DAMAGES—COLLATERAL SOURCE DOCTRINE—DEDUCTIBILITY OF SOCIAL SECURITY BENEFITS IN MITIGATION OF DAMAGES FOR BREACH OF EMPLOYMENT CONTRACT

United Protective Workers v. Ford Motor Co., 223 F.2d 49 (7th Cir. 1955)

While employed by defendant Ford Motor Company, plaintiff elected to participate in a company annuity plan. Unknown to plaintiff, the plan provided for compulsory retirement at age sixty-five. When, pursuant to the terms of the plan, the company retired plaintiff solely because of age, plaintiff brought an action for breach of contract, contending that defendant's action had violated a company-union collective bargaining agreement which provided that employees could not be discharged without cause. The Court of Appeals for the Seventh Circuit affirmed the judgment entered below for plaintiff, but modified the lower court's computation of damages, holding that defendant should be permitted to deduct from the total award amounts received by plaintiff as social security benefits during the remainder of the term of the employment contract.[1]

The traditional common-law basis for computing damages for breach of contract has been to compensate for losses flowing from the breach,[2] *i. e.*, to place a plaintiff in as good a position as he would have been in had he been allowed to complete the contract.[3] Thus, in keeping with the compensatory theory, the common-law rule for the measure of damages for breach of an employment contract has required a deduction of the employee's net earnings from other sources during the remainder of the term of the contract from the amount he would have received had there been no breach.[4] In those instances where the employee has had no earnings during the remainder of the contract term, the judgment will be reduced by the amount he would have been able to earn through the exercise of reasonable diligence in seeking other employment.[5] Similarly, the measure of damages in tort actions has also been stated to be based upon compensatory principles,[6] but under a well established exception—the collateral source doctrine—a tortfeasor will not be allowed to deduct in mitigation of damages

1 United Protective Workers v. Ford Motor Co., 223 F.2d 49 (7th Cir. 1955). While other interesting questions appear in the case, this comment will be restricted to consideration of the measure of damages. The facts have been stated with this end in view.

2. Schlottman v. Pressey, 195 F.2d 343 (10th Cir. 1952); Blair v. United States, 150 F.2d 676 (8th Cir. 1945).

3 Baer Bros. Land & Cattle Co. v. Palmer, 158 F.2d 278, 280 (10th Cir. 1946); 5 WILLISTON, CONTRACTS § 1338 (rev. ed. 1937).

4 Phelps Dodge Corp. v. NLRB, 313 U.S. 177, 198 (1941); Republic Steel Corp. v. NLRB, 311 U.S. 7 (1940); 5 WILLISTON, CONTRACTS § 1358 (rev. ed. 1937).

5 223 F.2d at 52; Taylor v. Tulsa Tribune Co., 136 F.2d 981 (10th Cir. 1943).

6 MCCORMICK, DAMAGES § 137 (1935); PROSSER, TORTS § 2 (2d ed. 1955).

benefits received by a plaintiff from a collateral source.[7] Thus, the question presented by the principal case is whether the collateral source doctrine should be extended to an action for breach of contract so as to preclude defendant from mitigating damages by deducting from the total award payments received by plaintiff as a result of social welfare legislation.

The basis for application of the collateral source doctrine in tort actions is that a tortfeasor should not be allowed to escape the consequences of his wrongful acts merely because his victim has received a benefit from a collateral source.[8] A tort action usually involves fault of some kind, and, because of this, it is not surprising that the collateral source doctrine, with its punitive overtones,[9] should have come into existence as an exception to the compensatory theory. On the other hand, the measure of damages for breach of the ordinary commercial contract has been developed so as to avoid the often futile determination of the degree of moral obliquity of the party who has breached.[10] For this reason the collateral source doctrine has not generally been extended to actions for breach of contract.[11]

In the principal case, the court was presented with the argument that the collateral source doctrine should be extended to a contract action because of the asserted authority of a line of cases involving the power of the NLRB to issue orders disallowing deduction of collateral benefits from back-pay awards to wrongfully discharged employees.[12] It is to be noted, however, that under the NLRA,[13] the

7. *E.g.*, NLRB v. Marshall Field & Co., 129 F.2d 169, 172 (7th Cir. 1942); United States v. Shipowners & Merchants Tugboat Co., 103 F. Supp. 152 (N.D. Cal. 1952); RESTATEMENT, TORTS § 920, comment *e* (1939). See generally, Note, 1953 WASH. U.L.Q. 453.

8. See note 7 *supra.*

9. See Note, 1953 WASH. U.L.Q. 453.

10. 5 CORBIN, CONTRACTS § 1077 (1951).

11. 223 F.2d at 54.

It is interesting to note that, in those cases where the collateral source doctrine has been extended to employment contract actions, the courts have rejected contentions that, because tax rates are based upon the employer's unemployment experience record, unemployment compensation benefits are direct benefits from the employer rather than from a collateral source. NLRB v. Marshall Field & Co., 129 F.2d 169 (7th Cir. 1942); see also NLRB v. Gullett Gin Co., 340 U.S. 361 (1951); Bang v. International Sisal Co., 212 Minn. 135, 4 N.W.2d (1942). This reasoning simply refuses to trace the source of the benefits any further than the fund maintained by the state through taxes. *Ibid.* "How the State raise[s] the funds is a matter between the State and its taxpayers." NLRB v. Marshall Field & Co., *supra* at 173.

If a jurisdiction should adopt the position taken by the principal case and refuse to extend the collateral source doctrine, the foregoing reasoning could be applied to reject an argument by the employee that at least the amounts received from the social welfare fund which are attributable to taxes paid by him should not be deducted, since there is no logical basis of distinction between tracing the employee's taxes and tracing the taxes of the employer. It is conceded, however, that a court might conclude that since the purpose of the welfare statute is to alleviate hardships of the employee, his taxes should be traced so as to preclude deduction by the employer.

12. The courts have upheld orders by the Board where deductions of collat-

Board has power to issue such orders as will effectuate the policies of the act.[14] So broadly has this power been interpreted that it is apparently within the discretion of the Board to change the common-law measure of damages if such a change could fairly be said to effectuate the policies of the act.[15] If this is true, it would appear that the court in the principal case properly determined that cases involving proceedings to enforce an order of the NLRB were not controlling in a common-law action for damages for breach of an employment contract.

The precise question presented by the principal case appears to have arisen in only two other cases, neither of which was argued before the instant court or cited in the briefs. In *Bang v. International Sisal Co.*[16] and in *Billetter v. Posell*,[17] which were common-law actions for breach of employment contracts, it was held that unemployment

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eral benefits from back-pay awards were disallowed in cases where the benefits consisted of groceries received from a labor union while the employee was unemployed, see NLRB v. Brashear Freight Lines, Inc., 127 F.2d 198 (8th Cir. 1942), or of unemployment compensation payments, NLRB v. Gullett Gin Co., 340 U.S. 361 (1951); NLRB v. Marshall Field & Co., 129 F.2d 169 (7th Cir. 1942), *aff'd*, 318 U.S. 253 (1943).

Under the NLRA, see note 13 *infra*, however, the NLRB has issued orders pursuant to § 10(c), see note 14 *infra*, both allowing, Mannato v. Dutch Sales Co., 14 CCH Lab. Cas. ¶ 64,418 (D.N.J. 1948) (unemployment compensation); Hopper v. Republic Steel Corp., 11 CCH Lab. Cas. ¶ 63,404 (N.D. Ala. 1946) (unemployment compensation), and denying, *In the Matter of* Walter Stover, 15 N.L.R.B. 635, 651 n.28 (1939) (unemployment compensation); *In the Matter of* Oil Well Mfg. Corp., 14 N.L.R.B. 1114, 1129 n.9 (1939) (work relief project payments), deductions of benefits received from government social welfare agencies. Since Congress has reenacted the pertinent parts of § 10(c) without change, it has indicated its approval of the Board's interpretation of its discretion under the section. NLRB v. Gullett Gin Co., *supra*.

13. 49 STAT. 449 (1935), as amended, Labor Management Relations Act, 1947, 29 U.S.C. §§ 141-88 (1952).

14. Section 10(c) provides that the Board may issue cease and desist orders to stop unfair labor practices "and to take such affirmative action including reinstatement of employees with or without back pay, as will effectuate the policies of this Act . . . ." 49 STAT. 454 (1935), as amended, 29 U.S.C. § 160(c) (1952).

15. See Virginia Elec. & Power Co. v. NLRB, 319 U.S. 533, 540 (1943), quoted in Eichleay Corp. v. NLRB, 206 F.2d 799, 805 (3d Cir. 1953). In addition to congressional acquiescence in the Board's interpretation of its power, see note 12 *supra*, this proposition is also strongly supported by NLRB v. Seven-Up Bottling Co., 344 U.S. 344 (1953). In that case the Board had devised a back-pay computation scheme on a quarterly basis whereby the employee's earnings in one quarter would have no effect upon back-pay liability for other quarters. The Board gave as its reasons for the scheme that where a wrongfully discharged employee obtained a higher paying job, it was to the employer's advantage to delay an offer of reinstatement as long as possible, since the more time the employee spent at the new job, the greater the back-pay liability was reduced. Since the employee could terminate the running of back pay and prevent further reduction of the amount due him as damages by a waiver of his right to reinstatement, he had a great incentive to do so. The Board determined that these practices were contrary to the policies of the act and therefore introduced the new method of computation. The Supreme Court held that this scheme was within the discretion of the Board under § 10(c). Since the common-law rule required deduction of the employee's earnings from his measure of damages, see text supported by note 4 *supra*, it would seem clear that, in effect, the *Seven-Up* case holds that the NLRB has power under § 10(c) to change the common-law measure of damages if such a change can reasonably be said to effectuate a policy of the act.

16. 212 Minn. 135, 4 N.W.2d 113 (1942).

17. 94 Cal. App. 2d 858, 211 P.2d 621 (1949).

compensation benefits are not deductible in mitigation of damages. The reasoning of these cases recognizes that the purpose of unemployment compensation benefits is to alleviate distresses of unemployment,[18] and not to relieve employers of amounts to be paid as damages. Therefore it would seem that although a plaintiff should not be made more than whole,[19] his employer should not be allowed to place the burden of his breach of contract upon the unemployment compensation fund.[20] This reasoning could as well be applied to social security benefits.[21] The purpose of these benefits is to alleviate financial difficulties resulting from the inability of many aged persons to earn a living.[22] This purpose would appear to be complemented by a policy encouraging continued employment of elderly workmen for as long as it is practicable for them to work. Such a policy would be defeated if the employer is allowed to place the burden of his breaches of contract upon the social security fund.

The solution to the problem whether mitigation should be allowed depends upon a reconciliation of the compensatory theory of damages[23] with the policies of the social welfare program.[24] It has been proposed that, in order to preserve the compensation theory and at the same time give effect to the policies of the welfare statutes, a theory of subrogation or reimbursement of the government agency be adopted.[25] Thus, the amount received by the employee as social security benefits would be deducted from his measure of damages and paid by the employer to the government agency administering the program. This proposed solver of the problem appears to coincide with the purposes of the law and should be adopted. Society can have its cake and eat it too. Whether this may be accomplished by court decision is perhaps another problem,[26] but if the courts cannot presently effect such a scheme, then legislative authorization is indicated.

18. Many of the unemployment compensation acts have similar statements of public policy. See, *e.g.*, ILL. REV. STAT. c. 48, § 300 (1955).

19. 223 F.2d at 53; 5 WILLISTON, CONTRACTS § 1338 (rev. ed. 1937).

20. See notes 16 & 17 *supra*; Republic Steel Corp. v. NLRB, 311 U.S. 7, 14 (1940) (dissenting opinion); see also 4 NLRB ANN. REP. 100 (1939).

21. While it is realized that certain administrative differences as to eligibility for benefits exist between the social security system and the unemployment compensation programs, it is nevertheless submitted that the same policy considerations are applicable to each.

22. See Social Security Board v. Nierotko, 327 U.S. 358, 364 (1946); Helvering v. Davis, 301 U.S. 619, 641 (1937).

23. See text supported by notes 2-6 *supra*.

24. See notes 18 & 22 *supra* and text supported thereby.

25. Note, 63 HARV. L. REV. 330, 337 (1949).

26. In Republic Steel Corp. v. NLRB, 311 U.S. 7 (1940), the Supreme Court refused to enforce a back-pay order of the Board which not only directed deduction of work relief project payments but also directed the amount deducted to be paid to the relief project agency. The Court said that the Board is without power to impose a penalty upon the employer. But the vitality of this case seems to have been greatly diminished by NLRB v. Gullett Gin Co., 340 U.S. 361 (1951) where it was held that the Board had power to prohibit entirely the deduction of unemployment compensation benefits.