IMPERMISSIBLE WINDFALLS?: UNEMPLOYMENT INSURANCE, BACK PAY, AND THE TWO CLASSES OF TITLE VII PLAINTIFFS

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I. INTRODUCTION

Prevailing plaintiffs in employment discrimination cases brought under Title VII of the Civil Rights Act of 1964 may be entitled to an award of back pay relief, intended “to make the victims of discrimination whole by restoring them so far as possible . . . to the position where they would have been were it not for unlawful discrimination.” Back pay relief under Title VII compensates plaintiff-employees for loss of pay attributable to discriminatory employment acts, including losses due to unemployment, underemployment, and failure to promote. Most common are suits alleging discriminatory firings, in which case back pay relief compensates, in whole or in part, for loss of income suffered during the period when the plaintiff was unemployed or underemployed due to an improper termination. Since many employees bringing Title VII firing suits qualify

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2 Ford Motor Co. v. EEOC, 458 U.S. 219, 230 (1982) (noting that this compensatory goal, while important, is a purpose that is secondary to the primary goal of Title VII to stop illegal employment discrimination) (citation omitted) (internal quotation marks omitted); see Griffith v. City of Des Moines, 387 F.3d 733, 746 (8th Cir. 2004) (“Title VII is not designed to provide a windfall to plaintiffs, but rather serves to put the plaintiff in the same position he or she would have been in absent discrimination.”).

3 See LAURA BETH NIELSEN ET AL., THE AMERICAN BAR FOUNDATION, CONTESTING WORKPLACE DISCRIMINATION IN COURT 6 (2008), available at http://www.americanbarfoundation.org/uploads/cms/documents/nielsen_abf_edl_report_08_final.pdf (noting that 60% of all employment discrimination cases are brought because the plaintiff was fired, allegedly because of illegal discrimination).
for unemployment insurance,\(^4\) prevailing plaintiffs in such suits are likely to receive back pay awards that cover periods during which the plaintiff also received unemployment insurance benefits.

The overlap of back pay and unemployment insurance benefits described above is widely acknowledged to be a double recovery or “windfall” for plaintiffs.\(^5\) Consider the following illustration: employee “E,” living and working in Connecticut, suffers a discriminatory firing causing six weeks of unemployment. If E previously earned $1,000 per week, her loss of pay from the firing is $6,000, and she would likely collect $6,000 in back pay under Title VII. If E also receives unemployment insurance benefits, she will be paid about $462 for each week that she is unemployed,\(^6\) totaling $2,772 over the six-week period of unemployment. Absent intervention, E collects a total of $8,772 in compensation for the six-week period during which she actually lost $6,000 of income. That is, from the perspective that unemployment insurance benefits stand in the shoes of a claimant’s ordinary wages, E actually lost $3,288\(^7\) due to the discriminatory firing, and was overcompensated by the back pay award to the tune of $2,722. On the other hand, if unemployment insurance benefits are not fully or truly paid for by employers, or if the benefits should not stand in the shoes of back pay as a matter of public policy, the $8,772 in compensation may not be an overpayment.

\(^4\) A basic requirement to receive unemployment insurance benefits is that the applicant be involuntarily unemployed—a condition that an employee who is fired clearly meets. See generally infra Part II.B.

\(^5\) See, e.g., Thomas W. Lee, Deducting Unemployment Compensation and Ending Employment Discrimination: Continuing Conflict, 43 EMORY L.J. 325, 335 (1994) (“[W]hile the deduction of unemployment compensation from back pay may provide a windfall for the employer . . . failure to offset unemployment benefits similarly provides a windfall for the employee.”) (footnote omitted) (internal quotation marks omitted).

\(^6\) See CONNECTICUT DEPARTMENT OF LABOR, ELIGIBILITY REQUIREMENTS – UNEMPLOYMENT INSURANCE, http://www.ctdol.state.ct.us/progsupt/unempl/uceligb.htm#Basic%20Eligibility%20Requirements (last updated Oct. 11, 2011) (stating in Connecticut, a weekly unemployment insurance benefit entitlement is calculated by averaging the claimant’s income in the two highest of the four most recent quarters, and dividing that average by 26). Therefore, in E’s case, assuming a stable salary for the calculation period, E is entitled to \[(((2*12,000)/2)/26), or $461.54\] per week.

\(^7\) The difference between E’s ordinary weekly salary and her unemployment insurance entitlement.
This conflict has been divisive and remains unresolved by the Supreme Court. Absent controlling precedent, the lower federal courts have taken two distinct approaches.⁸ Some circuit courts of appeals have held that unemployment insurance benefits must be ignored when calculating a back pay award (the “restrictive rule”). In other circuits, the established rule allows district court judges to consider such benefits in their sound discretion (the “discretionary rule”), in which case the court may choose to either deduct unemployment insurance benefits from a back pay award or leave the back pay award undisturbed. (No circuit requires that the benefits be deducted.)

Much of the difference of opinion regarding the treatment of unemployment insurance benefits centers on whether or not those benefits are rightly considered “collateral sources.” Collateral sources are, in the simplest sense, benefits received by plaintiffs that are independent of—that is, collateral to—the defendant, and courts have traditionally been barred from considering such benefits when calculating a plaintiff’s damages.⁹ For example, a plaintiff who receives $100 in support from his mother to compensate for a tortious loss of $100 would be allowed under the collateral source rule to collect the full amount of damages from the tortfeasor, as those benefits were not sourced from, and are thus collateral to, the tortfeasor. Unemployment insurance benefits, on the other hand, are superficially not collateral to employers, since those employers are responsible for funding the unemployment insurance program.

Complicating this field further is what this Note terms “subrogation statutes,” which have been enacted in a significant minority of states. Subrogation statutes automatically reduce back pay awards by the amount of unemployment insurance benefits received during the same time period covered by a back pay award, and repay the recovered funds directly to the unemployment insurance fund.¹⁰ In those circuits with a discretionary rule, there is some evidence that district court judges consider whether or not a plaintiff will be subject to subrogation when calculating his or her back pay award.¹¹ On the other hand, district court judges in circuits following the restrictive rule are barred from considering the effect of subrogation.

⁸ See infra Part III.
⁹ See infra Part II.C.
¹⁰ See infra Part II.D.
¹¹ See infra Part III.B.2.
The effect of the circuit courts’ approaches is illustrated in the following table, assuming the same income and unemployment insurance benefit figures from the aforementioned illustration of plaintiff E:

<table>
<thead>
<tr>
<th>Table 1 – Subrogation and the Circuit Courts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plaintiff A</td>
</tr>
<tr>
<td>Subject to subrogation, in a discretionary circuit.</td>
</tr>
<tr>
<td>Total lost income.</td>
</tr>
<tr>
<td>Unemployment insurance benefits received.</td>
</tr>
<tr>
<td>Amount recovered by unemployment insurance fund through subrogation.</td>
</tr>
<tr>
<td>Back pay awarded by the court as damages in Title VII suit.</td>
</tr>
<tr>
<td>Total compensation received by plaintiff.</td>
</tr>
</tbody>
</table>

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^{12} This table assumes that judges with the discretion to reduce a back pay award by unemployment benefits received will always reduce back pay in the absence of a subrogation statute and never do so when the plaintiff is subject to subrogation.

^{13} In the discretion of the district court judge, the $6,000 back pay award is reduced by the amount of unemployment insurance benefits received, resulting in the prevailing plaintiff collecting a total of $6,000 of both unemployment insurance benefits and back pay.
As is evident from the above table, three out of four combinations of circuit court approach and state law ensure that a plaintiff will receive the “right” amount of total compensation.\textsuperscript{14} But in states that do not have subrogation statutes in circuits following the restrictive rule, the prevailing plaintiff receives nearly 50\% more compensation than otherwise similarly-situated plaintiffs.\textsuperscript{15} Though this result only occurs in one possible combination of state and federal law, a restrictive approach without subrogation is the governing legal standard in as many as twenty states, including California and Florida,\textsuperscript{16} and it is therefore likely that the majority of Title VII plaintiffs who have collected unemployment insurance benefits receive this double recovery.

This result is due exclusively to the complex and sometimes contradictory statutory and doctrinal frameworks that underlie this area of the law, particularly from the delegation of unemployment insurance regulation to the states and the resultant lack of a centralized policy regarding treatment of such benefits. This Note first discusses these discrete frameworks: Title VII,\textsuperscript{17} unemployment insurance, the collateral source rule, and state subrogation statutes. The approach by the federal appeals courts is subsequently discussed, as well as how the federal district courts exercise their discretion to consider back pay awards where they may lawfully do so. This Note then recommends an approach that may bring coherence to these inconsistent and often colliding structures and the approaches taken by the circuit courts, in the absence of a major reform of the unemployment insurance system.

II. THE STATUTORY AND DOCTRINAL STRUCTURE

\textsuperscript{14} That is, the back pay award that is necessary to replace the wages that the plaintiff actually lost due to a discriminatory employment action but not including unemployment insurance benefits, without regard for, as discussed infra Part II.B, the incidence of the unemployment insurance tax on employers.

\textsuperscript{15} This figure, of course, will vary based on factors including replacement rate, length of unemployment period, and salary. For example, since unemployment insurance benefits typically have an individual weekly benefit ceiling employees with high salaries will be overpaid by unemployment insurance benefits by much less than medium- and low-income plaintiffs as a proportion of their ordinary wages. See, e.g., CONNECTICUT DEPARTMENT OF LABOR, supra note 6 (in Connecticut as of October 2011, $573).

\textsuperscript{16} See infra note 74, Part III.A.

\textsuperscript{17} For purposes of simplicity, this Note focuses on actions brought under Title VII, though the debate is relevant to other forms of employment discrimination, including suits arising under Section 1981 and the Americans with Disabilities Act.
This Note addresses the deductibility of unemployment insurance benefits from back pay awards in Title VII suits through analysis of the legal structures operating in the foreground and background of such cases. This Part will generally discuss the purpose of Title VII and remedies available under that statute, the system of unemployment insurance in the United States, the origins and rationale of the collateral source rule, and state subrogation statutes.

A. TITLE VII OF THE CIVIL RIGHTS ACT OF 1964

Title VII of the Civil Rights Act of 1964 prohibits discrimination on the basis of race, national origin, religion, or sex by private employers.18 Through express language, judicial interpretation, and congressional revision, the Act proscribes both intentional discrimination by employers as well as employment actions that lack discriminatory intent, but which have a disparate impact on persons from a protected class.19

While the Equal Employment Opportunity Commission is the official enforcement agency for Title VII,20 the Commission brings only a small fraction of the employment discrimination cases that it reviews. It follows that most Title VII suits are brought by individuals hiring private counsel or proceeding *pro se.*21 As a result, plaintiffs have an important role under Title VII as private attorneys general, both asserting their individual right to be free from discriminatory employment actions and policing employers to vindicate the broader purposes of the statute—namely, to eliminate employment discrimination.22

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19 See generally Rutherglen, supra note 18.
20 See id. at 8.
21 See Nielsen, supra note 3, at 15 (noting that the EEOC intervenes as plaintiff in just 3% of all employment discrimination cases).
22 See Donald T. Kramer, Factors or Conditions Said to Justify Increase in Attorney’s Fees Awarded Under § 706(k) of the Civil Rights Act of 1964, 140 A.L.R. Fed. 301 (1997) (stating the private attorney general model serves as the justification for Title VII’s fee shifting structure, which awards attorney’s fees to prevailing plaintiffs, but not to prevailing plaintiff’s under ordinary circumstances).
Section 706(g) of Title VII permits courts to award back pay as an equitable remedy for illegal employment discrimination. Though Title VII back pay sounds in equity and the plain language of Title VII is permissive, the Supreme Court has indicated that judges are significantly limited in their discretion to decide not to award back pay relief. In addition to back pay, prevailing plaintiffs in Title VII suits have available a broad range of statutory relief: reinstatement or, if reinstatement is impossible, front pay; additional compensatory damages for both pecuniary and non-pecuniary losses like job search expenses, reputational damage, and emotional pain and suffering; punitive damages in circumstances where a defendant acts with malice or reckless indifference to the federally-protected rights of the plaintiff; and finally, reasonable attorney’s fees.

Part and parcel of using back pay as the primary remedy under Title VII is that suits brought under the statute tend to be low in value.

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23 Civil Rights Act of 1964, Pub. L. No. 88-352, § 706(g), 78 Stat. 241, 261 (current version at 42 U.S.C. 2000e-5(g)(1) (2006)) (“If the court finds that the respondents has intentionally engaged in or is intentionally engaging in an illegal employment practice, the court may . . . order such affirmative action as may be appropriate, which may include, but not limited to, reinstatement, or hiring or employees, with or without back pay”); see Albemarle Paper Co. v. Moody, 422 U.S. 405, 415-22 (1975) (stating back pay has become the presumptive remedy for employment discrimination).

24 See Albemarle Paper Co., 422 U.S. at 421 (“[B]ackpay should be denied only for reasons which, if applied generally, would not frustrate the central statutory purposes of eradicating employment discrimination throughout the economy and making persons whole for injuries suffered through past discrimination.”).


27 Id. (stating punitive damages are only available in certain forms of employment discrimination cases and subject to the same caps as compensatory damages); see Kolstad v. American Dental Ass’n, 527 U.S. 526, 529-40 (1999) (stating the standard for whether punitive damages are appropriate is not egregiousness, but rather whether the employer has engaged in discriminatory act despite perceiving that the act is in violation of federal law).


29 Discrimination Law in the 1990’s, in HANDBOOK OF EMPLOYMENT DISCRIMINATION RESEARCH: RIGHTS AND REALITIES 261, 265 (Laura Beth Nielsen
While the size of damages awards increased after the 1991 amendment of Title VII, which made available compensatory relief, punitive damages, and jury trials, the median Title VII back pay award remains under $50,000.

B. UNEMPLOYMENT INSURANCE IN THE UNITED STATES

The Social Security Act of 1935 first enabled the unemployment insurance system. Rather than creating a federal regime, the Act instead encouraged the states to enact their own unemployment insurance programs, so long as they operated within certain federal guidelines (such as minimum tax rates). This joint federal and state statutory scheme has resulted in state unemployment insurance programs that are often widely divergent with respect to coverage, benefits, funding, and administration.

Despite this divergence, there are points of congruence among the state systems. Across all states, unemployment insurance benefits share a common aim of providing partial and temporary wage replacement for involuntarily unemployed workers meeting certain conditions regarding continuity and type of employment. These benefits primarily serve two goals: narrowly, to stabilize the standard of living for unemployed individuals during those individuals’ periods of unemployment, and broadly, to reduce overall economic volatility during periods of widespread unemployment.

& Robert L. Nelson eds., 2005) (showing that pre-1991, employment discrimination back pay awards were usually small and positively related to an employee’s pay).

Id. at 268 tbl.3.

Id. at 279 tbl.8. The $50,000 figure is one that is not per plaintiff, but rather per case; because a not-insignificant number of cases are brought with more than one plaintiff. See Nielsen, supra note 3, at 12 (6% of employment discrimination cases involved 2-10 plaintiffs); it is likely that plaintiffs’ actual awards are somewhat lower.

Edwin E. Witte, Development of Unemployment Compensation, 55 Yale L.J. 21, 22 (1945); U.S. Gov’t Accountability Office, GAO-10-440, Unemployment Insurance Trust Funds 3 (2010).


See id. at 344-46.

Id. at 341-42.
The unemployment insurance system is directly financed by both state and federal payroll taxes, paid solely by qualifying employers, which together constitute as much as 15% of an employer’s total annual tax bill. The structure of tax rates is twofold: first, a federal rate that is as low as .8% and is applied to a base of an employee’s first $7,000 of wages; second, a state tax, with rate and base terms that vary widely among the states, but that must remain within certain federal guidelines. These state tax rates are typically adjusted annually and calculated relative to a state’s unemployment insurance fund balance, with a lower balance triggering higher overall rates and a higher balance resulting in generally lower rates.

Through a process known as the “experience rating,” market-wide state tax rates are adjusted for each employer based on that employer’s history of firing its employees, with the resultant individualized tax rate

36 With the notable exceptions of Alaska, New Jersey, and Pennsylvania, which withhold unemployment insurance taxes from employee wages in addition to taxing employers. See U.S. Gov’t Accountability Office, supra note 32, at 4 n.9. For the purposes of simplicity and coherence, this Note ignores these exceptions to the general rule.

37 Lester, supra note 33, at 340. The employer-funded model used by the United States is distinctly different from the financing of unemployment insurance in other countries, where funds come from a variety of sources exogenous to employers. See Steven Jurajda, Unemployment Outflow and Unemployment Insurance Taxes, CERGE-IE Working Paper Series No. 143 at 2 (1999).

38 U.S. Gov’t Accountability Office, supra note 32, at 5.

In Connecticut, for example, the tax rate for newly established employers is 3.7% as applied to the first $15,000 of each employee’s wages, with rates for established employers ranging from 1.9% to 6.8%. See Employer Information Notice, CT Unemployment Insurance Tax, Connecticut Department of Labor, Sept. 2011, available at http://www.ctdol.state.ct.us/uitax/EmplNotices/EmplNotice0911.pdf. Thus, newly-established Connecticut employers employing employees making $15,000 or more per year pay $555 in unemployment insurance taxes per employee per year. See id.

In Texas, for another example, the rate for a new employer is .78%, with maximum and average tax rates of 8.25% and 2.03%, respectively, applied to a base of $9,000 of wages. Unemployment Tax Rates, Texas Workforce Commission, http://www.twc.state.tx.us/ui/tax/unemployment-tax-rates.html. Thus, an employer would pay (per year and per employee earning $9,000 or more in annual wages) unemployment insurance taxes of $70.2 at the minimum rate and $182.70 at the average rate.

39 See U.S. Gov’t Accountability Office, supra note 32, at 7.
called the “experience-rated component.”40 Through use of the experience rating, an employer with a history of many firings (and one that has thus imposed a high cost on the unemployment insurance pool) is subject to a higher tax rate than an employer without such a history. Use of the experience rating can adjust the effective tax rate on an employer to as high as 10.5%,41 though states typically set a maximum rate. Because the experience rating can thereby impose significant financial consequences on an employer for firing employees, the rating is believed to have the effect of deterring layoffs,42 and may be a means of controlling employer-side moral hazard in unemployment insurance generally.

To be sure, the cost of unemployment insurance benefits may be indirectly paid, in whole or part, by employees in the form of reduced earnings—that is, the ultimate incidence of the unemployment insurance tax may fall on employees. The significance of tax incidence is that, to the extent that the cost of unemployment insurance is borne by employees instead of employers, the benefits are less clearly categorized as independent of (that is, not collateral to) employers, and public policy and collateral source rule doctrine thus may more strongly favor treating the benefits as collateral.

The unemployment insurance system appears designed for the incidence of the tax to apply fully to employers, by not requiring contribution from employees and through use of the experience rating.43 Despite this intention, however, it may be that employers shift the incidence of the unemployment insurance tax forward, by charging consumers more for goods or services, or backwards, by reducing the price they pay for labor input.44 There is no consensus that the unemployment insurance tax is back-shifted, and those studies that have attempted to isolate the effect of the unemployment insurance tax have come up with divergent results.45 Recent data suggests that the costs may be shared between employers and employees, with one study showing that employers

40 Id. at 5.
41 Lester, supra note 33, at 345 (in Pennsylvania).
42 See Jurajda, supra note 37, at 2 (the experience-rated component has been demonstrated to influence employer decision-making in regards to both initially laying off workers and recalling previously laid-off workers).
43 See generally Lester, supra note 33.
44 Id.
45 See id. at 382.
are not able to shift the costs of inter-firm experience rating variances, but may be able to shift some portion of the “market rate”, or base tax burden.46

Cost shifting, if it does occur, may not be so simple in the case of unemployment insurance, however. Since the experience rating means that a firing costs an employer money in the form of higher tax rates, and, as discussed above, that upward adjustment is not shown to be back-shifted, any employee contribution to the unemployment insurance tax may be negated by the cost of his firing to the employer. For example, Texas calculates its experience rating by dividing the last three years of unemployment insurance benefits paid out over three years of an employer’s taxable wages, and multiplying that by a flat tax rate.47 For example, suppose a new Texas employer employs three workers at $10,000 per year for a period of three years, but fires one worker at the end of year 2, entitling that worker to collect a 50% unemployment insurance benefit. That employer’s effective unemployment tax rate will resultantly increase from 2.72% to 8%;48 on the Texas taxable wage base of $9,000, the employer would pay $1,440 in unemployment insurance tax in year three per employee, as compared to $482 in year two. That is, the firing will cost the employer nearly $1,000 per employee per year for the three years that the firing is computed in the employer’s experience rating. This is all to demonstrate that the back-shifting of tax may be mitigated by the

46 Patricia M. Anderson & Bruce D. Meyer, Effects of the Unemployment Insurance Payroll Tax on Wages, Employment, Claims and Denials, 78 J. PUB. ECONOMICS 81, 95 (2000) (noting, however, that “large standard errors preclude [the authors] from drawing strong conclusions”). In Texas, for example, the “market” tax rate is .78%, while the average experience rating tax rate is 1.96%, both applied to $9,000 of wages. If employees are responsible for the entire market rate (as opposed to partial responsibility, as demonstrated by the above-referenced study), and employers were responsible for the experience rate, the proportion of employee to employer contribution would be roughly 1:3. See Texas Workforce Commission, supra note 38.

There is an intuitive logic to the findings by Anderson and Boyer, if back-shifting does in fact occur. Since the experience rating is determined based on an employer’s past history of layoffs, firms that reduced employee wages to account for higher unemployment taxes that result from the experience rating would essentially expect employees to be paid less to work for an employer that is more likely to cause them to be unemployed.

48 Id. (That is, [5,000/$8,000] * [1.28]).
Unemployment insurance funds have been in financial peril in recent years. At the close of the fourth quarter of 2009, state unemployment insurance fund balances were the lowest they have ever been in the history of unemployment insurance, and this undercapitalization is expected to worsen with the ongoing recession. Compounding these historically low funding levels is the reality that loans from the federal government are currently buoying the balances of many state unemployment funds; because these loans are reflected in the historically low fund balances, state funds are likely even more weakly positioned than they appear at first glance.

C. THE COLLATERAL SOURCE RULE

Circuits that follow the restrictive rule typically do so on the basis that considering unemployment insurance benefits violates the collateral source rule. As a general principle of tort law (treated as both a rule of evidence and as substantive law), the collateral source rule proscribes courts from considering benefits received by a plaintiff that are independent of (i.e., collateral to) a defendant when calculating a plaintiff’s damages. The collateral source rule typically does not protect benefits provided by a defendant or a party identified with a defendant, but rather only applies to truly independent or third-party sources, such as gratuitous support from family members or an unintended benefit arising from a defendant’s wrongful act.

Perhaps the quintessential application of the collateral source rule is to exclude evidence of plaintiff-purchased insurance benefits covering a loss for which that plaintiff is later awarded damages. For instance, due to a negligent act by tortfeasor “T”, plaintiff “P” incurs medical expenses that are covered by P’s insurer. In a later suit against T, P may still collect damages for medical expenses when the collateral source rule is applied, even though P did not pay for those expenses out of pocket. In this

49 U.S. Gov’t Accountability Office, supra note 32, at 9 (after figures were adjusted for inflation).
50 Id. at 13-14.
51 See id. at 9 (overall balance of state fund reserves was negative $15 billion).
circumstance, P effectively receives a double recovery—one from the insurer and another from the tortfeasor, both purporting to compensate for the same injury. It is in reaction to such results that proponents of “tort reform” efforts have sought to abrogate the collateral source rule.\(^{55}\)

This common application of the collateral source rule may not in fact result in a windfall,\(^{56}\) however, despite the mechanism of P receiving two payments for one injury. In the above example, P purchased insurance coverage and paid insurance premiums in exchange for the contractual right for payment upon the occurrence of the tortious act at issue. Because the insurance coverage was purchased in order to cover the cost of the injury, presumably the premiums were calculated so as to pay for the cost of covered events, plus overhead.\(^{57}\) By charging P a rate calculated to the risk and cost of a covered event, the insurance policy primarily changes the timing of the payment for the injury to the period when P makes premium payments, but does not alter that P has a cost associated with the injury that will require compensation in order for P to be made whole.

Further preventing a windfall in many traditional insurance applications of the collateral source rule is the effect of a subrogation right, held by many or even most insurers.\(^{58}\) Where this right exists, a collateral source is entitled to the rights and remedies belonging to the plaintiff for which the plaintiff was compensated by the collateral source, eliminating any windfall \textit{ex post}.\(^{59}\) Thus, if P’s insurance contract includes a subrogation right (and it likely does), his insurer may seek to collect the medical damages awarded to P to the extent that it reimbursed P for such damages.


\(^{56}\) For the purposes of this note, “windfall” and “double recovery” are distinguished. Windfall will describe the situation where a plaintiff collects more than his actual losses, and is thus overcompensated or “profits” from a defendant’s wrongdoing. Double recovery will mean that a plaintiff receives two payments for the same injury, which, as this Note explores, may or may not result in a windfall. See BLACKS LAW DICTIONARY, 1738 (9th ed. 2009) (defining windfall as “[a]n unanticipated benefit, usu. in the form of a profit and not caused by the recipient”). Compare id. at 1389, \textit{Double Recovery} (“a judgment that erroneously awards damages twice for the same loss . . . [or] recovery by a part of more than the maximum recoverable loss . . .”).

\(^{57}\) RICHARD A. POSNER, \textit{ECONOMIC ANALYSIS OF LAW} 253 (8th ed. 2011).

\(^{58}\) Wershbale, \textit{supra} note 55, at 349-50 (noting, however, that subrogation rights are rarely asserted).

\(^{59}\) See \textit{id.} at 349.
expenses, and P will (theoretically) have paid lower premiums to account for this.60

Aside from factors that mitigate the occurrence of a windfall, there are public policy justifications that favor the collateral source rule even when it does result in a windfall. Windfalls can serve as a rough means of providing for attorney’s fees, which, if not otherwise available, would detract from the make-whole nature of compensatory relief.61 Similarly, a windfall may be used to award punitive damages when they are not provided by law.62

Perhaps more convincing are those policy arguments related to the redistributive and deterrent uses of windfalls. For one, allowing insurance coverage to reduce a wrongdoer’s cost for his wrongs reduces the concomitant incentive to prevent future wrongdoing to avoid future costs of similar wrongs.63 The collateral source rule thus furthers the deterrent function of compensatory relief.64 There is also an intuitive preference to award windfalls, where they must exist, to the victim and not the violator.65 Finally, if insurance reduces a plaintiff’s tort award dollar-for-dollar, there is significantly less reason to buy insurance in the first place, and there are strong reasons for favoring insurance coverage.

There are, however, several competing considerations. Any windfall may be inappropriate in a make-whole relief scheme, which is focused on compensating plaintiffs for actual losses, and is less concerned with the source of that compensation.66 Where statute or other relevant law speaks clearly on the issue, using the collateral source rule to roughly

60 POSNER, supra note 57, at 253.
61 That is, a plaintiff with paid counsel will either pay an hourly fee or will have a contingency agreement, costs of which may not be accounted for in an ordinary damages award that is not accompanied by attorney’s fees. Since unreimbursed fees either indirectly (in the case of an hourly rate) or directly (in the case of a contingency agreement) reduce the amount of damages actually recovered by the plaintiff, the award may no longer put the plaintiff in the position he or she would have been in but for the wrongdoing. See, e.g., Daena A. Goldsmith, A Survey of the Collateral Source Rule: The Effects of Tort Reform and Impact on Multistate Litigation, 53 J. Air L. & COMM. 799, 802 (1988); Robert Hernquist & Arthur v. Catour, An Examination of the Collateral Source Rule in Illinois, 38 LOYOLA U. CHI. L. J. 169, 172-73 (2006).
62 See Hernquist, supra note 61, at 181.
63 POSNER, supra note 57, at 253.
64 Goldsmith, supra note 61, at 801; POSNER, supra note 57, at 253.
65 House, supra note 53, at 104; Hernquist, supra note 61, at 188.
66 Hernquist, supra note 61, at 182.
provide attorney’s fees and punitive damages may be unnecessary or improper.\textsuperscript{67} Finally, subrogation rights may be an inefficient solution to preventing windfalls,\textsuperscript{68} and the collateral source rule may, by increasing damage awards, artificially inflate insurance premiums.\textsuperscript{69}

Perhaps as a result of these concerns, the collateral source rule has been steadily weakened: erosion of the rule began almost immediately following its adoption by the Supreme Court in the 19th Century,\textsuperscript{70} and by 2007 all but 12 states had created some statutory alteration to the common law rule.\textsuperscript{71} For example, a number of states now allow post-verdict reduction of a defendant’s liability for collateral benefits received that are not subject to subrogation, while refusing such a reduction where the collateral source does hold a subrogation right.\textsuperscript{72}

D. STATE SUBROGATION STATUTES

States have taken several statutory approaches to the double recovery that can result when back pay awards overlap with unemployment insurance benefits,\textsuperscript{73} but by far the most common is to invest a legal subrogation right in the state’s unemployment insurance fund. At least 16 states accomplish this through statutes requiring reimbursement of state unemployment funds for insurance benefits paid that overlap with back pay awards, typically by the employer repaying the fund directly and then

\textsuperscript{67} See id. at 186.
\textsuperscript{68} This is said to result from the additional litigation costs incurred by both private and public actors in order to enforce subrogation rights. House, supra note 53, at 105-06.
\textsuperscript{69} House, supra note 53, at 106.
\textsuperscript{70} Hernquist, supra note 61, at 177.
\textsuperscript{72} Wershbale, supra note 55, at 353-54 (noting that these post-verdict hearings likely increase the litigation and administrative costs of actions subject to the collateral source rule).
\textsuperscript{73} Some states require that an employer repay state unemployment funds if a plaintiff’s back pay award is reduced by the amount of unemployment insurance benefits received. See, e.g., TEX. LABOR CODE § 210.001 (2011); MASS. GEN. LAWS ch. 151A, § 69C (2004); CAL. UNEMP. INS. CODE § 1382 (2010). At least one state does not set off unemployment insurance benefits from back pay awards, but allows back pay to be considered employment such that it serves to toll the accrual of unemployment benefits. See TENN. CODE ANN. § 50-7-303(e) (2008).
giving the plaintiff a reduced award. Thus, in states with subrogation statutes, a prevailing plaintiff who is awarded back pay damages for a period in which that plaintiff also collected unemployment insurance benefits would typically receive as his back pay damages the difference between his total lost wages and the unemployment benefits he had received during the benefit period. The defendant-employer is then required to directly remit to the unemployment insurance fund an amount equal to the overlapping benefits.

The following table illustrates the effect of subrogation, using the same income, back pay damages, and unemployment insurance compensation figures as Table 1:

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74 See, e.g., COLO. REV. STAT. ANN. § 8-73-110 (2011) (“[A]n individual who has an award for any week and for which week he, at a subsequent date, received a pay award by reason of a decision of the national labor relations board or other source, as a result of the action taken by the National Labor Relations Board or other source, shall immediately repay to the division such amounts as will reimburse the division for all benefit payments made for the period during which he drew benefits and for which the national labor relations board or other source has caused a payment to be made in the form of back pay award to the claimant; and the employer's account charged for such benefits shall be credited accordingly.”); see also ALA. CODE § 25-4-78 (LexisNexis 2011); DEL. CODE ANN. tit. 19, § 3325 (2005); 820 ILL. COMP. STAT. ANN. 405/900 (West 2011); IND. CODE ANN. § 22-4-13-1 (LexisNexis 2011); IOWA CODE ANN. § 96.3 (2011); KAN. STAT. ANN. § 44-719 (2000); KY. REV. STAT. ANN. § 341.415 (West 2011); MD. CODE ANN., LAB. & EMP. § 8-809 (LexisNexis 2011); MINN. STAT. ANN. § 268.085 (West 2010); MO. REV. STAT. § 288.381 (West 2005); NEV. REV. STAT. ANN. § 612.371 (LexisNexis 2011); 43 PA. STAT. ANN. § 874 (2011); VA. CODE ANN. § 60.2-634 (2010); WASH. REV. CODE ANN. § 50.20.190 (West 2002); WYO. STAT. ANN. § 27-3-306 (2011).

75 Though this Note refers to statutes having this effect as “subrogation statutes,” they may share some characteristics with repayment arrangements (agreements by which a victim agrees to pay back an insurer for benefits received when he sues and collects from an injurer). See SHAVELL, supra note 54, at 238-39.

In traditional insurance relationships, it may be that a repayment arrangement would be a disincentive to bringing suit, since most or all of the award would necessarily be repaid to the insurer. Id. at 239. This does not likely hold true in the case of repayment of unemployment insurance benefits in Title VII firing suits, since those benefits are typically 50% or less of a claimant’s salary.
Table 2 – Subrogation and Back Pay

<table>
<thead>
<tr>
<th></th>
<th>With subrogation statute</th>
<th>Without subrogation statute</th>
</tr>
</thead>
<tbody>
<tr>
<td>Back pay award</td>
<td>$6,000</td>
<td>$6,000</td>
</tr>
<tr>
<td>Unemployment benefits received</td>
<td>$2,772</td>
<td>$2,772</td>
</tr>
<tr>
<td>Amount paid by Defendant to Plaintiff</td>
<td>$3,228</td>
<td>$6,000</td>
</tr>
<tr>
<td>Amount reimbursed to unemployment insurance fund</td>
<td>$2,772</td>
<td>$0</td>
</tr>
<tr>
<td>Total damages paid by Defendant</td>
<td>$6,000</td>
<td>$6,000</td>
</tr>
<tr>
<td>Change in unemployment insurance fund balance</td>
<td>$0</td>
<td>($2,272)</td>
</tr>
</tbody>
</table>

As demonstrated in Table 2, subrogation ensures both that the plaintiff receives the “correct” amount of compensation for loss of wages and that the unemployment insurance fund balance remains as if a discriminatory firing had not occurred. Moreover, the employer is still responsible for the full cost of his discriminatory firing. It is also evident that without subrogation, with the plaintiff receiving both unemployment insurance benefits and a back pay award, the assets of the unemployment insurance fund are impaired.76

Though subrogation is the most common statutory approach to the problem discussed in this Note, the majority of states do not vest any legal subrogation right in their unemployment insurance funds. In these states, prevailing Title VII plaintiffs receive both a full back pay award and unemployment insurance benefits absent judicial intervention. As described earlier in this Note, many of such states are located in federal circuits that follow the restrictive rule, where district court judges cannot consider unemployment insurance benefits received by plaintiffs and, as a result, the

76 Though, of course, this impairment is not necessarily a problem: unemployment insurance funds exist to pay out benefits to the unemployed.
plaintiff receives both the unemployment insurance benefits and the full back pay award.

III. APPROACH BY THE CIRCUIT COURTS OF APPEALS

The Supreme Court has simply never resolved the question presented by this Note. The most frequently cited Supreme Court case in this area is NLRB v. Gullet Gin, in which the Court held that the National Labor Relations Board did not abuse its discretion when it refused to reduce a settlement under the National Labor Relations Act by amounts received as unemployment insurance benefits; but even there, the Court made no affirmative holding on the Board’s discretion to make such a deduction.\textsuperscript{77} The Court stated only in dicta that unemployment insurance benefits were collateral sources, on the basis that the state, not the employer, made such payments, and because the NLRB had a long-standing practice of refusing to deduct such benefits.\textsuperscript{78}

The \textit{Gullet Gin} ruling has failed, however, to elucidate this area of the law. It has been interpreted both as supporting the discretion to deduct unemployment insurance benefits, since it upheld the NLRB’s discretionary approach to withholding,\textsuperscript{79} and as prohibiting discretion by its dicta regarding the collateral source rule.\textsuperscript{80} In the absence of a clear directive from the Supreme Court, the federal circuit courts of appeals remain split as to whether or not district courts are prohibited from considering unemployment benefits when calculating back pay awards, or whether the those courts may, in their discretion, reduce back pay awards by unemployment insurance benefits received. This Part examines each approach in turn.


\textsuperscript{78} Id. at 365-66.

\textsuperscript{79} See, e.g., EEOC v. Fin. Assur., Inc., 624 F. Supp. 686, 694 (W.D. Mo. 1985) (quoting \textit{Gullet Gin}, and stating that, “by analogy, one might well argue that a similar discretion—either to deduct or to refuse to deduct—is vested in the courts in connection with administering Title VII.”).

A. THE RESTRICTIVE RULE: UNEMPLOYMENT INSURANCE BENEFITS CANNOT BE CONSIDERED IN CALCULATING BACK PAY AWARDS

The Third, 81 Fourth, 82 Sixth, 83 Eighth, 84 Ninth, 85 and Eleventh 86 Circuits have held that unemployment insurance benefits are collateral sources that courts cannot consider when calculating a plaintiff’s back pay damages. The cases rely on the traditional definition and treatment of collateral sources;87 legislative intent; 88 preference for shifting any double recovery to plaintiffs over defendants;89 and furthering the statutory objective to end employment discrimination.90

Typical is the approach of the Sixth Circuit Court of Appeals in Thurman v. Yellow Freight Systems, Inc. That court strongly opposed allowing the district courts discretion to consider unemployment insurance benefits, holding that that such benefits were plainly a collateral source that were paid to serve a social policy of the state, rather than to discharge an obligation of the employer.91 The court there also based its holding on its

84 See Gaworski v. ITT Commercial Fin. Corp., 17 F.3d 1104, 1114 (8th Cir. 1994) (noting that the state had a subrogation statute).
85 See Kauffman v. Sidereal Corp., 696 F.2d 343 (9th Cir. 1982).
86 See Brown v. A.J. Gerrard Mfg. Co., 715 F.2d 1549 (11th Cir. 1983) (reversing prior 11th Circuit precedent allowing the district courts to make such a deduction on the basis that, at the time Gullet Gin was decided, it was the NLRB’s practice to always refuse to make such deductions, and as such the refusal to deduct had become “settled back pay law” under the NLRA, which served as the model for the Title VII back pay provision).
88 See Maxfield v. Sinclair Int’l., 766 F.2d 788, 793 (3d Cir. 1985) (noting that Congress included a deduction for interim earnings and amounts reasonably earnable, but failed to provide for other setoffs).
89 Craig v. Y & Y Snacks, Inc., 721 F.2d 77, 83 (3d Cir. 1983) (“There is no reason why the [unemployment] benefit should be shifted to the defendant, thereby depriving the plaintiff of the advantage it confers.”).
90 Id. at 84.
belief that two “identically situated claimants” could not be made whole by “radically different backpay awards.”

In accord with Thurman was the Eighth Circuit Court of Appeals in Gaworski v. ITT Commercial Finance Group, where the court reversed a district court ruling deducting unemployment benefits from a back pay award. The court held that the collateral source rule applied even when the employer contributes to the unemployment insurance fund, and noted that the deterrence purpose of back pay awards was ill-served by deduction of unemployment insurance benefits because it made discrimination less costly for defendant-employers.

Though it found the question “extremely close and one over which reasonable persons could differ,” the Third Circuit Court of Appeals in Craig v. Y & Y Snacks, Inc. reversed a district court’s reduction of a back pay award by unemployment benefits received. The reversal was, in large part, grounded on the Craig court’s finding that unemployment insurance benefits were collateral and intended for the benefit of employees, not employers. Craig went further to declare that deductibility should never be left to the discretion of district court judges, relying on the Supreme Court’s holding that the courts of appeals must apply the back pay provision in a “consistent and principled” manner, and noting that while back pay might ordinarily be discretionary because it sounds in equity, it has become a presumptive and near-mandatory remedy for prevailing plaintiffs in Title VII suits. Significantly, however, the court also noted

92 Id. (quoting Rasimas v. Mich. Dept. of Mental Health, 714 F.2d 614 (6th Cir. 1983)). It should be noted that it is not clear that a plaintiff who has received unemployment insurance benefits is identically situated to a plaintiff who has not received said benefits.
93 See Gaworski, 17 F.3d at 1114.
94 Id. at 1112 (quoting Chi. Great W. Ry. v. Peeler, 140 F.2d 865, 868 (8th Cir. 1944) (holding that insurance or Workmen’s Compensation Act funds were collateral sources)). The Gaworski Court does not indicate whether it believes that the funds are collateral despite employer contribution because: (a) of the incidence of the unemployment insurer tax; (b) direct employee contributions; or (c) regardless of incidence or direct contribution.
95 Id. at 1113.
96 Craig, 721 F.2d at 82.
97 See id. at 82-85.
98 Id. at 85 (quoting Albemarle Paper Co. v. Moody, 422 U.S. 405, 421 (1975)).
99 Id.
that the plaintiffs in that case were subject to a state subrogation statute, so that their back pay would later be reduced by operation of law.

B. THE DISCRETIONARY RULE: THE WITHHOLDING OF UNEMPLOYMENT BENEFITS FROM BACK PAY AWARDS IS LEFT TO THE SOUND DISCRETION OF THE DISTRICT COURTS.

The First, Second, Fifth, Seventh, and Tenth Circuits have held that deduction of unemployment benefits is properly left to the discretion of the district courts. This Part examines both the reasoning for this conclusion and the practices of the district courts in exercising this discretion.

1. Reasoning

Circuits adopting the discretionary approach generally do so with the goal of preventing double recoveries. A robust example is the Second Circuit Court of Appeals in *EEOC v. Enterprise Steamfitters*:

> We see no compelling reason for providing the injured party with double recovery for his lost employment; no compelling reason of deterrence or retribution against the responsible party in this case; and we are not in the business of redistributing the wealth beyond the goal of making the victim of discrimination whole.107

The holding in *Enterprise Steamfitters* was cited favorably and clarified by the Second Circuit in *Dailey v. Société General*. There, the

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100 Id. at 83-84.
101 That is, the *Craig* court could not have possibly reduced the plaintiff’s back pay award without interfering with the operation of the state unemployment insurance statute or causing a double reduction of back pay.
103 See *EEOC v. Enter. Ass’n Steamfitters Local No. 638 of U. A.*, 542 F.2d 579, 592 (2d Cir. 1976).
104 See *Merriweather v. Hercules, Inc.*, 631 F.2d 1161, 1168 (5th Cir. 1980).
105 See *Bowe v. Colgate-Palmolive Co.*, 416 F.2d 711, 721 (7th Cir. 1969).
106 See *EEOC v. Sandia Corp.*, 639 F.2d 600, 639 (10th Cir. 1980).
107 *Enter. Ass’n Steamfitters*, 542 F.2d at 592.
court declined to mandate that unemployment funds be deducted from back pay awards, acknowledging “compelling reasons” for why such benefits should not be deducted, but ultimately left the deduction of said benefits to the “sound discretion” of the district courts instead of following the restrictive rule.

Similarly, the Third Circuit Court of Appeals in Ostapowicz v. Johnson Bronze Co. upheld a district court decision reducing a plaintiff’s back pay award by the amount of unemployment compensation that either was or reasonably could have been received by the plaintiff, holding that the district court’s deduction represented a “conscientious effort to calculate reasonable and equitable awards under conditions which do not allow for absolute precision.”

2. Discretion in the District Courts

District courts in circuits following the discretionary rule have focused on several factors to determine whether or not to deduct unemployment insurance benefits from back pay awards. Significantly, some courts have recognized the existence of state subrogation statutes and chosen not to deduct insurance benefits when a plaintiff is subject to subrogation, because the plaintiff’s award will later be reduced by operation of law. In addition to the effect of subrogation, district courts have refused to reduce a plaintiff’s back pay award where, in the particular circumstances of the case, the plaintiff did not receive a windfall, and where the court generally preferred awarding windfalls to plaintiffs rather than defendants.

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108 Dailey v. Societe Generale, 108 F.3d 451, 460-61 (2d Cir. 1997) (giving, as an example, that where the choice lies with awarding either the plaintiff or the defendant a windfall, the windfall should inure to the plaintiff).
109 Id.
111 See, e.g., Cooper v. Asplundh Tree Expert Co., 836 F.2d 1544, 1555 (10th Cir. 1988) (holding that an offset for unemployment insurance benefits was “particularly inappropriate . . . because, under Colorado law, an employee who receives a back pay award must repay the Colorado Division of Employment and Training all unemployment benefit payments received for the period covered by the back pay award”).
Those district courts that have chosen to reduce back pay awards to account for unemployment insurance benefits have done so for a variety of reasons: because unemployment insurance benefits are not a collateral source,\textsuperscript{114} because the purpose of the back pay remedy is not to punish employers or to provide windfalls for employees, but rather solely to compensate for a plaintiff’s actual economic losses;\textsuperscript{115} because deduction would have a negligible effect on deterrence;\textsuperscript{116} and, significantly, because unemployment compensation was not recoverable by the unemployment insurance fund because the jurisdiction lacked a subrogation statute, and “a double recovery was not necessary to make [the] plaintiff whole.”\textsuperscript{117}

IV. ANALYSIS

This Part concludes that unemployment insurance benefits should not be treated as traditional collateral sources for the purposes of Title VII back pay awards, both as a matter of law and public policy. Next, this Part reaffirms that the restrictive approach has effected to arbitrarily favor certain plaintiffs over others. Finally, this Part concludes by proposing that all circuits adopt the discretionary approach.

A. UNEMPLOYMENT INSURANCE BENEFITS SHOULD NOT BE TREATED AS SOURCES COLLATERAL TO EMPLOYERS.

Unemployment insurance benefits should not be treated as sources collateral to employers for two reasons. First, insurance coverage paid for by an employer cannot be collateral to that employer, even if employees indirectly pay for a portion of coverage. Second, the policy justifications that underlie the collateral source rule in its traditional applications are inconsistent with the nature of back pay relief under Title VII and in the context of unemployment insurance benefits.

\textsuperscript{114} Truskoski v. ESPN, Inc., 823 F. Supp. 1007, 1015 (D. Conn. 1993) (“While collateral sources are not offset, unemployment compensation is not from a source independent of the employer . . . [m]aking a person discriminated against whole is not achieved by awarding damages in excess of the actual loss when the excess does not come from a collateral source.”).


\textsuperscript{117} Thurber v. Jack Reilly’s Inc., 521 F. Supp. 238, 243 (D. Mass. 1981) (“[E]quitable considerations militate in favor of a reduction of the gross back pay award here [where] [t]he unemployment compensation paid to the plaintiff is not recoverable from her by the commonwealth.”).
1. Unemployment Insurance Benefits Are Not Collateral Sources as Traditionally Defined

Collateral benefits are “compensation ... from a source independent of the tortfeasor,”118 that is, a collateral source is one “other than the injurer.”119 In the context of Title VII, however, it is the employer who is the injurer. And though unemployment insurance benefits are actually paid out by the government, to the extent that the source of compensation is an employer, these payments cannot be considered “collateral.”

True, state governments act as administrators of unemployment insurance funds and collect premiums through taxation. But relying on this aspect of the unemployment insurance relationship to characterize unemployment benefits as collateral privileges form over function. First, the state’s role as intermediary has no bearing on the fact that employers are the sole direct source of funding that provides for the unemployment insurance benefits. Indeed, we would consider ordinary insurance premiums paid by an individual insured to be sourced from that individual, even though the premiums are later intermingled with other insureds’ premiums and invested by an insurer, as the states similarly do with employer unemployment insurance tax proceeds. Second, insurance relationships are nearly always characterized by the presence of an intermediary—typically, insurance contracts create a principal-agent relationship, with the purchaser of insurance acting as principal, appointing the insurer as his agent to take care of insured losses on his behalf.120 Through a slight variation of this familiar agent/principal lens, states are the agents designated by federal and state law to represent the employer-principal and to discharge its obligations to the employee-beneficiaries. This intermediary relationship does not alter the fact that unemployment insurance payments made by the agent-state are still attributable to the principal-employer, and represent the discharge of liability.121

118 BLACK’S, supra note 52.
119 SHAVELL, supra note 54, at 142-43.
120 See TOM BAKER, INSURANCE LAW AND POLICY 5 (2d ed. 2008).
121 See RESTATEMENT (THIRD) OF AGENCY § 1.01, cmt. g (2006) (“Employee and nonemployee agents who represent their principal in transactions with third parties on the principal’s account and behalf. Employee-agents whose work does not involve transaction interactions with third parties also act ‘on behalf of’ their employer-principal.”). But note, however, that while the employer/state relationship in the unemployment context may lack the required control element. (“Agency is the fiduciary relationship that arises when . . . the agent shall act on
Of course, as discussed earlier in this Note, the incidence of unemployment insurance taxes may play an important role in resolving this dispute. That is, employees may bear some of the cost of unemployment insurance programs to the extent that the cost of the tax is back-shifted through reduced earnings. But although there is no consensus as to the incidence of the tax, the best estimates find that employees are responsible for no more than a portion of the market tax rate, so that ultimately, employers almost certainly pay for most of the unemployment insurance program. Moreover, it is not clear that unemployment insurance benefits are rendered collateral simply because the employer adjusts employee wages to reflect the cost of unemployment insurance. Even if so, the cost remains shared between the employee and employer, with the average employer responsible for the majority of the cost; the benefits can only colorably be considered collateral to the extent that the employee is responsible for paying for the benefits through a reduced wage. Further, the reasoning for excluding bargained-for insurance coverage as a collateral source—that the insured has paid for the covered event through premiums calculated to that plaintiff’s level of risk—does not hold true when only the base-rate, and not the experience rating, is back-shifted to an employee. In that case, there is no guarantee that the employee has made a contribution proportional to the risk and cost of loss.

With the exception of administration by state governments and, as described above, that risk is not related to premium, the unemployment insurance system closely tracks traditional forms of insurance in its operation and structure. Unemployment insurance, like traditional insurance, has as one of its primary functions risk-spreading; in this context, it is attempting to ensure that the risks posed by unemployment to both individuals and society as a whole are spread among employers. And, as in insurance generally, risk-classification is undertaken by unemployment insurers through the experience rating (in traditional insurance, “underwriting”), in order to charge participants for the amount of risk that they bring to the insurance pool. In addition, the structure of unemployment insurance gestures to concerns about moral hazard and

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122 Tax incidence may, as discussed infra Part II.B., distort the effect of this intention.
adverse selection, both of which are familiar concepts in ordinary insurance. Though participation in the unemployment insurance system is mandatory, and though unemployment insurance may serve broader social goals, neither is unusual in the insurance context. Many ordinary forms of insurance require mandatory participation, and have at least a partial function of providing social stability and other positive externalities.

Even if one is inclined to the view that unemployment insurance benefits are payments made as a kind of social welfare, funded, like similar programs, through taxation linked to employment, it is not clear that such payments should be immune from deduction from back pay awards. Judge Richard Posner, for example, posits that such benefits, to the extent that they are financed by the government, should be deducted from back pay awards and that the government should have a right to recovery. The government, in his view, is another victim (in this case, of a discriminatory firing) and should not alone bear the burden of damages.

Thus, unemployment insurance is most closely associated with the employer, perhaps best analogized as a traditional insurance product that is bought and paid for by employers for the benefit of employees. In the case

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123 Policing of insured-side moral hazard – the theoretical tendency of insurance to minimize incentives to protect against or minimize the costs or risks of a loss—is reflected in unemployment insurance requirements that those collecting unemployment benefits actively look for jobs and request their insurance benefit anew each week. (Both of these requirements encourage the unemployed to find new employment, and to stop receiving insurance benefits, faster than they might without the requirements.) Insurer-side moral hazard is less of a concern with unemployment insurance than it is with traditional insurance because unemployment insurance is administered by the states, which lack the profit motive driving insurer-side moral hazard.

Adverse selection – the theoretical tendency for high risk insureds to over-consume insurance and for insurers to screen out high-consumption insureds – is controlled by measures that force employers to “purchase” insurance through mandatory taxation and by “enrolling” all involuntarily unemployed persons who apply for benefits and meet unemployment insurance requirements.

124 For example, auto insurance is required in almost every state. BAKER, supra note 120, at 451.

125 Examples of these positive externalities include liability insurance, which ensures that plaintiffs are guaranteed remuneration for covered losses, thus avoiding an insolvent or unwilling defendant from avoiding responsibility for his bad acts, and property insurance, which is universally required by mortgagors in order to secure their collateral, but which also provides the positive externality of neighborhood stability. See id. at 8.

126 POSNER, supra note 57.
of Title VII, however—where the employer is both the source of funds and the defendant—these funds cannot be considered collateral.

2. Public Policy Does Not Support Extending the Collateral Source Rule to Unemployment Insurance Benefits in the Title VII Context

It is not seriously disputed that application of the collateral source rule usually results in a plaintiff receiving a double recovery, which itself often, but not always, results in a windfall for the plaintiff. This Note has explored many of the various policy rationales that have been used to justify both the initial double recovery and the windfall that may result. But in the particular context of Title VII and unemployment insurance benefits, most of these rationales are simply inapposite.

To start, a double recovery cannot be justified as a means of indirectly awarding punitive damages or providing attorney’s fees in Title VII suits. Both punitive damages and attorney’s fees are explicitly available in the (relatively recently revised) text of Title VII, a clear expression of Congress’s intent as to how and when fees and damages should be awarded. Indeed, punitive damages are available on only a limited basis under Title VII, by so limiting their availability, Congress has indicated it almost surely did not intend punitive damages to be awarded to plaintiffs on the sole (and irrelevant to Title VII) basis of the plaintiff previously having collected unemployment insurance benefits. Attorney’s fees, on the other hand, are widely available under Title VII, even (after its 1991 revision) for certain plaintiffs who lose their cases, and thus it is simply not necessary to account for them by “rounding up” a damages award.

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128 See ANDREW S. BURROWS, REMEDIES FOR TORTS AND BREACH OF CONTRACT 162-63 (3d ed. 2005) (“[I]f punishment is desired, it is surely better to administer it through punitive damages [rather than the collateral source rule], where the punishment is explicit and where the amount awarded can be fixed in accordance with the extent to which it is felt the defendant deserves punishment.”).
129 See infra Part II.A.
130 See Civil Rights Act of 1964, Pub. L. No. 88-352, § 706(g), 78 Stat. 241, 261 (1964) (current version at 42 U.S.C. § 2000e-5 (2006)) (defendant is liable for attorneys fees if the plaintiff can show that a protected characteristic was considered by the defendant in taking an unlawful employment action, even if the defendant can show that the same decision would have been made without consideration of the protected characteristic, thereby avoiding liability).
Ordinary insurers avoid a double-recovery with the near-universal contractual assertion of a subrogation right, which eliminates the risk of a windfall to the insured by virtue of having obtained a collateral benefit. But, as this Note points out, the majority of states do not hold a statutory subrogation right, and thus have no means of collecting benefits for which there exists an overlap. In those states that have asserted a subrogation right, the concern that employers will not bear the full cost of their wrongdoing has been eliminated, along with the need to choose between awarding a windfall to either the employee or employer, because though unemployment benefits are deducted from a plaintiff’s back pay award, they are then remitted to the unemployment fund by the employer.\(^{131}\)

Similarly, deterrence and social responsibility for wrongdoing are not weakened as against the employer, since it remains fully responsible for lost wages. Indeed, subrogation has the effect of preserving the strength of the insurance pool, as compared to windfalls, which have the opposite effect.\(^{132}\)

To be sure, in those states lacking subrogation statutes, deducting unemployment benefits from an award favors defendants, because it reduces the amount of damages that he will have to pay the plaintiff and, in that sense, lowers the cost of its discriminatory act. But unlike other applications of the collateral source rule, in which the defendant’s reduced award is not mitigated by an associated cost, unemployment insurance administration is designed so that each firing has a commensurate effect on the unemployment insurance tax rate. Thus, there remains a disincentive to taking the wrongful action that, to some degree, mitigates forces impairing the deterrence effect of damages and social cost of a firing to an employer.\(^{133}\)

\(^{131}\) See infra Part II.D.

\(^{132}\) See infra Table 2. It is feasible that this approach would also provide a benefit to some employers in the form of reduced premiums by, as discussed earlier in this Note, increasing the overall strength of the unemployment fund.

\(^{133}\) It is very important to note, however, that this may not compensate for the full costs of discriminatory firings on society, the elimination of which is a primary interest of Title VII. Since the true social cost of such firings is not easily calculated, it is difficult or impossible to determine precisely whether or not the experience rating can capture these costs.

Another potential concern regarding the discretionary rule, even in a system with a subrogation right, is that it may create an incentive to settle cases for less than the full cost of the discriminatory act (though at least equal to or more than the amount of a back pay award less any unemployment insurance benefits received). That is, the defendant-employer knows that in a system with subrogation
B. UNEMPLOYMENT BENEFITS SHOULD NOT BE UNIFORMLY DISALLOWED AS DEDUCTIONS FROM BACK PAY AWARDS.

Because of the divergent approaches taken by both the circuit courts of appeals and of the state legislatures, prevailing plaintiffs in Title VII suits are placed on very different footings solely on the basis of residency. District court judges in at least 20 states are required to award plaintiffs what this Note has shown should be considered a windfall. In many other states, on the other hand, plaintiffs are subject to subrogation statutes or to judicial reduction of their back pay award. The basis of this differing treatment, however—essentially, disharmony in the law—has nothing to do with Title VII’s aim of making victims of discrimination whole and ending employment discrimination.

Take one example: the Fourth Circuit, whose jurisdiction includes Virginia and Maryland, which have subrogation statutes, and North Carolina, South Carolina, and West Virginia, which do not, has adopted the restrictive approach. Suppose that an employer located in Virginia discriminatorily fires employees living in West Virginia, Maryland, and Virginia. Further suppose that the firing causes all of the employees identical loss of pay, and that the employees collect identical amounts of unemployment insurance benefits as a result of the firing. Upon prevailing in a Title VII suit, the plaintiff-employees would each receive the same amount in back pay damages. Following the suit, however, those plaintiffs living in West Virginia are not subject to subrogation and enjoy both unemployment insurance benefits and a back pay award; their identically situated coworkers residing in Virginia and Maryland, on the it will remain fully responsible for the loss upon a verdict for the plaintiff-employee. The employee, however, knows that it will only receive the amount of back pay minus the unemployment insurance benefits upon prevailing, and resultantly has an incentive to accept a settlement for anything more than that amount.

Of course, a plaintiff who believes that he or she will be entitled to punitive or special compensatory damages may be less swayed to settle, as may a high-income plaintiff, for whom the deduction of back pay benefits represents a smaller proportion of the overall award.

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134 That is, in states that lack subrogation statutes that are located in circuits that do not allow the district courts the discretion to deduct unemployment insurance benefits from back pay awards. See infra Table 2.

135 See MD. CODE ANN., LAB. & EMPL. § 8-809 (LexisNexis 2008); VA. CODE ANN. § 60.2-634 (2006).

136 They would not, in reality, since they all live in different states.
other hand, repay the unemployment fund and receive the excess of back pay over amounts received as unemployment insurance compensation. As demonstrated in Table 1, this difference is significant: unreduced awards may be more than 50% higher than that of plaintiffs whose award is reduced by a court or through subrogation.

The result is indefensible in the context of the rule of law in general and of Title VII in particular, which mandates principled and uniform application of the back pay provision. In fact, while many circuit courts of appeals have gestured to the ideal of uniform application of Title VII when refusing to allow the discretionary approach, denial of discretion has, as illustrated above, produced the opposite effect of widening differences between similarly-situated plaintiffs.

C. THE DEDUCTION OF UNEMPLOYMENT INSURANCE BENEFITS SHOULD BE LEFT TO THE DISTRICT COURTS.

As just described, statutory methods of subrogation are incoherent across states, rendering identical back pay awards drastically different depending on a prevailing plaintiff’s state of residence. The restrictive rule, uniformly banning consideration of unemployment compensation when determining back pay awards, ignores and enables this incoherence. The federal district courts, however, are well-situated—both as fact finders and as a relatively localized adjudicative body—to ensure uniformity of back pay awards. The circuit courts of appeals can, and should, accomplish uniformity by adopting the discretionary rule, allowing district courts to consider evidence of unemployment benefits when calculating a Title VII plaintiff’s back pay damages. District courts, in turn, should leave unchanged awards for those plaintiffs whose unemployment insurance benefits will be subject to subrogation, but should reduce back pay awards when such benefits will result in a windfall, perhaps to the extent that those benefits are attributable solely to an employer and not to employees through back-shifting, when and if such a calculation can be reliably made.

The abandonment of the restrictive rule is necessary because the present two-tiered system of compensation for Title VII plaintiffs is in conflict with the “consistent and principled application of the [Title VII] backpay provision” required by the Supreme Court. And ensuring that Title VII is consistently applied by adopting the discretionary approach is

137 Infra Table 1.
139 Id.
unlikely to diminish the attainment of the statute’s ultimate goal: to reduce employment discrimination. Defendants do not receive a windfall in those states that have subrogation statutes, because the employer remains responsible for the entire amount awarded by the court; in states without subrogation statutes, the reduced awards likely have at most a minor impact on the deterrent effect of the back pay provision due to the increased costs associated with a firing for which unemployment insurance benefits and Title VII back pay damages are claimed.

In fact, reducing back pay awards is plainly consistent with congressional intent to put plaintiffs in the “position where they would have been were it not for the unlawful discrimination.” In a Title VII firing suit, the position that the plaintiff would have been in absent discrimination is employed; were the plaintiff employed, she would not have received unemployment compensation. Awarding a plaintiff the total amount of back pay that she would have received if she were not fired, while refusing to reimburse the plaintiff to the extent that she received a benefit as a result of a firing, is consistent with the make-whole nature of back pay relief under Title VII.

It cannot be ignored that employment discrimination suits are relatively low value, and that the private attorney general model is likely weakened by the lower incentives to sue that may result from reduced back pay awards. This incentive structure, however, was strengthened by the addition of attorney’s fees and punitive damages under the 1991 Civil Rights Act, both of which (perhaps unlike the windfalls at issue here) furthered Congress’s expressed intent that the back pay provision make plaintiffs whole, but go no further.

The discretionary approach is also in accord with the purposes of unemployment insurance. Recall that unemployment benefits are paid both to sustain individuals and their families during periods of temporary unemployment and to stabilize the economy during periods of high unemployment. The first purpose is fulfilled when the plaintiff is able to access his or her insurance benefits during unemployment, and is not nullified when those benefits are later recouped. At that point, the plaintiff has either found employment or no longer qualifies as “temporarily” unemployed; in either case, the insurance benefits have accomplished their income-flow-smoothing function. Nor does reduction of back pay awards impact the economy-wide purposes of unemployment insurance, which, again, is important during the actual period of volatility, but does not have its stabilizing function impaired when later recouped. On the contrary, the

140 118 CONG. REC. 7168 (1972).
restrictive rule, by lowering unemployment insurance fund balances as demonstrated in Table 2, may have the effect of reducing compensation, increasing the duration of unemployment and decreasing labor force participation.\textsuperscript{141}

Allowing the federal district courts to consider the amount of unemployment insurance benefits a prevailing plaintiff has received will help to ensure that Title VII back pay awards are truly compensatory. While in some cases a discretionary approach may result in some benefit to defendant-employers, in all cases it will ensure that the back pay provision is consistently applied in accord with congressional and Supreme Court mandates.

V. CONCLUSION

The nature of unemployment insurance and the text of Title VII counsel that the circuit courts of appeals allow the district courts the discretion to consider unemployment insurance benefits when calculating back pay awards for plaintiffs. In states that have subrogation statutes, the district courts should impose no offset, but rather allow reimbursement of the state fund by operation of law. This result ensures plaintiffs receive their entitled make-whole relief, holds defendant-employers liable for the full costs of their discriminatory acts, and benefits the entire pool of insureds by not contributing to the further destabilization of state unemployment insurance funds. Even in states that do not assert subrogation rights, consistent application of Title VII suggests that unemployment insurance benefits should be offset from a prevailing plaintiff’s back pay award.

Those states that do not have subrogation statutes should consider their role as a large-scale insurer and act to pass laws that guarantee fair and appropriate benefit payouts while considering the rights of all participating insureds to a stable and fairly administered fund. As 16 states have realized, the best way to accomplish this is, like the majority of conventional private insurers, vesting the unemployment insurance funds with a subrogation right.

\textsuperscript{141} See Anderson, \textit{supra} note 46. As discussed earlier in this Note, market rates for the unemployment tax are calculated by reference to the balance, income, and expenses of the unemployment insurance fund.