Can a Wrongful Discharge Statute Really Benefit Employers?

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Overall, there is overwhelming empirical support for the hypothesis that the Wrongful Discharge From Employment Act benefited employers in Montana. Shareholder returns were significantly higher given the Act than they would have been absent the law. This reflects shareholders' estimate of the effects of the Act on the future profitability of their firms. The increase in profitability would have been due to the benefits the Act gave to employers in Montana.

EMPLOYMENT-AT-WILL, the doctrine that allows an employer to discharge an employee for any reason, is generally considered extremely pernicious to employees. For years, advocates of employees and employees' rights have called for the passage of "wrongful discharge" legislation to protect employees from the consequences of employment-at-will. Such legislation, while benefiting employees, was presumed to be detrimental to employers[1] (Steiber and Block, 1992; St. Antoine, 1988). Despite these appeals, however, no state had enacted wrongful discharge legislation until 1987, when Montana passed the Wrongful Discharge From Employment Act (WDFEA). Given the nature of the employment-at-will doctrine and the numerous calls for "wrongful discharge" legislation from employees' rights advocates, one might expect that a statute entitled the "Wrongful Discharge From Employment Act"—which places limits on an employers' right to discharge employees—would be detrimental to employers. One also might expect exactly the opposite

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[1] Under wrongful discharge legislation, the reasons for certain discharges are treated as "wrongful," entitling employees discharged for those reasons to prevail in a lawsuit challenging their discharges.

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result, however. Given the state of the common law in Montana prior to the WDFEA and the provisions of the Act itself, it would be quite plausible to expect that the Act was beneficial for employers.

This article will investigate empirically whether, on balance, the WDFEA was beneficial or detrimental for employers through a technique known as *event study methodology.* The event study examines the effect of an event on the stock prices of a sample of firms likely to have been affected by that event. In this case, the "event" will be the passage of the WDFEA and the sample will consist of companies that operated in Montana at the time the Act was passed. A finding that the stock prices of firms with a strong connection to Montana were higher given the WDFEA than they would have been absent the law will indicate that the Act benefited employers overall. A finding that the stock prices of those same companies were lower given the Act than they would have been absent the law's passage will indicate that the WDFEA was detrimental for employers.

It is important to note that the results from the event study will test the *overall* effects of the WDFEA and will show whether, on balance, the Act was beneficial or detrimental for employers. Although the WDFEA might contain some provisions that were beneficial and others that were detrimental for employers, the event study cannot assess the effects of individual provisions of legislation. Further, normative issues surrounding the merits of the WDFEA specifically and wrongful discharge legislation in general have been treated extensively elsewhere and will not be treated in this article. The purpose of this article is to measure the effect of the Act on shareholder returns and to use that measurement to ascertain whether the WDFEA benefited employers, irrespective of whether the Act was "justified."

Employment-at-Will

The doctrine generally. For more than a century, the majority of employment relationships in the United States have been governed by a common law doctrine known as *employment-at-will*: If there is no written contract or collective bargaining agreement that specifies differently, an employer may discharge an employee at any time and for any reason, as long as that discharge does not violate a specific statute. In a frequently quoted passage, the doctrine was explained as follows: "[Employers] may dismiss their employees at will . . . for good cause, for no cause, or even for cause morally wrong, without thereby being guilty of legal wrong."[2]

[2] *Payne* v. *Western & A. R.R. Co.*, 81 Tenn. 507, 519–520 (1884).

The statutory limitations on employment-at-will apply only under limited circumstances and protect only certain classes of employees.[3] Therefore, since most employees are not covered by an individual contract or a collective bargaining agreement, and since most discharges do not violate a specific statute, the employment-at-will doctrine, in its absolute form, gives employers virtually unlimited freedom to discharge employees.

In a trend that gained momentum through the 1980s, however, courts in a number of states began to recognize common law exceptions to the employment-at-will doctrine. These common law exceptions can be grouped into three categories: (1) If an employee's discharge violated a public policy the state wished to uphold, the discharge was "wrongful," and the employee was entitled to recover damages. Examples of a public policy that would trigger wrongful discharge liability include the discharge of an employee for refusing to violate the law, for exercising a legal right, for satisfying a legal obligation, or for taking other actions that were deemed to be in the public interest (e.g., warning the public about safety hazards).[4] (2) An "implied covenant of good faith and fair dealing" exists in employment relationships, and this covenant was violated if an employee could establish that his (or her) discharge was in "bad faith" (e.g., an employer firing an employee for refusing to go on a date).[5] (3) Written and/or oral statements by an employer created an implied contract limiting the employer's right to discharge an employee.[6] Of the three theories, the first two are the most damaging to employers. Since the implied contract cause of action is based on contract law, the cases are tried by judges, and prevailing plaintiffs are entitled to recover solely actual "economic" or compensatory damages (i.e., back pay). Since the public policy and implied covenant causes of action are based on tort law,

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[3] For example, Title VII of the Civil Rights Act of 1964 prohibits employers from discharging employees on the basis of race, color, sex, religion, or national origin, 42 U.S.C. §2000-e2(a). The Age Discrimination in Employment Act, protects employees age 40 and over from being discharged because of their age, 29 U.S.C. §§621, 623(a). The National Labor Relations Act of 1935, prohibits employers from dismissing employees because of union activities, 29 U.S.C. §§ 157, 158 (a)(3).

[4] See, e.g., *Petermann* v. *International Brotherhood of Teamsters*, 174 Cal. App. 2d 184, 344 P.2d 25 (2d Dist. 1959) (employee discharged for refusing to commit perjury); *Nees* v. *Hocks*, 272 Or. 210, 536 P.2d 512 (1975) (employee discharged for refusing to be asked to be excused from jury duty); *Ludwig* v. *This Minute of South Carolina*, 287 S.C. 219, 337 S.E.2d 213 (1985) (employee discharged for complying with subpoena); *Phipps* v. *Clark Oil Refining*, 408 N.W.2d 569, 2 IER Cases (BNA) 341 (Minn 1987) (employee discharged for refusing to pump leaded gasoline into a car designed for unleaded gasoline only).

[5] *Monge* v. *Beebe Rubber Co*., 114 N.H. 130, 616 A.2d 549 (1974). See also, *Fortune* v. *National Cash Register Co*., 373 Mass 96, 364 N.E.2d 1251 (1977) (employee discharged so the employer could avoid paying him a large commission).

[6] See, e.g., *Toussaint* v. *Blue Cross & Blue Shield*, 408 Mich 579, 393 N.W.2d 880 (1980); *Pine River State Bank* v. *Mettille*, 333 N.W.2d 622 (Minn. 1983).

plaintiffs are entitled to a jury trial, and prevailing plaintiffs often recover punitive (exemplary) as well as compensatory damages. Punitive damages are usually significantly greater than economic damages (Edelman, Abraham, and Erlanger, 1992).

Montana law prior to 1987. At the time the WDFEA was passed, section 39-2-503 of the *Montana Code Annotated* provided:

> An employment having no specified term may be terminated at the *will* of either party on notice to the other, except where otherwise provided by this chapter . . . [emphasis added].[7]

In other words, Montana expressly recognized the employment-at-will doctrine by statute. Nevertheless, during the early to middle 1980s, Montana became one of the most "pro-employee" states in the employment-at-will area. The Montana courts recognized all three of the common law exceptions to the employment-at-will doctrine, and there were several highly publicized cases in which an employee prevailed in a wrongful discharge lawsuit and was awarded an extremely large damage award.[8] As stated by Schramm, "Montana was in the forefront of the trend towards rejection of the previously dominant presumption [of at-will employment] (Schramm, 1990, p. 96)." Hopkins and Robinson (1985, p. 23) noted, ". . . it appears that the ability of a discharged employee to contest his discharge judicially creates, as a practical matter, an exception that has swallowed the [at-will] rule. . . ." Andreason and Morton (1993, p. 23) stated:

> Montana's Supreme Court began to weaken the state's at-will employment doctrines in the mid 1970s. It developed a novel legal remedy known as the tort of bad faith for wrongful discharge. Briefly, the court's actions opened the door for emotional distress claims and punitive damages in employee dismissals.
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> In early 1982 the court held, without dissenting opinion, that Montana employers could be sued for wrongful discharge based on the nebulous concept of bad faith and be held liable for compensatory damages, punitive damages, and emotional distress. Employee termination issues suddenly ranked among the most hazardous problems facing Montana employers. Although the court couldn't repeal the state's at-will statute, it did routinely either ignore that statute or simply create exceptions it deemed in the public interest.

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[7] *Montana Code Annotated* Sec. 39-2-503 (1985).

[8] For example, *Flanigan* v. *Prudential Fed. Savings & Loan Assn*., 221 Mont. 419, 720 P.2d 257, 1 IER Cases (BNA) 1410 (1985), *appeal dismissed* 479 U.S. 980 (1986) (employee awarded $94,000 in economic damages, $100,000 for emotional distress, and $1,300,000 in exemplary damages); *Stark* v. *Circle K Corp*., 230 Mont. 468, 751 P.2d 162 (employee awarded $70,000 in punitive damages and ten years front pay); *Farrens* v. *Meridian Oil, Inc*., CV 85-229-BLG (1987), *aff'd in part and rev'd in part* 852 F.2d 1289 (9th Cir. 1988) (jury awards employee $2.5 million. 9th circuit upholds jury finding for employee on wrongful discharge claim but reduces $2.5 million award to $1.7 million).

The WDFEA

The passage of the WDFEA. In 1986, a number of businesses, business associations, individual chambers of commerce, and other groups representing the interests of business formed the Montana Liability Coalition (MLC). The MLC was established in response to a number of rulings in favor of plaintiffs that had been issued by the Montana courts in tort cases.[9] Throughout 1986, the Coalition worked with the Montana Association of Defense Counsel (MADC) (currently named the Montana Defense Trial Lawyers) on coming up with a way to limit recoveries by plaintiffs in a wide variety of tort cases. One of the tort areas the two groups wanted to see reformed was wrongful discharge.[10] Toward the end of 1986, the MADC drafted a bill entitled "An Act Providing a Procedure and Remedies for Wrongful Discharge; Authorizing Arbitration as an Alternative; Eliminating Common Law Remedies; and Repealing Sections 39-2-504 and 39-2-505, MCA."[11] The basic objective of the MADC's bill was to overrule many of the Montana Supreme Court's wrongful discharge decisions by statute and, for all intents and purposes, restore an employer's unilateral right to discharge employees.

The MADC's proposal was introduced into the Montana House of Representatives as HB 241 by Representative Gary Spaeth on January 16, 1987.[12] On being introduced into the House, HB 241 was referred to the House Judiciary Committee, hearings were held on January 28 and February 12, and the Committee recommended passage of the bill on February 13. The full House voted to pass the bill on February 16 (73 to 27, second reading) and February 18 (72 to 26, third reading), and HB 241 was then transmitted to the Senate on February 19. On being received by the Senate, HB 241 was referred to the Senate Judiciary Committee, hearings were held on March 10 and March 24, and the Committee recommended passage of the bill on March 26. The full Senate voted on HB 241 on March 30, passing it by a unanimous vote (50 to 0, second and third readings).

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[9] As noted earlier, the public policy wrongful discharge and implied covenant of good faith and fair dealing theories discussed above are both considered torts. As such, a prevailing plaintiff may recover punitive as well as compensatory damages. Since punitive damages are used to "punish" an employer, they are not dependent on a plaintiff's economic loss and can be considerable.

[10] The MADC prepared a position paper entitled, "The Need for Tort Reform," that discussed the changes in tort law in Montana since the 1970s and stated, "the legislature should assert its traditional legislative powers and place some checks and balances on the unrestrained expansion of our tort law system." Wrongful discharge was given a great deal of attention in "The Need for Tort Reform." A copy of the MADC's paper is on file with the author.

[11] A copy of the bill is on file with the author.

[12] All dates are in 1987 unless otherwise noted. A more extensive review of the legislative history of the WDFEA can be found in *Summary of H.B. 241, 50th Mont. Leg.* (1987).

Since the version of HB 241 that passed the Senate was different from the version that had been passed by the House, the bill was returned to the House for action on April 7. Following the House's failure to agree to the version of the bill that had passed the Senate, a Free Conference Committee consisting of members of the House and the Senate was created on April 21, and the Conference Committee agreed on a version of HB 241 designed to satisfy members of both houses.[13] The Committee's version was passed by the full House (74 to 21, second reading) on April 21 and by both the House (81 to 16, third reading) and the Senate (50 to 0, second reading; 49 to 0, third reading) on April 22. Thereafter, HB 241 was signed by the Speaker of the House on April 23 and the President of the Senate on April 24 and transmitted to Governor Schwinden. The Governor signed HB 241 on May 11, 1987, and the Montana Wrongful Discharge From Employment Act was set to be effective July 1, 1987. Thus HB 241 went from being introduced to being signed into law with little difficulty in slightly less than four months.

Provisions of the WDFEA. Although it is beyond the scope of this article to give a detailed description of the WDFEA, it is important to discuss how the Act changed the common law of Montana at the time of its passage. Thus, a few of the main points will be highlighted:

First, the Act specifically states that employment may be terminated "at the will" of either the employer or the employee except for the limitations provided by the Act itself. Further, only three "wrongful discharge" exceptions to the employment-at-will doctrine are provided:

1. Discharge based on the employee's refusal to violate public policy or for reporting a violation of public policy. (According to the Act, public policy must be expressed in a "constitutional provision, statute, or administrative rule.")
2. Discharge not for "good cause," after the employee has completed the employer's "probationary period."
3. Discharge in violation of the express terms of the employer's own personnel policy.

This could have benefited or been detrimental to employers in comparison with Montana law at the time the Act was passed. On one hand, there were no statutory restrictions whatever on employers' right to discharge

[13] A Free Conference Committee is a committee composed of members of both houses with the authority to consider a bill in its entirety.

employees at the time the WDFEA was passed. The fact that the Act placed statutory limitations on employers' right to discharge employees would have been detrimental to employers. In addition, the Act placed a new restriction on employers' right to discharge employees that had not even been recognized by the Montana courts (requiring good cause following the completion of employers' probationary period). On the other hand, employers would have benefited from the fact that the exceptions to employment-at-will provided for in the Act were narrower than those that had been recognized by the Montana courts in the 1980s.[14]

Second, the WDFEA limits back pay to "a period not to exceed 4 years from the date of discharge" and disallows punitive damages except where "actual fraud or malice" can be proved "by clear and convincing evidence." Employers would have benefited from these provisions, since some of the damage awards that had been issued by the Montana courts in common law wrongful discharge actions would no longer be available to employees under the Act. Third, the WDFEA established a 1-year statute of limitations for filing a lawsuit under the Act. Since this was shorter than the time limits that had applied to common law wrongful discharge actions, it would have benefited employers. Finally, the Act entitles an employer to establish internal grievance procedures and specifies that an employee's failure to exhaust such procedures is a bar to a lawsuit under the Act.

Previous assessments of the Act. A number of articles discussing the WDFEA have been written in the years since its passage, and the authors of these articles often attempt to assess the effects of the Act—albeit intuitively rather than empirically (e.g., Bierman, Vinton, and Youngblood, 1993; Bierman and Youngblood, 1992; Schramm, 1990; Tomkins, 1988). Several commentators assert that the Act benefited employers. To quote an article written in the *Montana Business Quarterly*, "Though [the WDFEA] did not affirm a return to strict at-will standards, the bill definitely moved in that direction. It restored much of the previous latitude employers had in the termination process (Andreason and Morton, 1993, p. 25)." Others, however, are more equivocal in discussing the Act and its effects. For example, Tompkins notes:

> [The WDFEA] represent[s] a fair balance between competing social interests. Employees receive protection from wrongful discharge in situations defined by statute law, and employers receive protection from excessive economic hardship resulting from large jury awards [1988, p. 396].

[14] For example, the definition of public policy in the Act was narrower than the courts' definition had been; the Act did not entitle employees to recover based on oral contracts of employment.

> If the bill had not represented a classic compromise between competing interests, it would have met the same fate as wrongful-discharge bills in other states [1985, p. 397].

And while the majority of commentators agree that the WDFEA benefited employers, there are commentators who point to the ways in which the Act benefited employees (Weiler, 1990). However, all previous assessments of the Act and its effects are based on inference and opinion. In this article, a different approach will be used. The event study will be used to test the effects of the Act empirically, and the results of the empirical test will be used to determine whether the Act was beneficial or detrimental to employers in Montana.

The Event Study

Schwert (1981) explains how event study methodology can be used to assess the effects of legislation. The event study examines changes in stock prices in response to a specific event. According to the efficient market hypothesis, the price of a firm's stock multiplied by the number of shares outstanding is an unbiased estimate of the future profitability of the firm; the change in a firm's stock price in response to an event is also a change in the firm's profitability in response to that event. Further, changes in firm profitability in response to an event are excellent indications of whether that event benefited the firm, since events that benefit a firm will induce an increase in the firm's profitability and events that are detrimental to the firm will reduce profitability. Thus, if the WDFEA induced an increase in firm profits, this will indicate that the WDFEA benefited employers in Montana, and vice versa.

A number of studies have tested the effects of legislation with event study methodology and concluded that legislation does affect the profitability of firms (Abraham, 1996; Chandy et al., 1995; Hackl and Testani, 1988; Connor, 1989; Romano, 1987). Two studies that are especially relevant to this article have tested the impact of labor relations legislation on firm profitability. Using the same methodology that will be used in this article, Olson and Becker (1990) found that the Wagner Act (the National Labor Relations Act) lowered shareholder wealth in a sample of 75 firms likely to have been affected by that statute relative to what would have been expected had the NLRA not been passed. These results would have been expected *a priori*, since the Wagner Act contained provisions regarded as beneficial to unions and employees. Based on their empirical results, Olson and Becker concluded: "We conclude that the Wagner Act substantially altered the distribution of power between firms and employees" (1990, p. 126). In other words, Olson and Becker used the event study to show that a statute dealing with the employment relationship was detrimental to employers. In another piece, Abraham (1996) tested the effect of the Taft-Hartley Act on shareholder returns with the event study. His empirical results were that shareholder returns increased in response to Taft-Hartley and led him to conclude that the Act benefited employers. Thus, the event study can be used to assess whether a wrongful discharge statute such as the WDFEA (also a piece of labor/employment legislation) benefited employers. If stock prices of firms with a substantial connection to Montana rose (fell) in response to the passage of the WDFEA, this will indicate that the Act was beneficial (detrimental) to employers in Montana.

Event-study methodology. When used to assess the effects of legislation such as the WDFEA, event study methodology examines the stock prices of a sample of firms likely to have been affected by the Act on the dates associated with its passage.[15] The difference between the returns of those firms given the Act and an estimate of what those returns would have been absent the Act will measure the effect of the Act on the future profitability of the firms.

The effect of the WDFEA on security returns in any particular time period is given by the equation

$$AR_{it} = R_{it} - E(R_{it} \mid \text{no WDFEA information}) \tag{1}$$

where AR_{it} is the abnormal return to firm i in time t due to the WDFEA, R_{it} is the actual return to firm i in time t, and $E(R_{it} \mid \text{no WDFEA information})$ is the expected return to firm i in time t absent any information about the WDFEA. R_{it} is readily available.[16] Since $E(R_{it} \mid \text{no WDFEA information})$ is not available, the researcher must predict what that return would have been. The predicted return is obtained by applying the market model, which posits that the return to any security in time t is a function of the

[15] Equity returns, rather than stock prices, are used to determine the impact of an event on a firm. The return to any security in time t is equal to its price change in that period plus any dividend disbursements:

$$R_{it} = \frac{\text{price}_{it} - \text{price}_{it-1} + \textit{dividends}_{it}}{\text{price}_{it-1}}$$

Data on firm returns are maintained by CRSP—the Center for Research on Security Prices connected with the University of Chicago School of Business.

[16] Data were obtained from the Center for Research on Security Prices associated with the University of Chicago School of Business.

stock market as a whole and the risk of investing in that security relative to the risk of investing in the market.[17] The *ex ante* return to security i in time period t equals

$$R_{it} = \alpha_i + \beta_i(R_{mt}) + \varepsilon_{it} \qquad (2)$$

where R_{it} is the return to security i in time t, R_{mt} is the CRSP value-weighted index of all securities in time t, and α_i and β_i are parameters. According to the market model, ε_{it} is a fair game variable with mean = 0 and var(σ^2). Therefore, Eq. (1) (the abnormal return to firm i in time t due to the WDFEA) is tested by examining

$$AR_{it} = R_{it} - [\alpha_i + \beta_i(R_{mt})]^{18} \qquad (3)$$

To determine the average effect of the event in period t for the sample of the firms, the researcher merely averages the *AR*s over all the firms in the sample:

$$\frac{1}{n}\sum AR_{it} \qquad (4)$$

Since more than one event period is being used to test the effects of the WDFEA, an average *AR* is computed for each event day, and the *AR*s are then summed over all the event days to estimate the average *total* effect of the Act. This total effect is known as the cumulative abnormal return (CAR):

$$CAR = \sum AR_{it} \qquad (5)$$

Whether the Act affected shareholder wealth is determined by testing whether the *CAR* computed in Eq.(5) is statistically different from zero. In order to make this determination, the *CAR* must be standardized to

[17] Although other return generating models are available, the market model has been shown to be the most powerful (Brown and Warner, 1989; Peterson, 1989).

[18] August 11, 1987 through December 31, 1987 were used to estimate the market model parameters of Eq. (3). Using August 11, 1987 as the first day of the model period satisfies the objective of ensuring that days mistakenly excluded from the event period relevant to the Wrongful Discharge Act are not included in the model period. A period of 100 days is used because this is long enough to provide an accurate prediction model without estimating the model over such a long period that it is unreasonable to assume that the parameters remained constant throughout the entire period.

account for the possibility of statistical error in the determination of the abnormal returns. Peterson (1989) discusses several ways to compute σCAR and obtains the following test statistic:

$$\frac{CAR}{\sigma(CAR)} \tag{6}$$

where CAR is the cumulative normal return and $\sigma(CAR)$ is the standard error of the cumulative normal return. This is the test statistic used to determine whether the WDFEA had an effect on the shareholder returns.

Since the WDFEA affected all firms simultaneously (in the same event periods), it is not known whether the *CAR*s in Eq. (6) are due to the WDFEA or something else that caused the firms' actual returns to be different from those predicted by the market model. This leads to cross-sectional correlation in the abnormal returns across firms that will bias the statistical test used to determine whether the *CAR* is significant. Any bias would lead to unwarranted statistical inferences.

Several procedures for dealing with this problem have been employed, each of which uses the variance-covariance matrix of the residuals from the model estimation periods to correct for the correlation in the abnormal returns across firms. In this article, the procedure proposed by Burgstahler and Noreen (1986) is used. The Burgstahler and Noreen procedure calculates an "*H* statistic" that includes the covariance among all the firms in the sample in testing the statistical significance of *CAR*. Including this covariance in the statistical test of the *CAR* increases the likelihood that if the *CAR* is significant, it is due to the legislation being investigated.[19]

Firms likely to have benefited from the WDFEA. Testing the impact of legislation with event study methodology requires identification of the firms that would have been affected by that legislation. The impact of the legislation will be reflected in the shareholder returns of these firms—and *only* these firms—as information about the legislation was revealed to the investing public. Since the WDFEA is a Montana State law, testing the impact of the WDFEA requires the identification of a sample of firms that

[19] Details of the Burgstahler and Noreen *H* statistic are described in their paper. Essentially, the standard errors used in testing the significance of the *H* statistic include the variance-covariance matrix for the estimated residuals in the parameter estimation periods. Including the standard errors in the test statistic helps correct for the correlated error terms and increases the likelihood that a significant result is attributable to the event being investigated. Under the null hypothesis that CAR = O, the *H* statistic is distributed as a *t* distribution with $N-2$ degrees of freedom, where *N* is the number of periods used to estimate the market model parameters in the nonevent periods.

had substantial operations in Montana and had stock that was publicly traded when the Act was passed. To form the sample, Compustat was used to identify firms whose *primary* location was Montana. Eight companies that satisfied the necessary criteria were found. The effects of the WDFEA were tested be examining the *AR*s and *CAR*s of these companies on the dates relevant to the passage of the WDFEA.[20]

Days on which shareholder returns would have been affected as a result of the WDFEA. When used to assess the effects of legislation, the event study requires the examination of stock prices on the days when investors would have adjusted their estimates of the value of their claims to firm profits that would occur as a result of that legislation. The researcher must identify every day on which investors concluded that a firm's expected profitability would change as a result of the legislation. Selecting the correct event days is of paramount importance. Omitting days on which investors adjusted their expectations of the value of their claims to firm profits due to the legislation will produce an estimate of the impact of that legislation that is biased toward zero. Including days on which investors did not make such adjustments will introduce additional variability in the estimated impact of the legislation.

To select the event days relevant to the WDFEA, the *Combined Final Status* from the Montana legislature was examined. This document tracks the status of every bill introduced into either house from its introduction to its passage. According to the premises of the event study, stock prices would have reacted every day there was action on the WDFEA in either house that would have increased or decreased investors' expectations that the WDFEA would be enacted. Between January 16, 1987 and May 11, 1987, there were eleven days on which there was legislative activity related to the WDFEA. These eleven days are referred to as the *event days* of the WDFEA and are listed on Table 1.[21]

Consistent with many other articles that assess the effect of legislation with the event study, shareholder returns were tested over four different periods in this article (Szewczyk and Tsetsekos, 1992). Test I examined

[20] Some might question the validity of testing the effects of the WDFEA on a sample of eight firms. While it would have been preferable to test the effects of the Act on more than eight firms, one should not think of this as a *sample* of eight. The eight firms listed in the text are the *only* firms with a substantial connection to Montana that traded stock on one of the three exchanges when the WDFEA was passed. Hence, these firms represent the population of firms, rather than a sample. Therefore, the effects of the Act were tested on the entire population of firms that traded stock in Montana when the WDFEA was enacted.

[21] In computing the *H* statistic that will test the effect of the WDFEA, each day was given a weight of 1 (meaning that each day was assigned an equal weight).

TABLE 1

EVENT DAYS OF THE WDFEA

Date	Reason
January 16	HB 241 introduced into Montana House of Representatives by Representative Spaeth
February 13	House Judiciary Committee passes HB 241
February 16	Second reading of HB 241 passed by House (73 to 27)
February 18	Third reading of HB 241 passed by House (72 to 26)
March 26	Senate Judiciary Committee passes HB 241
March 30	Second and third readings of HB 241 concurred by Senate (50 to 0)
April 21	Second reading of HB 241 concurred by House (74 to 21)
April 22	Thrid reading of HB 241 concurred by House (81 to 16); second and third readings adopted in Senate (49 to 0 and 50 to 0)
April 24	Final version of HB 241 signed by President of Senate and transmitted to Governor
May 11	Governor Schwendon signs HB 241: Wrongful Discharge From Employment Act becomes law (effective July 1, 1987)

shareholder returns over the eleven event days of the WDFEA. Test II examined shareholder returns over the same eleven days plus one day surrounding each event date.[22] Test III examined shareholder returns over the –5 to +1 period surrounding for each of the eleven event days.[23] Test IV examined shareholder returns over the entire 80 days from the introduction of HB 241 in the House on January 16, 1987 until the WDFEA was signed by Governor Schwinden on May 11, 1987.[24]

[22] Shareholder returns were examined one day prior to each event date to allow for the possibility that information about the event may have been leaked to the market before the event took place. Returns were examined one day following each event date to allow for the possibility that the event took place so late in the day that its effect was not impounded into security prices until the next day.

[23] The period is extended to five days prior to each event date to allow for the possibility that, as is often the case with legislation, news regarding impending legislative results was received by investors several days prior to the actual event. It is not extended more than one day past the actual event date because the efficient market hypothesis assumes that the effects of events on firms are immediately impounded into security prices. There is no lag or delay.

[24] The value-weighted market index was used and both firm and market returns were transformed to ln(1 + returns) before estimating the market model and calculating the *AR*s and *CAR*s.

Results and Implications

The results from the empirical tests are presented in Tables 2 and 3 and displayed in Figures 1 and 2.[25] According to Test I, the *CAR* over the eleven event days relevant to the Act (commencing with the introduction of HB 241 into the House on January 16, 1987 until the WDFEA was signed by Governor Schwinden on May 11) was .066 (p value < .01). In other words, the excess returns to shareholders over the eleven event dates relevant to the WDFEA were 6.6%. The results from Test II showed that *CAR* increased 8.11% (p value < .01), Test III shows that *CAR* increased 11.2% (p value < .01), and Test IV shows that *CAR* increased 23% (p value < .01). Thus, all four test periods show that shareholder returns of Montana firms rose on the dates corresponding to the passage of the WDFEA. In other words, shareholder returns rose over all four test periods used to assess the effects of the WDFEA on Montana firms. According to the premises of the event study, this increase would have been caused by investors' unbiased expectation that the WDFEA would increase the future profitability of firms that would now be governed by the WDFEA. This increase in profitability would have been due to the fact that the Act was beneficial to firms in Montana.

It is possible that unanticipated events other than the WDFEA were responsible for the observed rise in shareholder returns.To investigate the possibility that something other than the WDFEA was responsible for these results, an attempt was made to determine whether anything other than events related to the WDFEA occurred over the same event periods that could have induced the shareholder returns of these firms to rise more than the market itself. Eliminating this possibility increases the likelihood that the *AR*s and *CAR*s reported were induced by passage of the WDFEA.

If all or even most of these firms were in the same or similar industries, the results reported might be attributable to other events affecting those industries more than the market as a whole. For the most part, however, the firms in the sample are not in the same or even similar industries. In fact, only two firms share even the same two-digit SIC code. This makes it unlikely that industry-specific events unrelated to the WDFEA induced the *AR*s and *CAR*s reported earlier.

Another possibility was that other events besides the WDFEA took place that affected Montana firms more than the market as a whole,

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[25] Table 2 presents the *AR*s and *CAR*s for each of the eleven event days listed in Table 1 (Test I), and Table 3 lists the results from all four tests referred to in the text. Figure 1 displays the abnormal returns (*AR*s) for each of the eleven event days, and Figure 2 exhibits the trend in the cumulative abnormal return (*CAR*) over the same eleven days.

TABLE 2

ABNORMAL RETURNS AND CUMULATIVE ABNORMAL RETURNS
(t Value in Parenthesis)

Day	Abnormal return	Cumulative abnormal return
January 16	.0038 (.394)	.0038 (.394)
February 13	–.0200 (–3.204)***	–.0163 (–1.847)*
February 16	–.0054 (–.856)	–.0217 (–2.002)*
February 18	–.0085 (–1.350)	–.0301 (–2.409)*
March 26	.0234 (3.7429)***	–.0067 (–.4813)
March 30	.0291 (4.6344)***	.0224 (1.4601)
April 21	.0083 (1.3215)	.0307 (1.8514)*
April 22	.0102 (1.6297)*	.0409 (2.308)**
April 23	.0095 (1.5150)*	.0504 (2.6815)**
April 24	–.0049 (–.7870)	.0454 (2.2935)**
May 11	.0211 (3.3655)***	.06649 (3.2011)***
Overall Test	—	.06649 (3.2011)***

*P value < .10.
**P value < .05.
***P value < .01 (one-sided test).

TABLE 3

CUMULATIVE ABNORMAL RETURNS: ALL FOUR TESTS

Interval	*CAR*	*H* statistic
	Test I	
Eleven event days	.06649	3.2011*
	Test II	
-1 to +1	.0811	2.769*
	Test III	
-1 to +5	.1123	2.872*
	Test IV	
Jan. 16 to May 11	.23065	4.1168*

*P value < .01 (one-sided test).

FIGURE 1
AR by Event Date

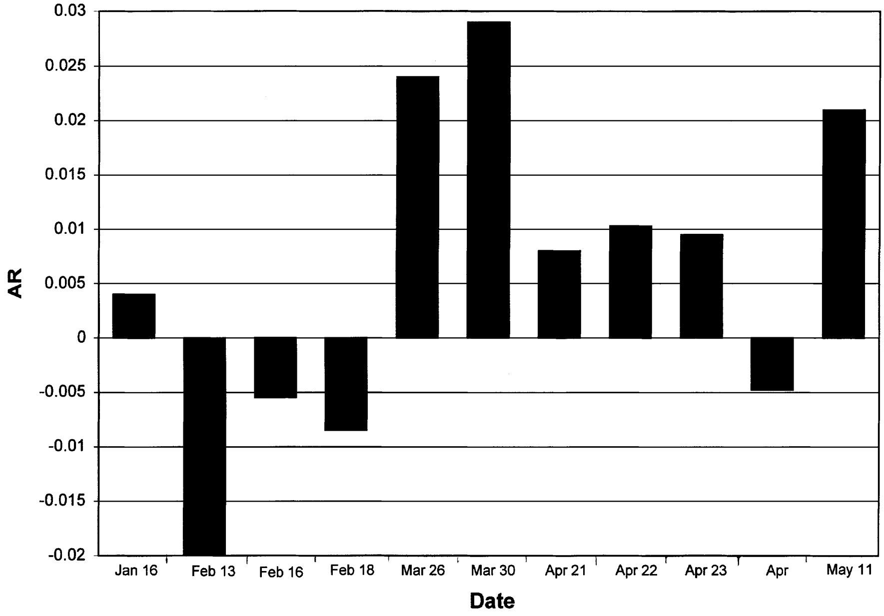
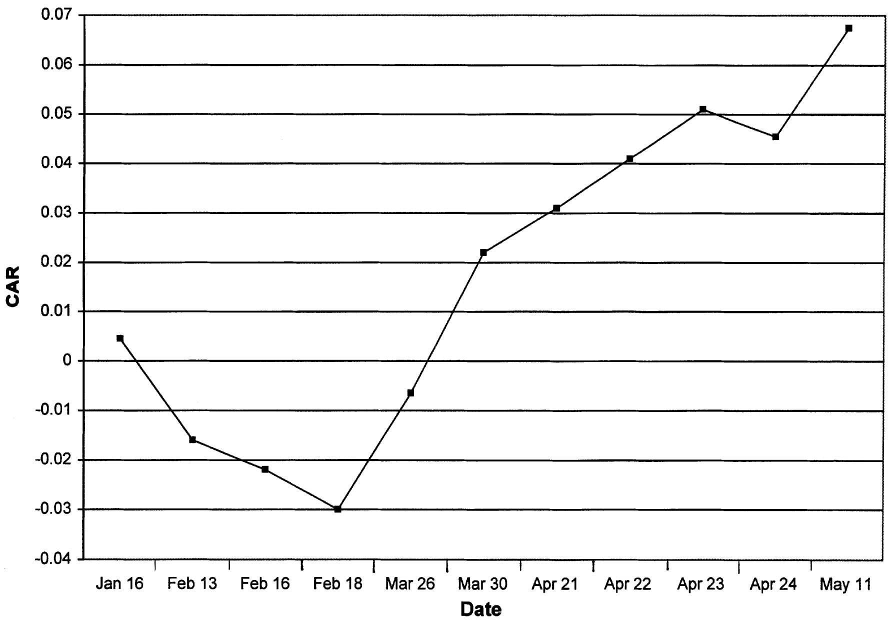


FIGURE 2
Trend in CAR



inducing their shareholder returns to rise relative to the market. An examination of newspapers and magazines from Montana, however, reveals nothing specific over the relevant event periods that might be responsible for firms in Montana to have abnormally high shareholder returns. One issue that does require discussion, however, relates to the fact that the event periods used to test the effects of the WDFEA roughly correspond to dates of the 50th Montana legislature in general. Specifically, the 1987 Montana legislature was in session from January 5, 1987 through April 23, 1987, and Governor Schwinden signed a total of twenty bills on May 11, 1987. If the legislation passed during this period was generally "pro-business," it might be argued that the results reported reflect the entire pro-business nature of the legislative session in general rather than the WDFEA specifically. Further investigation has led me to reject this possibility, however. First, the legislation passed during the 50th session was not necessarily pro-business. In fact, the Montana Chamber of Commerce, the National Federation of Independent Business in Montana, and the MADC (the organization that gave much of the impetus to the WDFEA) all reported that Montana businesses received losses as well as gains as a result of the 50th Montana legislative session. None of the three organizations reports that the 1987 Montana legislature was decidedly favorable to business in general.[26] Second, even though there might have been other laws passed by the 50th Montana legislature and signed by the governor that benefited business, the dates relevant to these other laws do not correspond to the event dates of the WDFEA. Specifically, Table 2 shows that there were seven event dates of the WDFEA from March 26, 1987 through May 11, 1987. Shareholder returns rose on six of those seven days (the increase was statistically significant at the .10 level on five of the seven days, and the decrease on April 24, 1987 was not statistically significant). Even though other legislation supported by the MADC was enacted in 1987, none of those bills or laws had event dates that corresponded to the event dates of the WDFEA. For these two reasons, it seems unlikely that the results reported reflect the effects of the entire 50th Montana legislative session.

In sum, as discussed previously, the results from all four tests show that shareholder returns of firms in Montana rose significantly in response to the passage of the WDFEA. According to the premises of event study methodology, this increase would have been caused by investors'

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[26] *Eye on Business* (Vol. 15, No. 5, May 1987), published by the Montana Chamber of Commerce; *1987 Final Legislative Report to the Membership* (April 28, 1987), published by the MADC; and *State Report* (1987), published by the National Federation of Independent Business (Montana) all discuss the 50th Montana legislature and give equivocal analyses as to the results of that session for business in Montana.

unbiased expectation that the WDFEA would increase the future profitability of firms that would now be governed by the Act. This increase in profitability would have been due to the fact that the Act was beneficial to firms in Montana. Therefore, the question presented in the title of this article should be answered in the affirmative: A wrongful discharge statute *can* benefit employers. The WDFEA was a benefit for employers in Montana as compared with the common law that existed at the time the Act was passed.

One must be careful, however, not to draw erroneous conclusions from the results reported herein. For example, while the results show that the WDFEA was, on balance, a benefit for employers, they do not indicate that the Act was detrimental for employees. Those who treat the interests of the employer and the employee as being diametrically opposed might assume that since the WDFEA benefited employers, it was, *a fortiori*, detrimental to employees. This would be an faulty assumption. While these empirical results *can* be interpreted as indicating that the Act benefited employers, they *cannot* be interpreted to establish that the Act was detrimental for employees. In fact, it is possible that many of the benefits the Act provided for employers (i.e., increased predictability) would have benefited employees as well. Further, the Act might have induced employers to alter their personnel policies in ways that benefited employees. Thus, the effect of the WDFEA on employees in Montana cannot be determined from the results reported here.

In addition, it would be a mistake to assume that wrongful discharge legislation in general will always benefit employers. In fact, these results do not even show that the WDFEA specifically (or a statute with the exact same provisions) would benefit employers in every state. As pointed out earlier, the common law in Montana had become extremely "pro-employee" in the area of employment-at-will and wrongful discharge. As a result, investors in Montana concluded that their firms would be better off (and hence more profitable) operating under the WDFEA than they were under the common law in Montana prior to the Act. In other words, the effects of the WDFEA in Montana were dependent on the common law in that state at the time the Act was passed. However, since employment-at-will is a common law doctrine, it varies from state to state. Many states remain true to employment-at-will entirely, and virtually all are less favorable to employees than was Montana in the 1987 (when the WDFEA was passed). In a state where the common law is more favorable to employers, the passage of the WDFEA actually might have been detrimental to employers. This possibility cannot be assessed, however, because no other state has adopted any form of wrongful discharge legislation. Therefore, the effects of wrongful discharge legislation in other states cannot be assessed.

Nevertheless, the results reported herein are noteworthy. They illustrate that wrongful discharge legislation—statutes that limit an employer's right to discharge employees at will—can be beneficial for employers. The empirical results presented here show that the WDFEA was better for Montana employers than the common law at the time the Act was passed. In addition, these results illustrate the value of using stock market data to assess the effects of legislation on firms. The effects of legislation are an interesting and often controversial subject, and the results reported herein illustrate the value of event study methodology as a tool that can be used to assess the effects of legislation.

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