

Reviews and Cases of Note

Possible Damage Elements in Wrongful Termination Litigation: Back Pay, Front Pay, and Lost Earning Capacity

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The purpose of this note is to show the distinction made in wrongful termination law between back pay, front pay, and loss of earning capacity. These terms have very specific meaning in wrongful termination litigation that an economist working on such cases would be well-advised to understand. There are many different acts at both the federal level and the state level under which such litigation might be initiated, not all of which involve terminations of employment. Further, such actions may be initiated through hearings at human rights commissions as well as in ordinary courts of law. For simplicity however, the term “wrongful termination” will represent any type of litigation under federal or state employment law under which workers might be awarded front pay or back pay to compensate for pay that was not or will not be received because of a wrongful act of an employer. Many such suits will not involve loss of earning capacity, which is for a different purpose than front pay.

The difference between front pay and lost earning capacity resulting from a wrongful termination is well explained in Bowles (2008) and repeated in my earlier paper (Ireland 2010). As Bowles explains, both back pay and front pay are part of an equitable remedy, while lost future earning capacity is a compensatory damage. Bowles’ focus, however, was on distinguishing between equitable remedies and compensatory damages. It did not consider how a report by a forensic economist might have to address the three types of damages. Understanding the distinction between equitable remedies and compensatory damages is helpful in understanding *why* there are three types of damages that might be calculated in preparing a report of

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damages, but it does not explain *in appropriate detail* what should be done in preparing a report that involves three types of damages. The intent of my previous paper was to explain the complex nature of tax adjustments that must be made because of the nature of the taxation of wrongful termination awards. At one time, back and front pay were treated differently for tax purposes than loss of earning capacity. Front pay and back pay were taxable, but loss of earning capacity was not. That is no longer the case for reasons explained in the Ireland paper, but an understanding of the differences between the three types of damages was necessary for fully understanding tax treatment of wrongful termination awards. However, as with Bowles, my paper did not focus on how these concepts might impact how an economic expert develops reports that may deal with all three concepts leading to award recovery.

The intent of this paper is to focus on what needs to happen in a report of damages and why the distinction between back pay and front pay, on the one hand, and loss of future earning capacity, on the other hand, is important to attorneys hiring economic experts. It is important to bear in mind, however, that judges at the trial court level often do not think in clear terms about the concepts of back pay, front pay, and loss of earning capacity. In particular, front pay and loss of earning capacity may be thought to be equivalent concepts. It is often at the appellate level that differences between these concepts become important. Even in those instances, however, it is useful for an economic expert to be familiar with the distinctions that exist between the concepts.

I. Defining Back Pay, Front Pay and Loss of Earning Capacity in Employment Discrimination Cases

Back pay does not have the same meaning in an employment discrimination case that *loss of past earning capacity* has in personal injury cases. If a personally injured plaintiff is still living, it is typically the case that past earning capacity losses are based on the concept of earning capacity. In an employment discrimination case, back pay is the pay, including fringe benefits, that a worker would have received from the time of discrimination first began until the trial at which time an award is made. In other words, this is pay and compensation for the fringe benefits that the worker was entitled to receive and did not receive because of the discrimination or event causing the loss of earnings.

If the worker has subsequently taken new employment on a full time basis at the same pay rate, the back pay period is typically

truncated at that point. If a worker has continued to be less than fully employed or is earning less than he or she would have earned as of the time of trial, forward looking losses based on not being employed in the old job are projected as front pay. However, back pay is not compensation for lost earning capacity, but for earnings the worker would have had if the discrimination had not occurred. Specifically, back pay is the amount of earnings that would be awarded to the worker if he was reinstated at his old job. If the worker has taken new employment, back pay will be determined as the earnings the worker would have earned up to the date of employment in a new job. If pay in the new job is higher than in the old job, back pay will stop at that point. If pay in the new job is lower than in the old job, back pay *may* be calculated as the difference between pay at the old job from that point forward to the date of trial. Alternatively, losses from that point forward might be calculated as the past portion of the worker's loss of earning capacity. A knowledgeable plaintiff attorney will *probably* want for you to calculate all past losses as back pay for reasons to be explained later in this paper.

Front pay is an extension of back pay. As Bowles (2008) explained with case citations, front pay is compensation during the period between a trial and the time when a worker is reinstated in his old job or in lieu of reinstatement until a worker has been able to find new employment. It is important to understand that a worker who has lost his or her job through discrimination may or may not have a mitigation requirement until it is determined that the worker cannot be reinstated in the old job. Whether a worker can be reinstated is an issue that may not be determined until the trial has taken place. In California, this depends on how the litigation process began (see *Commodore Health Systems v. Brown* 1982). The requirement to mitigate losses by finding new employment depends upon the assumption that reinstatement is not a viable alternative. A worker, however, can have already made that decision and found new employment. If the new employment is at a lower earnings rate than the old employment, the difference between the two earnings rates can be interpreted in some circumstances as additional back pay and possibly front pay for a period of time until the worker could find employment with earnings at the same or a higher earnings rate than before the discrimination. (This depends on venue and even on how the case was filed within the venue. An economic expert should seek guidance on jurisdictional questions of this sort.) Typically the period of time for which front pay is allowed is determined by a judge, not by an economist.

Loss of earning capacity has tort-like characteristics. A termination of employment can function much like a personal injury, a

fact that is noted in cases discussed in this paper. In finding new employment after a termination, a worker may be "tainted" by the fact of his previous dismissal. One can think of the "taint" as being like libel or slander in that the worker's reputation for having been fired may follow that worker for many years after a termination. Reputational effects are generally rendered irrelevant if the discriminated-against worker is reinstated to his or her old position. If a reinstatement is ordered, a worker's losses will ordinarily be limited to back pay and front pay only until reinstatement occurs. For example, assume that a worker was terminated two years ago and a court has ordered reinstatement of the worker to his old position as of three months in the future. The worker would have back pay losses of two years and front pay losses of three months (as determined by the judge). There would be no loss of earning capacity. Assume instead that the worker was terminated two years ago and it was determined by the parties in litigation and the judge that reinstatement is not feasible because of personality conflicts between the discriminated-against worker and his or her superiors. Back pay would be awarded for two years. Front pay would be awarded for a period of time the judge thought was reasonable for the worker to find new employment. However, evidence may also have been presented suggesting that the worker, having been "tainted" by the termination, will suffer a loss of earning capacity that can be much longer than the period for front pay losses. The loss of earning capacity might be judged to continue for a specific number of years into the future or potentially for the remainder of the worker's work-life. Just as libel and slander can affect a person's earning capacity through reputational effects even though no physical injury has occurred, the "taint" of a termination can similarly do so. In such cases, a calculation for loss of earning capacity is warranted.

This is how the courts have explained the differences in damages elements:

In *Pollard v. E.I. du Pont de Nemours & Company* (2001), the U.S. Supreme Court said:

Although courts have defined "front pay" in numerous ways, front pay is simply money awarded for lost compensation during the period between judgment and reinstatement or in lieu of reinstatement. For instance, when an appropriate position for the plaintiff is not immediately available without displacing an incumbent employee, courts have ordered reinstatement upon the opening of such a position and have ordered front pay to be paid until reinstatement occurs. . . In cases in which reinstatement is not viable because of continuing hostility between the

plaintiff and the employer or its workers as a result of the discrimination, courts have ordered front pay as a substitute for reinstatement.

The 7th Circuit in *Williams v. Pharmacia* (1998), the 7th Circuit said:

Pharmacia argues that the front pay award and the lost future earnings award are duplicative and therefore overcompensatory. . . [T]he two awards compensate the plaintiff for different injuries. Front pay in this case compensated Williams for the immediate effects of Pharmacia's unlawful termination of her employment. The front pay award approximated the benefit Williams would have received had she been able to return to her old job. The district court appropriately limited the duration of Williams's front pay award to one year because she would have lost her position by that time because of the merger with Upjohn.

The lost future earnings award, in contrast, compensates Williams for a lifetime of diminished earnings resulting from the reputational harms she suffered as a result of Pharmacia's discrimination. Even if reinstatement had been feasible in this case, Williams would have been entitled to compensation for her lost future earnings. . .

Front pay gives the employee the earnings she would have received had she been reinstated to her old job. But since the employee has a duty to mitigate damages, she may have taken another job in the interim (or be expected to find another job soon). . . Giving the employee the earnings from her old job without taking account of her earnings from her new (or expected) job would result in overcompensation. Thus, the front pay award gives the employee the present value of the earnings from her old job less earnings from her new (or expected) job. . .

Damages for lost future earnings, in contrast, are not limited in duration in the same way. The reputational or other injury that causes the diminution in expected earnings can stay with the employee indefinitely. Thus, the calculation of front pay differs significantly from the calculation of lost future earnings. Whereas front pay compensates the plaintiff for the lost earnings from her old job as long as she may have been expected to hold it, a lost future earnings award compensates the plaintiff for the diminution of expected earnings in all of her future jobs for as long as the reputational or other injury may be expected to affect her prospects.

Before 1996, a tax distinction was made between back-front pay and lost future earning capacity awarded in the same case. In

Johnston v. Harris County Flood Control District (1989), the 5th Circuit held that a front pay award was subject to income and payroll taxes, while an award for lost future earning capacity was not subject to income and payroll taxation. In that 1989 decision, the 5th Circuit explained that wrongful termination had both a contract-like and tort-like characteristics. Back pay and front pay essentially restore earnings that the worker was entitled to have as a result of his or her employment. Awarding back pay and front pay is restoring to the worker earnings the worker was entitled to have under the conditions of his or her employment. Once the pay (including fringe benefits) has been restored and the worker restored to his or her old employment, there is no harm left with which to be concerned. However, if the worker is not reinstated, harms may continue into the future in a way that is like a tort that has reduced that worker's future earning capacity beyond the period for which the worker would be entitled to recover back and front pay. In the *Johnston* case, the 5th Circuit held that damages such as loss of earning capacity, which is a tort-like damage, should be treated for tax purposes as a tort-like damage, which meant that while front and back pay were taxable under income and payroll taxes, loss of earning capacity was not. The tax distinction between front and back pay on the one hand and loss of earning capacity on the other ended when the IRS amended Section 104(a)(2) of the Tax Code, which governs taxation of awards. That section now limits tax exclusion for damages from litigation to:

[T]he amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as to lump sums or as periodic payments) on account of personal physical injuries or physical sickness.

As the result of this change in the IRS interpretation of the tax code, the distinction between taxation of back and front pay on the one hand and non-taxation of loss of earning capacity on the other hand disappeared. The new IRS distinction is that tort-like damages for loss of future earning capacity caused by reputational effects of the termination do not constitute a "physical injury" from the perspective of exemption from federal, state, and payroll tax liability. It is important to note, however, that the 1996 IRS ruling also applies to personal injury damages that are not "physical" injuries. Libel or slander claims can include loss of earning capacity resulting from an injured reputation. While libel and slander are torts and not forms employment discrimination, earnings losses resulting from libel and slander are no longer exempt from taxation.

II. Why Attorneys May Prefer Back Pay-Front Pay Loss to Loss of Earning Capacity in Wrongful Termination Contexts

In various anti-discrimination laws, caps exist on the amount of damages that can be awarded for compensatory purposes. There are no similar caps on equitable remedies. This was the specific issue that prompted the U.S. Supreme Court decision in *Pollard v. E. I. Du Pont De Nemours & Company* (2001), quoted above. It was also the issue in *Nelson v. Rehabilitation Enterprises of North Eastern Wyoming* (1997), as included in the "Case References and Descriptions" at the end of this paper. This distinction works in much the same way as the distinction between "economic" and "non-economic" damages in tort actions. Tort reform has resulted in many states establishing maximum amounts that can be awarded for what are referred to as "non-economic," "intangible," or "non-pecuniary damages." Such damages would include loss of love and affection, pain and suffering, loss of enjoyment of life, and grief and bereavement. To the best of this author's knowledge no state has put similar limits on earnings loss, loss of household services or costs in life care plans (though offsets for some collateral sources have been allowed). It is somewhat ironic that loss of earning capacity, which is a damage not subject to caps in tort litigation, but is a subject of caps in employment litigation, in contrast to back and front pay, which are not. If a cap exists on loss of earning capacity and does not exist with respect to back and front pay, it is obviously in the financial interest of a plaintiff to have specific portions of damages characterized as back and front pay, and not loss of earning capacity. On this issue, an economic expert should obtain and follow instruction from a retaining attorney.

III. Presenting Back Pay, Front Pay and Loss of Earning Capacity in a Forensic Economic Report

How damages should be calculated and presented depends on the circumstances of a case. Reinstatement may or may not be an option and the plaintiff may or may not have taken post-termination employment during the period before the trial.

In cases in which reinstatement is an option and there is no post-termination employment, the calculations required in an economic expert's report are straightforward. The economic expert will project back pay amounts (including a valuation of lost fringe benefits) from the date of the discriminatory firing (or other loss event) to the date of trial. Since wage rates and benefits are known, it is relatively easy to

project the amount of back pay loss. However, loss elements may include stock options, bonuses, matching contributions on deferred compensation plans, and other special benefits, which can add considerable complication to an assignment. Since an order of reinstatement will typically be within a period of less than a year, it will be fairly easy for the judge to add front pay for the appropriate fraction of a year, but less easy to determine the value of job-related fringe benefits that should also be added for that fraction of a year.

In cases in which reinstatement is not an option and the plaintiff has not taken new employment, damages may include back pay, front pay and loss of earning capacity. Front pay will depend on the judge's determination of how long it will take for the plaintiff to find new employment. An attorney might ask an economic expert to provide calculations for various periods of time that the attorney feels the judge might choose. Usually judge-determined time periods are fairly short, but judges may become known for amounts of front-pay time that they are likely to select. Straightforward projections of loss for such time periods may be helpful to the judge and therefore desired by a retaining attorney. An economic expert, however, is not competent as an economic expert to determine the appropriate period for front pay losses. In such cases, calculations for loss of earning capacity are relevant if there is a foundation for believing that the "taint" of the termination will have reduced the plaintiff's earning capacity in any new job for an extended period of time. The impact of the "taint" will depend on the unemployment rate, the age of the worker, how long the worker was in his or her career when terminated, whether the worker was "blackballed" by the employer who fired the worker, whether this was a "niche" job, whether the industry was in decline, whether another job would be found that would allow the worker to remain in the same pension system, and many other factors.

The foundation for a projection of loss of earning capacity must include an ability to determine how long the "taint" might be expected to last. A termination that occurred 20 years earlier is unlikely to have much "taint" left twenty years later. An economist is not an expert for purposes of determining how long such a "taint" might last, but there must be some basis for whatever assumptions an economic expert makes in this regard. If a foundation exists, loss of earning capacity would ordinarily begin at the end of the front pay period. Since that period would probably not be determined at the start of litigation, it is probably useful to assume no front pay, but to note that any years for which front pay is awarded must be subtracted from a projected loss of earning capacity.

There are other considerations if the plaintiff has taken employment between the date of a termination and the date of trial.

There are two ways of looking at a period during which the plaintiff has taken alternative employment. One might be that the plaintiff was still hoping for reinstatement, but took alternative employment to generate some income during the waiting period. (This is more rare.) The other is that the plaintiff did not want reinstatement and chose to obtain the best employment possible. If the new employment is at a higher pay rate than the pre-termination employment, there will be no continuing damages after the point of the new hire, assuming that the new job has the same likelihood of continuing as the pre-termination job. If the new job has a lower pay rate, loss will probably be calculated as the differential between the two pay rates. If caps apply to loss of earning capacity, it would probably be best to treat all past lost earnings as back pay defined as pay in the pre-termination employment minus post-termination earnings. It is possible that the plaintiff would still be looking for and have a chance of finding higher pay with a new post-termination job. Thus, it might still be possible to claim some amount of front pay loss, with loss of earning capacity beginning at the end of the front pay period based on the alternative assumption that the individual will not be able to find higher pay in a new job.

Different Consequences from Different Types of Wrongful Terminations

Since back pay is fairly straight forward and sometimes determined by a judge (see *Wade v. Wash. Metro. Area Transit Auth.* 2006) and front pay is determined by a judge, the primary role of a forensic economist in testifying before a jury in a case with a knowledgeable judge will be projections of loss of earning capacity. In doing so, the economist will have to take into account the reasons for the wrongful termination. Some economists rely upon data regarding displaced workers to estimate earnings losses following wrongful terminations. This is highly problematic in that there are important differences between displaced workers and wrongfully terminated workers. See Roney (2012) for a summary of studies of displaced workers. Workers are not likely to suffer injuries to their reputations following general plant shutdowns or collapses of specific types of employment and thus are not comparable to individuals who may be wrongfully terminated based on alleged discrimination, whistle blowing, illegitimate political dismissal or other alleged malfeasance on the part of the worker. Displaced workers often have advance notice of dates at which a plant will shut down. Further, all types of wrongful terminations are not the same. If workers are terminated because of being on the losing side in a political election it is not likely that the impact of the termination will be the same as workers fired for allegedly sexually harassing other workers. Impacts on the reputations

of the workers who are terminated will depend specifically on the reasons alleged for the terminations. This is an area in which economic expertise is not likely to provide a solid foundation, but economic expertise will be helpful in building a projection of loss from whatever foundation is being assumed for future losses.

Variations in the Courtroom

Each case, however, presents unique problems and challenges. In *Wade v. Wash. Metro. Area Transit Auth.* (1997), the District Court for the D. C. Circuit granted a defendant's motion to preclude testimony by the plaintiff's economist and rehabilitation expert on the ground that both back and front pay are a matter for judicial determination. The court allowed those experts to testify about compensatory damages (lost earning capacity) and indicated that decisions about back and front pay would be made after a post-trial hearing to be held only if the jury found the defendants liable for wrongful termination. One should note, however, that the judge did not necessarily preclude those experts from testifying before the judge at the post-trial hearing that he indicated would be held if the jury found that Wade had been wrongfully terminated. The judge was saying that back pay and front pay were decisions that the judge himself would make if the jury determined that the plaintiff should be reinstated. The judge allowed the experts to testify about compensatory losses because it would be a jury decision how much compensation should be provided if the jury determined that the defendant's actions had caused the plaintiff to have a loss of future earning capacity. Economic experts can have important roles to play in post-trial hearings.

One forensic economist has mentioned to this author that she has not typically seen the terms "back pay" and "front pay" used very often in working on a number of wrongful termination cases. Other economists have suggested that many judges treat front pay and loss of earning capacity as equivalent terms and that they have projected future loss of earning capacity in the same way as projecting loss of earning capacity in personal injury cases. Given these variations, an economic expert should be prepared to deal with a given case in the manner preferred by an employing attorney and the judge in a case. However, even in cases in which the terms back pay, front pay and loss of earning capacity may be used differently from the distinctions discussed in this paper, there are still advantages to understanding what the damage elements are, how they fit together, and why they are different from each other.

Article References

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Roney, Thomas. 2011. Estimating Duration of Economic Losses in Wrongful Termination Cases: Recent Literature on Duration and Magnitude of Earnings Losses from Job Loss. *Journal of Legal Economics*. 18(2): 107–127.

Case References and Descriptions

Pollard v. E. I. Du Pont De Nemours & Company, 532 U.S. 843; 121 S. Ct. 1946 (2001). This decision of the United States Supreme Court held that front pay is not a compensatory damage in a wrongful termination case, but an equitable remedy that serves in lieu of reinstatement in the job from which an individual was wrongfully terminated. This was relevant to the size of a plaintiff's award in that compensatory damages were subject to a statutory cap on compensatory damages. The Court defined front pay as follows: "[F]ront pay is simply money awarded for lost compensation during the period between judgment and reinstatement or in lieu of reinstatement. For instance, when an appropriate position for the plaintiff is not immediately available without displacing an incumbent employee, courts have ordered reinstatement upon the opening of such a position and have ordered front pay until reinstatement occurs."

Williams v. Pharmacia, 137 F.3d 944 (7th Cir. 1998). This decision held that it was appropriate for a judge to have awarded front pay and a jury to have awarded lost future earnings in an employment discrimination case. The Court provided clear definitions for the two types of awards in reaching its conclusions. The Court argued that the legitimacy of the trial court judge's award of front pay came from the authorization in Title VII of reinstatement as an equitable remedy saying that "front pay is the functional equivalent of reinstatement because it is a substitute remedy that affords the plaintiff the same benefit (or as close an approximation as possible) as the plaintiff would have received had she been reinstated. . . Thus, the district court did not err in awarding front pay after it concluded that Williams could not be reinstated to her old position." With respect to the jury award

for lost future earnings, the court said: "To recover for lost earning capacity, a plaintiff must produce 'competent evidence suggesting that his injuries have narrowed the range of economic opportunities available to him . . . [A] plaintiff must show that his injury has caused a diminution of his ability to earn a living' (citations omitted). Williams's expert witness testified that the poor evaluations Williams received and Pharmacia's eventual termination of her employment taint Williams's employment record. The jury was entitled to rely on this testimony in finding that Pharmacia's acts of discrimination diminish Williams's future earning capacity in the same way that a physical injury may diminish the earning capacity of a manual laborer." The court then considered the possible overlap between front pay and lost earnings. Front pay, the court argued, is for the limited duration of the period until the plaintiff finds new employment. Lost future earnings take over at that point based on differences between the old and new rates of pay.

Johnston v. Harris County Flood Control District, 869 F.2d 1565 (5th Circuit 1989). This decision involved a plaintiff who won an jury award under Title VII of the Civil Rights Act and 42 U.S.C.S. Section § 1983 for wrongful termination. The decision includes extensive discussion that would assist a forensic economist in understanding the nature of awards in wrongful termination cases. The 5th Circuit held that the decision about whether or not to treat Social Security disability benefits as a deductible offset from an award for back pay was within the discretion of the trial court judge. It held that the plaintiff by ceasing to search for new employment had failed in his duty to mitigate damages, requiring offset for that purpose. It also discussed the difference between back pay and past earnings loss that is "personal-injury-like" in character in that the former are subject to federal income taxes and the latter are not. This suggests that front and back pay can be coupled into the same decision with past and future earnings loss and that tax treatment of front and back pay is subject to tax while past and future earnings loss are not. The court also held that a plaintiff is liable for the Social Security taxes that would have accrued in the year the wages were due. This latter holding was subsequently overruled by *United States v. Cleveland Indians Baseball Company*, 532 U.S. 200; 121 S. Ct 1433 (2001). Based on that decision Social Security taxes are currently based on the year in which back pay is received.

Nelson v. Rehabilitation Enterprises of North Eastern Wyoming, 1997 U.S. App. LEXIS 22339; 1997 Colo J. C.A.R 1696 (10th Cir. 1997). This is an unpublished decision. Under 42 U.S.C. § 1981a(b)(3)(B) a \$100,000 cap existed on compensatory damages for sexual harassment and retaliatory discharge. A jury awarded \$90,000

for sexual harassment and \$100,000 for retaliatory discharge. The trial court judge held that \$39,000 of the \$100,000 portion of the retaliatory discharge award was for back pay. The 10th Circuit held that the judge had failed to provide clear jury instructions and a clear jury verdict form, but that there was no indication that the jury intended \$39,000 to be for back pay and that the entire jury award was for compensatory damages subject to the cap in the federal statute, thus reducing the award from \$139,000 to \$100,000. The 10th Circuit avoided establishing a precedent with this decision, but made it clear that the problem in this case would have been avoided with clear judicial instructions and a better form for the jury to report damages that asked the jury to make separate findings with respect to each jury element.

Wade v. Wash. Metro. Area Transit Auth., 2006 U.S. Dist. LEXIS 16447 (D.D.C. 2006). "WMATA seeks to preclude testimony by Plaintiff's economist and rehabilitation expert on the issues of front pay and back pay, arguing that because those remedies are equitable, the jury may not award them, and any evidence of them would only serve to distract and prejudice the jury. Because front and back pay is a bench issue, Plaintiff's experts will be precluded from testifying on that issue. Plaintiff's economist and vocational rehabilitation expert may still testify at trial regarding Plaintiff's compensatory damages claim. The Court will hear the evidence of front and back pay at a later hearing on equitable relief, should a verdict be returned in Plaintiff's favor."

Commodore Health Systems v. Brown, 32 Cal.3d 211; 649 P.2d 912; 185 Cal. Rptr. 270 (California 1982). This decision describes the processes that can be gone through with a filing with the California Department of Fair Housing and Employment (DFEH) versus a civil court filing.