

When evaluating economic damages related to employment claims there are two basic tasks that are called a “but-for” and an “offset” analysis. The “but-for” analysis consists of estimating the value of the lost employment situation, assuming the events in the case had not occurred. The “offset” analysis consists of estimating the value of the new employment situation, given that the events in question occurred as alleged. Economic damages are simply the difference between the two estimates.

The most common type of employment claim is wrongful termination, where the but-for is the value of the lost job at the terminating employer, and the offset is what happened or may happen instead. There are other types of employment claims that also may be considered in the “but-for minus offset” framework. Examples would include failure to promote and wrongful demotion. Other claims where a but-for and offset earnings structure exist can be analyzed using the same basic framework. For example, wrongful death or personal injury claims can be partially thought of as lost labor market opportunities, where a but-for earnings stream can be estimated. The offset would of course depend on the facts in each case, but may be approached in a similar manner to wrongful termination claims.

The analytical methods used to analyze lost labor market earnings are outlined below. The topical areas include the following: projecting but-for earnings, evaluating offset opportunities, approximating the expected duration of a job search, evaluating the possibility of future convergence between but-for and offset, and finally, converting the difference between but-for and offset earnings to a lump-sum present value. For illustrative purposes, the discussion below uses primarily the context of wrongful termination.

**But-For Earnings**

But-for earnings are defined as what the plaintiff would have earned had the incident in question, i.e. – termination, failure to promote, or wrongful demotion, not occurred. Since the incident did indeed occur, the analyst is required to construct a projection to estimate plaintiff's lost earnings. There are several key assumptions that must be understood prior to constructing the but-for projection. These assumptions include: the amount of cash compensation such as base earnings, bonuses, and overtime pay the plaintiff was earning at the time of incident, the rate at which base earnings are expected to grow in the future, and the economic value of the employer's contributions. The employer's contributions include monetary values paid to fringe benefits and retirement plans, as well as legally required benefits such as Social Security and Medicare, which are made by the employer on the employee's behalf.

Base compensation is defined as the earnings that exclude bonuses, commissions, and fringe benefits. For wrongful termination and wrongful demotion cases, but-for base compensation is simply the plaintiff's regular earnings at the time of termination, or prior to the demotion. For failure to promote cases, but-for base compensation is what the plaintiff would have earned if he or she were promoted to the position sought. Relatively speaking, determining the but-for base earnings immediately following the incident is an easy task. The more difficult part in projecting base earnings is determining the appropriate growth rate at which base earnings are expected to grow in the future.

The percentage increase in but-for base earnings is often a subject of debate. Typically, there are a few methods that the analyst could apply to derive the appropriate rate. Selecting the method is dependent upon the facts of the case and the job in question. The most common method is reviewing the plaintiff's

historical pay increases, then applying the average of these to the future projections. In many situations, averaging plaintiff's historical earnings growth, possibly with adjustments for experience earnings profile issues, is the appropriate method for predicting a future growth rate. However, there are some points that the analyst must consider prior to applying the historical growth rate to the future but-for earnings projection.

In general, earnings increases that occurred more than five years before the incident in question are less relevant to predicting future earnings growth than more recent earnings increases. Reasons for this include changing business cycle conditions, changes experienced by the employer, and other environmental factors. For example, when companies experience good years, they tend to reward employees with higher bonuses, increased profit sharing, and larger increases in base pay. To account for company specific downturns and changing labor market conditions, it may be more appropriate to consider the current earnings increases of the plaintiff's cohorts at the company, rather than the plaintiff's historical increases to determine but-for earnings growth. One common pitfall is including salary increases that occurred well in the past, or including increases that coincided with a promotion when calculating the average earnings increase. It should be noted, therefore, that selecting the appropriate method for determining but-for earnings growth varies case-by-case.

Promotions also present an issue for computing future earnings growth based on historical increases. Typically, when an employee is promoted, he or she receives a larger pay increase than would have been received had he or she remained in the pre-promotion position. A higher than usual promotion increase could distort the historical average if it is unlikely that the plaintiff would be promoted in the future.

## Employment Damages Analysis

Dec., 2001

A final element to consider when assessing but-for earnings growth is the impact of so-called human capital issues. A worker's human capital generally consists of education, labor market experience, and specific job-related skills. Increases in the stock of human capital theoretically leads to increased productivity and increased earnings. A considerable amount of labor economics research has been conducted which demonstrates the connection between earnings increases and gains in human capital. In general, productivity gains occur more rapidly in the early years of a person's career or in the beginning of an employment spell at a new employer. Since raises are correlated with productivity gains, one would expect higher earnings increases during the early years when the greatest productivity increases occur. As the rate of productivity increase slow over time, the corresponding earnings growth also slows. Hence, earnings growth tends to be non-linear, making simple linear extrapolations inappropriate. For short-term calculations, adjustments for human capital factors are less relevant. However, in long-term calculations, a failure to incorporate human capital factors into the growth rate produces too high a projection for but-for earnings.

After determining but-for base earnings and expected but-for growth rate, the next step in the but-for analysis is estimating future bonuses and overtime opportunities in the but-for job. In many instances, the plaintiff's historical bonuses and overtime hours serve as an appropriate estimate for expected future bonuses and overtime hours. However, prior to utilizing the plaintiff's historical amounts one must consider any overall changes that have occurred at the but-for employer that may result in a change in bonuses or overtime hours. Both bonuses and overtime hours represent the flexible element of total employee compensation for the employer. When times are good, or when there is an increase in work, employees typically receive higher bonuses or have more overtime work opportunities. When times are bad, bonuses are typically smaller, if they exist at all, and overtime work opportunities are reduced. For example,

perhaps the plaintiff had historically worked 600 hours per year (50 hours per month) of overtime. But now, two years after the plaintiff's termination, the employer hires part-time workers to fill in the overtime hours at a reduced cost. In this situation, applying the plaintiff's historical overtime hours to the future but-for earnings projection would result in overstating damages. On the other hand, perhaps the company laid-off workers and the continuing employees were now working 720 hours per year of overtime (60 hours per month). In this case applying the historical overtime would understate damages. Considering the example above, the analyst should review any changes at the company that would affect overtime hours and bonuses, and, where necessary, utilize current employee cohorts or make adjustments to the plaintiff's historical overtime hours and bonuses averages to account for current business conditions.

The final elements of but-for earnings analysis is estimating the value of employer-provided benefits such as medical insurance, dental insurance, life insurance, retirement contributions, and Social Security / Medicare contributions. An important consideration in estimating the value of these benefits is determining what portion of the total cost of the benefit in question is paid by the employer and which portion is paid by the employee. Only the portion of the benefit cost that is paid for by the employer is included in the but-for earnings analysis. Typically, the analyst will calculate the value of the plaintiff's benefits as a percentage of base earnings, and then account for inflation by applying the same percentage to future earnings. Again, like the assessment of but-for growth rate, overtime opportunities, and future bonuses, it is important to incorporate any post incident changes at the employer into the benefits analysis.

**Expected Job Search (Unemployment) Period**

In estimating damages related to lost employment earnings, the duration of any periods of unemployment and job search are a key factor in the damages

analysis. The job search period has a significant impact upon the final damages figure simply because during the time the plaintiff is searching for offsetting employment, the but-for earnings side of the equation continues to accumulate.

In situations where the plaintiff has not obtained offsetting employment, plaintiffs often argue that their job search activities were considerable, and that the fact that they were unable to secure appropriate alternative employment was simply beyond their control. The resulting implication is that the plaintiff is entitled to damages equal to the full amount of whatever he or she would have earned at the but-for employer for the entire duration of his or her unemployment.

Of course, another view of the situation would question the adequacy of plaintiff's job search efforts. The question then becomes, assuming a more vigorous job search, what duration of unemployment would be expected?

To answer this question, labor economists often review the Current Population Survey ("CPS") data released by the Federal Government's Bureau of Labor Statistics. This data includes information on the median and mean duration of unemployment spells. The median is the unemployment duration of the average person. The mean, or average, is simply the average of all completed job searches. The mean job search period is typically longer than the median. The reason the mean exceeds the median is that the distribution of job searches is skewed; in other words, there are proportionally fewer longer job searches compared to short searches.

Although every case is different, there are rules of thumb one can use in determining which job search statistic is appropriate for the plaintiff in question, and what, if any, adjustments should be made to the publicly available data to make it more applicable to the plaintiff in question. For example, the public data

is generally highly aggregated across occupations and industries. Growing occupations and industries generally have lower search times. Higher paying jobs generally have longer search times. All else constant, a higher than average education generally leads to shorter search times. Given that every employment situation has its unique elements, the publicly available statistics are only a guide to what is expected to occur. If the plaintiff were alleging that he or she is a high performer, then one would expect that the labor market will recognize this trait and consequently the plaintiff should be re-employed sooner.

**Offset Earnings**

Offset earnings are subtracted from but-for earnings, therefore forming a key element in the overall damages calculation. In most situations, offset earnings would contain many of the same elements as but-for compensation including base pay, bonuses, overtime pay, and fringe benefits. Also, like the but-for projection, one must estimate a rate of future growth for mitigation earnings and the economic value of benefits. While there are many similarities between the technical projection of but-for and offset earnings, there are significant differences in the judgmental aspects related to the assumptions utilized as the foundation of the projection. These differences are mainly the result of the fact that there is usually more concrete information available about the lost job as compared to the information available regarding plaintiff's post incident opportunities existing in the broader labor market.

There are two common approaches economic experts utilize to assess offset activities. The first approach assumes that the plaintiff has conducted a vigorous job search and whatever fruits the job search activities have produced are applied as the offset to but-for earnings. However, there are a few key caveats to accepting and using the actual post incident offset activities in the damages calculation. The first and most important caveat is that the plaintiff must seek

comparable work, or work for which his or her qualifications and experience are utilized most fully. For example, it may not be appropriate for a terminated executive to seek employment as a counter person in a fast food restaurant, and then claim the difference in pay as damages. Instead, the executive would be expected to seek positions that were similar in nature to the but-for position. The second caveat is that the plaintiff must actively seek alternative employment. In some instances, plaintiffs apply for only a few jobs per month, an effort that often results in a failed job search. In situations where the plaintiff has looked vigorously for comparable positions, then it may be appropriate to consider actual mitigation activity. Otherwise, the analyst may choose to infer an offset based on a hypothetical position.

In situations where the plaintiff has not been successful in securing appropriate offsetting employment, an analysis comparing but-for earnings to a hypothetical offset may be conducted. When creating a hypothetical offset, analysts typically utilize labor market earnings data from various sources to determine the approximate earnings the plaintiff would be expected to obtain if he or she were able to secure appropriate offsetting employment.

In many offset analyses, it is common to assume that the fringe benefits package offered by the hypothetical employer would be similar in value to the fringe benefit package that the plaintiff enjoyed in the lost position. The basis for this assumption is the notion of labor market equilibrium. If one employer in the same labor market were to offer significantly more in terms of compensation for the same skills and productivity compared to the labor market as a whole, the over-compensating employer would be at a disadvantage relative to its competitors. On the other hand, offering less than market would also cause problems since it would be difficult for the below-market employer to attract and retain employees. The result of these labor market equilibrium factors is that

employers who are competing for employees typically end up providing compensation packages that are comparable. Thus, benefits and wages are expected to be comparable.

**Ending the Damages Calculation**

In general, there are two events that can trigger the ending point of an employment damages analysis. These are earnings convergence between the but-for and offset, and retirement or other departure from the labor force. If the plaintiff secures comparable employment, then one would expect in many instances that he or she would converge, or “catch-up” at some point to his or her projected but-for earnings.

In some instances, plaintiffs secure comparable alternative employment in terms of occupation or industry, but at a pay level that is lower than what they were earning in their but-for position. When this occurs, analysts may consider human capital theory and labor market equilibrium concepts when considering if and when to catch-up the individuals earnings in the offset job. As noted above, human capital research shows that pay increases are relative to increases in productivity, and that most productivity gains occur early on at a new employer. Consequently, one would expect that new employees would receive correspondingly larger pay increases during those first few years at the new employer when their productivity increases are greatest. On the but-for side, the employee would not have the same productivity increases due to the fact that they had already gone through the initial productivity increase stage at their former employer. Of course, there are situations where no catch-up is achieved.

The alternative to catch-up is ending the damages at an expected retirement age. Some experts simply assume a retirement age while others utilize labor market statistics as the basis for deriving what is referred to as the “expected

worklife.” In general, labor market statistics are a better measure, since they incorporate the impact of various factors on the decision to leave the labor force. A plaintiff may state an intention to work until normal retirement at age 65. However, labor market data on worklife expectancy, which take into account all of the reasons for leaving the labor force, may produce a different answer. For example, the worklife data incorporates departures from the labor force due to retirement, disability, and death. At a given age, a worker has each of these possibilities ahead. Furthermore, the actual distribution of ages of voluntary retirement varies considerably, from early retirement at age 55, to retirement at ages well in excess of age 65. Based on an employee’s current age, education, race, and sex, the worklife tables provide an expected number of years of remaining worklife. These tables can serve as a guide, with appropriate adjustments dictated by each case, to the estimation of the ending point of a damages calculation.

**Present Value Calculations**

The courts require all damages figures to be reduced to a lump sum present value. This becomes especially important when the calculation projects damages far out into the future, when present value factors have their greatest impact. Typically, present value calculations are based on a risk-free rate derived from treasury bonds or other relatively risk-free financial instruments. As a general rule of thumb, the rates selected should be similar to the time period discounted. For example, using the short-term rates for a long span into the future would be inappropriate due to differences between the inflation expectations built into those rates. It is important to note that special risks to the income stream should be accounted for prior to reducing to present value. For example, a commissioned bond trader faces considerable uncertainty in their future earnings. An analyst may choose to simply use a higher discount rate to account for such risks to the earnings stream.

**Conclusion**

Employment damages estimates are conceptually straightforward in overall structure. Hopefully, the reader of this overview can appreciate that, in spite of the basic simplicity of the exercise, the details can lead to considerable complexity. Carefully considering the facts in each case will lead to greater accuracy in the resulting estimates of employment damages.