however, these two conditions do coalesce and an employer restricts the mobility of an employee who is a potential competitor in a market restricted by entry barriers. The restrictive covenant might then stifle competition and permit the employer to exercise monopoly power. Suppose, however, there were no restrictive covenant or that restrictive covenants were not enforced. A profit-maximizing firm would then find it in its interest to pay the employee enough to keep the employee from leaving the firm even if the price were very high. Moreover, if the firm can continue to reap monopoly profits in the absence of competition from the employee, it is likely to be in the employee's interest, as well, to accept higher compensation from the firm and share in monopoly profits, rather than to strike out on his own, increasing competition in the market, and reducing the opportunity for the firm or employee to reap monopoly profits. No state law prohibition would prevent the employee from accepting a raise in salary from the employer, and it is difficult to imagine a federal antitrust claim arising on these facts. Hence, in the very situations where enforcement of restrictive covenants would be most likely to restrain competition, restraint is likely even without enforcement of the covenants.

The anticompetitive effect of enforcing restrictive covenants, then, will probably be insignificant. Indeed, only the employer and the employee are likely to see any effects. That is because, in the above situation, the employee may be in a better position to reap the benefits of the employer's monopoly power if restrictive covenants are not enforceable. If the firm is to retain its monopoly power, and if no restrictive covenants bind its employees, the firm must satisfy employees who are potential competitors. Refusing to enforce restrictive covenants transfers some of the benefits of monopoly power from the firm to its employee but does little to eliminate the monopoly power itself.

2. *Inequality in Bargaining Power Between Employer and Employee*

A number of courts, in declining to enforce a restrictive covenant against an employee, have emphasized that the employee had little choice but to agree to the covenant put in front of him by an employer or prospective employer.[86] On one view, such concerns are misplaced: an employer could "coerce" an employee to sign a restrictive covenant only if the employer possessed monopsony power in the market for labor.[87] On this view, denying the monopsonist power to enforce restrictive covenants would simply cause the monopsonist to exercise that power in a different way—for instance, by offering lower wages.[88] Refusing to enforce restrictive covenants would not reduce the monopsonist's power.[89]

Deficiencies in information or imagination, however, might lead employees to sign restrictive covenants that are not in their interest.[90]

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86 See, e.g., Arthur Murray Dance Studios v. Witter, 105 N.E.2d 685 (Ohio Ct. C.P. 1952):

> The average, individual employee has little but his labor to sell or to use to make a living. He is often in urgent need of selling it and in no position to objeet to boiler plate restrictive covenants placed before him to sign. To him, the right to work and support his family is the most important right he possesses. His individual bargaining power is seldom equal to that of his employer.

Id. at 704.

87 See Richard A. Posner, Economic Analysis of Law (4th ed. 1992):

> The sinister explanation [for printed form contracts signed without negotiation] is that the seller refuses to dicker separately with each purchaser because the buyer has no choice but to accept his terms. This assumes an absence of competition. If one seller offers unattractive terms, a competing seller, wanting sales for himself, will offer more attractive terms.

Id. at 114. See also Rubin & Shedd, supra note 24, at 108 (rejecting as "incorrect in economic terms" the argument that restrictive covenants in employment contracts are the product of unequal bargaining power. The authors, however, do not consider the possibility that an employer might possess monopsony power.).

88 See Posner, supra note 87, at 114.

89 Of course, if courts were concerned about restrictive covenants for reasons other than unequal bargaining power—for instance, if courts were concerned about the "involuntary servitude" aspect of restrictive covenants, see infra text accompanying notes 93-96—courts might prefer that an employer exercise its monopsony power by offering lower wages, or by reducing employee benefits in other ways, rather than by enforcing restrictive covenants.

90 Lea VanderVelde has emphasized that at the commencement of employment, few employees contemplate the circumstances that might surround termination. VanderVelde, supra note 67, at 852 ("Most individuals enter into employment contracts with hopes and

Employees will not typically employ counsel to advise them about the legal consequences of the boilerplate clauses included in an employment contract, whereas employers, because they contract with many separate employees, frequently enjoy the benefit of counsel.[91] An employee beginning a new job may discount or overlook the possibility that she will later want to compete with her employer. By contrast, we might expect that employers who include restrictive covenants in their employment contracts have given more thought to the problems surrounding severance.

The desire to protect disadvantaged employees from the effects of employer-drafted adhesion contracts provides an explanation for judicial resistance to restrictive covenants—but only a partial explanation. If unequal bargaining power were the only reason for refusing to enforce restrictive covenants, one would expect full enforcement in those cases where sophisticated parties, negotiating at arms length and with the assistance of counsel, bargained for restrictive covenants. In fact, however, courts scrutinize restrictive covenants for reasonableness even in contracts for the sale of businesses.[92] Because inequality of bargaining power does not explain the nonenforcement of covenants in these cases, it can provide, at best, only a partial explanation for legislative and judicial reluctance to enforce restrictive covenants.

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dreams. Few enter with the end of the relationship clearly in mind."). See generally Mayer G. Freed & Daniel D. Polsby, Just Cause for Termination Rules and Economic Efficiency, 38 Emory L.J. 1097, 1105-07 (1989) (discussing possibility that employees will misperceive importance of issues that might arise in the future).

[91] See Todd D. Rakoff, Contracts of Adhesion: An Essay in Reconstruction, 96 Harv. L. Rev. 1174, 1226-27 (1983) (noting that in most consumer transactions, consumers will not find it worthwhile to study all terms of form contracts). See generally George J. Stigler, Information in the Labor Market, *in* The Organization of Industry 191, 201-03 (1968) (discussing the many variables that affect the search costs that would be involved in investigating the terms offered by various employers).

[92] See supra notes 43-49 and accompanying text. Moreover, the "reasonableness" rule applies to restraints negotiated after the commencement of employment, when the employee is more likely to understand his value, and where the employee's skills may mark him as a sophisticated person less in need of protection against inequality in bargaining power. On the latter point, see generally, Callahan, supra note 85, at 723 (discussing how the employees most likely to be subject to restraints are just those people likely to be sophisticated enough to bargain knowledgeably).

3. *Restrictive Covenants and Involuntary Servitude*

Finally, some courts refusing to enforce anticompetitive covenants against former employees emphasize that to do so would be akin to placing the employee in a state of "involuntary servitude."[93] Restrictive covenants do not, however, commit an employee to work for a particular employer. Even if enforced, then, they would not fit classic conceptions of slavery. Nevertheless, by limiting the number of attractive alternatives available to an employee, a restrictive covenant may in some sense "coerce" that employee to remain with his initial employer. When courts express hostility to restrictive covenants, it is this coercion that they most frequently cite.

Thus, in *Reed, Roberts Associates v. Strauman*[94] the New York Court of Appeals refused to enjoin a senior vice president in charge of operations from engaging in a competing business, noting that "[a] contrary holding would make those in charge of operations or specialists in certain aspects of an enterprise *virtual hostages of their employers*."[95] In *Lynch v. Bailey*,[96] the court refused to enjoin an accountant from practicing within one hundred miles of any offices of the firm in which he had formerly been a partner. The court noted that the firm had offices in ten large cities around the country, seriously limiting the accountant's work opportunities:

> The real purpose of this particular restrictive clause in its whole context and all facts and circumstances here disclosed, including defendants' own testimony and acts, is to prevent any voluntary withdrawals from the firm and compel active partners who came in with clients and good will to remain with the firm indefinitely until they are forced by partnership terms to withdraw or reach the age limit for retirement. . . . In the light of what appears to be the real purpose of the restrictive clause we may say of it what this court said of another restrictive clause that was held to have a similar purpose, namely, that it "savored of servitude."[97]

In other cases, courts have not expressly emphasized the servitude aspect of restrictive covenants but have instead focused on the limita-

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[93] See infra note 97 and accompanying text.

[94] 353 N.E.2d 590 (N.Y. 1976).

[95] Id. at 594 (emphasis added).

[96] 90 N.Y.S.2d 359 (N.Y. App. Div. 1949).

[97] Id. at 363. The same concern about servitude appeared in opinions and law review commentaries written at the turn of the century. See VanderVelde, supra note 67, at 836-37.

tion on the employee's right to earn a living.[98] Of course, a restrictive covenant does not prevent the employee from pursuing his livelihood: he is "free" to work for the original firm.[99] When a court expresses concern for the employee's ability to earn a living, then, the court in effect condemns the employer's exercise of economic power to keep the employee tied to the firm.

When courts express hostility to restrictive covenants in employment agreements on involuntary servitude grounds, they suggest in effect that the right to choose how to use one's "own" human capital is an important element of personal freedom. It is far from clear that enforcing restrictive covenants would reduce employee freedom, however. By protecting an employee's freedom to leave his employer without serious consequences, courts impose a corresponding restriction on an employee's freedom to contract about future use of his "own" human capital. If restrictive covenants are not enforceable, employees may be free to escape their past bargains, but they are not free to bind themselves for the future. There is, then, a paternalistic aspect to limitations on enforcement of restrictive covenants: courts or legislatures substitute social judgments about the appropriate

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98 See, e.g., Purchasing Assocs. v. Weitz, 196 N.E.2d 245, 247 (N.Y. 1963) (noting the "powerful considerations of public policy which militate against sanctioning the loss of a man's livelihood"); Murray v. Cooper, 51 N.Y.S.2d 935 (N.Y. App. Div. 1944), aff'd, 60 N.E.2d 387 (N.Y. 1945):

> contracts by employees, unreasonably limiting their right to pursue their trade or occupation in the future, are held to violate public policy, because the employees' means for procuring a livelihood for themselves and family are thereby diminished. They are deprived of the power of usefulness, and the public is deprived of the benefit of the exercise by them of their knowledge and skill.

Id. at 937.

99 Conceivably, a firm could seek to enjoin an employee from working for a competitor even after discharging the employee. It is virtually certain, however, that in such circumstances the covenant would not be enforced and could not, therefore, be used to deprive the employee of his livelihood. Cf. Post v. Merrill Lynch, Pierce, Fenner & Smith, 397 N.E.2d 358, 361 (N.Y. 1979) (holding that where an employee is involuntarily discharged without cause and thereafter enters into competition in violation of a restrictive covenant, forfeiture of the employee's pension benefits is unreasonable as a matter of law).

The doctrinal rule that prevents enforcement of a restrictive covenant against an employee fired without cause undoubtedly reflects a belief that no employee who thought seriously about possible termination of employment would enter into an agreement that would permit an employer to fire her without cause *and* prevent her from working elsewhere in the field. See supra notes 90-91 and accompanying text.

Indeed, in those cases where a person unequivocally gives up the right to work in a field—as, for instance, upon sale of a business for valuable consideration—courts do enforce restrictive covenants that effectively preclude the seller from working for anyone.

trade-offs between compensation and future freedom for the decisions parties make by contract.

Although contract law is marked by generous doses of paternalism, the reluctance to permit assignments of human capital is not matched by similar reluctance when more traditional property rights are involved. Presumably, an individual who sells land, machinery, or personal property is just as likely to make a bad bargain as a person who restricts his future right to use his human capital. Yet, if the owner of more traditional forms of property sells or restricts his future use of that property—as might be the case with the grant of an easement, for instance—courts are unlikely to invalidate the transfer years later unless presented with evidence of fraud or overreaching in the original bargain. With human capital, by contrast, judicial intervention to invalidate a restrictive covenant is much more likely.

E. Summary

In the employment context, alienability of human capital is more limited than alienability of more traditional property in at least two ways. First, a contract to work for a particular employer is not specifically enforceable: an employer who attempts to "buy" an employee's services for a period of time may not secure "property-rule" protection of the "property" he has attempted to purchase. Second, even more limited protection—the right to prevent a former employee from working for a competitor—is available only when the firm can persuade the court of a strong economic justification for enforcing the bargain. The existence of a bargain that both parties apparently believed beneficial is not by itself enough to secure judicial enforcement. These restrictions on a person's ability to alienate his own human capital have been justified in part by the need to discourage anticompetitive behavior, in part by the need to protect employees from the greater bargaining power of employers, and, most significantly, by the need to protect individual freedom. None of those justifications, however, is entirely persuasive.

II. Creditor Claims to Human Capital

In general, a creditor's claim to a debtor's property can arise in either of two ways. First, before extending credit, the creditor can insist that the debtor dedicate particular property to repayment of the debt. In other words, the creditor can obtain a security interest in property of the debtor. Even when a noncontractual obligation arises or where the contract obligation does not confer any security interest in particular property, an unsecured creditor acquires a right to levy against the debtor's property if the debtor defaults. Without such a right, unsecured credit would undoubtedly be more expensive and difficult to obtain. In either case, the creditor can legally take possession of the property—at least traditional property—in order to satisfy the debt.

When debt becomes sufficiently burdensome, a debtor may seek the protection of the bankruptcy laws to avoid repayment. Bankruptcy has a price for a debtor with traditional property, however. Subject to some exceptions, he must relinquish virtually all existing property in return for discharge of his debts. As in the employment context, however, human capital is treated differently than other forms of property when the owner of that property defaults on a debt.

Although creditors may, through wage garnishment, reach a debtor's human capital as well as the debtor's traditional property, creditor rights to human capital are limited, both in and out of bankruptcy. In exploring those limitations, this Part compares creditor rights against traditional property with creditor rights against human capital both in and out of bankruptcy. It goes on to examine the justifications for limiting creditor claims against human capital and concludes that these justifications rest on questionable foundations.

A. Creditor Claims Outside of Bankruptcy

1. Traditional Property

When an owner of traditional property falls into debt, that property is generally subject to creditor claims. State statutes may establish priorities among creditors—either based on time or based on the nature of the claim—but most of the debtor's traditional property will be available to satisfy the claims of *some* creditor.

Many states do exempt some of the debtor's property from execution by creditors.[100] Although state exemption statutes vary considerably in scope, they all serve somewhat similar functions. First, they

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100 New Jersey, for instance, exempts all wearing apparel plus $1,000 in personal property. N.J. Stat. Ann. § 2A:17-19 (West 1987). Homestead exemptions often protect some of a debtor's investment in the family home. See, e.g., N.Y. Civ. Prac. L. & R. § 5206(a) (McKinney Supp. 1992) (exempting home up to value of $10,000). California simply exempts

preserve some element of human dignity for insolvent debtors. State subsidies permit even people with no independent source of income to acquire at least some personal effects—even if only the clothes they wear. Permitting creditors to reach even the shirt off the debtor's back would constitute an affront to social conceptions of human dignity.

Second, state exemption statutes relieve taxpayers of the obligation to provide basic necessities for insolvent debtors. Even if one concludes that the debtor rather than his creditors should bear responsibility for the debtor's financial difficulties, the creditors nevertheless had more to do with the debtor's predicament than did ordinary taxpayers. By investigating the debtor's financial circumstances and habits before extending credit, the creditors might have prevented the debtor's insolvency. Exemption statutes, then, require creditors to bear some of the cost of relieving debtors from destitution.

Third, exemption statutes have some obvious efficiency advantages. If a debtor is to generate income, the debtor must have at least food, clothing, and shelter. Without an exemption statute, it may not be in the interest of any individual creditor to abstain from pursuing the proverbial shirt off the debtor's back. Although an individual creditor bears the full cost of restraint, the benefit of restraint may be spread among all creditors. Moreover, if one creditor leaves the debtor with enough assets to seek additional income, he has no assurance that other creditors will do the same. Externalities, then, might prevent efficient creditor behavior. Exemption statutes eliminate the inefficiency that would result from depriving the debtor of the capacity to pursue additional income—income that might ultimately be used to repay creditors. Moreover, the dollar value of many items of personal property—clothing, for instance—is quite small. These items are likely to be worth more to the debtor than to anyone else and exempting them from creditor execution assures that they stay with the person who values them most.[101]

The justifications for exemption statutes extend only to insulating the debtor's most basic needs from claims by creditors. The statutes themselves place fairly stringent limits on the debtor's right to resist

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all property necessary for the support of the debtor or his family. Cal. Civ. Proc. Code § 487.020 (West Supp. 1992).

[101] Cf. 11 U.S.C. § 522(f) (1988) (protecting certain items of personal property in the hands of the debtor in bankruptcy).

creditor claims against property. Moreover, the creditor may reach even otherwise exempt property if he has made prior arrangement—through creation of a security interest—to subject the property to his claim.

2. *Right to Future Income*

In addition to property the debtor has in hand or can easily reduce to possession, the debtor may have expectations of future income. These expectations may arise from a number of different sources: the debtor might be the beneficiary of a trust, the purchaser of an annuity, a participant in a retirement plan, or he might expect future income from future work. If the debtor's expectation of future income arises from an annuity or some other contract right, the creditor may, for the most part, reach that contract right to the same extent as traditional property.

By contrast, if the debtor's expectation of future income arises from his earning capacity, the creditor's right to reach that capacity is more limited. By federal statute, no more than twenty-five percent of an individual's disposable earnings are subject to garnishment.[102] Moreover, the federal statute does not preempt more stringent regulation by the states,[103] and many states do impose more severe restrictions on wage garnishments. In Texas, for example, the state constitution prohibits wage garnishment by a commercial creditor altogether.[104]

Unlike the exemptions for traditional property, the limitations on garnishment of wages do not simply protect against destitution. The twenty-five percent limit in the federal statute has no cap: even individuals with extraordinarily high incomes may receive seventy-five percent of disposable income free of creditor garnishment. Of course,

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102 15 U.S.C. § 1673 (1988). "Earnings" include all compensation for personal services and, in addition, "periodic payments pursuant to a pension or retirement program." 15 U.S.C. § 1672 (1988).

103 15 U.S.C. § 1677 (1988) provides, in relevant part: "This subchapter does not annul, alter, or affect, or exempt any person from complying with, the laws of any State (1) prohibiting garnishments or providing for more limited garnishment than are allowed under this subchapter . . . ."

104 Tex. Const. art. 16, § 28 ("No current wages for personal service shall ever be subject to garnishment, except for the enforcement of court-ordered child-support payments."). Unlike the federal statute, many state statutes differentiate between wage garnishment and garnishment of proceeds from retirement plans, but, by virtue of the Supremacy Clause, at least 75% of retirement income is now exempt from garnishment in all states.

once the income reaches the debtor's hands or is converted into traditional property the creditor may seize it, but that may be small solace for the creditor if the debtor spends his money as quickly as he receives it. Moreover, because garnishment limitations make it so difficult for a creditor to reach future income, a debtor whose principal asset is future income has considerable leverage to renegotiate the terms of his liability.

Human capital, then, is insulated from creditor claims to a much greater degree than most traditional forms of property. The disparity in treatment widens as the debtor's assets increase. With traditional property, exemptions generally protect a markedly smaller percentage of a debtor's property as the amount of the debtor's property increases; many wage garnishment statutes, including the federal statute, restrict garnishment to a flat percentage of earnings no matter how much the debtor earns.

Human capital is not the only form of property that receives this privileged treatment. Retirement income, which, like traditional property, is generally the product of past work, is also protected against garnishment.[105] The significance of the similar treatment afforded human capital and retirement income is unclear. In part, retirement income might have been included in garnishment statutes as something of an afterthought;[106] in part, protections of retirement income may reflect particular concern with protecting those with limited ability to generate future income; in part, the exemption may recognize that relatively few retired debtors have retirement incomes so substantial that the exemption will protect them against anything but destitution.

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105 In bankruptcy, too, retirement income is sometimes protected against claims by the bankruptcy trustee. See generally Elynn Lambert, Note, ERISA Plans as Property of Individuals' Bankruptcy Estates, 5 Cardozo L. Rev. 685 (1984) (discussing the conflict between the Bankruptcy Code's desire to reach all assets and ERISA's intent to protect an individual's retirement income).

106 The House Report on the federal statute limiting garnishment makes no mention of retirement income. The report simply provides that the statute "will relieve many consumers from the greatest single pressure, forcing wage earners into bankruptcies," H.R. Rep. No. 1040, 90th Cong., 1st Sess. 7 (1967), *reprinted in* 1968 U.S.C.C.A.N. 1962, 1963, and notes that "[h]undreds of workers among the poor lose their jobs or most of their wages each year as a result of garnishment proceedings. In many cases, wages are garnished by unscrupulous merchants and lenders whose practices trap the unwitting workers." Id. at 9-10, 1968 U.S.C.C.A.N. at 1966.

Whatever the explanation for protecting retirement income from creditors, one important fact remains: the debtor who has invested heavily in human capital, or who has been blessed with significant human capital at relatively little cost, is afforded substantially more protection against creditors than his counterpart who has invested in or been given traditional property.

B. Creditor Claims in Bankruptcy

State and federal antigarnishment statutes afford debtors considerable freedom from their creditors. For some debtors, however, bankruptcy might provide an even more attractive alternative, because bankruptcy permits debtors to escape debts altogether.[107] In exchange for discharge, the debtor must endure whatever "stigma" attaches to bankruptcy and must part with his existing assets for the benefit of creditors. In the bankruptcy process, as in debtor-creditor relationships outside of bankruptcy, traditional property and human capital receive markedly different treatment.

1. Traditional Property

Section 541 of the Bankruptcy Code includes in the bankruptcy estate "all legal or equitable interests of the debtor in property as of the commencement of the case."[108] Section 522 of the Code, however, permits the debtor to exempt some property from the bankruptcy estate.[109] Section 522 gives the debtor two alternatives. The debtor may choose either to exempt that property which is exempt under nonbankruptcy law,[110] or to exempt the property specifically listed in § 522(d).[111] Thus, a debtor would choose the § 522(d) exemptions ouly when they are more generous to the debtor than are state law exemptions.

Most of the exemptions in § 522 provide the debtor with some protection against the loss of a home, transportation, and items necessary

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107 But see Teresa A. Sullivan, Elizabeth Warren & Jay L. Westbrook, As We Forgive Our Debtors 338 (1989) (indicating that despite the economic attractiveness of bankruptcy, relatively few people take advantage of bankruptcy "to deal with relatively minor debts in relation to their incomes").

108 11 U.S.C. § 541(a)(1) (1988).

109 11 U.S.C. § 522(b) (1988).

110 11 U.S.C. § 522(b)(2).

111 11 U.S.C. § 522(b)(1).

to earn a living,[112] or against loss of items worth little to anyone but the debtor.[113] Some of the exemptions, however, appear to exempt more valuable assets. In particular, § 522(d)(10)(E) exempts the debtor's right to receive "a payment under a stock bonus, pension, profitsharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service."[114] The exemption, however, is subject to an important qualification: the payment is exempt only "to the extent reasonably necessary for the support of the debtor and any dependent of the debtor."[115] Thus, a debtor who has, through his past efforts, accumulated a right to substantial retirement income cannot insulate the retirement fund or the attendant income from creditors in bankruptcy because the fund or the substantial income will not be "reasonably necessary" for his support.[116] Similarly, § 522(d)(11)(E) exempts from the bankruptcy estate property traceable to "a payment in compensation of loss of future earnings of the debtor or an individual of whom the debtor is or was a dependent." Again, however, the payment is exempt only "to the extent reasonably necessary for the support of the debtor and any dependent of the debtor."[117] That is, a debtor who has received a large tort award to reflect his loss of probable future earnings may not insulate the award from creditors if the award is not "reasonably necessary" for support.

In bankruptcy, then, if the debtor chooses to take federal rather than state exemptions, the debtor may not protect an earned right to future income if that income would not be reasonably necessary for his support. That is, a debtor who has saved his income to provide for retirement is in little better position in bankruptcy than one who has used income to travel around the world or to buy corporate stock or

112 Thus, 11 U.S.C. § 522(d)(1) protects the debtor's interest, up to $7,500, in a home; § 522(d)(2) protects up to $1,200 in one motor vehicle, and § 522(d)(6) protects up to $750 in books or tools used in the trade of the debtor or one of his dependents.

113 Thus, 11 U.S.C. § 522(d)(3) protects up to $4,000 of apparel, furnishings, and personal property, so long as no single item exceeds $200 in value, and § 522(d)(4) protects up to $500 in jewelry.

114 11 U.S.C. § 522(d)(10)(E).

115 Id. The exemption is also subject to another qualification: if the plan was established by an insider, and if the payments are on account of age or length of service, the payments are not exempt unless the plan is a qualified plan under the Internal Revenue Code. 11 U.S.C. § 522(d)(10)(E)(i)-(iii).

116 See In re Kochell, 732 F.2d 564, 566 (7th Cir. 1984).

117 11 U.S.C. § 522(d)(11)(E).

real estate. The proceeds of income already earned are subject to creditor claims, except to the extent reasonably necessary to provide for the debtor's basic needs.

2. *Human Capital*

Federal treatment of unrealized human capital in bankruptcy differs markedly from its treatment of traditional property. The "fresh start" policy has been a cornerstone of American bankruptcy law since enactment of the Bankruptcy Act of 1898.[118] If a debtor relinquishes his claims to traditional property, the bankruptcy discharge permits him to earn future income free of creditor claims. Because the debtor's human capital is, by definition, his capacity to earn future income, the bankruptcy discharge effectively insulates human capital from creditor claims.

If human capital—future earning capacity—did not differ significantly from person to person, the fresh start policy would put all bankrupts in an equal position, free of debt and with the same opportunity to accumulate wealth in the future. But people do have significantly different endowments of human capital. The "fresh start" policy gives debtors with substantial human capital a "head start" over debtors whose assets consist primarily of traditional forms of property. That is, a bankrupt with substantial debts and significant human capital may escape his debt while keeping his capital intact; a bankrupt whose principal assets are in traditional property must give up his assets in order to shed his debt. The result is that the bankrupt with significant human capital is in a far better position to regenerate future income and future wealth than is the bankrupt with traditional property.

In recent years, however, bankruptcy law has withdrawn some of the extraordinary protection afforded holders of human capital. Two statutory changes best reflect this shift in the treatment afforded human capital. First, § 523(a)(8) excepts from discharge many student loans. Second, § 707(b), enacted in 1984 as part of a package of consumer credit amendments, permits a court to dismiss a bankruptcy petition if the debts involved are primarily consumer debts and

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[118] For a capsule discussion of the absence of discharge provisions in federal bankruptcy law before 1898, see United States v. Kras, 409 U.S. 434, 446-47 (1973).

if the court concludes "that the granting of relief would be a substantial abuse of the provisions of this chapter."[119]

The student loan provision excepts from discharge any "educational . . . loan made, insured or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution."[120] The student loan exception was enacted, in part, in response to public outcry over perceived abuses by former students seeking to avoid loan repayment.[121] Recent graduates, having little traditional property that they would lose in bankruptcy, could and did shed student loans "cost-free" by declaring bankruptcy. Why did student loan discharges arouse such public ire? In part, hostility might have been exacerbated because public money was involved. In part, those seeking discharge were among the privileged members of society—college graduates with bright future prospects. But what made students seeking discharge particularly unsympathetic was that the loans they sought to avoid permitted them to acquire the very human capital that would be exempt from the bankruptcy estate. If the student borrower seeking discharge were required to surrender human capital, not just traditional property, discharge of student loans would not have captured the same public attention. Indeed, many loan programs, by their very terms, discharged all or part of student loans if the borrower performed specified public service work after graduation. Hence, if the borrower voluntarily committed human capital in return for forgiveness of indebtedness, the trade was not perceived as unfair. The new statute does not permit a recent graduate to disavow her obligations to repay student loans while retaining the human capital "purchased" with the borrowed money.

Section 707(b) of the Bankruptcy Code also limits the right of debtors to maintain human capital while avoiding creditor claims. The

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119 11 U.S.C. § 707(b) (1988).

120 11 U.S.C. § 523(a)(8) (1988 & Supp. III 1992). The student loan exception is itself subject to two exceptions: student loans are dischargeable if the loan became due at least seven years before the petition in bankruptcy was filed, or if excepting the debt from discharge would impose "undue hardship" on the debtor and his dependents. Id.

121 Indeed, outrage over student defaults occasionally spawned creative judicial doctrines designed to prevent discharge of student loans. See, e.g., State v. Wilkes, 363 N.E.2d 555 (N.Y. 1977) (refusing to discharge student loan because the loan agreement had permitted student to substitute teaching obligation for loan repayment, making the value of the obligation too contingent to permit discharge).

statute permits a bankruptcy court to dismiss a case filed by an individual debtor if the "debts are primarily consumer debts" and if, in the court's view, "granting of relief would be a substantial abuse of the provisions of this chapter."[122]

Empirical work suggests that few bankruptcies involve debtors with the capacity to repay their debt from future income.[123] Nevertheless, for a few debtors who are poor in material goods but rich in future prospects, bankruptcy discharge would permit debt avoidance at minimal cost. Indeed, it was the prospect of discharging debtors with bright future prospects that led Congress, in 1981, to consider a bankruptcy reform bill that would have explicitly denied discharge to debtors who could pay "a reasonable portion of [their] debts out of anticipated future income."[124] That bill was never enacted, but the more ambiguous "substantial abuse" language of § 707(b), enacted in 1984,[125] has nevertheless afforded courts a basis for denying discharge to debtors with substantial prospects for future income.

Most courts, for instance, have held that discharge would constitute "substantial abuse" of Chapter 7 if the debtor's future income could be sufficient to finance a Chapter 13[126] plan that would repay all

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[122] 11 U.S.C. § 707(b). The statute permits the court to act "on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest." Id.

[123] See Sullivan et al., supra note 107, at 205-13. From their examination of bankruptcy records, Sullivan, Warren, and Westbrook conclnde that "[t]he overwhelming majority of Chapter 7 debtors—90% by any measure—could not pay their debts in Chapter 13 and maintain even the barest standard of living." Id. at 212.

[124] H.R. 4786, 97th Cong., 1st Sess. (1981); S. 2000, 97th Cong., 1st Sess. (1981).

[125] Bankruptcy Amendments and Federal Judgeship Act of 1987, P.L. No. 98-353, 98 Stat. 333 (1984). No committee reports accompanied the final version of the Act, but the Congressional Record suggests that substitution of the "substantial abuse" language for the more explicit future income test was the result of negotiations between proponents and opponents of the future income test. See 129 Cong. Rec. S5358 (daily ed. April 27, 1983) (remarks of Senator Dole).

[126] Sullivan, Warren, and Westbrook provide a concise summary of the difference between a Chapter 7 plan and a Chapter 13 plan:

> In Chapter 7, the debtors give up all the assets not legally sheltered from creditor seizure. In exchange, they receive a discharge . . . .
>
> Chapter 13 . . . offers the debtors virtually the opposite deal. In Chapter 13 the law permits them to keep all property, exempt and nonexempt, in exchange for their promise to pay all or some specified part of their debts under a three- to five-year payment plan approved by the court.

Sullivan et al., supra note 107, at 25.

debt, generally within a three-year period.[127] Other courts have gone further, dismissing discharge petitions because debtor's future income would permit at least partial repayment.[128]

A few courts, however, have concluded that granting discharge to a debtor who retains the ability to repay debt out of future income does not constitute substantial abuse of the bankruptcy statute's discharge provisions.[129] Moreover, even the three-year rule hardly puts human capital on the same footing as traditional property. A debtor's human capital may produce returns for his entire life, while § 707(b), if interpreted to incorporate a three-year repayment rule, will generally require the debtor to devote only a small percentage of her total expected return on human capital to repayment of debt. Thus, although § 707(b) does make the bankruptcy discharge less available to debtors with substantial human capital, the statute is only one small step away from the "fresh start" policy.

Some bankruptcy commentators have argued that bankruptcy law should require more explicit consideration of future earning capacity—human capital—in deciding whether discharge is appropriate. Professor Eisenberg, writing before the current version of § 707(b) was enacted, noted:

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[127] See In re Walton, 866 F.2d 981 (8th Cir. 1989)(100% of debt repayable in five-year Chapter 13 plan); In re Kelly, 841 F.2d 908, 914 (9th Cir. 1988) ("[T]he debtor's ability to pay his debts when due, as determined by his ability to fund a Chapter 13 plan, is the primary factor to be considered in determining whether granting relief would be a substantial abuse."); In re Strong, 84 B.R. 541 (Bankr. N.D. Ind. 1988); In re Struggs, 71 B.R. 96 (Bankr. E.D. Mich. 1987).

[128] See In re Vesnesky, 115 B.R. 843 (Bankr. W.D. Pa. 1990) (75% of debt repayable in Chapter 13 plan); In re Roth, 108 B.R. 78 (Bankr. W.D. Pa. 1989) (43% payable over three-year period); In re Webb, 75 B.R. 264 (Bankr. W.D. Mo. 1986) (half of debt would be repayable in five-year period); cf. In re Krohn, 886 F.2d 123 (6th Cir. 1989) (denying discharge for substantial abuse because debtor had capacity to repay debts out of future income, even though Chapter 13 plan was unavailable because of excessive debt).

One court, while refusing to dismiss a Chapter 7 petition, nevertheless noted the anomaly of a rule that would require repayment if it could be accomplished in three years, but not in a longer period: "If the debtors had incurred debts within the Chapter 13 limits, they would be forced to pay some of their debts. But because they were greater spendthrifts, they will be discharged. This demonstrates a new axiom that pigs are put on a diet but hogs are set free." In re Wegner, 91 B.R. 854, 859 n.12 (Bankr. D. Minn. 1988).

[129] See In re Keniston, 85 B.R. 202 (Bankr. D. N.H. 1988) (concluding that discharge would not constitute substantial abuse, despite debtor's ability to repay out of future income); In re Deaton, 65 B.R. 663, 664 (Bankr. S.D. Ohio 1986) (refusing to dismiss petition for discharge even though debtors "could both comfortably support a Chapter 13 payout plan").

> We live to a great extent in a cash flow world. . . . in deciding what a debtor should pay his creditors in bankruptcy, revenue flow becomes irrelevant. The rights of unsecured creditors, who may lend at least in part on an expected flow basis, and the debtor who borrows on the same basis, suddenly are determined solely by the value placed on the debtor's nonexempt assets on the date of bankruptcy. Some judgment as to what the debtor can afford to pay on a monthly basis over the next few years more accurately reflects economic reality.[130]

That view does not enjoy universal approval, however. Most commentators continue to invoke the "fresh start" policy as a reason for insulating future earning capacity from creditor claims.[131] The appropriate scope of the fresh start policy has become more controversial in recent years, but movement toward subjecting human capital to creditor claims has, to date, been limited to a few specific provisions and the ambiguous "substantial abuse" provision in § 707(b). The Bankruptcy Code, like other state and federal statutes on debt collection, continues to afford holders of human capital substantially greater protection than holders of traditional property.

C. *Justifications for Insulating Human Capital from Creditor Claims*

Why should antigarnishment statutes and the Bankruptcy Act shelter a debtor's human capital from creditor claims? This Section examines four justifications for limiting creditor remedies: (1) if creditors could reach all of the debtor's future income, innocent third parties—the public at large—would bear the costs of the debtor's destitution; (2) unless protected from creditor claims against future income, debtors would substitute leisure for productive work; (3) individuals are naturally impulsive and should be protected against their own impulsiveness; and (4) unless human capital receives protection against creditor claims, debtors will be subjected to a form of involuntary servitude.

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130 Theodore Eisenberg, Bankruptcy Law in Perspective, 28 UCLA L. Rev. 953, 980-81 (1981).

131 See Karen Gross, Preserving a Fresh Start for the Individual Debtor: The Case for Narrow Construction of the Consumer Credit Amendments, 135 U. Pa. L. Rev. 59 (1986); Stephen L. Harris, A Reply to Professor Eisenberg's Bankruptcy Law in Perspective, 30 UCLA L. Rev. 327 (1982) (opposing a discharge proposal that would not insulate future earnings from creditors).

1. *Externalities: Protecting Taxpayers*

In our society, the state is committed to providing at least a minimal "safety net" for persons unable to support themselves. A former employee who has signed an enforceable covenant not to compete in the only trade he knows, or a debtor whose human capital is subject to unlimited creditor claims, may have created for himself financial problems that lead to demands for support. So long as the society believes that debtors are entitled to as much protection against destitution as other poor people, one might ask whether that support should come from taxpayers generally or from those persons whose behavior creates the risk of debtor destitution—participants in the credit market.

To require taxpayers to bear the primary burden of supporting destitute debtors wonld be to permit debtors and creditors, by private contract, to impose external costs on taxpayers.[132] That is, if, before contracting, debtor and creditor were both capable of supporting themselves, a contract that increases the risk that one will become destitute does more than shift risks among the contracting parties; it imposes a risk on a third party—the state. Limiting creditor access to the debtor's human capital requires the contracting parties to internalize the costs associated with debtor destitution, rather than imposing those costs on taxpayers who had no opportunity to veto the bargain.[133]

Restraints on alienation of human capital undoubtedly do operate to keep some debtors off the welfare rolls.[134] Percentage garnishment

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[132] See Sullivan et al., supra note 107, at 334 (noting that without discharge "[t]axpayers would be forced to assume the burden of supporting . . . [debtor's] families while the family income satisfied old debts and their attendant high rates of interest. In effect, tax dollars would be subsidizing creditors, many of whom were equally culpable players in the credit game."); id. at 335 ("The system places the losses on the debtors and creditors who accepted the benefits and took the risks of credit transactions."); see also Thomas H. Jackson, The Logic and Limits of Bankruptcy Law 231 (1986) ("If there were no right of discharge, an individual who lost his assets to creditors might rely instead on social welfare programs.").

[133] Douglas Baird and Thomas Jackson have also suggested that debtors may not take adequate account of the external effect their borrowing decisions might ultimately have on spouses, dependents, and other family members. Jackson, supra note 132, at 243-44; Douglas G. Baird, A World Without Bankruptcy, 50 Law & Contemp. Probs. 173, 176 (1987).

[134] Even without limits on wage garnishment and without bankruptcy discharge, creditors might find it worthwhile to bargain with debtors to work, rather than taking "safety net" payments, in return for a promise that the debtor will be able to keep a substantial share of the income she earns. For debtors with low income potential, however, the transaction costs of

limitations benefit high-income debtors much more substantially than low-income debtors, however. If one were concerned with limiting public liability, one would expect to see a flat exemption from creditor claims rather than a percentage limit.[135] Thus, because restraints on alienation of human capital disproportionately benefit debtors with substantial income earning capacity, protection of taxpayers against the responsibility to support destitute debtors furnishes little basis for existing limits on creditor remedies.[136]

2. *Preventing Substitution of Leisure for Work*

A creditor with a monetary claim against a debtor well-endowed with human capital has the capacity, by seeking to enforce that claim, to make earned income less valuable to the debtor. The creditor cannot, however, assert a claim against the debtor's leisure. The debtor, therefore, has an incentive to substitute leisure for work. In the extreme case, if a creditor were permitted to reach all of a debtor's income, the debtor would have no incentive to earn income. Unless the debtor valued work for its own sake, the debtor might just as well devote all of his time to leisure.

For the debtor to devote all of his time to leisure would, of course, be a disaster for the creditor. The creditor, therefore, would be unlikely to demand one hundred percent of the debtor's earned income; she would, instead, calculate her demand to maximize the debtor's repayment of his debt. Indeed, one might expect creditors and debtors to bargain to a point that would maximize their joint

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completing such bargains—especially if the debtor has more than one creditor—might exceed any gains the creditor could reap. That is, if the difference between debtors' earned income potential and "safety net" opportunities is smaller than the cost of bargaining, debtors and creditors would not find it in their mutual interest to strike a deal. On the other hand, to the extent that the social safety net is inadequate from the debtors' perspective, debtors and creditors will generally find it worthwhile to bargain rather than leaving debtors destitute and creditors with no return on their investment. See David G. Carlson, Philosophy in Bankruptcy, 85 Mich. L. Rev. 1341, 1374-75 (1987) (arguing that the "safety net" is more supposed than real and will not induce debtors to forgo work in the absence of discharge).

[135] See Jackson, supra note 132, at 232.

[136] Equally weak is the argument that restraints on alienation of human capital provide a better safety net to debtors—a safety net that we would extend to all poor people but for the public cost involved. For even if we conclude that debtors as a class should be better off than other poor people, why should this proteetion of debtors extend ouly to human capital, and not to other, more traditional forms of property? We could equally well provide additional proteetion to debtors by safeguarding tangible property from creditor claims as by safeguarding human capital.

welfare. Transaction costs, however, may prevent such bargains, especially when the debtor has not one creditor but many.[137] One justification for wage garnishment statutes, then, is that the statutes limit creditors to the percentage of wages that, in a world free of transaction costs, they would have received as the result of private bargaining.

The possibility that a debtor might substitute leisure for work also serves as a justification for the bankruptcy discharge. The bankruptcy discharge, by promising a defaulting debtor a debt-free future, induces him to make the socially optimal trade-off between work and leisure.[138] This efficiency justification for the bankruptcy discharge and wage garnishment limitations, however, is weakened by three factors. First, rather than substituting leisure for work, debtors subject to garnishment might simply work harder to repay debts more quickly. Second, debtors whose income is reduced by garnishment may value leisure relatively less than they did previously. Third, and perhaps most important, even if limitations on alienation of human capital do encourage debtors to work more productively, the limitations may operate to reduce the availability and increase the cost of credit for all potential borrowers.

If a debtor's debt were so large that he would never be able to repay it out of future income, the debtor might, if subject to extensive garnishment, substitute leisure for work even if he attached great value to his future prosperity. No amount of current work would preclude future garnishment, so why sacrifice current satisfaction for the hope of a debt-free future? In this context, the bankruptcy discharge induces the debtor to make the socially optimal trade-off between work and leisure by promising him a debt-free future.[139] Similarly, limitations on wage garnishment provide debtors with some incentive to continue working.

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137 Thus, the senior creditor would have no reason to abstain from garnishing all future wages if junior creditors would garnish wages the senior creditor sought to leave in the hands of the debtor to provide the debtor with an incentive to work. Unless all creditors were to bargain with each other, each creditor might have an incentive to seek all of the debtor's wages.

138 See generally Jackson, supra note 132, at 245 (arguing that burdening future income with debt repayment imposes a variety of negative externalities).

139 See id.

On the other hand, a debtor with some prospect of repaying his debts might continue working at peak capacity even if subjected to extensive wage garnishment. If the debtor is concerned for his future, income earned now can be used to repay his debt more quickly, freeing his future from garnishment. Such a debtor would not substitute leisure for work even if creditors had an unlimited right to reach his income.[140] This analysis is entirely consistent with recent interpretations of § 707(b) of the Bankruptcy Code: courts have generally barred consumer debtors from discharge if earned income would permit repayment of debt within three years.[141] Thus, where the prospect of repayment is real, courts appear unconcerned that debtors will substitute leisure for work.

Consider now the wealth effects of wage garnishment. The value a debtor attaches to leisure is likely to be a function of his income. Suppose for instance that a debtor, unencumbered by debt, would be indifferent between a demanding job that would pay $50,000 and a less demanding job that would pay $32,000. If the income the debtor would realize from each job were reduced by wage garnishment, it is by no means clear that the debtor would now choose the less demanding job at a salary of $24,000 over the more demanding job at a salary of $40,000. Given his new situation, the debtor is considerably poorer, and one would expect him to be willing to pay less for additional leisure than he would have before his wages were garnished.

Indeed, if the loss in income were large enough, the debtor might well choose to give up existing leisure in favor of a still more demanding job that produced more income. For instance, if creditors were authorized to garnish fifty percent of the debtor's wages of $50,000 per year and the debtor could not feed and clothe his family adequately for $25,000, wage garnishment would be likely to lead the debtor to sell some of his existing leisure for more salary. The effect of garnishment on the debtor's productive activities, then, is indeterminate: garnishment might cause him to substitute leisure for work, to substitute work for leisure, or to make no adjustments to his pre-garnishment activities.

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140 Indeed, as David Carlson has suggested, workers in debt might substitute work for leisure to speed up the date at which they become free from debt. See Carlson, supra note 134, at 1371.

141 See supra notes 127-28 and accompanying text.

Finally, consider the effect restraints on alienation have on the process of debt creation. Why not assume that if debtors were free to alienate their human capital, potential debtors and creditors would account for any work/leisure trade-off before consummating credit transactions?[142] Put another way, why depart from the premise, common in property law, that restraints on alienation are inefficient because they prevent exchange of assets to persons who value those assets most?[143]

The easy answer is that because we do not live in a world of perfect foresight and costless information, the private market would not eliminate inefficient substitution of leisure for work.[144] Lenders have little basis for assessing the risk that any particular borrower will substitute leisure for work after borrowing money, so, in a free market regime, all borrowers would have to pay a risk premium to reflect probable lender losses due to substitution of leisure for work. But a regime marked by limited garnishment and bankruptcy discharge merely replaces one risk with another: borrowers whose principal asset is future income can default on loans with virtual impunity.[145] If lenders cannot quantify this risk, they may charge a risk premium rate even higher than the one that would prevail in a free market regime—a premium that would effectively drive even more borrowers out of the market.[146] Which risk creates more inefficiency is impossible to

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142 Cf. David G. Carlson, Is Fraudulent Conveyance Law Efficient?, 9 Cardozo L. Rev. 643, 659-64 (1987) (emphasizing importance of analyzing debt-creation process in evaluating efficiency of fraudulent conveyance law).

143 See, e.g., Lewis M. Simes, Public Policy and the Dead Hand 34-35 (1955) (noting the common assumption that free alienation of land promotes productivity).

144 If someone did have perfect foresight, it would be possible to know which potential contract partners would default and which of those would substitute leisure for work if future income were subjected to creditor claims. If information were costless, all creditors would have access to that perfect foresight and would be able to make contract decisions that avoided inefficient substitutions of leisure for work. Moreover, even if foresight were not quite perfect—even if creditors were unable to predict default—creditors might still be able to avoid inefficient substitution of leisure for work by bargaining with debtors who might contemplate making such substitutions. The problem, however, is that such negotiations would not be costless—especially if the creditor did not know which debtors would be prone to substitution.

145 There may, however, be consequences if the borrower wants to borrow in the future or if the borrower wants to accumulate tangible, and therefore attachable, property in the future.

146 Intuition suggests, however, that some limits on the creditor's right to reach human capital may be more efficient than others. Consider, for instance, the bankruptcy discharge. To require a debtor with no hope of repayment to subject all future income to creditor claims would be quite likely to cause the debtor to substitute leisure for work. The likelihood might be so great that we would permit discharge even at the cost of moral hazard problems that

tell in the absence of empirical evidence. Hence, efficiency arguments based on the substitution of leisure for work rest on shaky ground.

3. *Correcting for Debtor Impulsiveness*

Thomas Jackson has argued that the bankruptcy discharge protects debtors from their own impulsive decisions by reducing their opportunity to overextend themselves.[147] Jackson argues that individuals often possess an "impulse personality" that "approaches life like an addict, unable to consider or plan for the future."[148] Although debtors may not be able to control their addictive behavior, legal rules that encourage lenders to monitor borrowing would make it more difficult for debtors to indulge any impulsive urges.[149] The bankruptcy discharge creates an incentive for lender monitoring by forcing creditors to bear more of the risk associated with debtor default.[150]

If the bankruptcy discharge is designed to encourage creditor monitoring, it does not seem to work: the risk of loss in bankruptcy is too small to induce lenders to monitor impulsive borrowing by debtors.[151] Because most consumer debtors who file for bankruptcy would be unable to repay their creditors in full or on time even if discharge

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would result from debtors who take risks knowing that their creditors will share some of the risks. Especially if the debtor stands to lose substantial tangible property, the moral hazard problem may not be great. But suppose the debtor has no tangible personal property, and suppose also that the debtor has substantial human capital. We might then believe that the moral hazard that results from permitting the debtor to declare bankruptcy is a greater cause for concern than the debtor's possible substitution of leisure for work. For example, if student loans were freely dischargeable, we might believe that a student would have nothing to lose by defaulting. Permitting free discharge would then reduce the willingness of lenders to lend to students, creating inefficiencies. In addition, if the debt is small compared to the value of the debtor's human capital, we might believe that the debtor is unlikely to substitute leisure for work even if the debt is not dischargeable. On this theory, we might restrict discharge of student loans, and indeed of all debts where the debtor has the ability to repay within a brief, defined, time period.

147 Jackson, supra note 132, at 232-43.

148 Id. at 235.

149 Id. at 236.

150 Id. Jackson rejects the notion that an impulse-control justification for the bankruptcy discharge is inherently paternalistic, arguing instead that individuals in a Rawlsian "original position" would choose a discharge rule to avoid their own impulsive behavior and "incomplete heuristics." Id. at 241. For a critique of Jackson's contractarian argument, see Carlson, supra note 134, at 1361-70.

151 See Sullivan et al., supra note 107, at 320-21 (finding from extrapolation that bankruptcy losses represent about .05% of consumer debt and that some finance companies lend "literally to the last available dollar of debtor income").

were not available,[152] discharge may impose few additional costs on lenders. Facts aside, it is hard to imagine why a legal system would choose the remote possibility of future bankruptcy as the best mechanism for encouraging creditors to monitor debtor borrowing. As Jackson himself points out in his discussion of what he calls "incomplete heuristics," decisionmakers appear systematically to process information in ways that underestimate future risks.[153] If, as Jackson suggests, even nonimpulsive individuals suffer from this problem,[154] one would expect lenders to discount the possibility that their borrowers will, at some time in the future, end up in bankruptcy. Hence, an effective system of encouraging creditor monitoring would have to impose more immediate consequences on creditors.

The legal system could, of course, impose a regulatory scheme that prohibited creditors from extending additional credit to debtors whose debt/income ratios have exceeded some threshold.[155] More traditional private law approaches could produce similar results. For instance, usury statutes, currently in disfavor, provide self-enforcing restrictions on lenders who might otherwise lend to overextended debtors. Usury statutes would limit the availability of credit to debtors who are bad risks, but, on Jackson's analysis, that would be a distinct *advantage* of usury rules. My point here is not to endorse usury statutes or any other restrictions on consumer lending, but simply to note that if creditor monitoring of debtor borrowing is a policy objective, the bankruptcy discharge is a poorly-designed mechanism for achieving that objective.

Finally, let us assume Jackson is correct when he argues that limiting a creditor's future right to collect debts would constrain lending to overextended "impulsive" creditors. Why limit the creditor's right to enforce those debts against human capital instead of limiting the creditor's rights to enforce against the debtor's tangible property? Jackson recognizes that the bankruptcy discharge operates primarily to protect human capital rather than more traditional property rights.[156]

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152 See id. at 212 ("The overwhelming majority of Chapter 7 debtors—90% by any measure—could not pay their debts in Chapter 13 and maintain even the barest standard of living.").

153 Jackson, supra note 132, at 237.

154 Id.

155 See Sullivan et al., supra note 107, at 324 (indicating that some countries have regulated credit in different ways).

156 Jackson, supra note 132, at 226-28.

The legal system could provide an incentive for creditor-monitoring, however, by exempting the debtor's tangible property whilc leaving human capital subject to creditor claims.[157] Jackson makes no attempt to explain why existing rules regarding human capital are more effective as a means for controlling impulsive behavior by debtors.[158]

Ultimately, then, impulse control serves as an implausible justification for the bankruptcy discharge. Protection of human capital might well reflect a social judgment that debtors should be relieved of the worst consequences of their impulsive decisions, but that is a far cry from arguing that this protection will deter impulsive borrowing by encouraging lender monitoring of debtors. To the extent that discharge does reflect a judgment that individuals should not be bound irrevocably by their past impulsive borrowing decisions, why exempt human capital, but not other property, from the creditor claims? The next Section discusses one explanation for the difference in treatment: to bind an individual to repay past debts out of future income makes him a "slave" to his past impulsive decisions.

4. *Protecting Debtors Against Involuntary Servitude*

Recent bankruptcy scholarship—especially scholarship reacting to Congressional efforts to curtail the availability of discharge in cases of "substantial abuse"[159]—has argued that bankruptcy's fresh start policy is necessary to protect against involuntary servitude. Karen Gross has been most explicit in labelling a debtor without recourse to dis-

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[157] Cf. Baird, supra note 133, at 177 ("[T]here are many different ways in which someone can be protected from his creditors. Instead of insulating future income, one can insulate present assets or some combination of the two.").

[158] Indeed, some of Jackson's alternative justifications for the bankruptcy discharge suggest that insulating human capital from creditor claims would be particularly ineffective as a mechanism for inducing creditor monitoring. Thus, Jackson notes that debtors have it within their power to substitute leisure for work. Jackson, supra note 132, at 257. That power reduces the value to the creditor of a right against the debtor's human capital. On this analysis, a creditor threatened with loss of this right through a discharge in bankruptcy would not materially alter his behavior because the right was of limited value to him anyway. If the potential for discharge would not materially affect creditor behavior, then debtors would be equally impulsive whether or not debts were dischargeable in bankruptcy—thus undercutting Jackson's argument.

[159] 11 U.S.C. § 707(b) (1988).

charge as a "modern day peon,"[160] but others have expressed similar views.[161]

Because debtors on the brink of bankruptcy get there as a result—at least in part—of their own actions, some proponents of the servitude justification for the fresh start policy have sought to justify protection against servitude that is, in some sense, voluntary.[162] Anthony Kronman has made the most extensive effort, placing bankruptcy in the context of other paternalistic contract law rules that protect promisors against regret caused by changes in personal goals. Kronman notes, for instance, that if "a person's goals have changed significantly, his earlier decision may now appear irrational, for his original aims no longer provide the framework for his deliberations."[163] Kronman argues that doctrines like the bankruptcy discharge enable the debtor to free himself from past decisions that he currently regrets.[164]

This anti-enslavement justification for the fresh start policy shares many elements with the antiservitude rationale courts have used to permit employees to escape from restrictive covenants in employment contracts.[165] Both the bankruptcy discharge and judicial hostility to restrictive covenants increase individual freedom to use one's own human capital. At the same time, however, both restrict freedom to contract about future contingencies. Before considering in more detail the merits of these justifications, let us consider yet another area in which courts have been reluctant to sanction transfer of human capital: family law.

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160 Karen Gross, The Debtor as Modern Day Peon: A Problem of Unconstitutional Conditions, 65 Notre Dame L. Rev. 165 (1990); see also Gross, supra note 131, at 69-70 (noting that expansive interpretation of the Consumer Credit Amendments could give rise to peonage concerns).

161 See, e.g., Vern Countryman, Bankruptcy and the Individual Debtor—And a Modest Proposal to Return to the Seventeenth Century, 32 Cath. U. L. Rev. 809, 827 (1983).

162 For Professor Gross, how the debtor reached the brink of bankruptcy is unimportant; she notes that as a historical matter, peons often entered into the peonage relationship voluntarily. Gross, supra note 160, at 178.

163 Anthony T. Kronman, Paternalism and the Law of Contracts, 92 Yale L.J. 763, 781 (1983).

164 Id. at 785-86. For a critique of Krouman, see Rochelle Spergel, Note, Paternalism and Contract: A Critique of Anthony Krouman, 10 Cardozo L. Rev. 593 (1988).

165 See supra text accompanying notes 95-99.

III. FAMILY LAW

Upon divorce, disputes frequently erupt over distribution of assets accumulated during marriage. In recent years, equitable distribution statutes, adopting the approach long followed in community property states, have reduced the importance of nominal title in resolving those disputes.[166] Equitable distribution (and, for that matter, community property) embodies two basic property rules. First, the identity of the spouse who holds nominal title to property is not determinative of ownership upon divorce. Distribution is made as if each spouse had an interest in all marital property.[167] Second, and this is in some sense a corollary of the first rule, under equitable distribution, the spouse without nominal title is not limited to restitutionary relief but is instead entitled to a share of marital property. "Equitable" distribution is almost invariably expressed as a percentage of marital assets, not in terms of the dollar contributions of each spouse. That is, each spouse shares in the appreciated (or depreciated) value of marital property.

These property rules disintegrate, however, when the marriage has produced an increase in human capital rather than more traditional forms of property. Most courts have declined to recognize human capital as property subject to equitable distribution. Parties have argued in recent years that increased earning capacity, particularly as that capacity is manifested in a more tangible form, should be treated as marital property subject to equitable distribution. In particular, litigation has focused on treatment of professional degrees and licenses, and on goodwill associated with professional practices. As this Section demonstrates, courts have almost universally rejected those arguments.[168]

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166 For a survey of equitable distribution statutes, see Deborah A. Batts, Remedy Refocus: In Search of Equity in "Enhanced Spouse/Other Spouse" Divorces, 63 N.Y.U. L. Rev. 751, 755 & n.17, 756-75 (1988).

167 Id. at 756.

168 See, e.g., Stern v. Stern, 331 A.2d 257, 260 (N.J. 1975) (recognizing that "a person's earning capacity, even where its development has been aided and enhanced by the other spouse, as is here the case, should not be recognized as a separate, particular item of property").

A. *Professional Degrees and Licenses*

Most states have concluded that professional degrees or licenses should not be treated as "property" for equitable distribution purposes.[169] Indeed, at least one court has opined that treating a professional degree as property would constitute a violation of the federal Constitution's Thirteenth Amendment.[170] More often, courts refusing to recognize degrees and licenses as property have focused on the absence of a market for the degree, the difficulties in determining the degree's value, or the "personal" nature of the degree.[171]

States that have declined to recognize professional degrees or licenses as property have nevertheless recognized the equitable claim of a spouse who has contributed to education or training that produced the degree. Thus, if the spouses have accumulated traditional property during the marriage, a spouse who contributed to the other spouse's professional degree or license is generally entitled to a share of that traditional property that reflects contributions to education.[172]

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[169] See, e.g., Nelson v. Nelson, 736 P.2d 1145 (Alaska 1987); Marriage of Graham, 574 P.2d 75 (Colo. 1978); Inman v. Inman, 648 S.W.2d 847 (Ky. 1982); Archer v. Archer, 493 A.2d 1074 (Md. 1985); Drapek v. Drapek, 503 N.E.2d 946 (Mass. 1987); Hubbard v. Hubbard, 603 P.2d 747 (Okla. 1979); Petersen v. Petersen, 737 P.2d 237 (Utah App. 1987).

[170] According to the court,

> The wife's claim to a vested interest in the husband's education and professional productivity, past and future, is unsupported by any statutory or case law. Indeed, such an award by the trial court would transmute the bonds of marriage into the bonds of involuntary servitude contrary to Amendment XIII of the United States Constitution.

Severs v. Severs, 426 So. 2d 992, 994 (Fla. Dist. Ct. App. 1983).

[171] For a case advancing all three reasons for declining to treat a degree as property, see Mahoney v. Mahoney, 453 A.2d 527, 531 (N.J. 1982) ("A professional license or degree is a personal achievement of the holder. It cannot readily be sold and its value cannot readily be determined. A professional license or degree represents the opportunity to obtain an amount of money only upon the occurrence of highly uncertain future events.").

[172] See id. at 535-36:

> [W]here the parties to a divorce have accumulated substantial assets during a lengthy marriage, courts should compensate for any unfairness to one party who sacrificed for the other's education, not by reimbursement alimony but by an equitable distribution of the assets to reflect the parties' different circumstances and earning capacities.

See also In re Marriage of McVey, 641 P.2d 300 (Colo. Ct. App. 1981) (stating that a court can consider contribution to education in dividing property equitably, and that equitable division does not mean equal division). But see Pyeatte v. Pyeatte, 661 P.2d 196 (Ariz. Ct. App. 1982):

> When the parties have been married for a number of years, the courts cannot and will not strike a balance regarding the contributions of each to the marriage and then translate that into a monetary award. To do so would diminish the individual personalities of the husband and wife to economic entities and reduce the institution of marriage to that of a closely held corporation.

If the spouses divorce before accumulating traditional property, courts sometimes tailor awards of alimony or maintenance to reflect contributions made to a spouse's education.[173]

Some of these states explicitly hold that a contributing spouse is entitled to share in the value of the other spouse's degree—generally through awards of alimony or maintenance.[174] More frequently, however, courts acknowledge the equitable claim of a contributing spouse to the degrees or licenses of the other, but limit the spouse's interest to restitution for contributions made to the education of the other. Thus, in California, a community property state, a statute requires a spouse to reimburse the community for "community contributions to education or training of a party that substantially enhances the earning capacity of the party."[175] The statute provides the exclusive remedy for the contributing spouse. Other states limit the contributing spouse to restitution for contributions made even without benefit of a statute.[176]

Limiting the contributing spouse's interest to restitution for contributions made advantages the spouse who has received an education that considerably expands earning capacity. If the investment in edu-

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Id. at 207. Note, however, that in the *Pyeatte* case itself, the marriage was not of long duration, and the court did hold that a contributing spouse was entitled to compensation for her contributions.

173 See Wisner v. Wisner, 631 P.2d 115, 122 (Ariz. Ct. App. 1981) (concluding that "while an *education* itself is not property subject to division, it is still a factor to be considered, in addition to others, in arriving at an equitable property division and in determining matters of spousal maintenance and child support"); Lynn v. Lynn, 453 A.2d 539, 542 (N.J. 1982) (rejecting treatment of degree as property, but concluding that "equity will better be served by an award of alimony that takes into account the parties' vastly different circumstances"); *Mahoney*, 453 A.2d at 536 (degree holder's earning capacity may be considered in setting alimony).

174 See, e.g., Inman v. Inman, 648 S.W.2d 847, 852 (Ky. 1982) (contributing spouse entitled to reimbursement for costs plus amount reflecting potential for increase in future earning capacity of educated spouse); Stevens v. Stevens, 492 N.E.2d 131, 135 (Ohio 1986) (future value of degree a consideration in setting alimony); Martinez v. Martinez, 754 P.2d 69, 78 (Utah App. 1988) (contributing spouse entitled to "equitable restitution"—not limited to reimbursement for contributions—in addition to traditional alimony), rev'd, 818 P.2d 538 (Utah 1991).

175 Cal. Civ. Code § 4800.3(b)(1) (West Supp. 1992); see In re Marriage of Sullivan, 691 P.2d 1020, 1023 (Cal. 1984) (applying § 4800.3).

176 See, e.g., Nelson v. Nelson, 736 P.2d 1145 (Alaska 1987); Pyeatte v. Pyeatte, 661 P.2d 196 (Ariz. Ct. App. 1982); In re Marriage of Olar, 747 P.2d 676 (Colo. 1987); Archer v. Archer, 493 A.2d 1074 (Md. 1985); Drapek v. Drapek, 503 N.E.2d 946 (Mass. 1987); Hubbard v. Hubbard, 603 P.2d 747 (Okla. 1979).

cation has produced a particularly large return, the spouse in whose education the investment was made reaps the full benefit of the good investment; the contributing spouse receives compensation only for the contributions made.[177] This result contrasts sharply with the contributing spouse's rights to investments in traditional property, where each spouse shares in the ultimate value of the asset.

A spouse who seeks recompense for contributions to the other spouse's degree or license often faces still another obstacle: some courts have bluntly indicated that compensation for contributions to education is only appropriate in cases where the marriage ends before the parties have had an opportunity to amass traditional assets.[178] These courts have suggested that if the marriage has endured for a sufficient period after the degree was earned, the contributing spouse has already been repaid for the investment in her spouse's human capital. The repayment, these courts suggest, has been through increased

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[177] See Joan M. Krauskopf, Recompense for Financing Spouse's Education: Legal Protection for the Marital Investor in Human Capital, 28 Kan. L. Rev. 379, 414 (1980) (criticizing the approach and illustrating its operation). At least one court has indicated that this substantial benefit to the degree-earning spouse would not be accompanied by a symmetrical disadvantage if the degree or license turned out to be worth less than the contributions made. The court in *Pyeatte*, in discussing the measure of damages in a case where the husband divorced his wife after she had helped put him through law school, indicated that if from the outset the anticipated benefit of the agreement to the working spouse were less than the working spouse's financial contribution to the student spouse's degree, the working spouse should not get more than the benefit of her original bargain. *Pyeatte*, 661 P.2d at 207.

[178] See *Pyeatte*, 661 P.2d 196:

> When the parties have been married for a number of years, the courts cannot and will not strike a balance regarding the contributions of each to the marriage and then translate that into a monetary award. To do so would diminish the individual personalities of the husband and wife to economic entities and reduce the institution of marriage to that of a closely held corporation.

id. at 207; see also Wisner v. Wisner, 631 P.2d 115 (Ariz. Ct. App. 1981), where the court rejected the wife's argument that she should be entitled to a share of the husband's medical degree, distinguishing the hypothetical case of a spouse who puts the other through professional school just before the marriage dissolves:

> However, the acquisition of a considerable estate obviously solves this problem. Such is the situation here. Wife shared in the fruits of husband's education for many years during their marriage, and ultimately realized a value therefrom by a substantial award to her of the community assets, plus spousal maintenance as set forth above.

id. at 123. Similarly, in Wilson v. Wilson, 741 S.W.2d 640 (Ark. 1987), the court indicated that a wife who had benefitted from the accumulation of considerable marital assets during an 18-year marriage was not entitled to share in the increased earning capacity created by her husband's medical degree. Id. at 645.

income and increased accumulation of traditional property during the course of the marriage. No court would use such a rationale to exempt from equitable distribution a home or a boat bought during the marriage; subsequent acquisition of additional assets would not convert the boat or the home from a marital asset into separate property of one of the spouses. Hence, the spouse who contributes to a spouse's education is disadvantaged relative to a spouse who contributes to acquisition of other assets.

A small minority of courts have held that a license or advanced degree is property subject to equitable distribution. *O'Brien v. O'Brien*,[179] decided by the New York Court of Appeals, is the leading case.[180] In *O'Brien*, the court awarded the wife forty percent of the value of the husband's medical license, noting that the wife moved with the husband to Mexico to enable him to pursue his studies and that the husband then sought divorce two months after receiving his medical license.[181] Analogizing her contributions to the medical license to contributions to a down-payment on a house, the court noted that limiting the wife to reimbursement would unfairly deprive her of a return on her investment.[182] The court refused to find that the absence of a market for the license should preclude treatment of the license as property:

> A professional license is a valuable property right, reflected in the money, effort and lost opportunity for employment expended in its acquisition, and also in the enhanced earning capacity it affords its holder, which may not be revoked without due process of law. That a professional license has no market value is irrelevant. Obviously, a license may not be alienated as may other property and for that reason the working spouse's interest in it is limited.[183]

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179 489 N.E.2d 712 (N.Y. 1985).

180 Some Michigan appellate courts have concluded that professional degrees are property, while others have rejected that approach. Compare Lewis v. Lewis, 448 N.W.2d 735, 739 (Mich. Ct. App. 1989) (considering M.B.A. degree a marital asset) with Krause v. Krause, 441 N.W.2d 66, 72 (Mich. Ct. App. 1989) (concluding that value of advanced degree is irrelevant because alimony should compensate contributing spouse). In Washburn v. Washburn, 677 P.2d 152 (Wash. 1984), the Washington Supreme Court declined to decide whether degrees or licenses are property, but nevertheless indicated that the earning potential of a spouse with a professional degree is a factor to be considered in determining maintenance.

181 *O'Brien*, 489 N.E.2d at 714, 716.

182 Id. at 718.

183 Id. at 717 (citations omitted).

Even in New York, however, the identity of the nominal "titleholder" of the degree or license is quite relevant.[184] Even when a license is held to be property subject to distribution, no court has awarded one spouse a share of the other's future earning capacity. At most, courts have awarded a share of the estimated present value of that future earning capacity. Consider the difference. If a spouse is awarded a share of traditional property held in the other's name, the two can negotiate over its ultimate disposition knowing that failure to agree will result in partition or, perhaps, in sale to a third party. By contrast, if a spouse is only awarded a share of the value, no negotiations are necessary or possible. The court, not the market, has fixed the value of the disputed property. Similarly, when a court awards a contributing spouse a share of the court-determined value of a degree or license, there is no room for negotiation. If the contributing spouse believes that the educated spouse will earn more money than the court has projected, the contributing spouse has no position from which to negotiate. By contrast, if she had a continuing lien against the educated spouse's future income, she would have a right that she might keep or sell depending on her evaluation of the educated spouse's prospects.

B. Goodwill in Professional Practices

Going concerns typically have value in excess of the concern's tangible property and accounts receivable. Reputation with customers and potential customers—"goodwill"—is frequently the most valuable asset a firm has. When one spouse is a shareholder in a firm with goodwill, the value of that goodwill is part of the shareholder-spouse's investment in the firm. Reflected as it is in the value of the shares, that goodwill typically qualifies as property for equitable distribution purposes.

Sometimes, however, the value of a firm's goodwill is bound up with the expectation that a particnlar person will continue to operate

[184] The New York courts have typically awarded the contributing spouse less than 50% of the value of any professional degree or license. See, e.g., Maloney v. Maloney, 524 N.Y.S.2d 758 (N.Y. App. Div. 1988), appeal denied, 529 N.E.2d 425 (N.Y. 1988) (awarding wife 35% of value of medical license); Morton v. Morton, 515 N.Y.S.2d 499 (N.Y. Sup. Ct. App. Div. 1987) (awarding wife 30% of value of degree and license obtained during marriage); Kutanovski v. Kutanovski, 502 N.Y.S.2d 218 (N.Y. Sup. Ct. App. Div. 1986) (awarding wife 10% interest for ten years in husband's license to practice medicine).

the business. Especially when the "firm" is a professional practice, much of the firm's goodwill may represent the human capital of the professional. If the professional were to leave the practice, the practice would be unable to retain the goodwill. As with degrees or licenses, the goodwill has value only in the hands of a particular person.

Courts generally agree that marketable goodwill—even if associated with a professional practice—constitutes property for equitable distribution purposes. That is, if a professional practice commands a price in excess of the value of its tangible assets, even without any commitment by the professional to continue an affiliation with the practice, then the market price for the entire practice, not just the tangible assets, constitutes property for equitable distribution purposes.[185]

By contrast, courts are sharply divided over whether nonmarketable goodwill should be treated as property subject to equitable distribution.[186] A number of courts treat nonmarketable goodwill in the same way they treat professional licenses and degrees—as attributes "nniquely personal to the holder" and therefore not subject to property claims by a spouse. Thus, the Alaska Supreme Court has recently noted that to treat nonmarketable goodwill as property would restrict the goodwill-owning spouse's freedom to change

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[185] See, e.g., Moffitt v. Moffitt, 749 P.2d 343, 347 (Alaska 1988); In re Marriage of Nichols, 606 P.2d 1314, 1315 (Colo. Ct. App. 1979); Prahinski v, Prahinski, 540 A.2d 833, 843 (Md. Ct. Spec. App. 1988); Hirsch v. Hirsch, 770 S.W.2d 924, 927 (Tex. Ct. App. 1989); Sommerfield v. Sommerfield, 454 N.W.2d 55, 61 (Wis. Ct. App. 1990).

[186] The goodwill associated with a professional practice is marketable only to the extent that the value of the practice can be transferred to a new practitioner. Thus, suppose Dentist Smith will pay Dentist Brown $300,000 for the goodwill associated with Brown's practice. Smith is guessing that many of Brown's patients will return to the same office regardless of the identity of the current practitioner. The $300,000 Smith will pay represents marketable goodwill.

Suppose, however, that Brown's reputation is such that many more customers would return to the office if they knew Brown were still the dentist. Smith would not be willing to pay for this aspect of goodwill, because those customers would not return if Smith were the dentist. The eagerness of these customers to return to Brown increases the value of Brown's practice and is part of the goodwill associated with Brown's practice, but this aspect of goodwill is nonmarketable: the value can be realized by Brown ouly if Brown continues to practice. Similarly, legal restrictions on sale of professional practices would operate to make goodwill nonmarketable.

careers.[187] The Kansas Supreme Court has written that "[t]he very nature of a professional practice is that it is totally dependent upon the professional. We refuse to adopt the theory that goodwill in a professional practice is an asset subject to division in a divorce action."[188] Other courts have reached similar conclusions.[189]

In some states, however, courts have not distinguished between marketable and nonmarketable goodwill, holding both subject to equitable distribution. Courts in these states have emphasized that "despite the intangible quality of goodwill in a professional practice, it is of value to the practicing spouse both during and after the marriage and its value is manifested in the amount of business and, consequently, in the income which the spouse generates."[190] These courts have distinguished goodwill from professional degrees or future earning potential, sometimes without clearly identifying critical differences,[191] and at other times noting that it is somewhat easier to value goodwill associated with an existing practice than it is to value a degree or license without an established earning record.[192]

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[187] *Moffitt*, 749 P.2d at 347 n.3. The court noted that the goodwill-owning spouse would, upon leaving his business or practice, have the same financial obligations as if he had remained but would not be able to "cash in" on the unmarketable good will.

More recently, the Alaska Supreme Court has held, in particular, that the goodwill associated with a law practice owned by a single lawyer is not property subject to distribution upon divorce. Richmond v. Richmond, 779 P.2d 1211 (Alaska 1989). A dissent sought to distinguish degrees and licenses on the ground that those "are intellectual accomplishments, personal achievements of the holder. The practice is a commercial enterprise, a business." Id. at 1218 (Rabinowitz, J., dissenting).

[188] Powell v. Powell, 648 P.2d 218, 223-24 (Kan. 1982); see also Kieffer v. Kieffer, 785 P.2d 1371 (Kan. Ct. App. 1990), 1990 Kan. App. LEXIS 28, at *4 (unpublished opinion) (finding that dog kennel's value based upon its tangible assets where its good name depends upon wife's continued presence and its location would discourage other buyers).

[189] See, e.g., *Prahinksi*, 540 A.2d at 843 ("[F]or professional goodwill to be marital property it must be a business asset having a value independent of the continued presence or reputation of any particular individual."); Nail v. Nail, 486 S.W.2d 761 (Tex. 1972); *Hirsch*, 770 S.W.2d at 927 ("[G]oodwill is not to be included or considered when placing a value on a professional corporation unless it can be determined first, that the goodwill exists independently of the personal ability of the professional person, and second, that if such goodwill does exist, it has a commercial value in which the community estate is entitled to share."); Holbrook v. Holbrook, 309 N.W.2d 343 (Wis. Ct. App. 1981).

[190] In re Marriage of White, 424 N.E.2d 421, 424 (Ill. App. Ct. 1981).

[191] See, e.g., In re Marriage of Hall, 692 P.2d 175 (Wash. 1984); In re Marriage of Fleege, 588 P.2d 1136 (Wash. 1979).

[192] See Dugan v. Dugan, 457 A.2d 1, 6 (N.J. 1983).

Even when courts have announced that nonmarketable goodwill is property for equitable distribution purposes, the rights of the professional's spouse may be more limited than they appear. When a professional practice is treated as property for equitable distribution purposes, the value of the practice may exclude the spouse's earning capacity. The Washington Supreme Court has been most explicit on this point, holding that nonmarketable goodwill is property only to the extent that the goodwill represents something more than the professional's earning capacity in another job.[193] That is, if a lawyer has built up a practice that produces $100,000 of annual income but the lawyer's talents, education, and experience would permit him to command a salary of $90,000 even if he were to abandon the practice, the goodwill subject to equitable distribution would be limited to the capitalized value of an annual income of $10,000. The lawyer's spouse would not be entitled to share in the lawyer's alternative income capacity of $90,000. Much of the lawyer's human capital would, therefore, be protected from spousal claims even in a state that treats goodwill as property.

C. Justifications for Special Treatment of Human Capital

Equitable distribution statutes do not typically define property in ways that would prevent courts from treating degrees, licenses, or nonmarketable goodwill as property. Why, then, do courts decline to do so? Possible reasons include the difficulty involved in actually valuing these forms of property for distribution and a desire to protect the degree holding spouse's future liberty.

Difficulties in measurement furnish the most frequent answer to the query posed above.[194] Because a professional's future income may depend on so many contingencies, determining the present value of that future income will often be difficult. That difficulty, however, would be minimized if courts simply awarded a nondegree-bearing spouse a percentage share of the degree-bearing spouse's income on a periodic basis, as the income was earned, rather than in a lump sum. As with other forms of wage garnishment,[195] this solution might induce the degree-bearing spouse to substitute leisure for work, but, as

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[193] *Hall*, 692 P.2d at 178.

[194] For extensive discussion of these difficulties, see Batts, supra note 166, at 776-97.

[195] See supra text accompanying notes 137-46.

we have seen, the evidence that this would produce any inefficiencies is highly problematic. Indeed, the assumption in some circles has been that giving a spouse a claim to future income would induce substitution of work for leisure.[196]

Of course, giving one divorced spouse a claim to the other's income stream would also increase the financial interdependence of the two, a result inconsistent with the current trend away from alimony as the principal mechanism for adjusting the financial aspects of divorce.[197] At least when the divorced couple has children, however, long-term interdependence is inevitable. In many divorce cases, then, eliminating interdependence is an unrealistic goal.

Even if courts did give the nondegree-bearing spouse a lien on the degree-bearing spouse's future income, that lien would not eliminate another measurement problem: how much did the degree contribute to income capacity? Not all of the degree-earning spouse's income is attributable to the degree; the spouse would have earned income, albeit less in most cases, even without the degree. If the nondegree-earning spouse is entitled ouly to a share of future income attributable to the degree earned during the marriage, no ready mechanism exists for determining that share.[198]

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196 Cf. O'Brien v. O'Brien, 489 N.E.2d 712, 720 (N.Y. 1985) (Meyer, J., concurring) (indicating that increased monetary obligations might lock degree-earning spouse into particular, more remunerative, forms of employment).

197 See Krauskopf, supra note 177, at 397 (indicating that substitution of a "property" regime for a traditional maintenance regime is designed to minimize future contact between the parties).

198 A variation on this problem exists even with traditional property. Suppose a wife who had completed her education before the marriage earns a high salary during the marriage and invests that salary in stocks, bonds, or real estate. Because those investments were acquired during the marriage, they qualify as property for equitable distribution purposes. But, to some extent, the investments represent a trade of the wife's human capital—capital in existence before the marriage—for traditional property. Hence, the husband would receive a share of property derived from "property" the wife brought into the marriage. By analogy, one might argne that a spouse should be entitled to a share of a divorced spouse's human capital however that capital was created.

How spouses should divide human capital and traditional property upon divorce depends in large measure on one's conception of marriage as an institution. Different conceptions abound in the literature. Compare Krauskopf, supra note 177, at 396 (advancing partnership conception for distribution of marital assets) with Ira M. Ellman, The Theory of Alimony, 77 Cal. L. Rev. 1, 40 (1989) (rejecting partnership conception). See also Martha L. Fineman, Implementing Equality: Ideology, Contradiction and Social Change. A Study of Rhetoric and Results in the Regulation of the Consequences of Divorce, 1983 Wis. L. Rev. 789, 875-80

Although courts have overwhelmingly cited measurement difficulties to support their refusal to treat degrees and licenses as "property," they have not excluded other justifications. Some opinions have expressed the concern that treating licenses and degrees as property would deny professional spouses the freedom to pursue alternative career paths. Thus, in *Stevens v. Stevens*,[199] the Ohio Supreme Court wrote, "A division of property based on the estimated value of a professional degree or license would be particularly unfair to a professional who wishes to change careers, because a property award cannot be modified after divorce to reflect a change in circumstances."[200] Judge Meyer's concurring opinion in *O'Brien v. O'Brien*[201] emphasized the constraint on a professional spouse's freedom:

> [A] professional in training who is not finally committed to a career choice when the distributive award is made may be locked into a particular kind of practice simply because the monetary obligations imposed by the distributive award made on the basis of the trial judge's conclusion (prophecy may be a better word) as to what the career choice will be leaves him or her no alternative.[202]

Indeed, one court went so far as to write that treating a degree as property might run afoul of the Constitution's Thirteenth Amendment.[203]

Even as courts have awarded nonprofessional spouses compensation based on the value of a degree earned through joint marital effort, they have sometimes sought to protect career choices made by the professional spouse. Thus, the Washington Supreme Court, in holding that trial courts may consider the expected standard of living of the degree-earning spouse in awarding maintenance to the other spouse, suggested that the degree-earning spouse's decision to change

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(noting that divorce reform movement focused on women's contribution to marriage rather than on their need).

199 492 N.E.2d 131 (Ohio 1986).

200 Id. at 134.

201 489 N.E.2d 712 (N.Y. 1985).

202 Id. at 720 (Meyer, J., concurring).

203 Severs v. Severs, 426 So. 2d 992 (Fla. Dist. Ct. App. 1983):

> The wife's claim to a vested interest in the husband's education and professional productivity, past and future, is unsupported by any statutory or case law. Indeed, such an award by the trial court would transmute the bonds of marriage into the bonds of involuntary servitude contrary to Amendment XIII of the United States Constitution.

Id. at 994.

careers might serve as a change of circumstances that would justify modification of the maintenance award.[204]

Thus, as with covenants not to compete and with creditor remedies, courts have been reluctant to saddle individuals with obligations that might constrain their future choices or opportunities.

IV. THE SERVITUDE JUSTIFICATION FOR RESTRAINTS ON ALIENATION OF HUMAN CAPITAL

A. Introduction

Although legal doctrine restrains alienation of human capital in a variety of substantive law areas, different justifications for the restraints have emerged in each area. One justification, however, transcends the boundaries between areas: in each area of substantive law, courts have suggested that to give one person a claim against another's human capital would create a form of involuntary servitude. The argument occasionally, but not always, suggests possible violations of the federal Constitution's Thirteenth Amendment. This Section explores the antiservitude justification for restraints on alienation of human capital. The justification's emotional power relies on images of trapped people, forced by circumstances beyond their control to work in jobs they despise.

To condemn a legal arrangement as an impermissible servitude or form of slavery, one must start with a conception of slavery.[205] In one sense, every commitment of future energy enslaves the person who makes the commitment by making breach of the commitment more difficult or costly, but the prevalent conception of slavery in our society does not preclude contract generally. Any antislavery justification, then, must focus on particular contracts. That is, in order to justify a particular restraint on alienation, one must explain how the restraint operates to protect whatever freedoms the society deems essential to distinguish free persons from serfs or slaves.

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[204] Washburn v. Washburn, 677 P.2d 152, 158 n.3 (Wash. 1984). Of course, the court could also have protected career choices of the professional spouse by awarding the nondegree-earning spouse a percentage of future income, rather than using the professional spouse's expected standard of living as a base.

[205] See Jonathan Bush, Hegelian Slaves and the Antebellum South, 10 Cardozo L. Rev. 1517, 1563 (1989).

One doctrinal restriction on alienation of human capital unquestionably qualifies as a protection against slavery or involuntary servitude: the contract doctrine that denies a promisee specific performance of personal service contracts. The prospect of a promisee, armed with a court order, compelling a promisor to perform services against the promisor's will and on pain of imprisonment for contempt, evokes images of slavery that have undoubtedly contributed to the universal acceptance of the doctrine.

Once the state makes clear that no party may force another to perform services against her will, however, the antislavery justification for additional restraints on alienation of human capital becomes less clear-cut. Even without these restraints—bankruptcy discharge, garnishment limitations, protection against spousal claims to future income, limitations on enforcement of restrictive employment covenants—obligees would be entitled only to impose financial sanctions on those who have breached their obligations; neither physical compulsion nor imprisonment would be available. Financial sanctions can and do operate to restrict personal freedom, but making those sanctions unavailable restricts freedom too. If creditors cannot count on repayment, the range of contract opportunities available may be significantly restricted. Moreover, economic constraints are a fact of life for nearly everybody within this and every other society. The financial constraints that resnlt from alienation of human capital can only be enslaving if they are somehow more coercive than the other financial constraints under which we all operate.

B. Restrictions on Employment Choice as a Form of Servitude

If courts were to order specific performance of personal service contracts, the promisor under the contract would risk contempt sanctions if he refused to perform. By contrast, even a debtor subject to unlimited claims against his human capital undertakes no obligation to work for a particular person, nor does he risk imprisonment for failure to pay his debts. The obligation to pay one's debts may, however, coerce some debtors to work more than they would otherwise want to or to take jobs they would prefer not to take. If a debtor wants to improve his lifestyle or his family's standard of living, either now or in the near future, he may be "forced" to earn more money now to pay off his creditors. To do this, he may have to work more or work in more remunerative but less enjoyable employment. This, however, is hardly the sort of coercion that justifies excusing debtors because of concerns about involuntary servitude. The choice between work and leisure is virtually never unconstrained by economic factors. Most persons in our society work more and enjoy less leisure than they otherwise would in an effort to secure the goods and services they want. So long as a debtor's standard of living is, in absolute terms, no worse than that of others in the society, the debtor is no more enslaved by debt than the poor are enslaved by poverty.

Similarly, concerns about job satisfaction are disproportionately upper-middle-class concerns. A lawyer who wants to work for a public defender's office might feel aggrieved if her consumer debts or claims by her spouse "coerce" her to work for a corporate law firm, but labelling the lawyer's choice "coerced" would ring hollow to most of society. Job satisfaction is important to people at all income levels, but for relatively poor workers, economic realities frequently dictate that job quality be measured in terms of pecuniary, not psychic, income: one job is "better" than another if it pays more than the other. These workers are often not in a position to sacrifice higher income to obtain greater satisfaction. For them, the notion that a person might be "forced" by obligations to take a higher paying job would be simply laughable. From their perspective, the choice facing our frustrated public defender is not an aberrational instance of coercion; the choice in favor of higher income is a foregone conclusion.

Moreover, for people at relatively low skill and education levels the "hard" choice facing the would-be public defender would be less likely to arise. Pay differentials among jobs available to working class persons are likely to be smaller than differentials among professionals. As a result, working class people would not often confront the type of choice that might face a lawyer; for them, taking the more satisfying of two jobs would be less likely to require the same sacrifice in income.

To summarize, permitting creditors to reach a debtor's human capital will, in some instances, constrain the debtor's career options. Conversely, protecting the debtor's human capital from creditor claims would give the debtor greater freedom in making career decisions. This freedom, however, is largely an upper-middle-class freedom not enjoyed even by debt-free members of the working classes. In economic terms, if creditor claims induce change in the debtor's career choices, that change is simply a wealth effect: as the debtor becomes poorer in money terms, money becomes relatively more valuable to her. Hence, she substitutes pecuniary income for psychic income by taking a job at a higher salary.[206] The debtor's poverty may "coerce" her career choices, but it is difficult to characterize her new position as an impermissible form of servitude when she is no worse off than so many other people.

C. *Slavery to One's Own Past Decisions*

Anthony Kronman has sought to explain a variety of paternalistic contract doctrines—including the nonwaivable bankruptcy discharge and the prohibition against contracts of enslavement[207]—as protec-

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[206] It is by no means clear that this substitution will take place. As we have seen, some have argued that giving creditors claims against a debtor's human capital would have the opposite effect by inducing the debtor to substitute leisure or psychic satisfaction, which creditors cannot reach, for money income, which creditors can reach. See supra notes 138-39 and accompanying text; see also William Shakespeare, Hamlet act 1, sc. 3 (speech by Polonius) (emphasis added):

> Neither a borrower nor a lender be,
> For loan oft loses both itself and friend,
> *And borrowing dulleth edge of husbandry.*

[207] Contracts of enslavement have historically presented a difficult problem for liberal thinkers. The central premise of individualist theories is that each individual should be free to pursue his own path to the good. Why, then, should the state deny an individual the opportunity to pursue a path that might lead to slavery? Mill dealt with the problem by distinguishing between individual liberty and individual choice and arguing that liberty was the end to which choice was a means. By according free choice to an individual, we generally increase his liberty. In Mill's view, however, if a particular individual were to choose slavery, he would have demonstrated that the reason for giving the individual, in general, the right to choose—the desire to increase his liberty—was not applicable to the particular choice the individual had made. Mill apparently believed that denying the individual the freedom to make himself unfree would ultimately advance individual liberty. Mill wrote:

> The reason for not interfering, unless for the sake of others, with a person's voluntary acts is consideration for his liberty. His voluntary choice is evidence that what he so chooses is desirable, or at least endurable, to him, and his good is on the whole best provided for by allowing him to take his own means of pursuing it. But by selling himself for a slave, he abdicates his liberty; he foregoes any future use of it beyond that single act. He therefore defeats, in his own case, the very purpose which is the justification of allowing him to dispose of himself. He is no longer free, but is thenceforth in a position which has no longer the presumption in its favour that would be afforded by his voluntarily remaining in it. The principle of freedom cannot require that he should be free not to be free. It is not freedom to be allowed to alienate his freedom.

John S. Mill, On Liberty 173 (Gertrude Himmelfarb ed., Penguin Books 1983) (1859). Compare with this argument against consensual slavery the "externalities"-based argument advanced by Calabresi and Melamed. Suppose Marshall and others find it revolting that Taney would agree, for money, to become Chase's slave. Even if Taney and Chase find the tions against regret caused by changes in one's personal goals. Kronman notes, for instance, that if "a person's goals have changed significantly, his earlier decision may now appear irrational, for his original aims no longer provide the framework for his deliberations."[208] Kronman argues that doctrines like the bankruptcy discharge enable the debtor to free himself from past decisions with which he feels no connection.[209]

Kronman's argument assumes that individual identity changes markedly over time, that the person who makes an initial and ultimately unfavorable commitment of hnman capital may be, in some ways, a different person from the one later burdened with the commitment.[210] On Kronman's analysis, we should not permit the initial decision to enslave the fundamentally different future self. As a result, we should not enforce contracts of enslavement, and we should permit enforcement of personal service contracts only through monetary damage awards, not by specific performance.[211]

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slavery arrangement mutually beneficial, the arrangement would not be efficient if the gains to Taney and Chase are smaller than the losses experienced by Marshall and others upset at the notion of consensual slavery. See Calabresi & Melamed, supra note 7, at 1112. For a critique, see Radin, supra note 7, at 1870-87.

208 Kronman, supra note 163, at 781.

209 Id. at 785-86. For a critique of Kronman, see Spergel, supra note 164.

210 Many would quarrel with Kronman's assumption of personal discontinuity. For example, Charles Fried has written:

> [R]espect for others as free and rational requires taking seriously their capacity to determine their own values. . . . Others must respeet our capacity as free and rational persons to choose our own good, and that respect means allowing persons to take responsibility for the good they choose. And, of course, that choosing self is not an instantaneous self but one extended in time, so that to respect those determinations of the self is to respeet their persistence over time. If we decline to take seriously the assumption of an obligation because we do not take seriously the promisor's prior conception of the good that led him to assume it, to that extent we do not take him seriously as a person.

Charles Fried, Contract as Promise 20-21 (1981). See also Friedrich Nietzsche, The Genealogy of Morals, ch. 2., § 1, at 42 (Horace B. Samuel trans., 1969) ("[H]ow thoroughly must man have first become *calculable, disciplined, necessitated,* even for himself and his own conception of himself, that, like a man entering a promise, he could guarantee himself *as a future.*"); Richard Schacht, Nietzsche 293 (1983) (arguing that one must have an "identity transcending one's desires, dispositions, immediate circumstances and momentary condition"). See generally Derek Parfit, Reasons and Persons 201-17 (1984) (discussing the difference between "qualitative" and "nnmerieal" identity of self).

211 Kronman writes:

> If the breaching promisor must continue to work or live with the other party and abide by the terms of a cooperative arrangement he now regrets, he will almost certainly find

Kronman then advances his personal discontinuity thesis as a justification for the bankruptcy discharge:

> [T]he right to a discharge in bankruptcy serves the same general goal as the right to depersonalize a contractual relationship by substituting damages for performance, and the inalienability of both can be explained on similar grounds. Bankruptcy reveals our acceptance of the fact that beyond a certain point, the sheer magnitude of a person's debt may be demoralizing.[212]

If the demoralization against which persons deserve protection results from grave financial pressures, why should persons with human capital be entitled to protection against that demoralization while persons with life prospects that have always been less promising receive no comparable protection? The problem is one of determining the appropriate baseline. The obligation to repay debts certainly leaves the debtor more constrained in choosing among life plans than she would be if freed from the obligation to repay debts. On the other hand, even if subject to an obligation to repay debts, the debtor will be no more constrained in choosing among life plans than a person not blessed with significant endowments of human capital.[213] Indeed, the debtor may have much greater opportunity to choose among alternative jobs than would a person poorly endowed with human capital; the obligation to repay debts deprives the debtor only of the financial rewards associated with those jobs.

> it more difficult to distance himself from his original values. He is likely, as a result, to feel more directly tied to the goals he has repudiated and to be more painfully reminded of their continuing influence in his life. By substituting damages for performance, the promisor gives his original commitment an abstract form less closely linked to the specific goals that led him to make the commitment in the first place; the edge of his regret is dulled and its disabling consequences ameliorated. If he cannot distance himself from the contract by depersonalizing his relationship with the other party, the promisor's regret is likely to be more intense and its effects more serious; the right to depersonalize a contractual relationship is an aid to forgetfulness, which—within proper limits—is a condition of moral health.

Kronman, supra note 163, at 783.

212 Id. at 786 (footnote omitted).

213 Thus, Parfit, in embracing the principle that "[a]utonomy does not include the right to impose upon oneself, for no good reason, great harm," wrote that "[w]e ought to prevent anyone from doing to his future self *what it would be wrong to do to other people*." Parfit, supra note 210, at 321 (emphasis added). Parfit's formulation suggests that permissible treatment of others should form the baseline against which we measure an individual's right to burden his future self. If he and the society permit others to live at a subsistence level, he has no cause for complaint about enslavement if his own decisions leave him at the same level.

D. Dashed Expectations as a Form of Servitude

The preceding Section considered the argument that people generally feel so little connection with their past decisions that to enforce those decisions would amount to a form of involuntary servitude. Consider now an argument that starts with virtually the opposite premise: that people generally feel so great a connection with their past expectations about life prospects that significant disappointment of those expectations would cause demoralization akin to slavery. If seriously disappointed expectations can amount to a form of slavery, a person might be enslaved even if he is materially far better off than many other members of the society. Hence, the disappointed expectations argument would justify limiting creditor access to human capital even if doing so would leave the debtor "richer" than most members of society.

That people become attached, through long use, to tangible items has long been advanced as a justification for particular property rules. Holmes, for instance, justified the adverse possession doctrine as a protection of expectations developed through long affiliation:

> A thing which you have enjoyed and used as your own for a long time, whether property or an opinion, takes root in your being and cannot be torn away without your resenting the act and trying to defend yourself, however you came by it. The law can ask no better justification than the deepest instincts of man.[214]

More recently, Margaret Radin has made the argument in general terms: "If an object you now control is bound up in your future plans or in your anticipation of your future self, and it is partly these plans for your own continuity that make you a person, then your personhood depends on the realization of these expectations."[215] Radin has used this argument—that some forms of property are so bound up with a person's self-image that they constitute a part of the person—to justify rent control regulations,[216] restrictions on eviction of residential tenants,[217] and restrictions on the sale of rights to bodily integrity.[218] But the argument might also be extended to protect

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214 Oliver W. Holmes, The Path of the Law, 10 Harv. L. Rev. 457, 477 (1897).

215 Margaret J. Radin, Property and Personhood, 34 Stan. L. Rev. 957, 968 (1982).

216 See Margaret J. Radin, Residential Rent Control, 15 Phil. & Pub. Affairs 350 (1986).

217 See Radin, supra note 215, at 992-96.

218 See Radin, supra note 7, at 1921-36.

individuals against disruptive change in their standard of living—change that disrupts the life plans individuals have formulated.

Richard Epstein's critique of this "protect expectations" argument reveals both the argument's weaknesses and its strengths. In discussing Professor Radin's advocacy of residential rent control, Epstein notes that her "principle cuts against the very idea of an open society in which there is equal opportunity for advancement and trade for all."[219] Moreover, in rejecting the notion that the "personhood" interests of existing residents should be given priority over the interests of disappointed competitors in the housing market, Epstein writes, "Once we intuit that certain positions, and hence certain people, are special, then we have to determine just how special they really are."[220]

Of course, in a society that champions equality of opportunity rather than equality of result, some people *are* special, in the sense that they are better endowed with human capital and, hence, more likely to prosper. Rewarding those with large initial endowments of human capital may be necessary to achieve greater economic well-being in the society at large. But why compound the inequality by protecting the high expectations those persons have developed against their own unwise decisions? Moreover, even if one were to favor such an inegalitarian rule, no readily ascertainable principle indicates how much protection a person well-endowed with human capital should receive against her own unfortunate decisions.

Perhaps paradoxically, Epstein's critique of the "protect expectations" argument also demonstrates its persuasive force. In parading the horribles that would be engendered by giving preferences to those whose expectations have been conditioned by the status quo, Epstein lists exclusionary zoning, trade union monopolies, price supports for farmers, and barriers to immigration as policies that would protect settled expectations.[221] To Epstein, the striking fact is that Radin or anyone else could advocate a principle that might encompass such policies. But what is more striking is that virtually all of Epstein's horribles, in one form or another, are established features of the American legal landscape. True, all of these practices are subject to

219 Richard A. Epstein, Rent Control and the Theory of Efficient Regulation, 54 Brook. L. Rev. 741, 771 (1988).

220 Id.

221 See id. at 771-72.

frequent criticism,[222] but they have nevertheless endured. Perhaps their endurance reflects the influence of strong pressure groups, but, in some instances at least, the pressure groups have struggled to convince elected officials (and the public at large) that they *deserve* protection from market forces. Indeed, some of those efforts have enjoyed wide success.

The point is not that Epstein is wrong when he attacks legal rules that entrench those who benefit from the status quo. I share Epstein's preference for market allocation of most goods and services. The point instead is that Congress and state legislatures frequently act to preserve the status quo—to protect people from the downward mobility that market forces sometimes produce. Indeed, some of the most expensive government social programs—social security and medicare, for instance—are not aimed at improving the lot of the poorest members of society but at maintaining the wealth of the middle class.[223] There are, of course, numerous other examples of government policies designed to protect against downward mobility.[224] Restrictions on alienation of human capital—limited enforcement of covenants not to compete, wage garnishment restrictions, the bankruptcy discharge—might reflect the same desire to protect people against unexpected changes in their life plans.

This "protect expectations" explanation for restrictions on alienation of human capital, however, leaves an important question unanswered: why does not legal doctrine, in the name of protecting expectations, impose comparable protections against loss of traditional property? That is, if a desire to avoid disruption of life plans has led to insulating future income from creditor claims, why has not the same impulse led to protection of wealth? Of course, homestead

222 See, e.g., Richard Briffault, Our Localism: Part I—The Structure of Local Government Law, 90 Colum. L. Rev. 1, 22-23 (1990); Lawrence G. Sager, Insular Majorities Unabated: *Warth v. Seldin* and *City of Eastlake v. Forest City Enterprises, Inc.*, 91 Harv. L. Rev. 1373 (1978) (both criticizing exclusionary zoning); The Trough, The Economist, June 27-July 3 1992, at 21 (criticizing American farm price supports).

223 Indeed, medicare and social security themselves might be viewed as limitations on alienability of human capital. Workers pay taxes for future benefits that they are not permitted to bargain away, even if they would prefer more current income.

224 Immigration restrictions, for instance, protect existing workers against loss of jobs to new entrants who promise to do the same jobs more cheaply or efficiently. Protectionist trade policies are designed to retain high-income manufacturing jobs for workers who might otherwise be forced to take lower-paying service industry jobs.

and other exemptions from creditor claims do leave debtors with minimal protection against loss of all tangible assets—particularly those Radin might characterize as most closely linked to "personhood." But are these limited exemptions enough to avoid disruption of life plans?

One answer is that, in a cash-flow society, expectations about life prospects for most people are determined by income, not by wealth. Thus, so long as legal rules permit people to safeguard future income from claims, subjecting tangible property to creditor claims does not alter fundamental life plans. The problem with that answer, however, is that for many persons—particularly older people and those who have little expectation that income will rise substantially with age and experience—wealth does play a substantial role in determining life prospects. Secondly, the notion that persons should not be able to avoid creditors while retaining valuable tangible property is too entrenched to be disturbed by modern notions that life plans ought not to be disrupted. Finally, protecting expectations about life prospects is only one goal among many, and permitting people to retain property while avoiding debtors presents too great a threat to the efficiencies of free commerce. In particnlar, borrowing money might be especially difficnlt if creditors could not look to any of the debtor's property as security.

None of these answers is entirely satisfactory. Indeed, perhaps the best explanation is that the legislators and judges who have created and implemented the existing system come largely from the professional classes for whom income—not wealth—is the predominant measure of well-being. For these people, disruption of income, not wealth, may represent the greatest threat to personal financial stability—a threat alleviated to some degree by protecting human capital from creditor claims.

This urge to protect people against downward mobility may not *justify*, in a normative sense, restrictions on alienation of human capital, but it may nevertheless serve as a powerful *explanation* of doctrines that privilege persons well-endowed with human capital. Doctrines that permit individuals to escape from unwanted jobs and that prevent individuals from becoming trapped by financial distress in unfulfilling careers, have an instinctual appeal. The conditions against which those doctrines provide protection, however, are conditions which much of the populace routinely endures. Hence, the instinctual appeal of inalienability doctrines like the bankruptcy discharge may be largely a function of the professional status of lawyers and academics. To the man on the street, the notion must be foreign indeed that a professional would be "enslaved" if denied the opportunity to avoid past debts while earning an annual income several times the national average.

V. DISTRIBUTIONAL CONSEQUENCES OF RESTRAINTS ON ALIENATION

We have seen that employment law, debtor-creditor law, and family law each impose significant restraints on alienability of human capital. In each case, we have also seen that the justifications offered for these rules rest on shaky ground, at best. In addition, proponents of inalienability of human capital rarely consider another strong argument against such rules: the distributional effects of inalienability. Who benefits from these rules, and who is hurt?

In one sense, the beneficiaries of inalienability rules are obvious: holders of human capital who find themselves insulated from creditor claims. Thus, the bankruptcy discharge benefits bankrupt debtors endowed with human capital, and hurts their creditors. A rule limiting enforcement of anticompetitive covenants benefits employees endowed with human capital by permitting them to take a new job or to strike out on their own over the objections of a former employer. Holders of traditional property rights enjoy no comparable protection because traditional property does not enjoy the same insulation from creditor claims.

Another, perhaps more plausible, view of this system's burdens and benefits is possible. Standard Coasean theory would suggest that no one benefits from inalienability rules, at least in the absence of transaction costs, because this "benefit" enjoyed by persons well-endowed with human capital is offset by a loss of freedom to enter into mutually beneficial exchanges that involve alienating human capital. Each individual is better off if the law enables her to choose whether to sell or retain her assets, whether they take the form of human capital or of traditional property. Similarly, potential purchasers or users of the goods are better off if given the opportunity to bid for those assets.

Of course, there would be little impetus for a court or a legislature to adopt a rule that made everyone worse off. In a system dominated by market ideology, inalienability rules are unlikely to arise unless they are perceived to benefit somebody. Several justifications have been advanced for rules restraining alienation of human capital. First, inalienability rules sometimes arise as a response to externalities that would be created by private contracting behavior.[225] Thus, if anticompetitive covenants in employment agreements would create monopoly power to the detriment of the consuming public, a rule restricting alienation of human capital would operate to benefit third parties—the public at large—at the expense of employer and employee.[226] Inalienability rules may also be designed to correct information asymmetries.[227] Rules limiting enforcement of anticompetitive covenants may be based, in part, on recognition that the contract itself is unlikely to reflect the agreement the parties would have reached if they both had access to the same information.[228] Similar fears about information asymmetries might underlie the refusal to enforce waiver of the right to discharge in bankruptcy. Alternatively, limits on alienability of human capital may reflect the belief that even adequately informed employees or borrowers will not act in their own interest. Paternalistically motivated restraints on alienation, like restraints based on information asymmetries, would operate primarily to benefit holders of human capital, even as they restrict the choices available to those holders.[229]

Thus, although restraints on alienation of human capital might hurt persons well-endowed with human capital by making credit less available and by limiting employment opportunities, the restraints appear, at least in part, to reflect a legislative and judicial belief that those persons would be better off if their choices were restricted.[230] Although, as I have shown, these justifications are of questionable strength, in some circumstances inalienability rules provide unequivocal benefits to holders of human capital. Thus, although discharge of contract claims in bankruptcy regardless of future earning potential

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225 See Calabresi & Melamed, supra note 7, at 1111-15; Rose-Ackerman, supra note 3, at 938.

226 See supra Part I.D.1 (discussing the anticompetitive effects of restrictive covenants).

227 See Rose-Ackerman, supra note 3, at 939.

228 See supra Parts I.D.2 and II.C.2.

229 See supra Part II.C.3.

230 In effect, restraints on alienation of human capital operate like a compulsory insurance policy: each individual must insure himself against loss of her right to benefit from her human capital. Payment for the insurance comes in higher credit costs or in restricted employment opportunities.

may make it more expensive for persons to contract, discharge of tort claims benefits holders of human capital without creating any corresponding harm. Similarly, when courts hold that professional degrees and licenses are not property for equitable distribution purposes, the benefit to the holder of the degree or license is clear.

Existing limitations on alienation of human capital, then, appear to benefit persons well-endowed with human capital. Most obviously, those people benefit with respect to their own creditors and spouses. Of equal importance, however, is the fact that persons well-endowed with human capital enjoy benefits not available to persons whose principal assets are in the form of traditional property. It is important, then, to consider the distributive effects of this preferential treatment.

By making human capital relatively inalienable, our system assures that individuals benefit from their "own" human capital no matter what commitments they violate in the process. This special protection afforded human capital is hardly egalitarian. The principal beneficiaries are, first, those with substantial skills and talents, because their capital is capable of producing the highest annual return; and, second, the young, because their capital will produce returns further into the future. These groups—the young and the talented—are hardly the most attractive candidates for preferential treatment.

VI. An Evolutionary Explanation for Inalienability Rules

We should not be surprised that the most prevalent justifications for restraining alienation of human capital rest on questionable foundations. The assumption that any particular rule of law can be "justified"—that the rule serves some instrumental goal—is always problematic. First, a rule of law may reflect existing power relationships, not more generalized social goals. Moreover, even a rule that once served a social goal may persist long after that goal ceases to be served, simply because the rule is of insufficient importance for anyone to muster the energy necessary to change it. Especially when legislation would be necessary to change an existing rule, inertia may provide a powerful explanation for the rule's persistence.

The legal rules that protect human capital from claims by employers, spouses, and creditors undoubtedly reflect, at least in part, past rather than present conditions. If protecting human capital is objectionable on egalitarian grounds, the objection rests on the premise that individuals enjoy significantly different endowments of human capital. Those differences have not always been as significant as they are today, however. One farmer's greater strength or endurance might have permitted him to till a field more effectively than another in a pretechnological era, but those differences are dwarfed by the differences in productive capacity that exist in an economy dominated by specialized labor, technological advances, and the emerging importance of service industries. Moreover, we, more than our ancestors, live in a cash-flow world; income-earning capacity, not the amount of traditional property we own, is often the best measure of our material well-being. Hence, not only are differences in productive capacity more pervasive than they once were, they are also more important in determining well-being.

Rules restricting alienation of human capital were not always as inegalitarian as they may be today. If, by comparison to other forms of property, human capital were small in value and distributed equally, providing special protections to human capital might even promote equality. With changes in the economic role of human capital, then, one might expect corresponding changes in the legal framework surrounding human capital.

Some changes have occurred in recent years. The most evident changes are those incorporated in the bankruptcy law: rules prohibiting discharge of student loans and making discharge unavailable to consumer debtors who have the capacity to repay their debts within a reasonable period. Similarly, in family law, the greater willingness of a few states to treat a professional degree as "property" subject to division among spouses also suggests that the legal system may be responding to change in the importance of human capital.

The legal system is often slow to respond to social and economic changes, especially when doctrinal change would require, as in the area of human capital, massive reconceptualization of legal rights and relationships. William Bratton, for instance, has recently documented the slow and uneasy doctrinal recognition that corporate bondholders are often investors in, as well as creditors of, the issuing corporation.[231] Arthur Jacobson has explored how the development of the modern corporation was slowed by the inability of common lawyers

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[231] William W. Bratton, Jr., Corporate Debt Relationships: Legal Theory in a Time of Restructuring, 1989 Duke L.J. 92, 117-21, 158-59.

to conceptualize managers of firms as agents of an invisible principal.[232] Property lawyers are quite familiar with the ongoing re-evaluation of landlord-tenant law to incorporate contract concepts, such as mitigation of damages and implied warranties, that better reflect current economic realities.

Reconceptualizing human capital as an alienable property interest has undoubtedly been slowed by a variety of additional checks—some doctrinal, some social—on the ability of holders of human capital to exploit their preferred status. State and federal garnishment statutes may limit creditors' access to the debtor's future earnings, but the stigma attached to garnishment probably serves to assure that debtors able to do so pay their debts without requiring their creditors to resort to garnishment. Similarly, for debtors with the capacity to pay off their debts, the social stigma long attached to bankruptcy undoubtedly serves to discourage petitions for bankruptcy discharge.[233]

The traditional structure of divorce law also operated to diminish the importance of treating human capital as property. As Joan Krauskopf has observed, the traditional divorce system, by permitting divorce only in cases of fault, gave the poorer spouse, generally the wife, considerable leverage against a wealthier spouse who wanted a divorce.[234] If that wife could prove fault, she was entitled to alimony, which gave her a continuing claim against the human capital of the husband. If the husband wanted a divorce and wanted to avoid payment of court-awarded alimony, he had to buy his way out of an alimony obligation.

Only recently, then, with the advent of no-fault divorce and the replacement of alimony with equitable distribution, has the failure to conceptualize human capital as alienable property presented a serious opportunity for unfairness. So long as one spouse could draw upon the other's human capital through alimony, little turned on how human capital was characterized. The characterization of human capital, however, has assumed greater importance as equitable distri-

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232 Arthur Jacobson, The Private Use of Public Authority: Sovereignty and Associations in the Common Law, 29 Buff. L. Rev. 599, 662-66 (1981).

233 See generally Sullivan et al., supra note 107, at 336-38, for a discussion of the social stigma attached to bankruptcy. The authors conclude that the social stigma remains a deterrent to bankruptcy, but also suggest that the stigma may have declined in recent years.

234 See Krauskopf, supra note 177, at 396.

bution of "property" has become the critical economic consequence of divorce.

To summarize, so long as disparities in return on human capital were relatively small, protecting human capital from claims by creditors, employers, and spouses would not have provided any disproportionate benefit to the well-endowed. Moreover, to the extent that disparities among individuals did exist, a variety of social forces and legal constraints limited the opportunities for individuals well-endowed with human capital to take advantage of special protections afforded human capital. As those forces and constraints have to some extent dissolved, there has been some movement toward treating human capital less favorably. Whether and to what degree that movement will continue remains uncertain.

CONCLUSION

A century has passed since John Chipman Gray railed against restraints on alienation of property, and especially against the spendthrift trust.[235] Gray, writing at a time when inherited wealth was a cause of significant inequality, wrote: "That grown men should be kept all their lives in pupilage, that men not paying their debts should live in luxury on inherited wealth, are doctrines as undemocratic as can well be conceived."[236] Gray's attack on the unfairness of permitting people to enjoy "the benefits of wealth without the responsibilities"[237] was met with a defense that emphasized freedom—the freedom of a donor to dispose of his property as he wishes.[238] No one, however, suggested that concerns for the beneficiary's freedom justified spendthrift trust doctrine.[239]

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235 John C. Gray, Restraints on the Alienation of Property (2d ed. 1895). George T. Bogert, Trusts § 40, at 148 (6th ed. 1987) defines a spendthrift trust as "one in which, either because of a direction of the settlor or because of a statute, the beneficiary is unable to transfer his right to future payments of income or principal and his creditors are unable to subject the beneficiary's interest to the payment of their claims." That is, a spendthrift trust is one in which the beneficiary's interest is inalienable.

236 Gray, supra note 235, at 246.

237 Id. at 243.

238 For a discussion of judicial endorsement of spendthrift trusts based on the desire to protect the donor's "freedom," see Erwin N. Griswold, Spendthrift Trusts 629-31 (2d ed. 1947).

239 See, e.g., In re Morgan's Estate, 72 A. 498 (Pa. 1909):

> It is always to be remembered that consideration for the beneficiary does not even in the remotest way enter into the policy of the law. It has regard solely to the rights of the

In today's society, differences in individual endowments of human capital may contribute to inequality as much as did inherited wealth when Gray launched his attack on alienation restraints. By protecting those well-endowed with human capital against claims by spouses, creditors, and employers, existing doctrinal rules exacerbate inequality: those endowed with human capital may escape their commitments while continuing to benefit from their earning capacity. Although particular restraints on alienation of human capital may be warranted to guard against inefficiencies, administrative costs, or bargaining asymmetries, I have shown that even these justifications are not as strong as they may first appear. Neither courts nor scholars, however, have been content to rely on those justifications for restraints on alienation of human capital. Instead, they have often suggested that such restraints are necessary to safeguard personal freedom—the freedom of individuals who have made commitments and now seek to avoid them. Upon closer examination, however, that justification is also unpersuasive. Given the inequitable distributional impact these rules have today, it is high time that we rethink them.

> donor. Spendthrift trusts can have no other justification than is to be found in considerations affecting the donor alone.

Id. at 499.