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Estimating Wrongful Termination Damages Amid COVID-19

By **Michaelyn Corbett** (June 10, 2020, 4:47 PM EDT)

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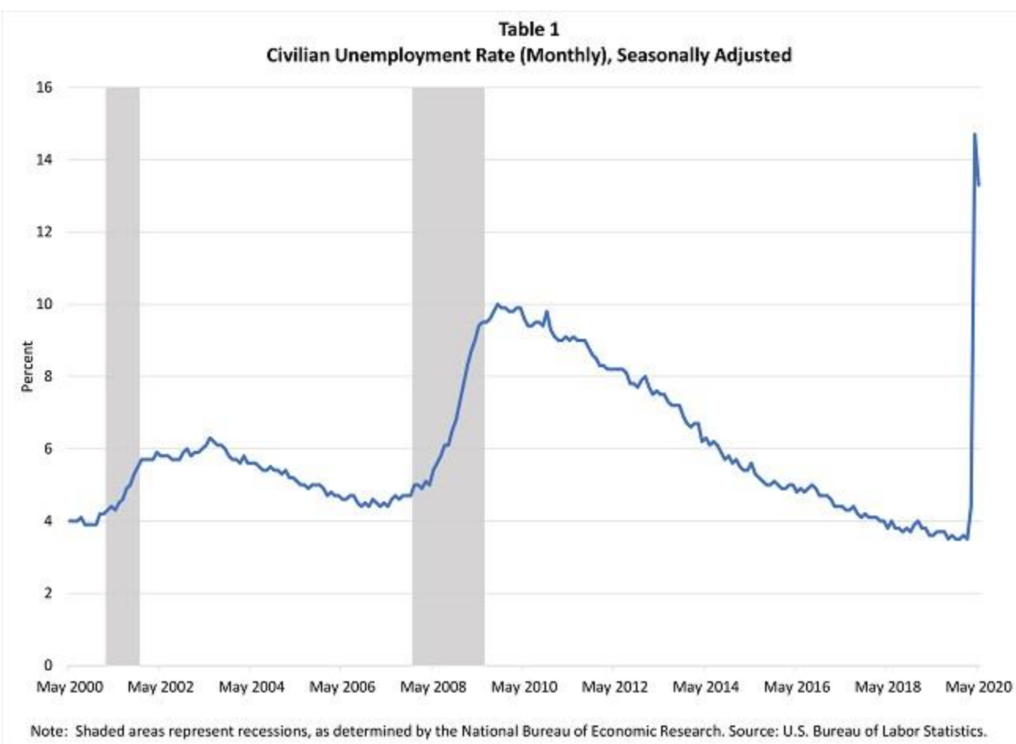
The U.S. economy is currently experiencing a broad-based contraction of labor markets unlike anything seen in modern times due to proliferation of COVID-19. At the end of May, just months after the first documented cases of the virus in the U.S.,[1] an astounding 21 million were reported unemployed, putting the unemployment rate at 13.3%, up from 3.6% in January.[2]

These statistics undoubtedly underestimate the magnitude of job loss, and do not reflect the millions who have stopped searching for work altogether, or who are employed but working with reduced hours and paychecks.[3]

Table 1 presents the monthly unemployment rate over the past 20 years through May, where the initial COVID-19 unemployment experience is juxtaposed with the last two identified U.S. recessions.



Thus far, layoffs have disproportionately affected certain industries and segments of the workforce, with workers in the bottom fifth of the wage distribution experiencing more severe declines in employment than those in the top fifth.[4] Workers in food service, hospitality, travel and retail industries were among the first to lose their jobs following government-announced stay-at-home instructions for all but essential workers and businesses. In very short order, massive, secondary waves of layoffs hit most other industries across the pay scale.[5]

The economic and labor market fallout from COVID-19 is occurring in real time and the ultimate trajectory remains unknown. While some labor market data and statistics will not fully capture either contemporaneous experience or future expectations, economic experts must nevertheless find reasonable approaches to address possible labor market scenarios when calculating lost earnings in wrongful termination matters based on the available evidence.

Each economic recession is unique — and the COVID-19 crisis is no different. Nevertheless, past recessionary experiences may provide useful guidance, if only directionally, to aid in the calculation of damages in wrongful termination cases where current data are presently lacking. For example, research conducted on displaced workers during previous recessions found that a majority experienced lower earnings upon reemployment that persisted for years.[6]

Impact on Damages Model Inputs

Earnings But-For Termination

The first input in a wrongful termination damages analysis is the estimation of "but for" earnings. But-for earnings are the employment earnings a plaintiff would have achieved absent the alleged wrongful conduct, accounting for all forms of compensation (i.e., salary, bonuses and benefits).[7]

A plaintiff's compensation and pay structure prior to termination form the building blocks of but-for earnings, and may also provide a basis for mitigation earnings (discussed below). However, the economic expert should consider whether typical assumptions and approaches to estimating but-for earnings are valid in the COVID-19 era.

This entails assessment of evolving evidence from the plaintiff's former employer, such as changes in actual pay data, contemporaneous business documents describing compensation policies, and prevailing trends in the industry.

A plaintiff's but-for earnings profile may be disrupted due to the pandemic's impact on industry demand and supply factors that affect an employer's financial stability. We have seen wide-ranging responses by firms to the crisis including workforce reductions and cuts to employees' work hours, pay rates, bonuses and benefits.[8]

These measures have also been instituted by financially stable employers, and across pay levels, to proactively fortify against a projected economic recession. In some cases, firms have filed bankruptcy proceedings only a few months into the crisis, while others are on the brink of insolvency, and may be unable to reemploy all furloughed staff.[9] Under these conditions, the likelihood that a plaintiff would have remained employed at the defendant employer's firm in the future is lower given the event's impact on employment overall.

Table 2 provides initial data on some of the catastrophic declines in employment and hours worked, by industry, at the onset of the pandemic.

Table 2: Paid Employment and Hours Change by Two-Digit NAICS Industry

Industry	Paid Employment Change (All)	Hours Change (Continuing Hourly Workers)
Art, Entertainment and Recreation	-56.40%	-19.2%
Accomodation and Food Services	-52.90%	-18.6%
Other Services	-23.60%	-8.6%
Administrative and Support	-19.80%	-5.1%
Real Estate, Rental and Leasing	-19.80%	-5.8%
Transportation and Warehousing	-17.80%	-2.8%
Manufacturing	-17.50%	-8.0%
Information Serivces	-16.10%	-2.1%
Educational Services	-15.90%	-4.0%
Retail Trade	-13.30%	-10.0%
Construction	-12.90%	-4.3%
Health Care and Social Assistance	-12.90%	-3.4%
Wholesale Trade	-10.90%	-9.4%
Professional, Scientific, and Tech Services	-8.90%	-4.3%
Public Administration	-8.20%	-2.5%
Finance and Insurance	-3.30%	-0.9%
Agriculture	0.50%	-1.2%
Utilities	3.80%	-0.5%

Table is from: Tomaz Cajner, et al., "The U.S. Labor Market during the Beginning of the Pandemic Recession," NBER working paper No. 27159, May 2020. The table shows the decline in total paid employment and hours worked for continuing workers who are paid hourly for two-digit NAICS industries between the pay weeks of February 15th and April 11th, 2020. Data are employee level samples from the largest U.S. payroll processing company.

In addition, approaches that rely on historical averages of base salaries, wage growth or discretionary forms of compensation may overestimate but-for earnings if firms have restructured their wage and bonus programs, or are likely to do so if demand for products and services does not fully rebound. Furthermore, it is expected that not all employees within a firm or industry will be affected similarly.

For example, companies may suspend operations in divisions focused on new product development, but may maintain normal function in core operations that generate cash flow. Such decisions will differentially affect employees.

In general, the heightened business uncertainty triggered by the pandemic conditions[10] may make future compensation streams more risky relative to periods of stable economic growth. Under normal business conditions, different components of compensation have inherently different levels of risk.

For instance, base pay rates are typically more stable than commission-based bonuses tied to sales or financial performance. Pandemic conditions would likely increase the uncertainty of many pay components, such as sales-based pay components.

This risk must be appropriately incorporated into any estimate of but-for earnings. As discussed, if past recessions are any guide, compensation growth may not resemble the growth patterns seen in the recent past. Accordingly, careful consideration of case-specific circumstances as well as economywide trends will be required to properly estimate a plaintiff's but-for earnings.

Mitigation Earnings

The second input required in a lost earnings analysis is mitigation earnings — the actual, or projected, earnings that occur, or would occur, had a plaintiff made reasonable efforts to secure work deemed substantially similar to the former occupation. These mitigation earnings are subtracted from but-for earnings to obtain the net earnings loss.

Typically, plaintiffs in wrongful termination actions have a duty to mitigate their damages. Proper estimation of mitigation earnings should follow similar basic principles as estimation of but-for earnings described above. In addition, examination of the plaintiff's mitigation efforts (i.e., to secure alternative work), and economic analyses of labor markets and available jobs, are often important components to the assessment.

Economic theory suggests that the duration of unemployment for those who have lost a job due to COVID-19 is likely to increase (all else equal) for many as the economy continues to struggle and alternative job opportunities shrink.[11] As the length of time it takes to secure work increases, earnings losses, and damages, will increase, all else equal. But this is only true to the extent plaintiffs can demonstrate they have been engaged in reasonable job search efforts, thereby mitigating economic losses, even if they have yet to find suitable work.

Factors such as Congress' emergency relief efforts that significantly enhance unemployment benefits for displaced workers for a defined period — on top of extended benefit periods in many states — may diminish the incentives of some to search out substantially similar work opportunities.[12] But this does not relieve plaintiffs from the duty to mitigate damages.

One recent study found that while job postings in the U.S. had decreased by approximately 30% between January and the second week of April, many job opportunities remained available.[13] Labor demand for certain occupations and industry segments are better situated to withstand an economic downturn than others, and in some cases may actually increase.

Mitigation analysis is a highly fact-specific endeavor in each case. During the COVID-19 era, an expert should assess whether available information appropriately captures the circumstances and economic conditions.

Duration of Loss

Another key component of a lost earnings analysis is the period of loss. This input is tied to some reasonable estimate of the plaintiff's worklife expectancy — the remaining time a worker is expected to participate in the labor market — as well as his expected remaining tenure with the defendant employer.

The work environment that emerges in a post-pandemic era may fundamentally alter the course of labor force participation for years to come. A study based on newly available survey data found that the COVID-19 crisis has already resulted in a significant increase in workers choosing voluntary early retirement.[14]

This finding, in part, may reflect some worker's recognition of a substantially higher risk for adverse health outcomes should they return to work. Alternatively, some workers may opt for early labor market withdrawal due to the reduced availability of child care and schooling options, or the increased need to care for, or protect the health of, other family members.

Accordingly, in addition to consulting various statistics and studies on worklife expectancy, the damages practitioner should also consider the specific circumstances connected to labor supply decisions in each case, such as a plaintiff's preincident health status, family circumstances and the availability of early retirement incentives.

Demand-side factors stemming from the COVID-19 crisis may also affect the duration of losses. As discussed above, business activity has sharply curtailed following the initial COVID-19 outbreak. In instances where a defendant employer institutes cost-cutting measures — a common occurrence during the pandemic — the probability that a worker's tenure is reduced increases.

Such an occurrence could result in the convergence of but-for and actual, or projected, earnings in a relatively short period if a plaintiff must seek an alternative but-for job irrespective of the alleged conduct. Here, full earnings recovery may be achieved prior to the end of the worklife, thereby ending damages.

Discount Rate

The last important component of a lost earnings analysis is selection of an appropriate interest rate with which to discount future earnings to the present value. Absent statutory guidelines that restrict an expert's choice of discount rate, the practitioner should choose a discount rate that reflects a reasonable assessment of the economic risk of but-for and actual (expected) earnings.

In response to tremendous economic upheaval in financial markets stemming from COVID-19, the Federal Reserve System has aggressively stepped in with a broad array of policy tools to bolster liquidity and help stabilize markets. Largely due to the Fed's active responses and forward guidance, both short-term and long-term interest rates have fallen to record lows.[15]

For example, the three-month U.S. Treasury bill rate fell from about 1.52% as recently as January to approximately 0.14% in April.[16] Rates on 20-year Treasury securities decreased from approximately 2.07% to about 1% over the same reference period.[17]

Other things equal, lower interest rates used to discount future dollars to present value will yield larger damages calculations. However, because Federal Reserve intervention is largely responsible for driving interest rates down to stabilize capital markets during the pandemic, it is fair to ask whether rates are likely to rise again during the damages period as economic conditions evolve, and whether the rates are appropriately capturing the inherent risk of future labor market earnings.

Conclusions

While the economic ramifications of COVID-19 continue to unfold, the issues discussed in this article are likely to be relevant for some time to come as the ultimate labor market impacts are gradually revealed.

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[1] The first documented cases of the novel Coronavirus, known as Covid-19, in the U.S. occurred in January 2020. See Grace Hauck, et al., "Three months in: A timeline of how COVID-19 has unfolded in the U.S.," USA Today, https://www.usatoday.com/in-depth/news/nation/2020/04/21/coronavirus-updates-how-covid-19-unfolded-u-s-timeline/2990956001/, accessed May 27, 2020.

[2] See Bureau of Labor Statistics, The Employment Situation for January, March, April and May 2020, news releases. The May unemployment rate rebounded from 14.7% in April.

[3] See, Alicia Parlapiano, "The Economic Pain That the Unemployment Rate Leaves Out," New York Times, June 5, 2020.

[4] See Tomaz Cajner, et al., "The U.S. Labor Market during the Beginning of the Pandemic Recession," NBER working paper No. 27159, May 2020.

[5] See Patricia Cohen and Tiffany Hsu, "For Workers, No Sign of 'What Normal is Going to Look Like,'" The New York Times, May 7, 2020; Kahn, Lisa, Fabian Lange, and David G. Wiczer, "Labor Demand in the Time of COVID-19 Evidence from Vacancy Postings and UI Claims," NBER working paper 27061, April 2020 (hereafter, Kahn et al., April 2020); Rachel Feintzeig and Patrick Thomas, "Companies Try to Preserve Jobs by Cutting Pay Amid Coronavirus Crisis," The Wall Street Journal, April 3, 2020.

[6] See Murat Tasci, "Displaced Workers and the Great Recession," Federal Reserve Bank of Cleveland, November 7, 2012; von Wachter, Till, Jae Song, and Joyce Manchester. Columbia University, "Long-Term Earnings Losses Due to Mass-Layoffs During the 1982 Recession: An Analysis Using Longitudinal Administrative Data from 1974 to 2008," working paper, 2009.

[7] But-for earnings and mitigation earnings can include both past and future projected amounts.

[8] See, for example, "U.S. Firms Foresee Intensifying Coronavirus Impact," at Federal Reserve Bank of Atlanta Macroblog at https://www.frbatlanta.org/blogs/macroblog/2020/05/04/us-firms-foresee-intensifying-coronavirus-impact.

[9] Bureau of Labor Statistics data in April 2020 show that over 90% of laid off workers believed it to be a temporary situation, although other evidence suggests many will not return to their jobs. See, The Employment Situation-April 2020, news release, Bureau of Labor Statistics, May 8, 2020; Christopher Rugaber, "More businesses are realizing their 'temporary' layoffs due to COVID-19 may become

permanent," Associated Press, May 10, 2020.

[10] The pandemic-fueled uncertainty runs the gamut: from infectiousness, prevalence, and lethality aspects, to whether and when a vaccine might be developed, the effectiveness of containment strategies and government economic interventions, among other unknowns. See, Baker, Scott R., Nicholas Bloom, Steven J. Davis, and Stephen J. Terry, "Covid-Induced Economic Uncertainty," NBER working paper 26983, April 2020.

[11] See, Patricia Cohen and Tiffany Hsu, "For Workers, No Sign of 'What Normal is Going to Look Like,'" The New York Times, May 7, 2020; Kahn et al., April 2020.

[12] Federal emergency legislation enacted by Congress in March 2020 increased each state's weekly unemployment Insurance (UI) benefits by $600 for a four-month period and expanded eligibility. See, Congressional Research Service, Global Economic Effects of COVID-19, Updated May 1, 2020, p. 29 at https://fas.org/sgp/crs/row/R46270.pdf; also, see Policy Basics, "How Many Weeks of Unemployment Compensation are Available?" Center on Budget and Policy Priorities, updated May 11, 2020 at https://www.cbpp.org/sites/default/files/atoms/files/policybasics-uiweeks.pdf. The combined state and federal UI benefits are often greater than what some workers earned on the job. See, Eric Morath, "Coronavirus Relief Often Pays Workers More Than Work," The Wall Street Journal, April 28, 2020.

[13] "As of the second week in April, there were 30% fewer postings, compared to the beginning of the year. To put this number in perspective, over the Great Recession, the total number of vacancies in the U.S. declined by 50% in the 1.5 year time interval from recessionary peak to trough." Also, Kahn et al., April 2020.

[14] See, Coibion, Olivier, Yuriy Gorodnichenko, and Michael Weber, "Labor Markets During the Covid-19 Crisis: A Preliminary View," CESifo working paper No. 8238, April 2020.

[15] Marc Labonte, "Federal Reserve: Recent Actions in Response to COVID-19," Congressional Research Service, updated March 31, 2020.

[16] Board of Governors of the Federal Reserve System (US), 3-Month Treasury Constant Maturity Rate [DGS3MO], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/DGS3MO, accessed May 26, 2020.

[17] Board of Governors of the Federal Reserve System (US), 20-Year Treasury Constant Maturity Rate [GS20], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/GS20, accessed May 11, 2020.