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THE EVOLUTION OF UNJUST-DISMISSAL LEGISLATION IN THE UNITED STATES

Alan B. Krueger

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ABSTRACT

In the last decade, state courts in many areas of the United States have ruled in favor of employees alleging they were improperly dismissed. Many economists have contended that any judicial or legislative departure from the employment-at-will doctrine is regressive and inefficient because it restricts employment flexibility and freedom of contract. This paper advances an evolutionary theory of unjust-dismissal legislation in which employer groups eventually support unjust-dismissal legislation in response to the threat of large and variable damage awards imposed by the judicial system. Legislation is sought to clearly define property rights and to limit employer liability. In comparison to the common law, the unjust-dismissal laws that have been proposed are likely to result in smaller awards, reduce uncertainty, resolve disputes rapidly, and reduce legal and other transactions costs. An institutional and empirical analysis supports the conclusion that the proposal of unjust-dismissal legislation is a response to court rulings that weaken and obfuscate the employers' right to dismiss employees at will. This evidence is inconsistent with the conventional political-economy view of unjust-dismissal legislation.

Alan B. Krueger
Woodrow Wilson School
Princeton University
Princeton, NJ 08544
(609)452-4845

For the last 100 years, job security in the United States has been governed by the common law "employment-at-will" doctrine.[1] Under this doctrine, an employer can legally dismiss an employee for a good reason, a bad reason, or no reason at all. The employer's unmitigated right to dismiss at-will employees, however, has been weakened by autonomous state court rulings in several jurisdictions in the 1980s. In addition, legislation to require some form of "just cause" to dismiss at-will employees has been introduced in ten state legislatures.[2] And in 1987, Montana passed landmark legislation requiring firms to have a just reason to fire a worker. Epstein (1984), Lazear (1987), Posner (1988), and others have argued that judicial and legislative departures from the employment-at-will doctrine should be resisted because they have deleterious economic effects.

This paper focuses on the positive issue of the origin of unjust-dismissal legislation instead of the normative issue of whether such legislation is desirable.[3] The paper advances the hypothesis that independent judiciary decisions lead a state's legislative branch to propose an unjust-dismissal law to clarify employment rights and to limit employer liability. Under the strict employment-at-will doctrine the property rights to jobs -- meaning the set of actions that either party to an employment relationship could take to terminate the relationship -- are clearly defined and enforced.

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[1]See Jacoby (1982) for an historical overview of employment at will.

[2]Legislation such as the Civil Rights Act of 1964 and the Age Discrimination in Employment Act also restrict the right to fire at will. My interest in this paper, however, is in legislation which covers a broad class of actions and is not limited to particular subgroups of the workforce.

[3]Examples of other economic analyses of the factors leading to the passage of laws include Leffler's (1978) and Bloch's (1975) analyses of support for the minimum wage, Farber's (1988) analysis of the determinants of state public sector bargaining laws, and Feenberg and Rosen's (1987) examination of states' decisions to index tax laws.

Once state courts modify the common law, however, the property rights to jobs become uncertain and incomplete. Moreover, unjust-dismissal suits impose large legal costs on all parties concerned, and carry the prospect of unpredictable, highly variable, and occasionally excessive awards.

An institutional and empirical analysis suggests that the combination of uncertain property rights and large penalties for violation of the nebulous precedents set by state courts has reduced or reversed employer opposition to unjust-dismissal legislation in many jurisdictions in the U.S. A variety of evidence supports the conclusion that just cause firing legislation is often supported by employers in a state in order to explicitly re-define and enforce property rights, and because such laws will limit the maximum damages that firms can be assessed. This conclusion is inconsistent with the conventional political economy view of unjust-dismissal legislation implicit in Blades (1967), Stieber (1979), and elsewhere, which predicts that such protective labor legislation will be supported by employees and opposed by employers.

The explanation for proposed unjust dismissal legislation developed in this paper may be relevant to a variety of other contexts. For example, the legislative history of state workers' compensation laws — which were enacted with the support of both the American Federation of Labor and the National Association of Manufacturers at the beginning of the twentieth century — closely parallels the recent developments in unjust-dismissal laws.[4] The idea that no-fault, limited liability legislation is a response to ad hoc changes in the common law seems to have broad applications.

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[4]The AFL officially supported workmen's compensation legislation in 1909, and President Gompers was a leader in the workmen's compensation movement. In the same year, a survey of the membership of the National Association of Manufacturers found a large majority of businesses in favor of workmen's compensation legislation (see Somers and Somers, 1954, p. 31).

1. At-Will Employment and the Coase Principle

As a benchmark, it is useful to consider the conditions under which departures from the employment-at-will doctrine will affect economic efficiency.[5] As is well known, the Coase principle holds that if property rights are clearly defined and tradeable with zero transactions costs, then economic efficiency is independent of the original distribution of property rights.[6] Under these assumptions, the allocation of property rights will have distributional consequences for the parties involved, but will not affect the allocation of resources or the Pareto optimality of a market economy. This has important implications for the legal controversy over employment-at-will.

In particular, if the rights to jobs (e.g., the restrictions and review procedures that govern firings) are clearly defined, tradeable, and if transaction costs are insignificant, then a direct application of the Coase principle would imply that economic efficiency is independent of whether the right to terminate an employment relationship at will is originally assigned to the employer or to the employee. To illustrate this point, consider the equivalence of the following two examples.

In the first example, employers have the legal right to arbitrarily fire employees at will. Suppose that employees value protection from arbitrary dismissal such as accorded by grievance procedures at $100 per year, and employers value the option to fire employees arbitrarily (e.g., to avoid having grievance procedures to review disputed discharges) at $50 per year.

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[5] Ehrenberg (1985) provides a useful survey of the economic implications of the employment-at-will doctrine.

[6] See Coase (1960). This conclusion is only a partial equilibrium one because income effects may alter the equilibrium. In addition, the Coase theorem rests on the assumption of complete information (see Farrell, 1987).

The efficient allocation of resources in this situation would dictate that grievance procedures be provided. Because the employee in this example would be willing to forgo up to $100 per year in wages to "purchase" grievance procedures, and the employer would be willing to provide grievance procedures for $50 or more, the parties will privately transact to introduce grievance procedures. Voluntary exchange would lead to the efficient outcome.

In the second example, the employee is initially assigned the right to a grievance hearing if he or she should desire to challenge a dismissal. In this situation, the employer would be willing to pay up to $50 to have the employee waive this right, but the employee would decline the employer's offer because the provision of grievance procedures is valued at $100. Again, the efficient allocation of resources obtains. The only substantive difference between the two examples is that the employee does not have to forgo $50 in wage payments when he or she is initially assigned the property right to protection from unjust dismissal.

Under the "Coasian" assumptions, opposition to wrongful-discharge legislation must rest on distributional arguments rather than efficiency arguments, because economic efficiency is not affected by the presence or absence of such legislation. On the other hand, if the assumptions of the Coase principle are violated, the neutrality of a move from the employment-at-will doctrine to an unjust-dismissal standard will not hold.

An obvious assumption to question is whether property rights could be traded at zero transaction costs under a court enforced just cause firing standard. In the first example discussed above, economic efficiency would clearly have been reduced if the parties were forbidden from trading the opportunity to have grievance procedures. If explicit trades over job

security were forbidden, however, it would still be possible for trades to take place along other margins. For example, even if it were nominally illegal to pay a worker a wage premium to relinquish the property right to protection from arbitrary dismissal, an employer could overcome this prohibition by offering a severance payment to a dismissed employee conditional on the employee not challenging the dismissal.[7] Although there is potential for trades along other dimensions of jobs, there are different transactions costs associated with alterations in the employment-at-will doctrine. If transactions costs inhibit trades, the efficient allocation would be to assign the right to termination review to the party that values it most highly.[8]

A related issue is whether job termination rights can be clearly defined under alternative legal schemes. As discussed in the next section, the current common law system generates considerable uncertainty over the ownership of job property rights and over the penalties for violations of those rights. Even for cases with similar circumstances, awards in unjust-dismissal suits vary depending on the particular judge and jury. This uncertainty can be characterized by an award distribution that is skewed positive, ranging from zero (which includes situations where an employee does not bring a suit) to a large award. Ex ante uncertainty would inhibit

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[7]Evidence suggests that this strategy is actually used: A Bureau of National Affairs (BNA) survey conducted in 1985 found that 23% of employers reported the "use of severance agreements with terminated employees for release of any claims against the organization" (BNA, 1985; p. 1).

[8]In addition, it may be efficient to shift the right to job security over time. For instance, given the uncertainty of job matches, employers may value the right to dismiss at will more highly for newly-hired workers. This may explain the existence of probationary periods during which new employees can be more easily dismissed.

efficient transactions because parties do not know their endowments. Moreover, if the parties are risk averse the introduction of a fixed award in unjust-dismissal judgments — or a limited liability rule which truncates the award distribution — can be Pareto improving.[9]

2. Institutional Analysis

In 1987, Montana became the first state in the U.S. to pass a broad law to protect at-will employees from unjust-dismissal.[10] Curiously, Montana has historically been a leader in labor law — it passed the nation's second compulsory workers' compensation law in 1909, and was among the first states to pass a mandatory maternity leave law and sexual harassment prevention law. A case study of the forces that led to the proposal and enactment of unjust-dismissal legislation in Montana is instructive.

In the early 1980s, state courts in Montana wrote several decisions that weakened the prevailing employment-at-will doctrine. These decisions resulted in large judgments against employers in several unjust-dismissal cases just before the introduction of the "Wrongful Discharge From Employment Act" in the state legislature in January 1987.

For example, in one well-publicized case (Mildred Flanigan v. Prudential Federal Savings) a 62 year-old employee was judged to have been wrongfully discharged from her job as an assistant loan counselor and therefore awarded $1.3 million for punitive damages, $100,000 for emotional distress, and

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[9]Although it is typical to treat employers as risk neutral, in this instance employers may reasonably be thought of as risk averse since it is difficult to diversify risks associated with dismissals.

[10]This law was held constitutional by the Montana Supreme Court in Meech v. Hillhaven West, Inc. in June 1989.

$93,000 for economic losses by a Montana jury. The circumstances of this case were as follows. Flanigan, after 34 years of service at Prudential Federal, was given four months notice that she would be terminated because of economic conditions. She was advised subsequently, however, to attend a week-long training program in Salt Lake City, Utah to prepare for a new job as a bank teller. Despite having attended the training course, Flanigan was discharged without notice or hearing less than one month after assuming a position as a teller. She was given six months pay as a severance benefit. She was also later offered an opportunity to return as a part-time teller, but refused. The court reasoned that Flanigan's discharge violated the covenant of good faith and fair dealing implicit in employment relationships. Moreover, the Flanigan verdict and award were both affirmed on appeal by the Montana Supreme Court in June 1986.

In another influential case (Farrens v. Meridian Oil), Michael Farrens was discharged for allegedly purchasing drilling mud from a supplier at inflated prices, for being on the take, for exclusively using the mud supplier, and for being a member of the mud supplier's board of directors. A Billings jury found these charges to be factually incorrect, and awarded the 34 year-old mechanical engineer $2.5 million for economic losses. After appeal, the Ninth Circuit Court of Appeals upheld the liability claim but ruled that the evidence supported a $1.7 million award for economic damages. At the time he was dismissed, Farrens was earning $85,500 per year: $63,000 salary, $11,000 bonus, and $11,500 fringes. Although the Flanigan and Farrens cases are extreme examples, they reflect the potential losses that employers faced if they were challenged in an unjust-dismissal case.

Employer groups protested the large magnitude of some of the awards in

unjust-dismissal cases, and objected to the uncertainty and expense created by the evolving common law.[11] As a consequence, many employer groups vigorously supported unjust-dismissal legislation. Consider, for example, the testimony of Kay Foster before the Montana State legislature:

> I am a business owner and Deputy Mayor of Billings, appearing on behalf of the Billings Area Chamber of Commerce. The Billings Chamber supports HB241 [the Wrongful Discharge From Employment Act] and the positive impact it will have, particularly on the business community in our area. Wrongful discharge has become the favored tort claim in the Billings District and Federal Courts with the number of cases swelling from '2' in 1981 to '89' in 1985. The rising number of claims allowed under present Montana statutes has become a major disincentive to local business development and expansion of employment. (Quoted from Kay Foster's written testimony on HB241, January 28, 1987.)

The unjust-dismissal legislation that was proposed and enacted in Montana was appealing to employers because, although it required a standard of "just cause" for dismissal (and other personnel actions such as demotions), it limited an employee's ability to recover punitive damages to cases where it could be established that the employer acted with "actual fraud or actual malice."[12] In the vast majority of cases where actual fraud or actual malice can not be established, the maximum award an employee can recover is limited

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[11] In addition to direct legal fees, other transactions costs incurred in unjust dismissal claims are likely to include a loss of management time while preparing the case, damages to employee relations, deterioration of the firm's public image, and the release of confidential and proprietary information which may be exploited by competitors.

[12] The act defines a dismissal as wrongful if it is not "for good cause," or if it is "in retaliation for the employee's refusal to violate public policy," or if it violates an express provision of the employer's personnel policy. Layoffs because of insufficient demand or other "business related" reasons are not proscribed by the act. See Table 3.

to four years of wages and fringes from the date of discharge, with interim earnings deducted. In addition, parties are encouraged to resolve their disputes via binding arbitration, which generally confers smaller awards than jury trials. The law has the effect of assigning employees the property right to a job (after a probationary period) as long as they adequately perform their work and are not laid-off because of fluctuations in demand, but limits the potential damages that employers could be assessed if they should violate this property right.

While employer groups in Montana supported a bill that would require just cause and limit their liability in unlawful-dismissal suits, unions and other employee representatives were either indifferent or also supportive of the legislation. Some employee groups appeared to welcome the "Wrongful Discharge From Employment Act" because it codified a just cause firing requirement into law. Although some economists have argued that limits on employment-at-will have been detrimental to union organizing efforts (e.g., Neumann and Rissman, 1984), labor unions in Montana did not testify in opposition to legislation that extended unjust-dismissal protection to nonunion workers.

Nationwide Developments

Exceptions to the employment-at-will doctrine recognized by state courts in recent years may be categorized into three main classes.[13] First, and most common, the judiciary in most states will now allow a cause of action alleging that an employee was fired for performing an act that was in the interest of

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[13]Professor St. Antoine (1985, p. 563) has claimed that, "The most significant development in the whole field of labor law during the past decade was the growing willingness of the courts to modify the traditional doctrine of employment-at-will." In addition to the three legal exceptions to the employment-at-will doctrine considered here, less common causes of action have been based on fraud and intentional or negligent infliction of emotional distress (see Shepard et al., 1989, pp. 127-147).

public policy, such as serving jury duty, filing a workers' compensation claim, or refusing to commit perjury (the "public policy exception"). Second, many state courts have held that an implicit contract exists between an employer and his employees which binds the employer to statements made in personnel handbooks, company manuals or oral promises (the "implied contract exception"). For example, some jurisdictions will hold an employer liable for damages if he or she fires an employee who is absent from work five times if a personnel handbook states that six absences are required for a dismissal.

Third, a minority of states have ruled in favor of employees in unjust-dismissal cases under the legal theory that an implied covenant of good faith and fair dealing exists between an employee and employer (the "good faith exception").[14] In essence, the good faith exception requires an employer to treat his employees in a fair and reasonable manner, which is the essence of a just cause firing clause in a union contract. An example of such a precedent would be a court ruling against a firm that fired a worker for no other reason but to avoid paying the worker a Christmas bonus. The good faith exception is probably the most radical departure from the traditional employment-at-will doctrine because it holds employers to a standard of behavior that is not prescribed by public policy and not set forth in an oral or written statement.

Table 1 reports the year in which a judicial precedent under each of these three legal theories was first established by either the state supreme court or by another court in the state.[15] There is considerable variation in

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[14]It should be noted that the good faith and fair dealing exception and the implicit contract exception are extensions of the existing law that applies to commercial contracts to the employment relationship.

[15]For the present analysis, whether a precedent is set by a State Supreme Court or by a lower court is of little consequence because both erode the employment-at-will doctrine, create uncertainty, and reallocate property rights.

Table 1

Chronology of Exceptions to the Employment-At-Will Doctrine

State	Year Exception Recognized		
	Public Policy Exception	Implied Contract Exception	Good Faith Exception
Alabama		1984	
Alaska		1983	1981
Arizona	1985	1984	
Arkansas	1982	1985	
California	1980	1976	1980
Colorado		1983	
Connecticut	1980	1986	1984
Delaware			
Florida			
Georgia			
Hawaii	1982		
Idaho	1977	1977	
Illinois	1981	1986	
Indiana	1980		
Iowa			1984
Kansas	1981	1984	
Kentucky	1982		
Louisiana			
Maine		1977	
Maryland	1981	1987	
Massachusetts	1982		1977
Michigan	1976	1980	
Minnesota	1987	1983	
Mississippi			
Missouri	1979		
Montana	1980	1983	1983
Nebraska			
Nevada	1984	1986	1987
New Hampshire	1974		
New Jersey	1980	1985	
New Mexico		1980	
New York		1982	
North Carolina	1985		
North Dakota	1987		
Ohio		1984	
Oklahoma		1976	

— Continued —

Table 1 — Continued

Chronology of Exceptions to the Employment-At-Will Doctrine

State	Year Exception Recognized: Public Policy Exception	Implied Contract Exception	Good Faith Exception
Oregon	1975	1979	
Pennsylvania	1978		
Rhode Island			
South Carolina	1985		
South Dakota		1983	
Tennessee	1985		
Texas	1985		
Utah			
Vermont	1986	1985	
Virginia	1985		
Washington	1984	1978	
West Virginia	1978	1986	
Wisconsin	1980	1985	
Wyoming			

Notes: Derived from Individual Employment Rights Manual (Washington, DC: Bureau of National Affairs, 1988); Without Just Cause, by Shepard et al. (Washington, DC: Bureau of National Affairs, 1989); and The Employment-at-Will Issue (Washington, DC: Bureau of National Affairs, 1982).

the exemptions to the employment-at-will doctrine among the states, and in the year that these exemptions were first recognized. In addition, there may be conflicting decisions within a state — an exception may be recognized by some courts in the state but not by others. There is no obvious chronological order to the exceptions recognized by state courts. In 25 states, the public policy exception was the first allowable cause of action, while in 14 states the implied contract exception preceded the public policy exception.

It should be stressed that entries in Table 1 represent state court rulings that break from the traditional common law; they are not based on legislation approved by the state legislature. The selection process and length of service of state court justices vary across states. These judges are typically appointed by the governor and serve terms ranging from two years to life.[16] As a result, the state court precedents are generated by a different process than bills that are proposed and adopted by the state legislature. Because these state court precedents reflect the extent of erosion of the common law employment-at-will doctrine, they form the key explanatory variables in the empirical analysis below.

Although precise information on the number of unjust-dismissal suits brought to state courts or settled out of court is unavailable, one estimate is that there were more than 20,000 suits alleging termination without cause pending in state courts in 1987 (see Westin and Feliu, 1988).

State-by-state information on the average or variance of the awards in unjust-dismissal suits (or in cases settled out of court) is not available. In some well publicized cases, however, awards granted to unjust-dismissal claimants have exceeded the prize for winning the state lottery! In contrast,

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[16]See Klein (1977) for an overview of the state court system.

awards granted in unjust-dismissal cases in countries that require just cause firing by statute typically limit the maximum amount an employee can recover to one or two years of back wages.[17]

Recent surveys by the Rand Institute (Dertouzos et al., 1988) and by the Bureau of National Affairs (Shepard et al., 1989) provide an indication of the average award granted in unjust-dismissal cases, and of the considerable legal costs of an unjust-dismissal suit.[18] The Rand survey examined 120 unjust-dismissal cases that were decided by a jury trial between 1980 and 1986 in California. In the 82 cases decided in favor of the plaintiff (employee), the initial average award was $646,000, but the median award was $177,000. Moreover, post-trial activities such as appeals and settlements reduced the initial jury award by about 55 percent, on average. Similarly, the BNA nationwide survey of 260 wrongful-termination cases between January 1986 and October 1988 found that in the 166 cases where employees were successful, the average award was $602,302, while the median award was $158,800.[19] Both of these surveys indicate that the award distribution is positively skewed.

Another finding of the Rand survey is that the average cost of litigation incurred by an employer in defending an unjust-dismissal suit is $80,073, while the median legal fee is $65,000. In addition, litigation costs for employees are typically based on a contingency of 40 percent of the award. Thus, with combined legal fees exceeding $150,000 on average, the cost of

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[17]See Dickens, Hart, Jones and Weeks (1984) for evidence on Great Britain.

[18]An important limitation of both of these surveys is that they exclude cases that were settled prior to trial, and exclude those that were decided in a bench trial.

[19]The BNA survey did not report the typical reduction in awards due to post-trial activities.

litigation is nearly as great as the average total monetary amount awarded to successful employees in unjust-dismissal cases.

Proposed State Legislation

The ten states in which a bill to require just cause firing has been introduced in the state legislature are listed in Table 2. The laws that have been proposed in these states are similar in many respects to the Montana law. Moreover, these laws were often proposed following well-publicized and costly rulings against employers. In California, for example, a $20 million verdict preceded a legislative proposal.

Table 3 summarizes the salient characteristics of several of the laws. The proposed unjust-dismissal laws typically limit employer liability by requiring arbitration rather than jury trials, or by denying damage awards, or by pursuing both approaches. In addition, the laws tend to cover a wide range of personnel actions, including forced resignations and demotions, while they exclude layoffs due to slack demand and employee-initiated turnover. The reliance on arbitration and a uniform definition of just cause are intended to reduce legal fees compared to the common law system. Finally, although reinstatement of fired workers is a remedy that is typically unavailable under the common law, the proposed laws frequently allow reinstatement in wrongful termination cases.

Business groups often supported the proposed unjust-dismissal laws in the states where they have been proposed. For example, a 1985 report of the California Manufacturers' Association encouraged employers to support a state unjust-dismissal law [SB 2800] because it would "provide a more expedient means by which an employee may be compensated for a truly wrongful discharge -- such as through the opportunity to arbitrate -- and remove an employer's

Table 2

States Where Just Cause Firing Legislation

has been Introduced into the State Legislature

State	Year(s)
California	1984, 1985, 1986 and 1988
Colorado	1981
Connecticut	1975
Michigan	1982
Montana	1987
New Jersey	1980 and 1984
Pennsylvania	1981 and 1985
Vermont	1988
Washington	1987
Wisconsin	1982

Sources: The Employment-At-Will Issue (Washington, D.C.: BNA, 1983); Charles Bakaly, Jr. and William Isaacson Employment At-Will and Unjust Dismissal: The Labor Issues of the '80s (New York: Law and Business, Inc., 1983) pp. 12-13; and Andrew Hill, 'Wrongful Discharge' and the Derogation of the At-Will Employment Doctrine (Philadelphia, Penn.: Wharton Industrial Research Unit, 1988), and personal phone calls to each state by Timothy Kastelle.

Table 3
Characteristics of Proposed Unjust Dismissal Laws[a]

State, Year and Bill No.	Coverage	Standard for Just Dismissal	Dispute Procedures	Remedies
California, 1986[b] [SB 2800]	Private sector workers with 5 years or more of tenure who worked 1,000 hours or more per year. Employees whose total annual remuneration exceeds $100,000 are excluded. Employees covered by a collective bargaining agreement or bilateral contract are excluded.	A discharge is wrongful if there is not "good cause" or a legitimate business reason for the discharge. Employee has burden of proof.	Parties may voluntarily agree to final and binding arbitration; otherwise, parties may bring the case to court.	There shall be no damages for pain and suffering, emotional distress, compensatory damages or punitive damages. Awards are limited to reinstatement and back pay. An employer who violates the act must pay a civil penalty to the state of $500 to $2,000 per violation.
California, 1988[c] [SB 1827]	Private sector workers earning less than $100,000 per year with more than 6 months of tenure. Employees covered by a union contract providing arbitration of unjust dismissal claims are excluded; employers with fewer than 5 employees are excluded.	"Just cause" is required for dismissal. Immediate discharge is legal if continued employment would endanger the health of others, or if the employee engaged in sabotage or willful misconduct.	Employer must notify employee of intent to discharge. Employee may file for a state appointed mediator to mediate dispute. Failing a settlement, the state will assign an arbitrator who will issue a final and binding award. Financed by a .25% payroll tax on employees.	The arbitrator may award, among other things, reinstatement, back pay, and attorney fees.
Colorado, 1981 [HB 1485]	Private sector workers not represented by a union.	"Unjust dismissal prohibited."	Employee has a cause of action in contract if unjustly dismissed.	Court may award lost wages during spell of unemployment relocation expenses, reasonable attorney fees, and other appropriate relief. Punitive damages allowed if dismissal is for refusal to perform an act that violates public policy.
Michigan, 1982 [HB 5892]	Private sector workers not covered by a collective bargaining agreement or contract. Public sector workers not protected by civil service. Coverage begins after a 6 months probationary period.	"An employer shall not discharge an employee except for just cause."	15 days of advance notice of reasons for discharge required. Then mediation followed by binding and final arbitration.	The arbitrator may award reinstatement with or without back pay, or severance pay.

Continued

Table 3 - Continued

State, Year and Bill No.	Coverage	Standard for Just Dismissal	Dispute Procedures	Remedies
Montana, 1987 [HB 241]	Public and private sector workers who have successfully completed the probationary period.	A discharge is wrongful if it is not for "good cause", or if it is in retaliation for employee's refusal to violate public policy, or if it violates written personnel policy. "Business related" layoffs are lawful.	Before filing a complaint, employees must exhaust all internal grievance procedures. Employers have up to 90 days to reach a decision on internal grievances. Failing voluntary resolution, parties may choose to bring the case to arbitration or state court.	Compensatory damages are limited to four years of back wages and fringe benefits. Employee must establish by clear and convincing evidence that employer engaged in actual fraud or actual malice to recover damages for pain, suffering and emotional distress, or punitive damages.
Pennsylvania, 1981 [HB 1742]	All employees excluding those protected by a collective bargaining agreement, civil service, or a fixed-length contract.	"An employer may not discharge an employee except for just cause."	15 days advance notice of reasons for discharge required. Then mediation followed by binding and finsl arbitration.	The arbitrator may reinstate the employee with no, partial or full back pay, or award a severance payment with no reinstatement.
Vermont, 1988 [SB 299]	All public and private sector employees employed by firms with 5 or more employees in Vermont.	An employee may be discharged only for "just cause." An employee fired for refusal to perform what he in good faith believes to be illegal is not a just dismissal. Layoffs and plant relocations are just cause.	Employer must notify employee of reasons for discharge in writing within 15 days after discharge. Employee may bring suit to state court. Employer has burden of proving that discharge was for just cause.	Employee may be awarded an injunctive order, and may recover from the employer damages, court costs and attorney fees.
Washington, 1987 [HB 1133]	Public and private sector workers with three or more years of service in a firm with 8 or more employees. Individuals covered by a collective or individual contract are exempt.	"Just cause" is required for dismissal. Just cause means there is a sufficient reason, judged by a "standard of reasonableness," for the discharge. Employer has burden of proving by preponderence of evidence "just cause" for dismissal.	Employee must file an appeal within 60 days of discharge to the county superior court. The court assigns an arbitrator whose decision is final and binding.	Arbitration award may include compensation for all economic loss, reinstatement, and up to 3 years of future lost wages. No punitive damages provided.

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Table 3 - Continued

State, Year and Bill No.	Coverage	Standard for Just Dismissal	Dispute Procedures	Remedies
Wisconsin, 1981	All private sector workers.	Any dismissal that employee believes to be "improper" can be challenged.	Employee must file a complaint to the Dept. of Industry, Labor and Human Relations with 20 days of discharge. An informal conference will be held between the employee and employer.	None. Bill only calls for a conference between the parties and voluntary settlement.

Notes:

a. Source: Compiled from original laws by the author.

b. California Bill No. SB 2800 is identical to California Bill No. AB 1400 which was introduced in 1985.

c. California Bill No. SB 1827 is identical to California Bill No. 1348 which was introduced in 1985.

exposure to punitive damages .... "

On the other hand, the same California Manufacturers' Association opposed an alternative unjust-dismissal bill [SB 1348] proposed in the same year because it would not shield employers' from large damage suits.

Hypothesis

A logical hypothesis for why employer and employee groups often jointly support just cause dismissal laws is that such laws are an acceptable compromise between limited employer liability and assumption of fault.[20] This compromise is reminiscent of the "great industrial bargain" that is said to have occurred in workers' compensation insurance where employers surrendered the common law defenses available in work-related injury cases in exchange for limited liability regardless of fault (see Hood and Hardy, 1984).

In the case of job security, many employers are willing to support unjust-dismissal legislation and accept a "just cause" firing requirement in exchange for the implementation of a strict standard for employees to recover punitive damages and a consistent, well-defined legal definition of unjust dismissals. An additional benefit of legislation is that it would likely reduce the uncertainty and expense inherent in common law unjust-dismissal suits. Legislation becomes an attractive alternative for employers when state courts break from the traditional common law employment-at-will doctrine.

A testable implication of this hypothesis is that unjust-dismissal legislation is more likely to be proposed and ultimately enacted into law in states where the courts have recognized exceptions to the traditional

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[20]An alternative response by employers, which was suggested by a referee, would be to lobby for legislation to place an across-the-board ceiling on all damage awards. This strategy, however, seems unlikely to be pursued in response to the erosion of the employment-at-will doctrine because, unlike wrongful-termination legislation, it is not a viable political compromise.

employment-at-will doctrine. Although only one state has actually enacted an unjust-dismissal law to date, bills containing just cause firing requirements have been introduced in several state legislatures in the 1980s. Moreover, it is not unusual for legislation to be proposed several times before it is finally enacted into law. The empirical analysis will try to explain the occurrence of these proposed laws.

3. Statistical Model

To put some structure on the empirical analysis, I assume that employer resistance to, or support for, an unjust-dismissal statute in a state is based on a comparison between the expected operating costs under a statute and under the common law. Specifically, employer support for legislation is summarized by a latent variable, y^*, determined by $y^* = C_N - C_L + \varepsilon$, where C_N is the expected costs in the absence of legislation, C_L is the expected costs under legislation, and ε is a random disturbance. Greater values of y^* indicate increasing employer support for unjust-dismissal legislation to limit liability and clarify property rights.

To focus on employer incentives, it will be assumed that employees are never opposed to unjust-dismissal legislation. This assumption may be justified either because a transfer of property rights to employees will increase their wealth, or because risk-averse employees prefer legislation which would reduce uncertainty under the current common law.[21] In this setup,

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[21] If awards granted employees become large enough (with a constant variance), employees will prefer the common law to an unjust-dismissal statute. The assumption that employees uniformly support legislation, however, is necessary for identification in this model because we only observe the occurrence of proposed legislation. Moreover, the assumption that employees do not oppose unjust-dismissal legislation seems consistent with casual empirical observation. The AFL-CIO Executive Council, for example, endorsed just cause firing legislation in February 1987.

the probability that a bill will be endorsed by employer groups and eventually gain enough support to be proposed and enacted by the state legislature is given by prob [y^*] > 0, or equivalently, by prob [$C_L - C_N$] > ε.

In the empirical implementation of this model, it will be assumed that ε has a logistic cumulative distribution function. The proposal of a bill in the state legislature will be used as an indicator of the latent variable y^*. In particular, the variable y_t is defined to equal one if a law is proposed in year t, and zero in other years.[22]

Dummy variables for the three main types of exceptions to the employment-at-will doctrine recognized by the court system in each state will proxy for employers' expected costs in the absence of legislation. Specifically, suppose exception i is first recognized in year t^*, then the dummy variable $E_{i,t}$ is defined to equal one if $t \geq t^*$, and zero if $t < t^*$.[23] These dummy variables are a plausible proxy for the cost under the common law because they reflect the incompleteness of property rights, the magnitude and variability of awards, and the legal transaction costs involved in unjust-dismissal suits.

Exceptions to the common law doctrine are likely to have a delayed effect on the proposal of legislation. Some state legislatures, for example, only meet every other year. Consequently, the basic equation estimated is

$$y_t = F(E_{1,t-1}, E_{2,t-1}, E_{3,t-1}, X_t),$$

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[22] An alternative approach, which was suggested by a referee, is to let y_t equal one every year after a law has been first proposed in a state. Estimation with this dependent variable led to more significant coefficients on the legal exceptions reported in Table 4. The definition of y_t given in the text is used in the empirical analysis, however, because it is a precise indicator of current support for legislation.

[23] Because none of the exceptions was unambiguously reversed during the period under study, the exceptions are assumed to hold in every year after they were first recognized.

where X_t is a vector of state-level explanatory variables and F( ) is the logistic CDF. In addition, estimates that are presented in Section 5 allow for different assumptions about the timing of the relationship between the common law exceptions and the proposal of wrongful-termination laws.

4. The Determinants of Proposed Unjust-Dismissal Laws

To examine the possible effect of exceptions to the employment-at-will doctrine I have assembled data on proposed unjust-dismissal statutes and court rulings by state for each year from 1981 to 1988. The Appendix Table contains descriptive statistics for the data set. Table 4 presents maximum likelihood logit estimates of the occurrence of proposed unjust-dismissal laws for the pooled sample of states.

The first column presents estimates of the effect of the three exceptions to the common law without controlling for covariates. The results show that if a state court system allows one of the exceptions to the employment-at-will doctrine in a given year, the probability that an unjust-dismissal bill will be introduced in the state legislature the following year is increased. The likelihood ratio test of the joint significance of the three exceptions reported in the last row of the table indicate that together the exceptions are highly statistically significant. Furhthermore, in spite of the high correlation among the three dummy variables, the good faith exception and the public policy exception are individually statistically significant.

Several covariates are included in Columns 2 and 3 to control for political and economic factors that might influence the introduction of an unjust-dismissal law. The good faith and public policy exceptions to the

Table 4

Logit Estimates of Proposed Unjust-Dismissal Laws, 1981-1988[a]

Variable	Coefficient (S.E.) (1)	(2)	(3)	(4)	(5)	(6)
Intercept	-5.947 (1.051)	-6.112 (1.781)	-6.664 (1.987)	-5.419 (.694)	-5.898 (1.620)	-6.590 (1.873)
Good Faith Exception	1.616 (.612)	1.825 (.649)	1.994 (.703)	—	—	—
Public Policy Exception	2.561 (1.052)	2.537 (1.057)	2.508 (1.099)	—	—	—
Implied Contract Exception	.856 (.606)	.645 (.627)	.604 (.665)	—	—	—
Total Number of Exceptions Allowed	—	—	—	1.505 (.333)	1.474 (.350)	1.534 (.367)
Union Rate	—	7.912 (5.121)	6.314 (5.603)	—	7.184 (4.728)	6.129 (5.230)
Democratic Legislature	—	-2.463 (2.233)	-2.580 (2.245)	—	-1.655 (2.199)	-1.730 (2.193)
Proportion Manufacturing	—	—	1.641 (4.725)	—	—	3.341 (4.467)
Unemployment Rate	—	—	8.177 (13.163)	—	—	2.812 (12.592)
Log Likelihood	-47.68	-46.01	-45.75	-48.83	-47.47	-47.15
χ^2 for Exceptions[b] [Prob. Value]	26.01 [.0000]	23.36 [.0000]	23.72 [.0000]	NA	NA	NA

Notes:

a. Sample size is 400. The three exceptions to the common law pertain to year t-1. The mean of the dependent variable is .035.

b. These likelihood ratio test of the joint contribution of the three exception dummies has three degrees of freedom. The critical value for such a test at the .005 level is 12.8.

employment-at-will doctrine are individually statistically significant when these additional variables are included in the equation, and the exceptions continue to be jointly highly statistically significant. The point estimates in Column 3 imply that, on average, the probability that a state legislature proposes an unjust-dismissal law is increased by 6.7 percentage points if its court system has recognized the good faith exception, by 8.5 percentage points if the public policy exception has been recognized, and by 2.0 percentage points if the implied contract exception has been recognized.[24] Put another way, the probability that a law is proposed is more than quadrupled if these causes of action have been allowed in a state.

A positive but statistically insignificant relationship is found between the union membership rate and the likelihood that an unjust-dismissal law is proposed in a state.[25] In addition, an unjust-dismissal law appears less likely to be proposed in states where the legislature consists of a greater proportion of democratic members. The variables measuring the proportion of employment that is in the manufacturing sector and the unemployment rate both have coefficients that are smaller than their standard errors.

Because of strong multicollinearity between the three common law dummy variables, Columns 4-6 report specifications that use the total number of exceptions recognized in a state each year instead of the individual common

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[24]These derivatives were calculated as $100 \times \bar{y}(1-\bar{y})\beta_i$, where $\bar{y} = .035$ is the proportion of state/year cells to have proposed legislation, and β_i is a logit coefficient estimate.

[25]Because state-level union rates are no longer available from the Bureau of Labor Statistics, a series was estimated by the author from the May and March Current Population Survey (CPS) from 1981 to 1987. The 1982 state union rates were interpolated because the CPS did not collect union data in that year.

law dummies.[26] Estimation of the new specification yields results that are similar to the previous specification. The total number of exceptions to the employment-at-will doctrine in a state has a positive and statistically significant effect on the probability that unjust-dismissal legislation will be proposed by the legislature in the following year. According to the point estimate in Column 4, each additional exception allowed by the courts increases the probability that legislation is proposed by 5.2 percentage points. Moreover, likelihood ratio tests of the (restricted) specifications that sum the exceptions (Columns 4-6) compared to the specifications that enter the exceptions as separate dummy variables (Columns 1-3) do not reject the restrictions imposed in Columns 4-6.[27]

5. Causality

The results presented so far have established that a relationship exists between the erosion of the employment-at-will doctrine and the proposal of unjust-dismissal legislation. A much more difficult question to answer is whether this relationship is a causal one, or whether it is due to omitted factors that are correlated with the erosion of the common law and with the proposal of legislation in a state. Although causality is difficult to establish in the social sciences even when a randomized experiment has been conducted, the issue of causality should be considered here because it is

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[26] In other words, this variable equals the sum of the three exception dummies ($E_{1,t-1} + E_{2,t-1} + E_{3,t-1}$). Although other methods of aggregating the dummies are possible, this approach is simple and is not rejected by the data.

[27] Two times the absolute difference in the value of the log likelihood function asymptotically follows a chi-square with two degrees of freedom. For example, the chi-square statistic for a test of the hypothesis that Columns 3 and 6 perform equally well is 1.40, and the critical value for such a test at the .10 level is 4.61.

central to the interpretation of the evolution of unjust-dismissal legislation given in this paper.

The timing of the recognition of exceptions to employment at will provides some leverage to determine causality in this case. The basic premise for the analysis is that if the erosion of the traditional common law caused support for legislation, then the erosion of the common law should precede, rather than succeed, the proposal of unjust-dismissal legislation (see Granger, 1969). Table 5 presents a variety of estimates of the determinants of proposed legislation using different lags and leads of the common law variables to examine causality. The equations use the total number of common law exceptions as an indicator of the erosion of the common law because this variable is a simpler summary than separate dummy variables for each exception, and because the exceptions are multicollinear.[28]

The results in Table 5 lend some support for the view that the erosion of the employment-at-will doctrine causes a state legislature to propose unjust-dismissal legislation. In Columns 1-4 the past values of the exceptions to the common law have a greater impact on the proposal of legislation than do future changes in the common law. Both the future and past court rulings, however, are found to have a statistically significant effect at the .10 level, which may be due to the high serial correlation in the common law decisions in states.

More compelling evidence is in Columns 5 and 6, which include both past and future indicators (one or two year lags and leads) of the common law in

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[28]Also note that observations for states after 1985 were dropped from the sample so that the equations would be estimated for a consistent set of observations. This is necessary because future values of the exceptions are unknown for these years.

Table 5

Examination of Causality
Logit Estimates of the Proposal of Unjust-Dismissal Laws, 1981-1985[a]

Variable[b]	Coefficient (S.E.) (1)	(2)	(3)	(4)	(5)	(6)
Intercept	-4.979 (1.915)	-4.826 (1.869)	-4.787 (1.862)	-4.894 (1.918)	-4.710 (1.865)	-4.821 (1.917)
Total No. of Exceptions (t-2)	1.277 (.428)	—	—	—	—	1.484 (.725)
Total No. of Exceptions (t-1)	—	1.026 (.428)	—	—	1.370 (1.044)	—
Total No. of Exceptions (t+1)	—	—	.798 (.444)	—	-.400 (1.074)	—
Total No. of Exceptions (t+2)	—	—	—	.758 (.446)	—	-.292 (.792)
Union Rate (t)	10.719 (6.520)	10.105 (6.195)	9.972 (5.934)	10.014 (5.929)	10.171 (6.153)	10.786 (6.423)
Democratic Legislature (t)	-3.604 (2.960)	-3.328 (2.864)	-3.179 (2.795)	-3.079 (2.805)	-3.316 (2.826)	-3.532 (2.902)
Log Likelihood	-27.87	-29.50	-30.67	-30.80	-29.42	-27.80

Notes:

a. Sample size is 250. The mean of the dependent variable is .032.

b. The dependent variable pertains to year t. The year that the independent variables pertain to is listed in parentheses.

the same equation.[29] These equations indicate that recognizing more exceptions to the traditional common law in the past increases the likelihood that legislation is proposed; while in contrast, the recognition of exceptions that erode the common law in the future has a small, negative effect on the proposal of current legislation. Moreover, the effect of future erosion of the common law on current legislation becomes statistically insignificant once we account for the past extent of the erosion of the common law. These results support a conclusion that changes in the common law precipitate legislative attempts.

Finally, two additional pieces of evidence are also consistent with the interpretation that the erosion of the common law has caused the state legislature in many jurisdictions to consider unjust-dismissal legislation. First, available evidence suggests that the pattern of recognition of exceptions to the employment-at-will doctrine by state courts is haphazard, unrelated to the wage level, unemployment rate, region, or demographic characteristics of states (see Dertouzos et al., 1988). This finding suggests that the common law exceptions are uncorrelated with omitted variables because they occur more or less randomly. And second, the political and economic variables that were included in the equations in Table 4 had little explanatory power and did not reduce the effect of the common law exceptions.

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[29]Additional leads and lags were not included simultaneously in the equations because of severe multicollinearity.

6. Conclusion

In many states the common law employment-at-will doctrine has been eroded over the past decade by state court rulings. It is argued that the new employment-sometimes-at-will common law doctrine has produced uncertain and incomplete property rights to jobs, often leaving employers and employees unsure of the legality of personnel actions. Moreover, when disputes arise over improper dismissals the current judicial system imposes large transactions costs and highly variable awards on the parties.

Evidence is presented showing that unjust-dismissal legislation is more likely to be proposed in states where the departure from the traditional employment-at-will doctrine by the courts has been most extreme. When proposed, this legislation is typically designed to limit employer liability, expedite dispute settlements, reduce legal costs, and clarify property rights. There is a possibility, of course, that at least initially unjust-dismissal legislation could increase uncertainty and disputes over property rights.

As a practical matter, unjust-dismissal legislation may be Pareto superior to the withered employment-at-will doctrine. The anecdotal evidence that employer groups in some states actually support and sponsor unjust-dismissal legislation to limit liability suggests that such "no-fault-firing" legislation is a viable political and economical alternative to the ad hoc court system. If state courts continue to dilute the employment-at-will doctrine, the analysis presented in this paper would predict that many states will follow Montana by proposing and enacting legislation to limit employer liability, clearly re-define property rights, and reduce legal costs.

A natural question to raise is, why has only one state been successful so far in passing wrongful-termination legislation? Two answers suggest

themselves. First, the threat to employers under the common law is not great enough in most states to provoke sufficient support for legislation. Second, a nontrivial waiting period is often required before legislation can be successfully steered through the legislature. For example, more than a decade passed before Alabama became the first state to enact a right-to-work law after such laws were sanctioned by the Taft-Hartley Amendments of 1947.[29] Similarly, there were long lags in the adoption of public sector bargaining laws in many states (Farber, 1988).

The results in this paper suggest that in the long run, the prospects for the passage of unjust-dismissal legislation are linked to the erosion of the common law employment-at-will doctrine. Although it is difficult to predict the future course of the common law, Donald Horowitz (1977, p.12) has noted that "doctrinal erosion in particular is not easily stopped" because precedents make it difficult for courts to reverse themselves, and because judges typically serve long terms. On the other hand, a recent decision by the California Supreme Court (Foley v. Interactive Data), which among other things, limits damage awards in cases over a breach of the covenant of good faith and fair dealing, and recent rulings in Michigan, suggest that the dramatic transformation of the employment-at-will doctrine may have been abated in some jurisdictions.

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[29]Six states, however, passed right-to-work laws of dubious legal status prior to the Taft-Hartley Amendments.

Appendix Table

Means and Standard Deviations

Variable	Law Proposed	No Law Proposed	All States
Good Faith Exception (t-1)	.429 (.514)	.080 (.272)	.093 (.290)
Public Policy Exception (t-1)	.929 (.267)	.430 (.496)	.448 (.498)
Implied Contract Exception (t-1)	.643 (.497)	.319 (.467)	.330 (.471)
Total Number of Exceptions Allowed (t-1)	2.000 (1.038)	.829 (.791)	.870 (.828)
Union Membership Rate	.213 (.053)	.171 (.072)	.172 (.072)
Democratic Legislature	.538 (.064)	.598 (.194)	.596 (.191)
Proportion Manufacturing	.191 (.063)	.186 (.074)	.186 (.074)
Unemployment Rate	.079 (.027)	.075 (.024)	.075 (.024)

Notes: The sources used to derive the common law variables are listed in Table 1. The union rate was calculated by the author based on the CPS. The unemployment rate and proportion of the workforce in manufacturing are from the Economic Report of the President (Washington, DC: Government Printing Office, 1989). The fraction of the legislature that belongs to the democratic party is derived from various issues of Statistical Abstract of the United States (Washington, DC: Department of Commerce, Bureau of the Census).

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