

REGARDING THE CALCULATION OF LOST PENSION
BENEFITS FOR RAILROAD WORKERS: A REPLY

by

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In their comment, Eric Frye and David Hatcher indicate that we have made “a useful contribution to an understanding of the way in which retirement benefits are actually calculated for railroad workers” and that we have provided “a good summary of the various components of pension benefits under the railroad retirement system.” They also say that we have done “an admirable job of summarizing much of the basis for computing retirement pensions” and that our explanation of the RRAMAX provision is a “model of clarity.” However, the foregoing compliments notwithstanding, Frye and Hatcher take us to task in various ways.

In this note, the term Payout Method refers to calculating the present value of lost pension benefits as the difference between the present value of pension benefits that would have been received if a person were not injured, and the present value of pension benefits that will be received given that an injury occurred. The term Contribution Method refers to the calculation of the pension loss as the present value of lost employee and employer pension contributions arising from an injury.

We feel that most of the comments made by Frye and Hatcher are due to their misinterpretation of our position regarding the complexity of the Payout Method. A basic conclusion of our paper was that the Payout Method does not completely capture the value of lost pension benefits if family and social insurance benefits are not included in the valuation. In brief, we argued that the Payout Method provides an accurate estimate of lost pension benefits as far as it goes -- but that in many instances it may not go far enough. In what follows, we briefly indicate Frye's and Hatcher's disagreements with our paper and our reactions to their criticisms.

1. Frye and Hatcher say that we “demonstrate that there are substantial differences” between the outcomes from the Payout Method and the Contribution Method, but they criticize us because they feel that we reject the Payout Method and recommend the Contribution Method. Their characterization of our paper is incorrect.

Most of our paper is devoted to delineating and clarifying the complex set of calculations that comprise the Payout Method. We did this because a US District Court in *Rachel v. Conrail* required the use of the Payout Method. However, even though we did describe the Contribution Method as straightforward -- which it certainly is relative to the Payout Method, we did not suggest the Contribution Method was preferable.

Moreover, we emphasized the difference in estimates of lost benefits that arises between the two methodologies. As we noted in our paper “This amount differs so dramatically from the estimate derived by calculating the present value of pension contributions that it becomes clear that the decision in *Rachel v. Conrail* raises a non-trivial issue in estimating economic loss.” It was our intention to demonstrate this difference in order to ensure a more rigorous approach to estimating the value of the lost benefits. Our conclusions were based on the recognition that the present value of premiums paid does not

provide an accurate assessment of economic loss. In fact, we stated that "In practical terms, we suggest that estimates of loss (in order to be consistent with new case law), be set equal to the value of direct benefits plus an estimate of additional family benefits" Nowhere in the paper did we suggest that the practitioner ignore *Rachel v. Conrail* and estimate the value of lost benefits as equal to the present value of premiums paid.

2. Frye and Hatcher argue that the most fatal flaw to calculating the value of lost pension benefits as equal to the present value of premiums is that it ignores the differences that family structure play in actual benefits received. We find their criticism mystifying as we argued that it is often exactly this factor that accounts for a substantial portion of the difference in estimates of pension benefits.

In particular, we noted that the railroad retirement system provides a comprehensive package of benefits to retirees, spouses, dependents, survivors, and disabled workers. Both employee and employer contributions finance these benefits, but there is a danger that the Payout Method may not pickup the value of some of these benefits. Although the court required the use of the Payout Method in *Rachel v. Conrail*, the court did not consider, to our knowledge, several questions which immediately arose from its own decision. For example, suppose an injured railroad worker attempts to recover lost pension benefits in a law suit. It seems very possible that the injured employee's spouse may not have legal standing in that law suit, and reduced spousal benefits (usually 50 percent of Tier I and 45 percent of Tier II) may not be recoverable.

Consider an example of a plaintiff who is 20 years old, unmarried, and has no children. Also assume that it is very likely the plaintiff will marry and have children in the future, or would have married and had children but for the injury. Will a court requiring the use of the Payout Method allow recovery of lost pension benefits for a presently nonexistent spouse and presently nonexistent children? To our understanding, courts that have required the use of the Payout Method have not clearly specified the property rights that a plaintiff has in the comprehensive set of family benefits and other benefits (including the value of social insurance) which collectively comprise the railroad retirement system. We think this a significant problem with the Payout Method at the present time; Frye and Hatcher do not see this as a problem.

3. Frye and Hatcher argue that we incorrectly applied the RRAMAX in our example and that the RRAMAX occurs so rarely as to "provide little indication of how the railroad system works other than in a pathological sense " We disagree on both counts.

In the detailed example in our paper, we dealt with a male who suffers an injury at age 45 and who had more than ten years, but fewer than 20 years, of railroad service. The example assumes that the injured person cannot perform his regular railroad work because of this injury. Such a person would not qualify for an occupational disability because he lacks 20 years of service and is under age 60. Furthermore, we assumed that the injured person has no earnings after being injured. Under these assumptions, future pension payments would be subject to the RRAMAX provision, and the maximum pension payment

is \$1,200 per month when payments commence at age 60. Frye and Hatcher maintain that the RRAMAX would not apply because we use the words "totally disabled" in our example. However, our example clearly refers to a person who is occupationally disabled, and the use of the words "totally disabled" was only meant to convey the point that there were no earnings after the injury occurred. We believe that the occupationally disabled person described in our example would be subject to the RRAMAX provision.

We disagree with Frye's and Hatcher's interpretation that the RRAMAX can only occur in "pathological" situations. For example, in the 1980s some relatively young employees took buyouts from their railroad employers even though these employees were more than ten years from receiving their railroad pensions. When their railroad annuities began in the 1990s, these people discovered, much to their dismay, that their pensions were subject to the RRAMAX; and their pensions were much lower than they anticipated because they had no railroad earnings in the ten years prior to the commencement of benefits. In addition, starting in approximately 1983, US railroad employees working in Canada were no longer given credit for railroad service; and their future pension benefits could easily be affected by the RRAMAX provision.

4. Frye and Hatcher note that the connection between premiums paid and benefits received is tenuous, a contention that we agree with; however, they take our statement out of context when they state the court, ". . . has correctly rejected the fundamental supposition posited by Ciecka and Donley, which is that the accumulated value of the pension account directly depends on employee and employer contributions."

We clearly stated in our paper that "the benefit structure does not return dollar for dollar benefits for premiums paid". We went into some detail about the possible role of social insurance in explaining this discrepancy. In our view, social insurance (*i.e.*, a system that provides a safety net for low-income earners by granting benefits in excess of their contributions by redistributing contributions from high-income earners) is a valuable commodity. Our paper recognized that courts may rule that plaintiffs do not have property rights in the social insurance aspect of their pensions. However, lost pension benefits are not only lost benefits accruing directly to plaintiffs. An accurate assessment of benefits should include family benefits as well.

We suggested that for younger workers (whose family structure at normal retirement is quite unclear) family benefits be set equal to 60% of the worker's direct benefits as calculated by the Payout Method. For older workers with a more clearly determined family structure, we suggested an individual-specific calculation based on the Payout Method using the current family structure because the inputs required in order to use this method are more clearly known. In defense of the 60% figure for younger workers, we offer the following facts which are consistent with the actuarial record of actual family benefits: spouses receive 50% of employee Tier I benefits and 45% of Tier II benefits, survivors receive 100% of Tier I benefits and 50% of Tier II benefits, spouses are typically women who are younger than their railroad employee husbands and women have longer life expectancies, and there are other family benefits (*e.g.*, for dependent children and parents). Therefore, 60% seems to be a conservative figure; and it was proffered in that sense. Frye and Hatcher contend that our 60% figure is demographically sensitive. Okay, perhaps it is;

suppose half the railroad labor force are women, suppose men start marrying women who are older than them, or suppose female life expectancies decline. It is still the case that spousal benefits are 50% of Tier I and 45% of Tier II, survival benefits are 100% of Tier I and 50% of Tier II, and there are still a whole host of other family benefits. Therefore, the 60% figure for family benefits for a young worker is still reasonable and conservative.

Finally, our paper never says, contrary to Frye's and Hatcher's interpretation, that "the computationally intensive approach required by the court lends itself to sloppiness by economists doing the computation because they may, for instance, ignore the railroad pension rights of the injured worker's family." Quite the contrary, most of our paper is devoted to an explanation of the Payout Method in the context of the railroad industry because we have every confidence that economists will get it right once they become familiar with railroad pensions. We are not worried that economists will ignore family benefits; but rather that considerations regarding the legal status of family members, or as yet nonexistent family members, may prevent economists from including family benefits in their calculations. We do not wish to avoid the "computationally intensive approach" or "crunching the numbers" if that is the most economically correct thing to do. We are reminded of an aphorism that has been attributed to E. J. Mishan; we paraphrase it as follows: *It is far better to have an approximate estimate of the precisely correct economic concept than to have a precise measure of a wrong concept*

References

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