

**USE CAUTION: AVOID WRONGFUL DISCHARGE,
A COSTING APPROACH**

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ABSTRACT

Using the framework of employee turnover, this article first discusses wrongful discharge and then attempts to provide a detailed path that may be used to determine likely economic and noneconomic costs associated with a charge of wrongful termination. The types of economic losses that are recoverable are past and future earnings, supplementary benefits, and pre-judgment interest. Most laws also require the employer to cover employee legal expenses and payment for intangible losses as well as for liquidated and punitive damages. To avoid these unnecessary costs, employers are encouraged to use caution and follow prescribed human resource procedures when terminating an employee.

When an employee leaves an organization, whether voluntarily or involuntarily, there is a quantifiable cost to the organization. Beyond the many turnover models available [1-4], industrial researchers have addressed the methods and formulas for costing turnover [5]; have calculated differential turnover costs by industry [6]; have used censored data via survival analysis to accurately predict turnover and therefore its cost [7, 8]; and have even identified the propensity to overlook programs that might serve to mitigate the probability and, therefore, the cost of turnover [9]. For the most part, each of these studies has based its analysis on

employer-incurred separation, recruitment, and training costs due to turnover, but does not consider the potential legal costs of termination.

The literature that stems from the legal side has attempted to provide practitioners with some help in avoiding wrongful discharge claims. Issues considered include how employers might win wrongful termination lawsuits [10], the extent of economic losses [11], how unfair treatment of employees may result in claims of retaliation [12, 13], the correlation between the educational level of the worker and the likelihood that they will sue [14], and even caution on termination during incidents of downsizing or plant closure [15].

This article attempts to focus exclusively on the cost of turnover created from a case of wrongful discharge, while also acknowledging the value of each of the prevailing literature perspectives mentioned above.

WRONGFUL DISCHARGE: COSTS AND LAW

Practically speaking, wrongful discharge has never been an issue to which employers gave much thought because of the dominance of the employment-at-will doctrine [16]. Historically, employment at will suggests that either party may terminate the employment relationship between employer and employee at any time and for any reason (or no reason) with no ensuing backlash. However, this once-dominant doctrine has begun to take many blows that have served to curtail universal acceptance of employment at will [17, 18]. Obviously, as employment at will falters, employers must adapt their termination practices quickly or face the potential of wrongful discharge suits with all the accompanying costs. Even the original cause of the termination may not matter. Whether the involuntary termination is the result of poor performance, merger, acquisition, or necessary downsizing, employers now face the increasing likelihood of costly litigation as employees seek to recover damages.

When a discharged employee brings wrongful termination litigation, if the employer is found liable, it will most likely have to compensate the employee for the damages suffered. Often, employers attempt to limit their exposure to litigation by providing employees help in finding future employment and providing appropriate notice to the laid off or terminated employees [14]. Though employers should attempt to have layoff policies and procedures in place that will not lead to wrongful discharge suits, such suits will nevertheless occur. Hence, it is important for employers to be aware of the costs that may result.

This article strives to provide a relatively easy and generalized path to follow to identify damages for which an employer may be liable in the event of turnover considered as wrongful termination and to show how those damages are computed. The determination path is carefully woven throughout the article, while damages are considered first from an economic and then a noneconomic position. Figure 1 presents the full scope of the costs generally

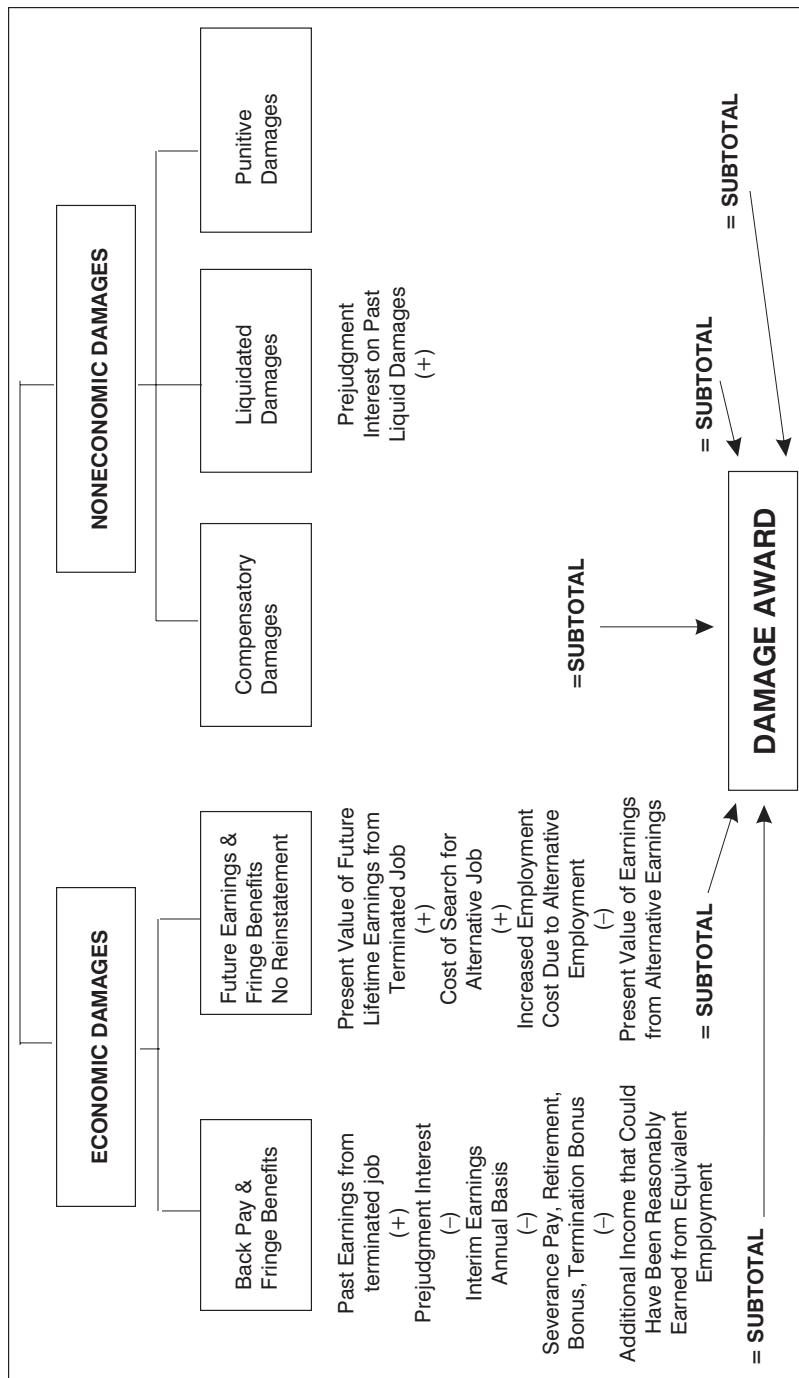


Figure 1. Cost of wrongful termination—private sector.

associated with wrongful termination in the private sector and serves as a guide for the remainder of our discussion.

Unfortunately, no single body of law governs remedies and damages for all statutory or common law wrongful-termination cases [19]. Each statute has its own purpose and special rules. However, all of these laws require payment for past and future earnings and the various types of fringe benefits as well as prejudgment interest. Most of these laws also require the employer to cover employee legal expenses, and some allow for payment of damages for intangibles as well as liquidated and punitive damages [20]. These costs arise only if the employer is found liable, but employers typically must pay their own litigation expenses, absent insurance, regardless of liability.

When a court finds that an employee has been wrongfully discharged, the remedy usually provides for the employee to be compensated in such a way that the person is restored to the financial position s/he would have attained had the discharge not occurred. This “make-whole” standard of relief is the guide for computing damages in wrongful discharge cases, but often the courts fail to specify how these damages should be computed [21]. It is, therefore, necessary to consider not only damage computations due to wrongful discharge, but also noneconomic approaches designed to make whole the wrongfully terminated employee and punish the employer.

Hedonic damages are those that attempt to assess the loss to the plaintiff for the lost value of the enjoyment of life. This type of damage is not typically allowed, based on the Supreme Court case of *Daubert v. Merrill Dow Pharmaceuticals, Inc.* [22] and therefore is not discussed here in more depth [23].

ECONOMIC DAMAGES

Once the termination has occurred, an employee who believes that s/he has been terminated illegally may choose to file a complaint with the court. When finding for the employee, the court must then determine the extent of the damages. Although the effects of the termination on the former employee may range from economic to noneconomic or even psychological, we will first consider economic damage computations.

Back Pay

Back pay reflects the loss of total past earnings. These earnings include all past wages, salaries, profits, and commissions that would have been earned, but for the act of wrongful discharge. Bonuses, overtime shift differential, premium pay, and changes in pay due to promotions, changing costs of living, or productivity increases should also be included [3]. To compute the loss, the first factor to consider is the length of the back-pay period.

Determining the back-pay period requires starting and ending dates for the pay period. The starting date should be the first day of work lost owing to wrongful discharge. The ending date should be the last day of the earnings loss had the discriminatory layoff not occurred. The courts have also used the final court decree or the date of trial [24]. The back-pay period may also end when employment would have been terminated due to death, retirement, illness, a crime, or other action that would be cause for discharge or when there is an unconditional and bona fide offer of reinstatement to the same or equivalent job [21]. The number of days or hours worked at various rates between the beginning and ending dates must be determined and adjusted for absenteeism. Generally, to recover back pay the terminated employee must be ready, willing, and able to work.

Normally, back pay is relatively simple to compute when the employee is salaried, when general increases and promotions can be easily traced, or when absenteeism is very predictable. However, computation of back pay may be more complex when jobs are seasonal, when hours worked fluctuate, when differential pay applies to different types of hours, or when the employee did not work steadily.

The most accurate compensation method requires comparing all costs incurred as a result of using a substitute employee in place of the discharged employee. If the levels of skill, experience, education, productivity, and rate of absenteeism were fairly similar for the two employees, the substitute worker's earnings would accurately reflect back-pay losses. If any differences in experience, productivity, skill, education, and/or absenteeism exist, appropriate adjustments would have to be made.

A second method for back-pay computation is to use the earnings before the discharge as a base for projecting back pay. This historical approach automatically takes into consideration seasonal changes in hours worked, differential pay rates, and absenteeism as they relate to the discharged employee. Fairly accurate estimates, however, require that the employee's past work experience on this specific job be of sufficient length and that the earnings during the back-pay period be fairly normal. Proper adjustment for typical pay increases would also have to be considered.

The third approach to back-pay computation would be to use average earnings of employees doing similar jobs in the firm. Although perhaps not as accurate, this representative-worker approach may be the best method available when an employee has worked only a relatively short time or when a substitute employee does not exist.

Just as back-pay earnings must be computed, so also back-pay deductions must be considered. Specifically, actual earnings from interim employment during the layoff period should be deducted from back pay; otherwise the employee would be overcompensated. In terms of timing the deductions, most courts take a year-by-year approach. If in one year interim earnings exceed back

pay, for that year there is no recovery, but the excess earnings for that year are usually not deducted from back pay due in other years [21].

In one example of overtime pay from interim employment, courts have favorably compared these earnings to earnings from moonlighting. Currently, there does not seem to be consistent agreement. Some courts have held that these earnings should be deducted, while other courts have disagreed [25]. Though the make-whole concept requires that all extra income received be used as an offset, the courts do differentiate between employer originated income and collateral source income, at least where private employers are concerned. Thus, the courts have generally not deducted unemployment compensation, welfare payments, and income from other nonemployer sources [21]. However, they have deducted this collateral source of income, including Social Security, from back pay of public employees [3]. Employer-generated income, which resulted because of the discharge, such as severance pay and retirement or termination bonuses, should be used as an offset [3].

The wrongfully discharged employee also has an obligation to minimize the damages commonly called mitigation of damages. The former employee should extend reasonable effort in finding new employment that is substantially equivalent. Otherwise, pay from such employment that could have been earned can be deducted from back pay [26]. However, the former employee is not required to seek and accept a job that pays significantly less; is in a different line of work; has less responsibility; must be performed under more-dangerous conditions; requires heavier work or longer hours of work; requires working a different shift; or necessitates movement to a significantly different location [3].

To get an offset for what could have been earned, the employer must prove that essentially equivalent employment was available and the reason the plaintiff failed to obtain such a job was he did not exercise reasonable diligence [24]. However, merely showing the comparable jobs available in the community by using help-wanted ads or the testimony of employment agents is not sufficient. It has to be clearly established that the plaintiff failed to use reasonable diligence to obtain such a job [3]. Once that has been proven, it seems fair that an average of the earnings that could have been obtained from these available jobs should be used as offset.

Loss of Future Earnings

In addition to back pay, it is also important to consider the loss of future earnings because of the wrongful discharge. The make-whole concept requires reinstatement to the job that was previously held, with all seniority rights and promotion opportunities that would have accrued otherwise. Reinstatement is generally recommended as a remedy because employment opportunities elsewhere may be nonexistent or curtailed after termination. A plaintiff's future employability may be greatly reduced as a result of his/her termination. In addition, reinstatement

may be the only way to remove the embarrassment and humiliation resulting from the termination. Therefore, to prevent future earnings losses, a plaintiff is often restored to the position s/he would have held without the termination.

Naturally, there are times when it is not advisable to reinstate the employee [27]. For example, the hostility, discord, tension, suspicion, and antagonism between employer and employee may be so great that it prohibits a productive relationship. This situation is generally not the case for rank-and-file workers, but more typically for working relationships that are close and confidential, and that involve high-level, unique, or sensitive positions [27]. In this type of situation, front pay should be considered.

Front pay compensates for future earnings expectancies that have been diminished or lost. It also encourages employers not to discriminate in employment practices. Although the payment of front pay may vary in practice, it is intended to be paid for the length of the period of lost employment or time of restoration of earnings [24].

To compute front pay, a base amount of the employee's current earnings is determined. These earnings must then be increased annually by the raises that would have been forthcoming for the number of years that the employee would have worked for the employer. Next, this future income stream must be reduced to the present value by an appropriate discount rate. Finally, the present value of earnings from alternative employment, if any, must also be deducted after it is adjusted for employment costs such as extra travel or outlays to find an alternative job. Neither reinstatement nor front pay is an appropriate remedy as a general rule [28].

Supplementary Benefits

Supplementary benefits entail compensation that an employee receives in addition to pay other than payment for time not worked. Benefits are substantial in many cases, since on average they constitute an additional 28% of the employee's salary compensation [29]. Examples of voluntary supplementary benefits range from medical insurance to retirement plans, while mandatory benefits include Workers' Compensation and Social Security, among others. Although the number and type of benefits available varies from employer to employer, the same basic computation philosophy used for determining compensation can be applied to supplementary benefits.

Prejudgment Interest

To properly compensate injured parties, interest should be paid on back pay, fringe benefits, and related expenses incurred in seeking and acquiring interim employment. Since these past claims are liquidated losses that can be readily calculated, prejudgment interest is generally granted with two exceptions: 1) Under the Age Discrimination in Employment Act, it can be recovered only if

liquidated damages are not granted, except when the amount of interest exceeds them; and 2) federal employees are not entitled to recover back interest unless there is expressed statutory or contractual authorization [21].

Computation of interest requires dates and amounts due of past payments and an appropriate interest rate. A guiding principle is the risk-free rate that the employee could have earned if s/he had had possession of the money. Generally, this would be the interest available on government investments of small, periodic payments [3].

Because punitive damages and damages for emotional and mental distress are not liquidated, interest cannot be received on them. However, postjudgment interest, calculated from the date of entry of the judgment, may be collected as a matter of right on all money judgments [3].

NONECONOMIC DAMAGES

There are three basic types of noneconomic damages: compensatory damages for intangible losses, liquidated damages, and punitive damages. The first is needed to make the wrongfully discharged employee whole, while liquidated and punitive damages are designed to punish the employer.

Compensatory Damages for Intangible Losses

Intangible losses include emotional and mental distress, damages to professional reputation, and loss of the ability to enjoy life. Very often in our society, a person's livelihood and status may depend to a great degree on employment; loss of the same may lead to emotional and mental distress. As a result of termination, considerable suffering may be incurred because the employee cannot find new employment and earn a living. In some situations, the emotional problems caused by the termination may have contributed to the employee's inability to find new employment. Since mental and emotional distress claims are difficult to prove, they have to be handled on a case-by-case basis. Psychiatric or psychological expert testimony is generally used by the former employee and often countered by the employer [30].

Losses as a result of emotional and mental distress are also very difficult to quantify. This burden is usually placed on the jury. One common approach is to ask each juror how much s/he would need to be compensated if s/he were in the position of the wrongfully fired person. A second approach asks the juror to consider the wrongful discharge as a stress-causing incident, which can then be ranked against other stressors to determine value [30].

As a whole, compensatory damages for intangible losses are very difficult to prove. However, a jury that is sympathetic to a creative emotional plea may cost the employer a significant amount.

Liquidated Damages

According to Black, the use of liquidated damages is appropriate when the judgment and specific amount of money have been determined by the court or when both parties (employer and former employee) have agreed to specific damages [31].

There are two types of liquidated damages. One results from a breach of a previous agreement by the parties. Generally, liquidated damages stated in the employment contract are recoverable, as long as the contracts were negotiated in good faith, are reasonable, and are not oppressive [21]. The second type of liquidated damage is a willful and complete disregard of the intent and purpose of the law [28, 32]. If the intent of such disregard can be proven, the discharged employee is entitled to double damages [33]. Thus, once compensatory damages have been determined, liquidated damages have also been set.

Punitive Damages

Punitive damages are for the purpose of punishing the guilty employer and deterring others from committing similar acts. They may be granted when malicious acts are proven “with an evil nature or reckless disregard for others” [2, p. 49]. The amount awarded in punitive damages is at the discretion of the jury and, therefore, any estimation of an appropriate amount is a very imprecise undertaking. The amount should be large enough to punish and deter a guilty employer, but it should not be “so large as to suggest that the jury was inflamed by passion or prejudice” [24, p. 124]. Though no specific formula is laid down, the court expects that punitive damages bear some reasonable relationship to actual damages. In most cases, however, the jury is instructed to look at the financial health of the organization and directed to consider at the egregiousness of the action [18]. Additionally, the court may grant punitive damages when the employer’s actions were taken with malice or reckless indifference to the employee’s statutory rights [34].

SUGGESTED PRACTICES FOR AVOIDING WRONGFUL DISCHARGE ACTIONS

Avoiding wrongful discharge or termination lawsuits is imperative in the employer-employee relationship. There are a number of ways for employers to protect themselves. The following checklist may help employers reduce the number of lawsuits they need to defend.

- Does the company handbook have an “employment-at-will” statement?
- Does the company handbook have a disclaimer stating that the handbook is not intended to be a binding contract?

- Is the company handbook crafted carefully so that it does not create a contract of employment?
- Is the company handbook crafted carefully so that it does not create an implied contract of employment?
- Does the company handbook indicate that policies are subject to change at any time?
- Has the employee signed a statement acknowledging receipt and understanding of the company handbook?
- Does the company conduct annual and objective performance evaluations that allow employees to have some idea of how their performance is perceived by the company?
- Is the evaluation reviewed with employees?
- Are disciplinary problems or performance problems documented?
- Are employees made aware of these disciplinary or performance-related problems, so that a discharge would not present a surprise?
- Are supervisors trained in how to discipline and discharge employees to reduce the perception of favoritism?
- Are employees treated with respect?
- Are employees' complaints investigated promptly and thoroughly?
- Has someone reviewed the results of the complaint with the employee after the investigation?
- Is there a legitimate reason for firing the employee?
- If someone is going to be discharged, has this action been reviewed by the human resource manager or another manager/administrator to verify that the decision to terminate can be defended effectively?
- Is the reason for terminating the employee documented?
- Is the employee in a protected category?

Prevention is the key for an employer, and prevention requires that employers treat employees fairly and with respect and that they provide reasons for actions taken and document all employment decisions.

SUMMARY AND CONCLUSIONS

This article has focused on the aspect of turnover known as wrongful discharge and has provided a detailed path through the legal maze that may help both practitioners and scholars. To correctly consider the costs associated with turnover, it is imperative not to forget wrongful discharge costs. The types of economic losses recoverable in wrongful discharge cases are past earnings, future earnings, and the various types of fringe benefits. These costs should be offset by the pay and fringe benefits that have been earned or could be expected to be earned from alternative employment. Prejudgment interest also needs to be paid in most cases. Most laws also require the employer to cover employee legal expenses,

and some require payment for intangible losses as well as for liquidated and punitive damages.

Since in many situations the law does not spell out specifically how these damages are to be computed, the make-whole standard of relief from analogous cases is used as a guide wherever possible. Normally, economic solutions are suggested that make the former employee whole, are fair to the employer, and are consistent with legal intent.

There are additional costs to the employer that have not been covered. These include employer litigation costs and the costs of staff time to provide requested information for briefs, interrogatories, etc., and to give depositions and testimony. The total costs of a wrongful employment discharge case can therefore be substantial. Thus, businesses are well-advised to establish policies and procedures to prevent wrongful discharge suits in the first place. All terminations should be overseen by the employer's human resource department and should comply carefully with both company policies and relevant state law. The above checklist should be reviewed before terminating any employee.

LIMITATIONS AND FUTURE RESEARCH

The dynamic nature of the judicial landscape means we cannot generalize the information presented here. Indeed, the most useful advice may just be to encourage managers to consider the potential costs associated with their termination actions. In addition, since we did not try to account for differences in employment practices among industries nor for the professional nature of contemporary human resource departments, both elements can serve as obvious paths for possible future research.

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