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At the Crossroads of Law and Economics – A Few Labour Court Cases Revisited

Ture Sventon would have said:
'All in all – an interesting case'
(Åke Holmberg)

We are on the track, but whereto?
The answer is – the legal order.

1 Preliminaries

First of all – how does one interpret contracts and is there a duty to clarify what applies? And why is there a duty to act in order to avoid liability? The answer is efficiency. Part of it is that in some cases risk allocation is at stake.

It is basic in the field of law and economics to attempt to use economic theory in order to understand legal systems, or – for lawyers – to make use of the toolbox routines developed by the economists. Schäfer and Ott set the framework:

> A central problem of economics is the question of how a society can make use of its scarce resources in such a way so as to achieve the highest satisfaction of wants. If this is achieved, the economy is said to be efficient; if not, resources are being wasted. — The economic analysis of law is an application of this 'efficiency′ perspective to legal rules. The underlying supposition is that jurisprudence ought to evaluate legal rules and norms according to a criterion that determines whether or not they heed or hinder the efficient use of resources.[1]

[1] H-B. Schäfer and C. Ott, The Economic Analysis of Civil Law (Edward Elgar Publishing Limited 2004) 3.

In discussing the economic objectives of tort law, Harrison and Theeuwes submit the following remark: ‘In a world of scarce resources, the choices to be made are sometimes not for the squeamish. But they do occur.’[2] It means that one has to make a choice.

In my view the No 1 rule of law and economics is the following: ‘From the standpoint of economic efficiency, the court should assign the loss from non-delivery so as to make future contractual behavior more efficient. And a rule for doing this is *to assign the losses to the party who can bear the risk of such a loss at least* cost.’[3] This person is also called the ‘cheapest cost avoider’, i.e. the party who can bear risk at the lowest cost.[4]

2 Analysis of the hard-core cases

My applications are basically based upon four major Labour Court judgments (AD 1934 no 179, 1981 no 131, 1984 no 79 and 2014 nr 13).[5] The question is in what way an economist would analyze these cases. What do a mill worker, a bicyclist, a machinist and an ice-hockey player have in common? I intend to submit a few remarks upon these cases, using the toolbox of economics.

2.1 Labour Court judgment 1934 No. 179

This is a case concerning the question of whether a refusal to perform work is in violation of a collective agreement when there is a dispute about the scope of the duty to perform work and the dispute cannot be decided in court before

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[2] J. L. Harrison and J. Theeuwes, Law & Economics (W. W. Norton & Company 2008) 258.
[3] R. Cooter and T. Ulen, Law and Economics (Harper Collins Publishers 1988) 2–3. Italics in the original.
[4] See Schäfer and Ott (n l) 179, 276. See also L. Werin, Economic Behavior and Legal Institutions. An Introductory Survey (World Scientific Publishing Co 2003) 306 (‘First, there is a strong argument in favor of placing the burden of a loss on the party, who is the ′cheapest avoider′, that is, best able to foresee the risk of a loss, or counteract it, or to take out insurance. This is generally an efficiency-promoting solution, lowering the residual loss’). See also G. De Geest, J. Siegers and R. Van den Berg (eds), Law and Economics and the Labour Market (Edward Elgar Publishing Limited 1999) 35 (discussing information production at a pre-contractual stage which implies that: ‘The least-cost information gatherer should have a duty to produce information, as long as the information costs do not exceed its value, and a duty to reveal that information as long as the communication costs do not exceed its value’).
[5] A fuller account of the first three cases is given in R. Eklund, T. Sigeman and L. Carlson, Swedish Labour and Employment Law: Cases and materials (Justus Förlag 2008) 156–183, 226–231, 255–259. The fourth case is reported in International Labour Law Reports Vol. 34 (Koninklijke Brill NV, Leiden 2015).

the work is performed. The employer *Stokkebyes* runs a mill outside Gothenburg. The employer announced that 'The mill will be run in three shifts on Sunday 27 May 1934' due to heavy workload. The employer requested overtime work according to the collective agreement. The workers refused to perform work on Sunday. Several issues were raised before the Labour Court.[6] However, as regards the main issue the Court established the principle that an employer was entitled to interpret an agreement with respect to the duty to obey orders, alongside pertinent collective agreements. Only in exceptional cases would an employer's standpoint be rejected.

The main issue in the *Stokkebyes* case related thus to the refusal to perform overtime work at the request of the employer. The Labour Court found it necessary to assess the case from a broader perspective and held accordingly:

> With respect to the more general principle as to whether a refusal to work is an unlawful act, irrespective of the proper interpretation of the collective agreement as regards the scope of the duty to perform work, the union has argued that the workers were under no duty to perform work when the parties were in disagreement about it, since the employer could then make a *per se* impossible interpretation of the agreement in order to have work done unlawfully. However, it could be argued with equal force, that if a refusal to work was considered lawful in such a dispute, the workers would be able to prevent work being done with reference to another *per se* untenable interpretation of the agreement that the employer is entitled to request that work be carried out. *It should be noted in this context that it is generally more difficult to receive a post-factum compensation for damage arising from the fact that reasonably requested work has not been performed due to a refusal to perform it, as compared to damages that may arise due to the fact that workers have been forced to perform work which they had no duty to perform*. A refusal to perform work may also be frequently classified as industrial action taken in order to put pressure on the counter-party to resolve a dispute of interpretation. *In consideration of the employer's right to direct and allocate work,*[7] the Labour Court must assume that whenever a dispute related to the duty to perform work occurs and the dispute cannot be resolved in due time by the Labour Court prior to when the work is to be performed, the employer must be entitled, as

[6] Only the main issue is dealt with here.
[7] My italics.

> a rule, to request that work be done while pending the resolution of the legal dispute. Exceptions to this rule can exist in several cases. For example, in AD 1931 No. 15 the Labour Court stated what was required from an employee had to be reasonable, and, likewise, that the main rule had to be relinquished in view of a conflict of interests of a higher order. In this context, it is also relevant when assessing issues related to a refusal to work to consider whether the employer in question has acted in good faith with respect to the dispute. If the employer's order to perform work is based on an employer's interpretation of an agreement which the employer ought to have understood was not tenable, the employer cannot blame the employee if the order is not obeyed. Concerning then the meaning of the collective agreement relating to Sunday work, Section 2 provides without restriction that work is to be performed in addition to regular working hours at the request of the employer. That workers are not exempted from overtime work on Sundays and public holidays follows from the fact that special compensation is provided for such work in the contract. — In want of clear provisions in the agreement, in cases of urgency the employer may order shift work on Sundays, including time-consuming repair work. Accordingly, the Labour Court has come to the conclusion that the refusal of the workers to perform the required overtime work on the Sunday of 27 May 1934 was not justified with respect to the meaning of the agreement.

Stokkebyes can be seen as an early example in Swedish labour law of the allocation of risk between contractual parties in an area of law in which conflicts at that time were frequent, departing from that which was applicable to disputes in private law in general.[8] The employer´s right of interpretation came to be a property right, among the bundle of rights that correspond to the employer's prerogative.[9]

In *Stokkebyes* the Labour Court determined that it was much easier for an employer to compensate an employee afterwards if the employer should be proven wrong in a given dispute, than to impose a potentially heavier financial burden on employees in the form of damages that would have to be paid if the employees' interpretation of the contract was held incorrect.[10]

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[8] See Harrison and Theeuwes (n 2) 164, 171: 'contracts are basically tools for allocating risks'.

[9] See Werin (n 4) 14.

[10] Cf. F. Schmidt, Law and Industrial Relations in Sweden (Almqvist & Wiksell 1977) 154, arguing that the outcome only reflects the old Swedish regulatory regime in which a servant was under complete control of his master. Cf. a learned treatise by M. Kumlien, Continuity and Contract.

This type of reasoning fits well within the modern school of legal theory in law and economics. It would seem that the Court adopted a 'deep pocket approach.' Schäfer and Ott submit: 'The party with the deepest pocket – the so-called ´deep pocket approach´ by Calabresi – should be held liable.'[11] The Court applied the efficiency argument, where, as stated above, Rule No. 1, stipulates that losses should be assigned to the party who can bear the risk of such losses at the lowest cost.[12]

A relevant interlude

Before proceeding to the next case the reader should note that the reasoning of the Labour Court in AD 1934 No. 179 predates the first-ever article on law and economics by R.H. Coase from 1937.[13] He is the founding father of the concept of 'transaction costs'. To achieve efficiency, one has to keep track of the transaction costs. This is the way Coase formulated it in his 1937 seminal article:

> The main reason why it is profitable to establish a firm would seem to be that there is a cost of using the price mechanism. The most obvious

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Historical Perspectives on the Employee´s Duty of Obedience in Swedish Labour Law (Institutet for rättshistorisk forskning 2004) arguing at 317 that the Labour Court elaborated 'a teleological method based upon hidden terms and natural presuppositions', and at 326 that 'the worker´s duty of obedience marks a prerequisite and, at the same time, a consequence of the employment relationship'. Apart from the fact that the later statement smells of a circle argument, the first argument about a teleological method is not convincing. Chief Justice Arthur Lindhagen, who took up his office in 1929 in the Swedish Labour Court, lasting until 1946, when he was appointed President of the Svea Court of Appeal, developed modern industrial common law. I agree, however, with Kumlien 323 when he submits the view that Lindhagen was given 'the predominant role in the making of the modern contract of employment'. Mr Lindhagen was an eminent lawyer and judge. He was also one of the main architects of the 1929 legislation, i.e. Act on Collective Agreements and Act on the Labour Court. The titillating question is what the Court departed from when it started its activities in 1929. In fact, there was nothing to depart from in terms of statutory frameworks, there were only collective agreements. Gaps were to be filled in. It must be recalled that between 1920 and 1928 Mr Lindhagen was also the chairman of the Central Arbitration Board (Official Gazette 1920:246), which was a voluntary institution geared toward solving disputes with respect to the content and application of collective agreements. It is plausible that Mr Lindhagen already during those years was confronted with many of the major issues that the Labour Court had to resolve later on, during the formative years of the Court. I know of no other source that highlights the actual case practice of the Central Arbitration Board.

[11] Schäfer and Ott (n 1) 291. See also Werin (n 4) 283–284, arguing that on a somewhat practical plane a guideline for the courts to protect the weaker party is that '[l]osses should burden those who have the "deepest pockets"', although "several arguments speak against the guidelines", says Werin.

[12] See J. Hellner, Skadeståndsrätt och rättsekonomi, *Tidsskrift for Retsvidenskab* (1998) 374 ('*riskallokering*') and 384 what is called 'the cheapest cost avoider' in the Swedish Act on Torts, applying especially to Ch. 3 Sec. 1 and Ch. 4 Sec 1 of the Act with respect to liability for damage and that a choice has been made; the employer is the better 'cost avoider' than the employee.

[13] R.H. Coase, The Nature of the Firm (ECONOMICA 1937) 386–405.

> cost of ′organising′ production through the price mechanism is that of discovering what the relevant prices are. —The costs of negotiating and concluding a separate contract for each exchange transaction which takes place on a market must also be taken into account. —There are, however, other disadvantages – or costs – of using the price mechanism. It may be desired to make a long-term contract for the supply of some article or service. This may be due to the fact that if one contract is made for a longer period, instead of several shorter ones, then certain costs of making each contract will be avoided. — Now, owing to the difficulty of forecasting, the longer the period of the contract is for the supply of the commodity or service, the less possible, and indeed, the less desirable it is for the person purchasing to specify what the other contracting party is expected to do. — We may sum up — by saying that the operation of a market costs something and by forming an organisation and allowing some authority (an ′entrepreneur′) to direct the resources, certain marketing costs are saved. The entrepreneur has to carry out his function at less cost, taking into account the fact that he may get factors of production at a lower price than the market transactions which he supersedes, because it is always possible to revert to the open market if he fails to do this. — The point has been made — that *a firm will tend to expand until the costs of organising an extra transaction within the firm become equal to the costs of carrying out the same transaction by means of an exchange on the open market or the costs of organising in another firm.*[14]

Coase repeated the same theme in 1972: 'The way in which industry is organised is thus dependent on the relation between the costs of carrying out transactions on the market and the costs of organising the same operations within the firm which can perform this task at the lowest cost.'[15]

Coase also addressed the issue of transaction costs in another seminal article published in 1960. He stated that it is of course, 'a very unrealistic assumption' to think that there are no costs involved in carrying out market transactions, and continued:

[14] Coase (n 13) 390–392 and 395. My italics. Werin (n 4) 118 adds to it: 'The conclusions may seem eminently simple and almost self-evident, once we are confronted with them.'

[15] R.H. Coase, Industrial Organisation: A Proposal for Research, reprinted in R.H. Coase, The Firm, the Market and the Law (The University of Chicago Press 1990) 63.

> In order to carry out a market transaction, it is necessary to discover who it is that one wishes to deal with, to inform people that one wishes to deal with and on what terms, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed, and so on. These operations are often extremely costly, sufficiently costly at any rate to prevent many transactions that would be carried out in a world in which the pricing system worked without cost.[16]

Transaction costs are obviously an integral part of all market transactions, say Harrison and Theeuwes and state the following:

> In order to get a contract, you first have to incur costs in order to find a partner with whom to make a contract (find somebody who is willing to sell, lend, or rent you something you want or find an employer who is willing to hire you). These search and information costs involve buying a newspaper and checking the advertisements, phoning around, travelling to the other party, checking the goods, and so on. Next, you have to bargain about the terms of the contract (date of delivery, payment, after-sale service). These are the costs of drawing up a contract. Finally, there are the costs of monitoring the execution of a contract (Does the other party deliver on time? Is the quality satisfactory? Does he pay on time?), and there are the costs of dealing with non-compliance and, if worse comes to worse, there are costs relating to breach of a contract.[17]

The next case is a good example of the way in which the parties could have avoided the court proceedings (transaction costs) if the information asymmetry had been disclosed at an earlier stage between the prospective employee and the employer.

2.2 Labour Court judgment 1981 No. 131

A professional bicyclist, Mats Ericsson, applied for a job and there were extensive preliminaries between the prospective employer and the employee. No employment law provisions exist with respect to the conclusion of employment contracts in Sweden. The courts consequently seek guidance in

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[16] R.H. Coase, The Problem of Social Cost, reprinted in R.H. Coase, The Firm, the Market and the Law (The University of Chicago Press 1990) 114. Werin (n 4) 82 is keen to stress that Coase was anxious to demonstrate 'the immense importance of nearly unavoidable transaction costs'.

[17] Harrison and Theeuwes (n 2) 91.

the general law of contracts.[18] The general principles of Swedish contract law not only entail that an explicit offer of employment is binding on the offeror, but also that the offeror's conduct and implied intent can be binding on the offeror. An employment contract may consequently arise if the employer acts in such a way that the job applicant has reason to believe that he or she has been employed.

The Labour Court held:

> It is not necessary for the conclusion of a valid employment contract that the parties follow any specific standard. It is also quite common that employment relationships are established by means of oral agreements stipulating that an employee is to begin work at the company on a particular day. In exceptional cases, such agreements do not even have to be explicit, but may be inferred from the parties' conduct. — The question that arises is whether Ericsson may have had reason to believe that the company had employed him. The following circumstances are of importance in this connection. The company took the initiative in contacting Ericsson by placing an advertisement for a salesperson at the end of November 1979. This advertisement led to a meeting between Ericsson and the company's representative, Mr Ekberg, on 3 December. At the meeting, Ericsson gave an oral presentation of his qualifications. Ekberg on his side informed Ericsson about the advertised position. He also asked Ericsson whether his girlfriend would have anything against the fact that the work was demanding and required a lot of travelling. Ekberg considered it important that the families of the employees had nothing against the demanding character of the work. The next meeting, which took place on 11 December, came about due to the fact that Ericsson approached Ekberg, and asked him how things were going. At that point in time, Ericsson was the only applicant for the vacancy. Ekberg questioned Ericsson on that occasion about his girlfriend's attitude, upon which Ericsson replied that she had nothing against the work in question. Thereafter, a long discussion took place regarding the work and what it involved, as well as the salary and other compensation that could be relevant. Regarding this point, Ekberg's son, Kenneth Ekberg, employed as a salesman and having held the position that had become vacant, also

[18] For an account of the case law on this issue, see R. Eklund, Att ingå avtal om anställning – ett blad ur arbetsdomstolens praxis, in Festskrift till Jan Ramberg (Juristförlaget 1990) 119–140.

provided further information. Finally, there was a question of whether Ericsson would have a company car, which the company's representative answered in the affirmative, and said that Ericsson could, as did the company's other salespeople, have a leased car with free petrol of up to 30 000 km/year. He could also use his own car for work, receiving compensation equivalent to the company's net costs for leasing a car. At one of these two meetings, Ekberg asked Ericsson when he could start work at the company. Ericsson informed Ekberg as to this by telephone on 21 December, and said that he could start on 1 February 1980. From the information submitted by Ekberg to the Labour Court, it appears that at the end of December he was still uncertain whether he would employ Ericsson, who had never worked as a salesperson, and whether he really was the right person for the post. He was also doubtful whether Ericsson would be able to do his job well, as he was in training as a racing cyclist, aiming for the Olympics in Moscow.

It is important to consider, however, how the situation appeared to Ericsson at that point in time. From his point of view, all the essential questions concerning his employment had been cleared up. Ericsson's future work tasks, his salary, the possibility of using a company car, as well as the question so important to the company concerning Ericsson's family, or, more specifically, his girlfriend, and her acceptance of the demands of the job, had all been examined. Finally, Ericsson had also informed the company that he could start in the near future, namely on 1 February 1980. Ericsson told the Labour Court that already at the meeting on 11 December he had a definite impression that the company had employed him. The Labour Court finds this information reliable. As shown above, Ericsson had reason to believe at least by the end of December that this was the case. This impression must be seen as having been further confirmed by the contacts between Ericsson and the representatives of the company on 4 and 8 January. On both of these occasions, further discussions were held concerning Ericsson's employment, without any of the company's representatives implying that Ericsson had not yet actually been employed. Finally, it must be mentioned that Kenneth Ekberg phoned Ericsson on 11 January, asking him how he spelled his name. In accordance with the statement submitted by Kenneth Ekberg to the Labour Court, the objective of the telephone call was to obtain that information, as the company was planning on having new business cards printed for all the staff.

> The Labour Court has come to the conclusion that by the beginning of January, the many discussions between the parties upon different occasions concerning Ericsson's employment had gone so far that the company's representatives must be considered to have had a duty to make their position clear, and explain that a contract of employment had not yet been concluded. The company's representatives, however, did not do this. On the contrary, on several occasions and in the manner described above, they took various measures that strengthened Ericsson's belief that he had been given the advertised position. Due to the aforesaid, the Labour Court is of the opinion that an employment relationship was established between Ericsson and the company. —-[19]

It is obvious that after a tedious and protracted scrutiny the Labour Court found that the parties had entered into a contract of employment, inasmuch as the discussions concerning Ericsson's employment had gone so far that the representatives of the employer had a duty to make their position clear and explain that no contract of employment had been concluded.[20]

How would an economist argue? Who is the cheapest cost-avoider? It is no doubt that this is the prospective employer. Werin argues when referring to this case, that the outcome is 'efficiency-promoting, as it signals to employers not to be unclear in their contacts with potential employees, who might be led to make wrong decisions.'[21] It is a recurrent theme in the law and economics literature that recruitment relates to information asymmetries. Milgrom and Roberts say:

> With employment being a complex, long-term, multifaceted relationship rather than a simple market transaction, both sides will be particularly careful to avoid entering the relationship with an inappropriate partner, and, once it is entered, both will be concerned with maintaining and building the value of the relationship. — These information asymmetries are especially a problem in recruiting where each side has information about itself that the other does not have but that is important for judging the quality of the potential match.[22]

Mundlak makes the following statement with respect to one-sided information

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[19] The issue of damages according to the Employment Protection Act related to wrongful dismissal in not dealt with here.
[20] A similar approach is also adopted in another Labour Court judgment, AD 1988 No. 169.
[21] Werin (n 4) 294.
[22] P. Milgrom and J. Roberts, Economics, Organization and Management (Prentice Hall International, Inc. 1992) 338–339.

asymmetry, relating to Israeli labour relations: 'There are several causes for concern about information asymmetry at the stage when the employment contract is bargained. For most employees, the search for employment is a process in which the employee gives all requested information, while the employer can easily withhold or obscure information.'[23] This may lead to opportunistic behaviour when one party does not pass information to the other party, because withholding it brings an advantage to that party.[24]

It is obvious that the lawyer and the economist are using different toolboxes. Hellner once acknowledged that economists and lawyers approach the problems in different ways.[25] But the outcome and conclusion of a lawyer and an economist in a specific case can be the same as in AD 1981 No. 131 case.

Schäfer and Ott argue that they intend to 'go further to postulate that wealth maximization is an implicit ethic of civil law and that the courts use this principle in the weighing of individual interests,' and they add: 'That we can frequently find a correspondence between legal principles and judge-made law and efficiency should not really come as a surprise.'[26] I will come back to this aspect at the end of this contribution. My thesis is that skilled judges have a built-in compass to find an efficient solution to a dispute they have to resolve.

2.3 Labour Court judgment 1984 No. 79

The legal framework relating to the normative effect of a collective agreement is explicitly stated in Section 26 of the Joint Regulation Act. The collective agreement is binding upon members of the contracting parties, but the statute is silent regarding the applicability of the agreement to non-union or rival union employees. However, Swedish employers have a long-standing practice of applying these agreements also to non-union members of the contracting trade union.[27] Accordingly, the terms and conditions of a collective agreement will *fill in* the gap of the contract of employment if the employer and the

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[23] See G. Mundlak, in G. De Geest, J. Siegers and R. Van den Bergh (n 4) 67.

[24] Schäfer and Ott (n 1) 94, see also 369 where a distinction is made between *ex ante* and *ex post* opportunism. *Ex ante* opportunism means: that 'one of the contracting parties possesses or has easy access to information that the other does not and which is to the disadvantage of the other party.'

[25] Hellner (n 12) 358.

[26] Schäfer and Ott (n 1) 47. A similar remark is found in D.D. Friedman, Law´s Order. What Economics Has to Do with Law and Why it Matters (Princeton University Press 2000) 22: 'As we develop the economic analysis of law we will observe a surprising correspondence between justice and efficiency. In many cases principles we think of as just correspond fairly closely to rules that we discover are efficient. Examples range from "thou shall not steal" to "the punishment should fit the crime" to the requirement that criminal penalties be imposed only after proof beyond a reasonable doubt'.

[27] See AD 1977 No. 49.

individual employee have not agreed otherwise. In this case, Odenlid was employed as a machinist by Nynäshamn municipality. He received wages that were lower than those of the other machinists employed by the municipality, although the machinists all performed the same kind of work. One difference between Odenlid and the other machinists was that Odenlid was not a member of the Swedish Municipal Workers' Union, i.e. the contracting trade union with the municipality. Odenlid argued that the so-called normative effect of the collective agreement in force entitled him to wages equal to those of the other machinists.[28] The employer argued that Odenlid received wages within the range provided by the national collective agreement and that Odenlid was not entitled to higher wages.

The Labour Court found that Odenlid had no legal basis for claiming equal wages, based on the so-called *normative effect* of the collective agreement. The Labour Court held:

> With respect to the parties' arguments, the Labour Court will first of all address the notion that a non-union employee's contract of employment is a reflection of the collective agreement at the work place.
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> Problems seldom arise concerning this issue. This is particularly true when the agreement is quite clear in that it may be applied to the employment relationship between the employer and non-union employees without any difficulty (see, for example, NJA 1948 p. 1, NJA 1967 p. 513 and NJA 1973 p. 423). In the opinion of Professor of Labour Law Folke Schmidt in such cases the practice at the work place creates a legal norm, provided that the parties have not expressly opted for a different solution (Löntagarrätt p. 40).
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> This principle is more difficult to apply, however, if the agreement does not offer a general, uniformly applicable solution, as well as in those cases where local and central collective agreements have been combined. How is such a principle to be applied to cases when the collective agreement offers some basic norms with regard to wages, but at the same time, leaves room for various kinds of individually regulated wages and when the local trade union is involved to a greater or lesser extent? What wage level applies in such a case with regard to a non-union employee under the individual contract of employment?
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> When answering such questions, one must bear in mind that freedom

[28] Odenlid also alleged two other grounds to uphold his claim, but these grounds are not dealt with here.

of contract is the paramount principle with respect to wages, which means that the employer and the non-union employee may agree upon any wage whatsoever. However, in the absence of such an agreement, there is a need for a default rule – call it a presumption – in order to be able to determine what wage the employer is legally obliged to pay. It goes without saying that it is natural to assume in such cases that the parties are in agreement that the employee will be paid with respect to the work in question according to the collective agreement in force at that work place. Such a presumption about the will of the parties is legitimate if the norm of the collective agreement is clear and generally applicable. If not, a good deal of the underlying basis for such a presumption will not apply. If the collective agreement provides that wages are to be set on an individual basis, there is no longer a clear comparison for such a presumption. In such a case, it may only be assumed that the employer and the non-union employee have agreed that the minimum wages set out in the collective agreement will apply.

That this should be so follows also from the fact that it would not be reasonable to have a presumption that would give the unorganised employee a more advantageous position than an organised employee. If the employer has decided to pay – or has the right to pay – one or more of its employees a wage that corresponds to the minimum wage level, while other organised employees receive a higher wage, the unorganised employee cannot claim a wage higher than the minimum wage. Accordingly, with reference to the contract of employment, he cannot make a claim to receive wages equal to those received by one or several of his fellow workers who have been given a higher wage, while other employees in the same group have not been treated in the same way. It follows from this that at work places where wage setting is done on an individual basis, the collective agreement will be of lesser importance to the unorganised employee. The same applies to latitudinal wages in which the unorganised employee cannot lay a claim to more than the minimum wage by reference to the contract of employment.[29] On the other hand, if the employer applies a strict tariff wage system that prescribes the same wage for a certain category of workers, the unorganised employee belonging to a given category will

[29] The term 'latitudinal wages' was previously used in the municipal sector where there was both a wage floor and a wage ceiling in the wage-system, and where wages could vary within the limits thus set.

receive the same wages as those received by his fellow-workers in accordance with the main rule of the normative effect of the collective agreement.

In summary, the normative effect of a collective agreement is consequently limited to the norms of the agreement applicable to the entire group of workers of which the non-union employee is a part. Thus, the way in which the non-union employee's wage level is protected depends on the structure of the collective agreement. There is no general rule in Swedish law granting employees equal pay for equal work. In fact, the legal order allows employers to pay non-union employees lower wages, unless otherwise provided for in the contract of employment. Since the right not to belong to a trade union, denominated as the negative right of association, is not legally protected in Swedish law,[30] the aforementioned is an inevitable consequence of the freedom of contract principle when it comes to the setting of wages. —

In the foregoing, the Labour Court has limited itself to the matter concerning the normative effect of the collective agreement as applied to non-union employees with respect to the rules concerning the setting of wages. However, one must also raise a question as to whether the unorganised employee may refer *to the manner in which the employer has in fact acted*[31] or, in other words, whether the actual wages of the fellow-workers constitute such a tradition at the work place as to force the employer to apply the same wages in relation to the non-union employee.

According to the Labour Court there is no scope for such a consideration at work places where the wages are set collectively. It is very common at those work places that the wages are decided by means of collective agreements and that additional wage supplements are set individually. As a consequence of this practice, the surplus wages are related to single individuals — The same is true when the surplus individual wages are set by agreement with the local trade union.

In general, it is therefore fair to conclude that the non-union employee may claim wages in accordance with the minimum *collective*

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[30] This law has changed to a certain extent since the incorporation of The European Convention for the Protection of Human Rights and Fundamental Freedoms in 1995. It is probably no infringement of the negative right of association to deny rival union employees a wage increase, refer to Labour Court judgment 1982 No. 69.

[31] My italics.

> level set forth in the collective agreement governing the work place, but that such an individual cannot claim wages based on the individual wage setting applying to other employees at the work place.[32] — The non-union employee is therefore left to his own devices when negotiations with the employer concerning any surplus wage exceeding the collectively regulated wage level. This is due to the fact that he has chosen to remain outside the trade union, and has thereby abstained from seeking help in negotiations that a trade union can offer to its members. —

The Court in *Odenlid* clearly states that a non-union employee may not claim equal pay for equal work by referring to the so-called normative effect of the collective agreement. However, the Court saw no problem in applying such a principle to *fixed* terms and conditions in the collective agreement, such as sick pay, usually set to a certain amount, with references to several Supreme Court cases on the same issue, wherein the Supreme Court declared once and for all that in cases where the employer and employee had reached no agreement with reference to a specific term or condition of work, the applicable collective agreement would apply. In such cases, the branch agreement most often has an effect on the content of the non-union employee's contract of employment. It is the same as *filling the gap* of the contract of employment. This can be seen as an efficient solution where the two parties have neglected to state exactly what is to apply. It is a clear example of judge-made law. However, wages that are set individually cannot be extended to include non-union workers in the same simple manner. This is why the Court concluded that a non-union employee *may claim only the minimum wage level.* One must observe here that the Labour Court very strongly referred to the parties' freedom of contract in order to avoid being implicated in local wage disputes. It is also a well-established view in Swedish labour law that there is no principle of equal wage for equal work with respect to union membership or a lack thereof. This was stated for the first time already in AD 1942 No. 72, and the principle was also applied later on by the Supreme Court in NJA 1973 p. 423.

What the Court did in this case was to apply a *default rule*, which has been very effective. To my knowledge, no other similar case has been adjudicated before the Labour Court.[33] The basic idea here is the following. A fully

[32] Italics in original.

[33] Another default rule was implemented in the so-called 'sauna bath case', Labour Court judgment 1978 No 89, to limit an employer´s right to transfer an employee to other working tasks at the workplace. It was like opening Pandora´s box. Many cases of a similar kind followed.

specified contract is but a thought experiment. High transaction costs mean that such contracts are unlikely to come into being. To reconstruct the fully specified contract is to use default rules. 'These are those terms that fill the gaps in a contract and would have been those that the parties would have negotiated themselves but failed to do.'[34] These are also called *gap fillers*. Gap-fillers are default contract rules that become part of the contract when the parties either choose not to or forget to include a specific term.'[35]

It makes sense for a collective agreement to fill the gap in case the contracting parties have not opted for a specific solution themselves if the Court's advice is to apply a clear and unequivocal rule. No doubt, simple rules are the best rules.

The last case is of recent date.

2.4 Labour Court judgment 2014 No. 13

An ice hockey player (Marcus Nilsson) entered into a contract of employment with a premier league hockey club (Djurgården Hockey AB) for four seasons. The issue that emerged was whether the contract ceased to have effect when the club was demoted to a league below the premier league (Swedish Hockey League). The Labour Court found that the hockey player´s contract of employment did not cease to have effect when the club was demoted. He was awarded economic damages corresponding to the difference in pay between what the hockey player would have earned if he had stayed in the club, and what he actually earned after his transfer to another ice hockey club in the Premier League (altogether 470 019 SEK); in addition, exemplary damages in the amount of 75 000 SEK were awarded to him.

The Labour Court held, in the pertinent parts which are of interest here, first of all that the employer (the club) had not proved that the contract of employment contained a provision implying that the contract should cease to have effect if the club should lose its position in the Premier League, and secondly, that the action of the employer amounted to summary dismissal of the hockey player. The Court proceeded subsequently to analyse the claim for damages, and, in particular, whether the claim for damages should be modified. The Court held:

> The next issue to consider was whether Marcus Nilsson´s wages should be modified, owing to the fact that the club would be playing in a league below the Premier League. Both the club and Marcus Nilsson assumed

[34] Schäfer and Ott (n 1) 299.
[35] Harrison and Theeuwes (n 8) 168.

> that during the contractual period the club would be playing in the Premier League. *It was no doubt in the best interests of the club to stipulate contract provisions that should apply if the club lost its position in the Premier League.*[36] Marcus Nilsson was not in any better position to foresee that the club would lose its status in the Premier League, or to counteract such an event. — In the light of the foregoing there exists no reason for any modification of the original amount of wages, when we take into consideration both what took place at the time of the conclusion of the contract and what transpired afterwards. —

First of all, it may sound strange that team sports are regulated by collective agreements, but this is actually the case in soccer/football and ice hockey in Sweden. This means that the semi-mandatory provisions of the Employment Protection Act concerning fixed-term contracts may be derogated from if there is an exemption from the statutory provisions in the collective agreement. This is why the contract of employment for four years, such as in this case, is legal. This kind of a fixed-term contract may not be concluded under the provisions of the Employment Protection Act, unless derogation from its provisions has been made by means of a collective agreement.

Secondly, however, the case did not affect the derogation provisions of the pertinent collective agreement at all. The case concerned only the question as to whether the employer/club was entitled to decide that the contract of employment with the ice hockey player had ceased to have effect due to the fact that the club had lost its position in the Premier League. The Court held that this was not the case.

With respect to the claim for economic damages the Court held: 'It was no doubt in the best interests of the club to stipulate contract provisions that should apply if the club lost its position in the Premier League. Marcus Nilsson was not in any better position to foresee that the club would lose its status in the Premier League, or to counteract such an event.'

What the Court has done here is to apply what I call Rule No. 1 of law and economics (refer above to Cooter and Ulen): 'From the standpoint of economic efficiency, the court should assign the loss from non-delivery so as to make future contractual behavior more efficient. And the rule for doing this is *to assign the losses to the party who can bear the risk of such a loss at the lowest cost.*' Harrison and Theeuwes add the following:

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[36] My italics.

> The issue of excusing performance is ultimately one of risk allocation in a context in which the parties did not actually consciously allocate the risk at all. — The best outcome from an economic standpoint is to find that the party did assume the risk if he or she was in a better position to anticipate the event, assess the consequences, and insure against it. That party was most likely in a position to avoid the losses of the unexpected event at a lower cost than the other party. — When the party is not excused, the plaintiff is entitled to damages.[37]

What the Labour Court is saying here is that the hockey club (employer) could have discussed the issue of alternative contractual terms regarding the salary with the ice hockey player in case the club was to be demoted to the league below the Premier League already at the time when the contract of employment was entered into, since it was definitely in its best interests to do so. It means that law and economics are on a par with legal reasoning.

The issue under discussion has to do, of course, with the problem of incomplete contracts.[38] It is hard to foresee all modalities. 'Bounded rationality' is the catchword, launched by the Nobel Laureate, Herbert Simon.[39] 'Relational contracting' is another catchword developed by Oliver Williamson, another Nobel Laureate. Examples include major commercial contracts and labour and family relationships, where there is always a need to iron out solutions which you could not foresee at the very start of the relationship.[40]

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[37] Harrison and Theeuwes (n 2) 244.

[38] See C. Estlund, in C. Estlund and M. Wachter (eds), Research Handbook of the Economics of Labor and Employment Law (Edward Elgar Publishing Limited 2012) 474: 'The employment contract is highly incomplete. Most of its terms are relegated to employer's discretion, informal norms, and reputational sanctions, and are not legally enforceable.. — Their raison d´etre is the avoidance of explicit contracting costs, and their terms are largely open-ended, leaving much to employer's direction and informal interaction.' The 'incompleteness' of the contract of employment is also highlighted by S. Deakin and F. Wilkinson, in G. De Geest, J. Siegers and R. Van den Berg (n 4) 11,14: 'The "incompleteness" of the contract of employment is widely recognized to be the consequence of its long-term orientation and the extreme degree of uncertainty over future performance. — In the case of most contracts of employment, it is unclear when the employment relationship is to end; the precise content of the employee´s obligation to work is rarely specified; and the intensity of work effort is also left unstated.'

[39] H. Simon, Rational Decision Making in Business Organizations (69 Amer. Econ. Rev 1979) 493–513. This article is the lecture Herbert Simon delivered in Stockholm, December 8, 1978, when he received the Nobel Prize in Economic Science. At 502–503 Simon says: '[B]oundad rationality is largely characterized as a residual category – rationality is bounded when it falls short of omniscience. And the failures of omniscience are largely failures of knowing all the alternatives, uncertainty about relevant exogenous events, and inability to calculate consequences. — Two concepts are central to the characterization: *search* and *satisficing*.— [T]he important thing about

3 To conclude

Werin argues that '[j]udges are intuitively reasoning economically in the basic sense of balancing costs and benefits. — This may sound somewhat disrespectful to courts, but it is not. The theory is based on a belief that courts are imbued by a tradition always to see to what is best in the longer run for all of us, and that they have acquired an intuitive feeling for what this implies for the framing of law. If anything, this gives reason to respect courts, not the opposite. — It is another matter how the courts choose to *formulate* their arguments. They do not even evoke ”efficiency” or ”promotion of wealth” explicitly in their statements. It is rather natural for courts to be reluctant to reveal the basic motives for their decisions.'[41] Schäfer and Ott submits a similar view: 'Civil codes often contain a multitude of imprecise rules. — The question is whether or not the courts are able to transform the rules into practical behavioural instructions for example by concretizing the meaning of ”due care”. The point is that this decentralized process of interpretation and adaptation is often much more effective at reaching precision than by legislative enactment because the courts are much closer to the sources of the

the search and satisficing theory it that it showed how choice could actually be made with reasonable amounts of calculation, and using very incomplete information, without the need of performing the impossible —' Milgrom and Roberts (n 22) 354 state: 'Herbert Simon introduced the idea of employment as a relationship into economics and explained the crucial features of the employment relation as responses to the necessary limitations on contracting that follow from bounded rationality', see also 329–330: 'The employment contract is typically quite imprecise. — The incompleteness, the implicit nature, and the shape of the employment contract are all responses to the impossibility of complete contracting. — The usual employment contract instead is much more a relational contract. It frames the relationship, specifying broad terms and objectives and putting in place some mechanisms for decision making when unforeseen events occur.' Werin (n 4) 292 also states: 'But there is a serious complication in that virtually all contracts are incomplete, if not otherwise because transaction costs usually prevent a perfect specification.'

[40] O. Williamson, Transaction-Cost Economics: The Governance of Contractual Relations (22 The Journal of Law and Economics 1979) 233–261. In conclusion he says, 261: 'Transaction-cost economics is an interdisciplinary undertaking that joins economics with aspects of organization theory and overlaps extensively with contract law.'

[41] Werin (n 4) 286–28, italics in original. A similar theme is developed by Schäfer, see H-B. Schäfer, in T. Riis and R. Nielsen (eds), Law and Economics. Methodology and Application (DJÖF Publishing Copenhagen 1998) 95–112 (stating at 110: 'Economic efficiency is a concept that can be legitimately used in the political dialogue. The dialogue in the courtroom is not in principle different from the general political dialogue. Consequently, the efficiency concept can be used as an argument by parties in the courtroom.') A good example of what is said is the Labour Court judgment 1992 No. 27. The dispute was whether the employer´s unilateral change with respect to subsidized lunches was a change in the terms of the contracts of employment of the employees. The Labour Court dismissed the claim, basically on technical grounds that it would amount to be a cumbersome and legally complicated procedure to dismiss all employees, in order to achieve a change of the subsidy, in particular as – the Court reminded – a better means of regulating the same

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problems and the necessary information that is required. In other words, judge-made law often produces more precise instructions at less cost than centralized debate at the highest legislative level.'[42] Friedman adds to it: 'Efficiency is a widely held value, and judges, even without the apparatus of economic theory, can figure out more or less what rules are efficient.'[43]

A tentative conclusion is therefore that skilled judges have a built-in compass to find a solution that is efficient.

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issue was by collective agreement. Transaction costs would have been high if the Court had approved the claim – an aspect which is not mentioned at all in the judgment (see analysis in R. Eklund, T. Sigeman and L. Carlson (n 5) 264–265). The case is another example of the way in which a court makes use of 'open' arguments instead of 'binding' arguments, based upon the statute, legislative history and earlier case law. See F. Schmidt, Bundna och öppna argument i rättsvetenskapen, in Festskrift till Per-Olof Ekelöf (PA Norstedt & Söner Förlag 1972) 569–585.

[42] Schäfer and Ott (n 1) 102.

[43] Friedman (n 26) 298.