Valuing Fringe Benefits & Other Elements of Recovery

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I. Calculating the value of medical benefits.

a. Medical benefits are an important and costly part of employee compensation. One simply way to value the benefit would be to consider what the employer paid on a per-employee basis to provide the benefit. However, the cases roundly reject this approach to calculating the benefit.

b. Rather, the decisions allow the employee to recovery either (1) the cost of obtaining substitute coverage or (2) the actual medical expenses incurred by the employee (or dependents) that would have been covered that were not. *Kossman v. Calumet County,* 800 F.2d 697, 703-704 (7th Cir. 1986); *McMillan v. Massachusetts Society For The Prevention of Cruelty To Animals,* 140 F.3d 288, 305-6 (1st Cir. 1998); *Pearce v. Carrier Corp.,* 966 F.2d 958 (5th Cir. 1992); *Galindo v. Stoody Co.,* 793 F.2d 1502 (9th Cir. 1986); *Miner v. City of Glens Falls,* 1992 WL 349668 at *10-11 (WN.D. N.Y. 1992).

c. Logic would also dictate that the employee portion of the premium cost of the coverage, which is an expense the employee avoids by not carrying the coverage with the former employer, should be deducted from the employee's recovery for medical benefits.

II. Physical injuries and impact of worker's compensation.

a. Recovery for physical injuries under §1981a may be available in cases of sexual or other harassment where physical harm has occurred. As is discussed in Robert Wood's materials, this is one recovery in an employment case that would not be subject to federal income taxation.

b. Most common law claims in tort may be subject to the exclusivity remedy bar of a state's worker's compensation statute, but claims for injury under Title VII, which arise under federal law, are not barred.

c. Where the employee has sought and obtained a remedy in worker's compensation proceedings for the injury in question, however, the election of remedies doctrine has been applied to bar recovery, even though the amount received under the worker's compensation statute is less generous that what is available under Title VII, *e.g., Hogue v. Sam's Club,* 114 F.Supp.2d 389 (D. Md. 2000); *Moniz v. Reitano Enterprises, Inc*., 709 So.2d 150 (Fla. Dist. Ct. App. 1998).

III. Long-term career injury

a. Discussion of the economic factors worth considering in determining the period over which post-termination employment may be assumed and loss of income may be calculated without speculation:

b. Distinction between pre-trial and post-trial loss. The two sides of the calculation, what the employee would have earned and mitigation are both unknown post-trial, whereas the pre-trial mitigation may be

c. The essential problem: where it is plain, from the back pay award if nothing else, that there will in fact be post-trial loss of income, for what period can front pay be awarded before the calculation becomes speculative and recovery is no longer available?

    i. Consideration of factors personal to employee: past career history and stability, medical condition, career path, performance history, etc.

    ii. Consideration of factors affecting employer: business history and stability, organization stability, industry changes, competitive factors, impact of technology, etc.

IV. <u>Stock options and restricted stock plans</u>.

a. Includes: phantom stock, restricted stock, qualified or unqualified options, stock bonus plans and company subsequent issuances or written policy

b. Typical provisions

    i. Stock options (a right to acquire stock in the company, usually a listed public company, at a price determined at the date the option vests, generally fair market value)

        1. Explanation of purpose of option as a fringe benefit: align employee interest with company, so value increases as company value increases; ability to cover obligation through issuance of stock to cover obligation.

        2. Detailed description of typical option plan, including explanation of distinction between issuance or grant of option, vesting of option, vesting schedules, strike price and exercise price, “in the money” or “under water,” expiration of option and termination of options with termination of employment, how options are exercised.

        3. Practical observations: the option allows the employee to select a date when the option will be exercised, many plans provide that employee may immediately sell stock at market and need not put up cash to exercise, tax election and its impact.

4. Tax and securities issues (Just flag, you need not explain fully): how employee is taxed and employer's deduction, controversy over issuance of stock options at below-market value strike price and SOX limitations.

ii. Restricted stock plans (an outright grant of stock that employee must hold for a particular period of time before sale is permitted). Purpose of restricted stock as a fringe benefit: align interests of employee with corporate success.

c. Valuing stock options

i. Categories

1. Options the employee exercised at time of termination.

2. Options that terminated upon termination of employment (either because employee did not choose to exercise or because there was no provision for a 30-day or 90-day post-termination exercise).

3. Options that had been granted but that had not yet vested at the time of termination.

4. Options that allegedly would have been granted under post-termination programs for which employee would have been eligible.

ii. Methodology

1. Comparison with stock options or other stock-based compensation at new position.

2. Valuation based on post-termination and pre-trial events (i.e. changes in stock price during litigation)

3. Black-Sholes calculation

4. Considerations where options not vested or issued at date of termination of employment.

5. The speculation problem of knowing when the employee would have chosen to exercise the option, since employees will typically exercise and immediately sell, since at the time of the damage calculation, market changes are known, while they would not have been known when employee was deciding whether to exercise options. Is it fair to allow the employee to recover based on assumption that employee would have sold at the moment when

the stock reached its market peak? How do you decide the likely time of exercise?

d. Valuing restricted stock

i. Categories

1. Restricted stock issued but forfeited at termination under terms of plan.

2. Restricted stock not yet issued but scheduled for issuance under terms of plan and grant.

3. Restricted stock that allegedly would have been issued under plan or grants occurring after date of termination.

4. Restricted stock under any of the above categories cannot be sold as of the time of trial.

ii. Methodology

1. Comparison with stock-based compensation in subsequent employment

2. Valuation based on stock price (public companies)

3. Valuation in thinly traded or closely-held companies.

4. Impact of restrictions on sale of stock

5. Considerations where stock not issued at date of termination of employment

V. Loans & loan forgiveness.

a. Description

i. Loan at hiring with annual forgiveness

1. Describe (payment of loan proceeds at time of hiring with obligation to repay at termination of employment)Economically, a pre-scheduled bonus program.

2. Employee taxed on forgiveness when it occurs

3. As an incentive device, it is designed to take advantage of the human tendency to be adverse to losses (obligation to repay upon termination of employment) to discourage resignation. Employees

also tend to spend or invest the money received at hiring and may not be in a position to repay the loan comfortably at termination.

4. Valuation methodology for the lost benefit

    a. Assuming that employee would have remained employed for balance (or some portion) of the period after termination and thereby received the benefit of the loan forgiveness.

    b. Other valuation considerations (for instance, value of below-market interest rate, any other approaches).

ii. Home purchase/home loan programs.

1. Describe: Generally, a recruitment tool designed to induce the employee to accept a job because it will require moving and housing market conditions make the employee reluctant to accept employment. Sometimes formalized in an overall company plan. How (if at all) the employee is taxed for the value of the benefit.

2. Valuation methodology (describe—I assume that the employee may have a higher interest rate, or that the employee was required to sell the home in a depressed market).

VI. <u>Retirement plans (Pensions, 401(k), savings plans & SERPs)</u>.

VII. <u>Deferred compensation</u>.

a. How taxed

VIII. <u>Vacations</u>.

a. Economic analysis of vacation time: Vacation pay is pay for time not worked. IT means that the effective rate for working time is greater than the stated salary or wage.

b. Earned vacation at termination: this can be an independent element of damages where the employer has violated an obligation to pay the monetary equivalent of earned vacation time, which some States require under Wage Payment & Collection Acts.

c. Valuation: requires comparison of the vacation that would have been received if the employee remained in the job with the vacation the employee obtains in subsequent employment. Thus, for instance, where a manager or executive goes from having four to six weeks of vacation annually to working as an independent consultant or free-lance contractor, this can represent several months of lost income when calculated over a period of years.

IX. Club memberships.

X. Use of company car.

XI. Other perks

a. Children's education funds

b. Financial/tax/estate planning services

c. Use of company plane

d. Gross-ups for taxes

XII. Golden Parachutes/Change of Control Agreements.

XIII. Termination Severance Provisions.

a. Typical case: The employment contract provides for some per-month or annual compensation figure to be paid (in lump sum or over time) in the event of termination without cause. Where the employee has been terminated and the employer asserts that the termination was "for cause," and the severance amount has not been paid, the employee may sue for the contractual amount due.

b. Typical case: The employment contract includes the same provision, but the severance pay is represents six months of base salary. The employee's losses (which include lost bonuses and fringe benefits) during the first six months following termination of employment, net of mitigation, represents more than the unpaid severance. But the employee's new position does not include any provision for severance pay in the event of termination of employment. [Describe theories and analysis for claim of lost value]

c. Typical case: The company severance pay policy/plan provides that persons laid off are paid three months of base salary as severance pay. The plaintiff was laid off and received the severance pay, but suffered losses (with lost bonus and fringe benefits) exceeding the severance pay. Result: the severance pay represents an offset to recoverable damages. But what about these atypical cases:

i. The employee asserts a claim not for layoff, but for failure to recall from layoff or to rehire? Should the employee be able to avoid the offset because s/he could have received the severance pay and still recovered the loss of income?

ii. The employee has a claim against a party other than the former employer (e.g., third party interference with contract, union in a duty of fair representation case, claim against joint employer to whom a leased employee was assigned who insisted on employee's removal)? Legally, might the severance pay be characterized as a collateral source payment?

XIV. <u>Working with experts</u>.

a. Do you need an expert at all?

b. When might you not want to have an expert even if expert testimony is available?

c. Some less obvious benefits to using an expert: improved discovery, no gaps in information needed to develop sound valuation, finding additional issues on which expert testimony will be helpful

d. Communication and obtaining information for expert opinion.

e. Development of the expert opinion

XV. <u>Tax impact of recovery</u>.

a. When an award of damages is made to replace a stream of payments in a lump sum, the result can be an increase in the marginal income tax rate that is applied to the recovery. Instead of five years of $20,000 in additional income being taxed at a taxpayer's marginal rate for that year of, say, 20%, the first $20,000 of the lump sum payment will be taxed at that rate and a larger percentage of remainder of the award will be taken, as the payment pushes total income into progressively higher marginal rate tax brackets.

b. *Fogg v. Gonzales,* 492 F.3d 447 (D.C. Cir. June 29, 2007) refused to permit a request to "gross up" back pay to relieve the plaintiff of the adverse tax consequences associated with recovering multiple years of pay in a single year, acknowledging that as a result, most of the award will be taxed at a higher marginal tax rate. The court cited and relied on *Dashaw v. Pena,* 12 F.3d 1112 (D.C. Cir. 1994), which denied such relief absent a voluntary settlement agreement among the parties based strictly on the absence of any case law being cited to support Plaintiff's request. The plaintiff argued that the trial judge had been a member of the *Dashaw* panel and had relied on a decision permitting such relief, *Sears v. Atchison, Topeka & Santa Fe Railway Co.,* 749 F.2d 1451 (10th Cir. 1984), that was obviously overlooked in *Dashaw*. The court nevertheless reversed, in reliance on *Dashaw,* despite the fact that the Tenth Circuit decision articulated a policy justification for such relief (placing the plaintiffs in the same position they would have occupied had there been no discrimination).

c. None of these decisions discuss or appear to be aware of the U.S. Supreme Court's decision addressing this issue in the context of a Federal Employer's Liability Act ("FELA") case, *Norfolk & Western Railway Co. v. Liepelt,* 444 U.S. 490 (1980). In that case, the plaintiff's recovery was non-taxable, although it was based in part on an estimate of future income that, but for the wrongful death, would have been wages and subject to taxation. So in that case, the employer and employee were on opposite sides of this legal question of whether taxability is an appropriate consideration in damage calculations. Citing the FELA damage standard ("the damages . . . [that] flow from the deprivation of the pecuniary benefits which the beneficiaries might have reasonably received . . "), the Court concluded:

> The amount of money that a wage earner is able to contribute to the support of his family is unquestionably affected by the amount of the tax he must pay to the Federal Government. It is his after-tax income, rather than his gross income before taxes, that provides the only realistic measure of his ability to support his family. It follows inexorably that the wage earner's income tax is a relevant factor in calculating the monetary loss suffered by his dependents when he dies. *Norfolk & Western,* 444 U.S. at 493-94.

d. Another concern was that the jury might incorrectly assume that its award was taxable and hence "gross up" its award accordingly without any instruction to do so. In that case, the difference between an award taking taxes into consideration and one ignoring them was substantial, and the Court concluded that the tax effect should be presented to the jury in making its damage assessment. Explaining this decision, the Court observed: "…it surely is not proper for the Judiciary to ignore the demonstrably relevant factor of income tax in measuring damages . . ." *Id.,* at 495-96.

e. The only significant difference between this holding and those cited above is whose ox is being gored by the Internal Revenue Code. If there is something to be said for ensuring that a defendant is not improperly punished by a jury's misconceptions about taxes in a personal injury award, there is also much to be said for ensuring that none of what the discrimination laws and a jury give to provide full compensation is not taken away by the IRS. The calculations of tax impact are no more complex and confusing than other damage calculations such as valuing stock options and discounting future loss to present value.

f. In *Gelof v. Papijneau,* 829 F.2d 452 (3d Cir. 1987), the court allowed this element to be included where the defendant did not object, and in that case it represented an increase in the award of $85,000. The court approved remand to allow the plaintiff to calculate prejudgment interest on that sum, but noted that it was not deciding whether the element of damage itself would be recoverable in every back pay case. A request for recovery of the tax bump was denied in *Hukkanen v. I.U.O.E Local 101,* 3 F.3d 281 (8th Cir. 1993), but only because the plaintiff presented no evidence in support of this theory and provided the court with no convenient way to calculate the amount.

g. *Barbour v. Medlantic Management Corp.,* 952 F.Supp. 857 (D. D.C. 1997) spelled out what must be done to satisfy this evidentiary burden. The court rejected the plaintiff's proposed $700,000 element of damages because it represented the full tax impact of the award, rather than calculating the difference between the tax on the lump sum award and the tax that would have been imposed on the stream of payments for which compensation was being given.