

THOMAS ECONOMETRICS

**quantitative solutions
for workplace issues**

**Calculation of Damages in
Wrongful Termination
Litigation**

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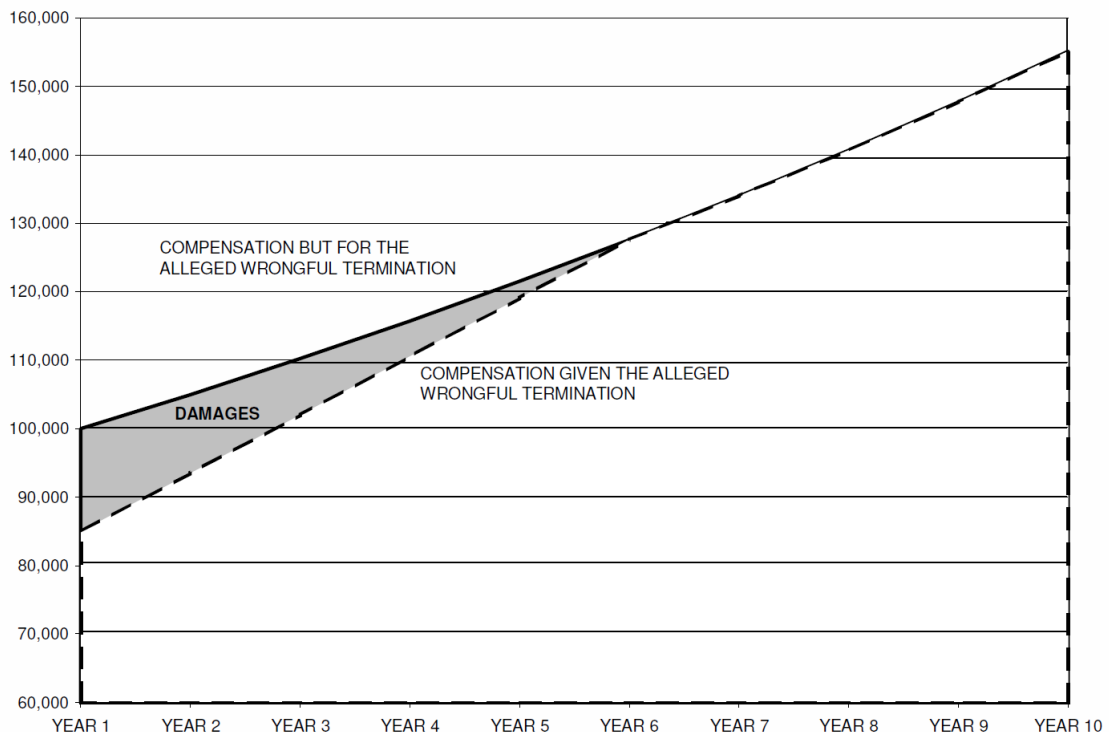


Introduction

When evaluating the economic damages in wrongful termination litigation, the central question being addressed consists of two components:

1. What is the likely compensation (including benefits) that the plaintiff would have earned but for the alleged wrongful termination;
2. What is the likely compensation (including benefits) that the plaintiff can be expected to earn from alternate employment given the alleged wrongful termination.

The amount of damages is equal to the difference between the two compensation streams. Graphically, this can be expressed as follows:



The task at hand, then, is to appropriately calculate the two compensation streams.

Compensation But For the Alleged Wrongful

Termination

Compensation but for the alleged wrongful termination is calculated under the assumption that the individual would have remained employed by the employer in question.¹ Essentially, the calculation assumes that the alleged wrongful termination did not occur and that the individual's compensation stream from the employer in question would have continued uninterrupted.

The compensation stream but for the alleged wrongful termination has two components: (a) back pay and (b) front pay. An accurate calculation of back pay is important since it is typically the departure point for the estimation of front pay. Errors in the calculation of back pay will typically “feed into” the front pay calculation, potentially compounding the degree of error.

¹ It is not always appropriate to assume that the individual would have remained employed by the employer in question indefinitely. For example, if an individual was subject to an employment agreement with a finite time period, and it is demonstrated that the agreement would not have been renewed irrespective of the alleged wrongful termination, the expiration date of the agreement would serve as the date upon which the individual's loss as a result of the alleged wrongful termination would cease.

Back Pay But For the Alleged Wrongful Termination

The first step of this calculation is to construct a base of earnings but for the alleged wrongful termination. Typically, the individual's earnings at the time of separation is taken as the base of earnings. Assume that John Smith was allegedly wrongfully terminated from ABC Corp on December 30, 2009. Typically, Mr. Smith's earnings for calendar year 2009 would be used as the base of earnings but for the alleged wrongful termination.

It is important to ensure that the dollar figure used for the base of earnings includes only earnings that are likely to recur in the future, absent the wrongful termination. Any bonus payments, long term incentive payments, or other cash supplements or benefits payouts should be carefully examined. In these amounts were paid post-separation, or if they are unlikely to be paid again in the future (but for the alleged wrongful termination), they should be excluded from the base of earnings estimate.

For example, assume that Mr. Smith's W2 Wage and Tax Statement from ABC Corp for 2009 showed total compensation of \$258,000. Further assume that this amount consisted of \$208,000 in base salary and \$50,000 in vacation time payouts and severance payments. Clearly, neither vacation payouts nor severance payments would recur in the future had Mr. Smith not been separated from ABC Corp. The use of his total W2 amount of \$258,000 would overstate the base of earnings by \$50,000. This, in turn, may inflate the calculated amount of economic damages.

After the base of earnings has been appropriately determined, the next task is to estimate the likely rate of growth of earnings. Estimation of the rate of growth is important because we are assuming that but for the alleged wrongful termination, the plaintiff would have remained employed by the defendant.

In estimating this growth rate, the expert economist may be guided by the individual's actual past earnings growth. However, caution should be exercised. It may be the case that during his tenure with the employer in question, the plaintiff received a series of promotions or experienced other events that generated larger than typical earnings growth. In this case, the use of actual past earnings growth would be building into the calculation not only merit increases and cost of living adjustments; it would also implicitly assume that the plaintiff would have continued to receive promotions or other such events at the same pace for the remainder of his expected tenure. This may overstate the appropriate earnings growth rate, which in turn could lead to an overstatement of economic damages.

Additionally, the expert economist may be guided by average rates of earnings growth of individuals employed in the plaintiff's occupation, individuals employed in the same industry as the employer in question, or the plaintiff's similarly-situated coworkers. Again, caution should be used, as these statistical averages may under- or over-state the likely earnings growth rate of the plaintiff.

When possible, documentation from the employer outlining merit increases and cost of living adjustments should be considered in constructing an appropriate rate of growth of earnings. This documentation will indicate the actual merit and cost of living increases the employer actually awarded. The use of this information in determining past earnings growth renders a more accurate estimate that is consistent with actual history.

Front Pay But For the Alleged Wrongful Termination

Most commonly, the back pay calculation serves as the basis for the front pay calculation. In essence, the earnings stream is extended into the future. Following on the example above, assume that Mr. Smith's base of earnings as of December 30, 2009 was \$208,000 (the actual salary component of his 2009 W2 earnings). Further assume that documentation from ABC Corp indicates that all employees, regardless of performance, tenure, etc., received a 5% increase each and every year on the first of the year. Mr. Smith's estimated earnings for 2010 and 2011 would be as follows:

<u>Year</u>	<u>Earnings</u>
2010	\$218,400
2011	\$229,320

This \$229,320 figure in 2011 would be used, along with a 5% annual growth rate in this case, to estimate his likely earnings in 2012, 2013, 2014 and so forth:

<u>Year</u>	<u>Earnings</u>
2012	\$240,786
2013	\$252,825
2014	\$265,467

Compensation Given the Alleged Wrongful Termination

The calculation of compensation given the alleged wrongful termination is likely to employ more assumptions than the calculation of compensation but for the alleged wrongful termination. Here, the expert economist has to consider not only the actual employment and earnings of the individual after separation; mitigation plays an important role in this calculation as well.

The Importance of Mitigation

The plaintiff has an obligation to mitigate his damages by seeking employment comparable to the position he held with the defendant employer. Under Title VII of the Civil Rights Act, “interim earnings or amounts earnable with reasonable diligence by the person or persons discriminated against shall operate to reduce the back pay otherwise allowable.”²

The defendant has the burden of demonstrating a failure to mitigate. In demonstrating a failure to mitigate, the defendant must show (a) that “substantially equivalent employment” was available and (b) plaintiff did not exercise reasonable diligence in seeking alternate employment.³ The

² 41 U.S. Code Section 2000e5(g)(1).

³ “Substantially equivalent employment” is defined as “employment which affords virtually identical promotion opportunities, compensation, job responsibilities and status as the position from which the Title VII claimant has been discriminatorily terminated.” (Sellers v. Delgado College, 902 F.2d at 1193, 5th Cir. 1990).

assessment of reasonable diligence in seeking alternative employment is a function of the plaintiff's skills and abilities and the position in question.⁴

For example, assume that Mr. Smith was employed by ABC Corp as Assistant General Counsel, and that his annual salary – exclusive of benefits – was \$208,000 at the time of his separation. Further assume that after his separation, Mr. Smith secured employment as a cashier at a local retailer on July 1, 2011, and that he was paid \$10.00 per hour.

This example highlights many of the potential issues surrounding mitigation. Actual earnings given the alleged wrongful termination may be disputed “if the defendant argues that the plaintiff took too long to find a job or the job taken was not sufficiently remunerative. Even more problematic may be the situation where the plaintiff continues to be unemployed.”⁵

In this example, it is likely that the defendant will argue that given reasonable and diligent job search efforts, Mr. Smith could have secured employment in less than 18 months, and that this alternative employment would have provided compensation on par with his employment at ABC Corp. The defendant will likely argue that Mr. Smith's retail position – which pays \$10 per hour – is not “sufficiently remunerative” or “comparable” to his previous employment at ABC Corp, which paid \$100 per hour.

To support this argument, the defendant may offer expert testimony from a job placement specialist regarding the availability of jobs in a given occupation or industry, the typical length of time it takes to secure a

⁴ Tubari Ltd. v. NLRB, 959 F.2d 451, 454 3d. Cir. 1992.

⁵ Reference Manual on Scientific Evidence, Federal Judicial Center, Second Edition, p. 312.

position in a given occupation or industry, etc. Expert economic testimony may also be given regarding these issues. There is a wealth of information available from the U.S. Bureau of Labor Statistics on the post-separation experiences of displaced workers, ranging from length of job search to earnings recapture rates in subsequent employment.

Perhaps the most important information regarding mitigation comes from the plaintiff himself. The plaintiff should be asked about his job search and mitigation efforts via deposition, and documentation regarding job search and mitigation efforts should be requested. This documentation includes, but is not limited to, items such as:

- Plaintiff's resume(s);
- Cover letters sent to all potential employers;
- Documentation detailing each position for which the plaintiff applied;
- Letters of offer received by the plaintiff;
- Letters of rejection received by the plaintiff;
- W2 Wage and Tax Statements from all post-separation employers;
- Salary administration guidelines from all post-separation employers;
- Summary plan descriptions for all benefits provided by all post-separation employers.

Back Pay Given the Alleged Wrongful Termination

The calculation of back pay begins with a decision of whether to base the calculation on the plaintiff's actual post-separation employment and earnings, or whether to base the calculation on the likely employment and earnings the plaintiff could have generated given reasonable diligence and job search efforts.

If the plaintiff's mitigation efforts are accepted, the actual duration of unemployment and earnings generated in each year from alternate employment serve as the basis of the calculation.

If the plaintiff's mitigation efforts are not accepted, statistical information is relied upon in the calculation of likely earnings given the alleged wrongful termination. As noted previously, there is a wealth of statistical information available regarding the post-separation experiences of individuals. One such study is the Displaced Worker Survey.

Since 1984, the U.S. Bureau of Census has conducted a biannual supplement to the Current Population Survey on behalf of the U.S. Department of Labor, Bureau of Labor Statistics. This supplement is known as the Displaced Worker Survey. This survey collects information from individuals displaced from employment within three years of the survey date. This information includes items such as:

- Demographic information (gender, race and ethnicity, age at time of displacement, educational attainment, geographic region, etc.);
- Reason for displacement;

- Industry and occupation information regarding the position from which the individual was displaced;
- Whether the individual found work subsequent to the displacement;
- Whether the individual is currently employed;
- Whether the individual is still searching for employment;
- The duration of unemployment (time between displacement and the commencement of alternate employment);
- Earnings information regarding the position from which the individual was displaced;
- Earnings information regarding any positions the individual has held subsequent to the displacement.

The information contained in the Displaced Worker Survey and other labor market literature can be used to construct the “typical” experience – from length of job search and unemployment to earnings recapture – of a displaced individual with demographic characteristics, skills and abilities similar to those of the plaintiff.

The amount of back pay given the alleged wrongful termination is equal either to (a) the actual earnings the individual generated since separation through the present date, or (b) the earnings the individual is expected to have generated from separation through the present date had he engaged in reasonable job search efforts, based on labor market information.

Once one determines the base of earnings given the alleged wrongful termination – whether based on the actual post-separation experience of the individual or based on the typical experiences of similar displaced individuals – the next step is a projection of the likely earnings stream from this alternate employment.

Front Pay Given the Alleged Wrongful Termination

Unlike personal injury litigation in which an individual may suffer a permanent diminution of earnings for the remainder of his work life, damages in wrongful termination litigation usually do not extend through the remainder of the individual's work life.⁶

Labor market studies generally indicate that an individual displaced from employment suffers a temporary diminution of earnings, followed by a catch up to pre-displacement levels of earnings.⁷ This catch up typically occurs within three to five years.

⁶ While it is *possible* that an individual could suffer a permanent diminution in earnings as the result of an alleged wrongful termination under certain circumstances, this situation is the exception to the rule.

⁷ One such study is the Displaced Worker Survey, previously discussed. Others include "Job Displacement, Relative Wage Changes and Duration of Unemployment", J.T. Addison and P. Portugal, *Journal of Labor Economics* (1989) and "Returns to Seniority After Permanent Job Loss", *American Economic Review* (June 1989). Both of these articles support the notion that earnings of displaced workers, particularly those with higher levels of education and greater transferability of skills, catch up to pre-displacement levels.

Thus, the loss of earnings as a result of the alleged wrongful termination is not ongoing; at some point – typically three to five years – the loss of earnings ceases.

Calculation of Potential Lost Benefits

In calculating the total economic damages associated with an alleged wrongful termination, benefits should be considered in addition to potential lost earnings. “Benefits” includes such things as health coverage, retirement and pension plans or 401(k) plans, and other fringe benefits provided by an employer to an employee. The manner in which a potential loss of benefits is calculated depends on the nature of the particular benefit.

For example, the loss of health care coverage is typically valued using actual out-of-pocket expenses. If an individual elected COBRA benefits following his separation, and paid \$300 per month for three months until he secured alternate employment providing him with health care coverage, the loss associated with health care would be \$900 (\$300 per month X 3 months = \$900).

Calculations of loss from retirement / pension plans are more complex in that the pension calculations themselves should be based on the formulae provided in the Summary Plan Descriptions of the pension plans themselves. It is necessary to understand the type of pension plan (defined benefit or defined contribution), eligibility requirements, vesting requirements, election dates, etc., before any calculations can be undertaken.

Calculations involving other fringe benefits, such as stock options, employer-provided automobiles, transportation and commuting reimbursements, etc., are also specific to the particular benefit and should to be considered on a case-by-case basis.

It should be noted that in some instances, the benefits associated with alternate employment are assumed to be equivalent to the benefits received prior to the alleged wrongful termination. In this case, the “benefits components” of the calculations cancel each other out, and it is assumed that there is no loss associated with benefits.

Final Points To Consider

It is important to keep in mind that the economic damages associated with an alleged wrongful termination are only those damages directly attributable to the alleged wrongful termination.

For example, assume that one month after his separation from ABC Corp, Mr. Smith was involved in a car accident and sustained a serious head injury. As a result of this head injury, Mr. Smith is precluded from any and all employment for the remainder of his work life. Mr. Smith’s damages as a result of the alleged wrongful termination would not be equal to his likely earnings from ABC Corp but for the alleged wrongful termination less \$0 (the likely earnings from alternate employment). Mr. Smith’s head injury, and resulting permanent disability, is unrelated to the alleged wrongful termination. Therefore, the damages Mr. Smith may suffer as a result of the head injury must be separated out from the damages Mr. Smith may suffer as a result of the alleged wrongful termination.

While extreme in nature, this example illustrates the necessity of including in the economic loss estimate only those losses directly attributable to the alleged wrongful termination.

Finally, it is important to keep in mind that while the general structure and calculation of economic damages in wrongful termination litigation are similar across matters, the elements included in the calculation depend on the particulars and the unique fact patterns of the litigation. It is not the case, for example, that a loss associated with health care coverage should always be included, or that the actual post-separation employment experience should always be discarded in favor of data from the Bureau of Labor Statistics. The components of economic loss should carefully be considered for each matter on a case-by-case basis.