EXHIBIT 3
DATE 1/21/05
HB 257

To: **Rep. Gary Branae**
From: **Scott J. Burnham**
Date: **January 10, 2005**

Re: **Repeal of MCA § 28-2-722**

Summary. Montana Code Annotated § 28-2-722, which makes employment contracts with a term of more than two years illegal, should be repealed. This antique statute serves no public purpose and may inhibit modern economic development.

Background of the Author. I have been a Professor of Law at The University of Montana School of Law for almost 24 years. I received my B.A. from Williams College and my J.D. from New York University School of Law, from which I also received an LL.M. I am the author of numerous books and articles in the field of contract law.[1]

The Statute. The statute is codified with other "Illegal Objects and Provisions" of Contracts. It provides in full:

> **28-2-722. Contracts for personal services limited to two years.** A contract to render personal services cannot be enforced against the employee beyond the term of 2 years from the commencement of service under it, but if the employee voluntarily continues his service under it beyond that time, the contract may be referred to as affording a presumptive measure of the compensation.
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> **History:** En. Sec. 2675, Civ. C. 1895; re-en. Sec. 5258, Rev. C. 1907; re-en. Sec. 7773, R.C.M. 1921; Cal. Civ. C. Sec. 1980; Field Civ. C. Sec. 1013; re-en. Sec. 7773, R.C.M. 1935; R.C.M. 1947, 41-206; amd. Sec. 20, Ch. 117, L. 1979.

History. This statute was among those that the 1895 Montana legislature took from California. California had taken it from the code proposed by David Dudley Field (hence called the Field Code) for New York in the 1860s but never adopted there.[2]

The Field Code statute was also adopted in North and South Dakota and the Territory of Guam. In 1931, California amended the statute to provide for a seven year limit. Similarly, Guam made it a five year limit. Louisiana, which inherited its law from the French civil law tradition, enacted a similar statute in 1825 with a five year limit. In 1964, Louisiana extended the limit to

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[1] I have been paid by Deaconess Billings Clinic for my services in preparing this report. It accurately reflects my views, as I am on record as regretting Montana's adoption of the Field Code and encouraging its repeal. See, e.g., Scott J. Burnham, *Debating the Field Code 105 Years Late* (with Andrew P. Morriss and Hon. James C. Nelson), 61 Mont. L. Rev. 371 (2000).

[2] See the cites in the MCA History to Cal. Civ. C. Sec. 1980 [California Civil Code § 1980] and Field Civ. C. Sec. 1013 [Field Civil Code § 1013].

10 years, and in 1990, repealed the statute "on the ground that it had become essentially anachronistic."[3] So at the moment there are only three other American states with a limit on the term of employment contracts: California, 7 years; North Dakota, 2 years; and South Dakota, 2 years.

It is not surprising that Montana is out of step, for in most American jurisdictions the law of contracts is governed by the common law and not by codes. The principal advantage of the common law is flexibility, allowing the law to develop rather than being frozen in time. The Field Code was largely a codification of the common law as it stood in the mid-19th century, but this statute seems to be an exception. In his annotations to the Code, Field included the source of most of his provisions, but for this one, he merely stated without explanation, "This section is new."[4]

Purpose. It is clear from Field's historical note that this is a regulatory statute and not just a restatement of a common law rule, but it is not clear what purpose was served by a regulation that placed a limit on the term of an employment contract. Presumably it was included for the purpose of protecting workers.[5] If that is the case, the issue boils down to whether such protection is needed 140 years later. It might be noted that if 46 American states think it is not

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[3] John Devlin, *Reconsidering The Louisiana Doctrine of Employment At Will: On The Misinterpretation of Article 2747 and the Civilian Case Requiring "Good Faith" in Termination of Employment*, 69 Tul. L. Rev. 1513, 1529 (1995).

[4] David Dudley Field, THE CIVIL CODE OF THE STATE OF NEW YORK (Proposed Draft 1865) § 1013.

[5] One commentator thinks it was "originally enacted to protect employers from being obligated to their employees who came West at their suggestion." Nicholas Baumgartner, *The Balance Between Recording Artists and Record Companies: A Tip in Favor of the Artists?* 5 Vand. J. Ent. L. & Prac. 73, 77 (2003). I am skeptical of this view, since the provision was in Field's version of the Code and was not written to address the labor situation in California.

needed, then Montana is either particularly progressive or particularly regressive in having this provision.

It must be borne in mind that the fundamental principle of contract law is freedom of contract – through bargaining, parties hammer out the contract terms that will meet their mutual needs. Thus, every intervention by the state must be scrutinized to determine whether the regulation serves a higher purpose than this.

One would think that if a millworker were offered a commitment of employment for five years, the millworker would grab the opportunity. This example points out the anachronism of the regulation in a modern economy where most workers are employed at will. The workers to whom employers offer the commitment of a contract for a term of years are largely professional, white-collar workers. These workers are in a good position to freely negotiate the terms of the contract. This regulation therefore inhibits the private ordering of employment relationships in important high-growth areas such as technology, education, and medicine.

Remedies. If the statute were repealed, and an employee entered into a long-term contract that proved to be improvident, what would happen if the employee wished to escape from it? In modern contract law, courts have the inherent power to protect workers from unfair or unconscionable contracts. Courts would certainly not see the repeal of this statute as an invitation to bring back indentured servitude. Interestingly, my research turns up no case where it was even necessary for a court to offer this protection to a worker. Nor has the statute ever been cited by the Montana Supreme Court.[6] In jurisdictions that do not have this regulation, the system is working efficiently, with employers and employees using their freedom of contract to form long term contracts that they rarely try to avoid.

But if the contract was not unconscionable, what would it cost the employee to break it? Montana has made clear that the employer would not be able to obtain specific performance or a negative injunction.[7] So the employer would be entitled only to money damages. These damages could include the additional cost of a replacement employee for the balance of the

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[6] Outside Montana, the equivalent California statute was litigated in a case brought by Warner Brothers against the actress Olivia de Haviland. The court held that the limit, which at that time was seven years, was a proper exercise of the state's regulatory power. See *Olivia de Haviland v. Warner Bros. Pictures, Inc.*, 67 Cal. App. 2d 225, 153 P.2d 983 (1944). The statute was raised peripherally in the North Dakota case of *Vandall v. Trinity Hospitals*, 676 N.W.2d 88 ¶ 17 (N.D. 2004), where a doctor was employed under a five year contract. The parties called the attention of the court to an ambiguity in the statute – after two years, does the employee become an at-will employee or is the contract still in force but only enforceable against the employer? The court determined that it did not have to decide the issue.

[7] See MCA §§ 27-1-412(1) and 27-19-103(5) as interpreted in *Reier Broadcasting Co. Inc. v. Kramer*, 316 Mont. 301, 72 P.3d 944 (2003).

contract term and, if foreseeable, costs such as recruitment and training of the replacement employee. Of course, as with all breaches, the employer would have a duty to mitigate to keep the damages as low as reasonably possible.

Thus, in the absence of the statute, the consequence to an employee of breaching a long-term contract would not be onerous. The employee would have an economic decision to make when contemplating breach, weighing the pros and cons of the choices – the same economic decision the employee would have to make when contemplating entering into the contract. That is how it should be under a regime of freedom of contract.

Freedom of Contract. The regime of freedom of contract was recently emphasized by the Montana Supreme Court in construing a companion Field Code provision, MCA § 28-2-721, which renders liquidated damages provisions in contracts presumptively void. In *Arrowhead School District No. 75 v. Klyap*, the court stated that "the principle of freedom of contract holds that the parties themselves are in the best position to determine the terms of a contract because the parties are free to get information and bargain the private law of the contract in their own interest," and held that liquidated damages provisions are valid unless unconscionable.[8] This case signals the proper approach to contracts providing for the term of employment.

Conclusion. To modernize the law of Montana and encourage economic development in areas employing highly paid professionals, the legislature should eliminate regulation with respect to the term of employment by repealing MCA § 28-2-722.

Respectfully submitted,

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Professor of Law

[8] 2003 MT 294, 79 P.3d 250, ¶ 49.