

ICJR Research Brief

Wrongful Termination -- What are the consequences of recent legal changes?

The last two decades have seen a major expansion in tort liability, and at the Institute for Civil Justice (ICJ) we have devoted much research to determining the outcomes of these substantive changes in the law. Pinning down the specific outcomes of particular legal changes often proves a highly complex task. Besides the challenges inherent in separating out and tracking the various factors that influence trial outcomes, the research task is often complicated by the fact that many of the most significant legal changes occurred some years in the past. The trail of cause and effect is sometimes cold and therefore even harder to follow than it would otherwise be.

But recent changes in case law concerning wrongful termination provide an exceptional opportunity to study the impact of expanded liability—to follow a trail that is not just warm, but is still being blazed. *The Legal and Economic Consequences of Wrongful Termination (R-3602-ICJ)*, by James N. Dertouzos, Elaine Holland, and Patricia Ebener, presents our findings to date. The report:

- documents the shift in case law from “employment at will” to wrongful termination;
- investigates the factors behind the pattern of change observable from state to state;
- measures the effects of such changes on litigation rates and outcomes—who wins, who loses, and how much;
- and explores the social and economic implications of the changes.

This marks the beginning of a new look for ICJ Research Briefs. We've always intended the Research Briefs to be a convenient way for people interested in the civil justice system to keep abreast of our current publications. We hope the new format will add to the level of convenience by being quicker to read and handier to file and access.

“Employment at will” declines

Traditionally, employment of most workers has depended upon the discretion of employers, who could fire an individual “for a good reason, a bad reason, or no reason at all.” Exceptions to this “at-will doctrine” included workers covered by collective bargaining agreements and other forms of explicit contracts. In addition, federal civil rights and equal employment legislation prohibited general discrimination directed against groups on the basis

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of race, age, sex, or religion. In the early 1980s, however, state courts, led by the judiciary in California and a few other states, began creating additional, significant limitations on the employment-at-will doctrine. In recent years legislation against wrongful discharge has spread rapidly, now affecting employment law in a substantial majority of states.

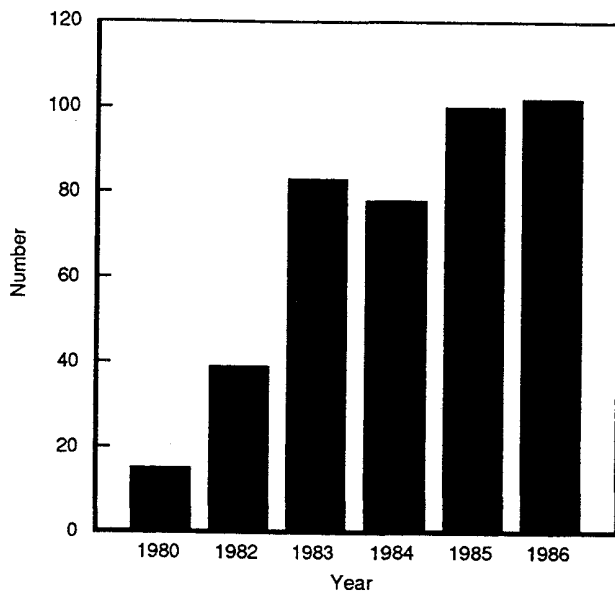
So far, no clear socioeconomic reason has emerged to explain why some states have instituted change and others haven't. The prevailing doctrine on wrongful termination doesn't appear to be related to wage levels, population demographics, region, or measures of cyclical economic activity. A precise identification of factors relating to the “supply or demand for legal doctrine” requires still more research.

Caseload rises rapidly

One pattern does hold across the states, though: Change in judicial doctrine concerning wrongful termination has been followed quickly by discernible increases in legal activity. An analysis of wrongful

termination suits filed in Los Angeles, California, provides a representative example.

A survey of court documents filed in Los Angeles Superior Court during March and April of selected years since 1980 reveals a rapid rise in total cases filed. In 1980, immediately following California's initial ruling recognizing the application of the covenant of good faith and fair dealing to employment relationships, 15 wrongful termination cases were filed in the two-month period. Two years later, more than twice as many cases were filed during the same period. Over 80 percent of these 39 cases asked for punitive damages under the covenant of good faith. In the following year, the volume of cases more than doubled again, rising to 83 during March and April of 1983. During the same period in 1986, over 100 cases were filed. Assuming a similar pattern of filing over the course of the year, a total of more than 600 cases entered the system in 1986. Statewide we estimate the total at 1,000.



Court Filings - Los Angeles Superior Court
(March/April)

Outcome patterns emerge

Our analysis of 120 jury trials in California between 1980 and 1986 shows plaintiffs victorious in about 68 percent of these trials, enjoying a greater success in the initial years following the revolutionary judicial decisions at the turn of the decade. Although the probability of victory appeared to be unrelated to a variety of plaintiff, defendant, law firm, and case characteristics, the status of insurance coverage was highly correlated with jury decisions. Cases in which coverage was provided for both liability and defense costs were much more likely to result in plaintiff

victories. In contrast, cases in which insurance companies accepted a duty to defend but were not liable for major damages had a much lower probability of plaintiff victory.

Award amounts were strongly correlated with measures of economic loss. The earnings and age of the plaintiff can explain over 30 percent of the case-to-case variation in compensatory and punitive damages. Holding other factors constant, differences in plaintiff salaries before termination are typically matched by equivalent percentage differences in the money awarded by juries. In addition, jury awards, holding salary constant, rise until age 50. For older employees expected to be in the work force for a short time anyway, awards diminish.

Indirect costs threaten to surpass direct costs

Our examination of case filings in California and of trials across jurisdictions nationwide reveals that the *direct* costs are not nearly as large as employers' concern over wrongful termination might suggest. Annual trials in jurisdictions recognizing the covenant of good faith and fair dealing add up to only 8.8 trials per one million workers. With an average final payment of \$208,000 and \$81,000 in defense fees, the annual cost of jury trials sums to \$2.56 per worker. Even after including estimates of payments and legal fees for the 95 percent of all cases that are settled without going to trial, the total expense per worker still amounts to only \$12.25.

It is likely, though, that corporate fear of wrongful termination charges results in hidden *indirect* costs, costs that may be quite significant. Firms may provide large severance payments, retain poor performers, and respond to business expansion by using contractors, part-time employees, or increased overtime. Administrative costs may rise as personnel decisions become more centralized, more methodical, and more carefully documented. Labor-displacing technologies may be passed over despite their economic potential. Investigating these potentially exorbitant indirect costs will be the next step in our research on wrongful termination.

The research summarized in this brief was carried out within the Institute for Civil Justice of The RAND Corporation. Research results are described in detail in R-3602-ICJ, *Introduction to the Legal and Economic Consequences of Wrongful Termination*, by James N. Dertouzos, Elaine Holland, and Patricia Ebener, ISBN 0-8330-0915-X, 73 pp., \$7.50.

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