

Compensation and Employment Law Practice Group

Client Alert

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Third Circuit Increases Damages Exposure in Discrimination Cases

The Third Circuit Court of Appeals recently decided a case that has significant implications for damages in Title VII cases, as well as affecting virtually all settlements in employment discrimination cases. The holding, found in *Eshelman v. Agere Sys., Inc.*, No. 05-4895 (3d Cir., Jan. 30, 2009), holds that an employment discrimination plaintiff is entitled to money above and beyond the back wages award to compensate her for negative tax consequences of that award.

Eshelman involved a claim of employment discrimination based on age and disability. While *Eshelman* lost her age discrimination case at trial, the jury found in her favor on the disability discrimination claim and awarded her back-pay and compensatory damages totaling \$200,000. After the trial, *Eshelman* filed a motion for an additional monetary award to offset the negative tax consequences of receiving the back-pay award in a lump sum. The District Court granted the motion to augment the back-pay award and *Agere* appealed. In analyzing the increase of the award, the appellate court stated that the chief remedial purpose for employment discrimination statutes is “to make persons whole for injuries suffered on account of unlawful employment discrimination.” The Court also noted that the anti-discrimination statutes granted courts broad equitable powers to achieve this make-whole remedy and that back-pay was one of these typical equitable awards. Commenting that back-pay awards were taxable, the Court said that employees may be subject to higher taxes if they receive a lump sum back-pay award in a given year. The Court also said that the Tenth Circuit found that compensation for additional tax liability incurred as a result of receiving back-pay in a lump sum was appropriate in a 1984 case – *Sears v. Atchison, Topeka & Santa Fe Ry. Co.*, 749 F.2d 1451 (10th Cir.1984). The tax issue there involved some seventeen years of compensation that was to be awarded in a single tax year. Finally, the Court noted that prejudgment interest on back-pay awards is universally awarded and provides a useful comparison to justify awards designed to make up for tax liability.

The Court’s determination introduces yet another element into the damages for which employers may be liable as a result of an adverse verdict. Moreover, the decision raises a red flag for any type of settlement negotiations in which a lump sum award of back-pay might have some current year tax effect. Practitioners should expect more complete tax analysis in their settlement

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discussions on the part of plaintiffs, and an increasing number of demands for make-whole tax relief at both trial and in settlement and mediation discussions.

This information is intended to provide our readers with information on recent legal developments and issues of significant interest. It should not be regarded as legal advice or opinion. Baker & McKenzie LLP's North American Compensation & Employment Law Practice Group advises on all aspects of employment and labour law and regularly represents employers in legal proceedings.

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