

Your Pink Cadillac! How Much Is It Worth? What Can Forensic Economists Learn From Nonpecuniary Benefits?

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Abstract. A review of the literature on nonpecuniary benefits derived from employment is provided in order to assess nonpecuniary losses and damages suffered by an employee in wrongful termination cases and in injury cases that lead to long-term unemployment. The review shows instances where nonpecuniary damages are quantifiable in terms of a multiplier, and this research allows the forensic economist to provide opinions in specific cases. This review also shows where forensic economists cannot comment on nonpecuniary damages in easily quantifiable terms.

You cannot buy a pink Cadillac; you have to earn it being a top seller for Mary Kay Cosmetics. Peers, friends, and family will know that you earned it. You will bask in the sun of their admiration, for you have gained status that is achieved by only a few: you have received the top prize. But how much is it worth? Can economists put a value on this prize beyond the resale value of a generic Cadillac? Can they determine a *hedonic* value to account for the true value of a pink Cadillac?

In neoclassical economics, work provides income only. No psychosocial benefits are incorporated other than one's initial preferences between work and leisure. Work is considered a disutility, so the longer one has to work, the less happy one is. Under these circumstances there would be no accounting for a pink Cadillac. It would be merely a car that could be purchased with income. This standard assumption ignores other, noneconomic benefits a person might derive from being gainfully employed; it fails to explain why salaried workers happily work overtime or why others work for lower than prevailing market wages. Other shortcomings of neoclassical theory include its failure to explain the phenomenon of widespread volunteer work in the United States (something that is almost nonexistent in Europe other than at the local level of political parties). In short, there are nonpecuniary benefits from working that are not reported by neoclassical models and theories.

In a similar vein, the neoclassical framework is not helpful when assessing noneconomic damages a worker may experience during periods of unemployment. Neoclassical models measure only monetary earning damages. Recent research (most notably by Akerlof [2005], and Farzin [2006]) has recognized the obvious nonpecuniary benefits from working and has incorporated these into new theoretical models. The work is important because it corroborates efforts by human resource departments to devise schemes that will reward employees with noneconomic benefits in order to enhance productivity, status, and job satisfaction.

For forensic economists, this research is important in calculating damages a person suffers due to injury and wrongful termination, especially when these factors lead to

long-term unemployment. Many forensic economists maintain that they have no legitimate role in guiding a jury to determine nonpecuniary damages. They argue that an economist cannot comment on the psychological pain a person suffers when becoming unemployed. Essentially they are saying that economists are unable to comment on the psychosocial benefits a person experiences from working, because they cannot readily estimate a remunerative value for them. American courts recognize loss of enjoyment of life, but beyond that, nonpecuniary damages are not accepted in most states. And as Ireland (2001) points out, courts and judges put limitations on noneconomic losses. Nonetheless, knowing what nonpecuniary benefits potentially consist of would allow forensic economists to provide an opinion on this subject.

This paper explores and summarizes research in the noneconomic benefits workers experience in the workplace, and can be used as guidance in assessing and quantifying noneconomic damages. The scope of this paper does not include cases where juries have decided awards or have denied bulk damages. My aim is to provide more information on the kinds of nonpecuniary damages we might specifically look at and to derive a general framework that allows forensic economists to comment on nonpecuniary losses a plaintiff has experienced.

Review of the Literature

In a review of the European system, Comandé (2009) showed how courts and insurance companies use tables and previous jury awards to derive noneconomic damages. These strive to avoid variations in awards between comparable injuries in order to yield horizontal justice for like losses, as well as vertical justice accounting for the duration of suffering. While most of the European nonpecuniary damages address physical pain and suffering, they also incorporate psychosocial damages wholesale into the overall award. This system works well in injury cases; however, in wrongful termination cases it would not work at all, and this is not what can be brought to court in Europe.

In the United States several methods for wholesale injury damages have been put forth for medical malpractice and product liability. A commonly used method is the "Hand Rule" (Cooter, 2003). This method equates the cost of avoidance of risk with the probability that a specific event will occur, and derives a monetary value for that. There are several problems associated with this method, such as those pointed out by Shapiro and Rodriguez (2009). Beyond these shortcomings, the Hand Rule does not specifically address noneconomic losses in wrongful termination cases, because the cost of avoiding wrongful termination, and the probability of wrongful termination, are not known.

Abraham (2006) proposes to link noneconomic damages to economic damages using a multiplier similar to the Hand Rule as a way to incentivize potential tortfeasors to exercise due care. His multiplier also focuses on injury cases. Other multipliers can be derived using recent research into noneconomic benefits from employment and may help forensic economists calculate noneconomic losses in noninjury cases. Once the noneconomic benefits are clearly delineated, nonpecuniary losses can be supported by research. For certain classes of employment we might be able to show that there is a consistent nonpecuniary loss, and this would allow us to devise a matrix of a noneconomic damages multiplier for wrongful termination cases.

As will be seen, some employment situations lend themselves more readily to quantifiable nonpecuniary loss estimates, while other employment situations need more research or simply don't entail significant nonpecuniary losses.

Nonmonetary Incentives and Bonuses

In professions and jobs where productivity is readily measured and obvious to all coworkers, nonmonetary incentives and bonuses can play a large role in performance. Insurance salespeople are a prime example. Lavish annual meetings with prizes for the top salespeople are the norm. Trophy values are enormous even if the actual value of a trophy, such as a dinner for two or a weekend in Las Vegas, is relatively low. In fact research has shown that tangible nonmonetary incentives are valued higher than their retail market value or an equivalent in cash (Jeffrey, 2002).

In the one instance, cash would not allow the recipient to "brag" as much as a vacation in Las Vegas would. Once the cash bonus is received it is quickly forgotten, while a vacation in Las Vegas allows the recipient to talk about and have pictures of the trip in the office, which invites coworkers to say, "So how was Vegas?" thus prolonging and increasing the value of the prize far beyond its actual market value.

Some nonmonetary benefits include access to a private jet, the suite at the ballpark, and the pink Cadillac. While all of these have a readily defined cash value, an additional nonpecuniary value is clearly evident. The pink Cadillac handed out by Mary Kay Cosmetics to its top seller is perhaps the most flashy nonpecuniary benefit. We all know about it: it is in your driveway; we can see it at the mall and on the highway. Everybody knows you in the community. What a prize, what a conversation piece, and what an awesome woman you are to have received this top prize!

Cognitive dissonance theory explains why the value of noncash incentives and bonuses is inflated. Employees work hard in anticipation of an incentive or bonus only because they have convinced themselves that the reward is worth a great deal. Cash incentives don't suffer from this inflationary value. In fact, the more effort an employee puts into obtaining a nonmonetary incentive or bonus, the more inflated such a reward becomes.

Proposition: Nonmonetary incentives and bonuses have a value that is greater than their monetary equivalent. Cognitive dissonance inflates the value. The longer a person strives to achieve a prize or a bonus, the more inflated its value becomes.

For workers who earn relatively low wages, however, this type of reward is not valued as much (Nelson, 1994).

The Status Quo

People generally favor strongly the things they are used to, or the way things are. They put a great deal of effort into maintaining the status quo, and they resist change, especially radical change such as losing employment. Even when an alternative has greater value, people hate to lose the status quo. Tversky and Kahneman (1991) studied this phenomenon. They conducted experiments where participants were rewarded with a coffee mug or something else such as chocolate or even money. After participants received their reward, they were informed of its value and were given the choice to switch it for something else. In 90 percent of the cases, participants kept the reward

even though it was of lesser value than the alternative choices. The authors label this the “Instant Endowment” effect: people value a loss more highly than an equivalent gain. The pain of losing the mug is not offset by gaining the equivalent, or even more, in cash. The endowment effect can be as high as twice the value of a cash equivalent; the authors found the loss aversion coefficient to be between 2 and 2.5.

The status quo bias has been shown to operate in the choice of medical plans by Harvard employees, who preferred their current medical plan even when the “new,” alternative plan was equal to or better than the current one. This phenomenon spans many areas, such as choosing pension plans, purchasing an automobile, and brand loyalty for consumer goods (Samuelson & Zeckhauser, 1988). Research has found a status quo bias of 17 percent. This bias might serve as a measure of nonpecuniary damages in wrongful termination cases, including potential transaction costs, psychological commitment to prior choices, and the cost of thinking about an alternative.

People self-select their status quo. For instance, people who like to fly or stay in hotels might opt to become flight attendants or hotel workers for the potential benefits of free flights or free hotel stays. In fact, hotel chains that offer employee benefits of hotel stays in desirable places know very well that this self-selecting mechanism acts in their favor (Jeffrey, 2002). While such companies keep careful track of the monetary costs, the actual value of such benefits to the employee greatly surpasses the monetary value.

Companies in California’s Silicon Valley, such as Genentech, Google, and Yahoo, make heavy use of nonmonetary benefits, which are perceived as luxuries: onsite dry cleaners, dentists, and childcare; ski trips to Tahoe and tickets to ball games; vouchers to buy clothes at Banana Republic (seemingly so that the look of employees and hence an identity with the company is assured); and company-operated buses that pick up workers in San Francisco. Employees might pay for these things anyway, but since they are provided by the company, they entail a certain cachet and are valued higher than their actual monetary value. One of the reasons is that they have a lower transaction cost. To be able to say, “Guess what, Honey, we are going on a free ski trip,” entails a higher value than saying, “Honey, I would like to go on a ski trip”; for if Honey is not into skiing, some negotiation is necessary. Jeffrey (2002) labels this the justifiability of tangible nonmonetary benefits.

Research on the status quo effect shows that employees like their work life the way it is. Simply calculating the economic losses from loss of employment plus the monetary equivalent of benefits greatly underestimates the true losses. When employment entails nonmonetary benefits such as are bestowed on Silicon Valley employees, the loss of employment carries large nonpecuniary losses.

Proposition: Rewards, once obtained, constitute an endowment and become part of the status quo. People are generally reluctant to give this up, even if better choices are available. Endowment effects are large when losses are involved, up to twice as high as actual monetary value. Status quo effects are evaluated against alternatives and have as much as a 17 percent premium over the actual monetary value.

Nonpecuniary Damages and Status

John Adams said, “The desire of the esteem of others is as real a want as hunger, and the neglect and contempt of the world as severe a pain as the gout.” As Max Weber

(1978) pointed out, status is not directly related to wealth or income. Any kind of employment conveys a certain status and social recognition; being employed signals to family and the community that the person is stable, decent, and reliable. Employment signals psychosocial characteristics that are nonpecuniary, although wages and status are complements in many employment situations (Auriol & Renault, 2002). Auriol and Renault developed a model that shows how well-paid employees prefer status and recognition as work incentives. Their model also shows that if an employee already has a very high status, then monetary incentives are preferred. So the forensic economist has to treat wrongful terminations on a case-by-case basis.

A number of specific employment situations have been researched. They are grouped here into categories to help forensic economists frame potential nonpecuniary losses.

A. The Top Dog

As Auriol and Renault (2002) showed, once an employee has reached his or her potential, monetary rewards are more important than nonmonetary status symbols. At the very top, income is called compensation, which includes the base salary, cash bonuses, perks and other, stock awards, and option awards. The category “perks and other” varies widely but is small compared to the total compensation package. CEO compensation is not directly related to company performance.

An interesting set of research has looked at the status of CEOs and their ability to negotiate pay. Status can be defined in many ways and varies from country to country as well as with the prevailing culture. In Europe status is often defined first by one’s father’s education or by membership in a certain social class, such as the aristocracy or a titled nobility. In the United States this has less importance, and status is more often defined by the university one attended oneself, or even what sorority or fraternity one belonged to. Studies of CEO compensation show that high-status individuals were able to negotiate a higher salary than low-status CEOs (Belliveau, Reilly, & Wade 1996). The researchers tested the effect of social capital derived from social networks and elite institutional ties, which an individual uses to negotiate compensation with a board. Interestingly, when the CEO has a higher status than key board members, they agree to a higher compensation package. When the status of the CEO and key board members is similar, the compensation package is likewise high.

In firms where ownership is more concentrated, boards have more influence over compensation packages (Tosi & Gomez-Mejia, 1989). A recent list in the *New York Times* of the top one hundred CEOs’ compensation confirms this. Rupert Murdoch received only \$16.8 million, 6 percent less than the previous year, while John T. Chambers of Cisco Systems more than doubled his compensation to \$18.9 million. This was despite the fact that their respective revenue increases were 8 and 11 percent (*New York Times*, April 10, 2011). Murdoch received almost \$300,000 in perks; Chambers, \$11,000.

CEO compensation is not strongly related to company performance. Many cross-sectional economic studies have explained less than 30 percent of the variance in CEO compensation (Crystal, 1991). When a CEO is “asked” to resign, large severance packages are usually offered. In instances such as injury, where a CEO can no longer perform as CEO, the loss of status falls into the category described above as loss of the status quo.

B. Climbing the Ladder

Research has identified industry-wide wage differentials. In a longitudinal study controlling for labor quality and skills, workers could raise or lower their wages by moving to a better- or worse-paying industry (Krueger & Summers, 1988). Wage differentials can be seen in corporations that have a large skilled labor force, whose productivity is not easily measured. Additionally, these corporations make use of promotions as a more effective way to reward employees than monetary incentives alone. In that sense, status and income are complementary.

Status is used differently in different companies. Organizational hierarchies illustrate this point. Toyota has seven layers of management between its CEO and the workers on the assembly line; Ford has seventeen; and GM had twenty-two (Milgrom & Roberts, 1992). Status is more salient when performance cannot be measured easily. And status is also measured by whom you know and how you know them. Shared affiliation—the buddy system, an old-boy network, belonging to the same church, and other social indicators—increases liking and the potential for promotions (Burt, 2001). In large corporations, climbing up the ladder is facilitated by the old-boy system.

Status has a significant influence on performance, and employees compare both status and wages to like employees. People are willing to exert great effort in order to be selected for the next promotion. (Fershtman, Hvide, & Weiss, 2002). As employees move up the ladder, the desire for status is replaced by the desire for increased pay (Auriol & Renault, 2002). Also, status is more important in long-term employment situations because the individual is willing to invest in recognition in exchange for monetary compensation.

When output depends on more-cognitive processes, team work, and problem solving, studies have shown that monetary reward can undermine productivity (Kohn 1994). In such instances, monetary rewards are perceived by others as punitive, and they discourage risk-taking. In jobs where output depends on self-motivation, wages rank fifth in job satisfaction. This is the case for engineers, teachers, police, firefighters, nurses, and social workers.

For the forensic economist who has been asked to assess damages in wrongful termination cases involving individuals who work in organizations with well-defined hierarchical structures, loss of status can have potentially large nonpecuniary damages. Given that institutions and firms have highly variable hierarchical structures, such damages are not easily assessed. The review of research presented here should help define a framework to investigate assignments on an individual basis.

C. Status in the Social Context

Status and the need for recognition are closely related and are key factors in job satisfaction. Studies have shown that low job satisfaction leads to high turnover and absenteeism (Dunette, Campbell, & Hakel, 1967; Becker, 1962). Similar to status is the insider/outsider concept, which is used by institutions, corporations, and especially nonprofit and public organizations, including the military (Akerlof & Kranton, 2005). The reward for working in a nonprofit organization, or being part of the military, is one's strong identity with the organization; that is, in being an insider. Society plays its part by recognizing such individuals as putting mission before self. Wrongful termination in such situations carries high nonpecuniary losses.

D. Summary

Nonpecuniary benefits pertain in many employment situations. For the forensic economist, the value of nonpecuniary losses has to be assessed on an individual basis. For example, the loss of status in wrongful termination cases is complex. Is the person a CEO or a longtime employee in an institution or corporation? What is the social capital? Is there an insider/outsider context to consider?

Proposition: Wages and status are generally substitutable, but status can be more important than wages, especially when wages are average. Being terminated or laid off entails potential nonpecuniary losses. In employment situations where wages rank low in terms of satisfaction, and when the profession is mission-driven, wrongful termination will carry definite nonpecuniary losses; yet such losses are not easily quantifiable. More research is needed in this area.

Fair Wages

One area of investigation that forensic economists deal with is unequal pay. Research of interest in such cases can be summed up under the “fair wage-effort hypothesis.” This has been studied since the 1950s by psychologists, sociologists, and labor economists. Akerlof and Yellen (1990) compiled this research to develop theoretical models that are supported by observations in workers’ behavior.

In general, studies show that people who get paid below their fair wage invest less effort in their job, and even sabotage their work. Interestingly, people who get paid more than their perceived fair wage don’t work more. A “fair wage” is largely relative: a worker compares his or her compensation to that of others in the workplace, other workers in the industry, or some reference person (Carroll & Tosi, 1977).

A significant effect of unequal pay in the workplace is depressed morale. For instance, Martin (1981) found that people getting paid more than their fair wages can have a dampening effect on morale, especially of coworkers, who perceive that they are being paid less than their fair wages. The airline industry found this out the hard way after deregulation when it introduced a two-tier pay system for flight attendants. Lower-paid flight attendants would do just the minimum and often failed to collaborate with higher-paid attendants. Supermarkets and big chain stores that have unequal or tiered pay systems have similar problems, with the result of high turnover, tardiness, absenteeism, and lower productivity (Salpukas, 1987; Kochan & Barocci, 1985). When companies practice a code of silence around compensation, workers become suspicious and this too influences overall morale (Henderson, 1982). In short, underpaid workers adjust their effort and productivity at work in order to equalize pay.

The effects are self-fulfilling. From the employee’s point of view, it is not really worthwhile showing up regularly or working hard, as things at work are not really fair. From the employer’s point of view, this worker is unreliable and should not be paid more than what is offered. This argument is widely used, especially for differential pay for women and ethnic minorities. Additionally, research shows that when white males work with women or different ethnic groups, their work commitment is diminished; by contrast, women don’t feel that way (Tsui, Egan, & O’Reilly, 1992).

To conclude, the fair-wage hypothesis has been researched in the effect of unequal pay on workers’ productivity, job satisfaction, and morale. The fact that unequal pay

leads workers to sabotage their own potential leaves little room for forensic economists to quantify nonpecuniary damages other than to provide information about the psychosocial harm such a worker has suffered. In the United States, longitudinal studies of gender and race might provide more quantifiable information. The German Socio-Economic Panel (SOEP) has data that can be used to quantify the long-term effect of unequal pay, including nonpecuniary losses. But the labor market in the United States is very different, most notably by a higher turnover rate across the board.

For the present, the research into fair wages leads to the following proposition:

Proposition: In cases of unequal pay, the fair-wage hypothesis provides insights into workers' behavior, but so far there is little concrete information for forensic economists looking at potential nonpecuniary damages.

Nonpecuniary Loss Matrix: A Draft

This review of research into how employees behave, and how they perceive their work and their remuneration, can be summarized into a preliminary matrix:

Proposition	Case Application	Premium over Monetary Loss
Nonpecuniary damages from nonmonetary incentives and bonuses	Wrongful termination	Multiple value of monetary value of benefits
Nonpecuniary damages and the status quo	Wrongful termination	17% premium over monetary value at least, and as much as 2.7 times the monetary value of wages and benefits
Status:		
A. The top dog	Injury	Similar to status quo (above)
B. Climbing the ladder	Wrongful termination	When wages rank low in terms of job satisfaction, there is a nonpecuniary loss, but it is not easily quantifiable.
C. Status in the social context	Wrongful termination	When employment is mission-driven, nonpecuniary losses exist but are not easily quantifiable.
Fair wages	Wrongful termination	When a self-fulfilling prophecy operates, nonpecuniary damages are not readily evident.

Conclusion

This review of the research literature shows that a more nuanced opinion about nonpecuniary damages is available to the forensic economist. When nonmonetary incentives and bonuses are given to employees, the equivalent cash value is inflated; cognitive dissonance theory helps explain why and how this is so. In situations where nonmonetary incentives and bonuses play an important role, their inflationary value can be used as nonpecuniary damages in wrongful termination cases.

Research into status quo effects shows that actual values for rewards obtained are higher than their cash values. This is called the endowment effect. The premium over the cash equivalent has been estimated to be 17 percent and in some instances as much as 150 percent in terms of loss aversion. People value a loss more highly than an

equivalent gain; they resist change. Such was the case with Harvard's medical program: although it provided a superior alternative, employees were reluctant to switch from their current medical plan.

I have presented a separate section on status and have shown that arguments about loss of status do not readily lead to estimates of nonpecuniary damages. This is especially true with high-income earners, who prefer monetary over nonmonetary rewards. In middle-management positions, an employee's self-ranking of the importance of wages in job satisfaction can demonstrate nonpecuniary damages, but such ranking does not easily lend itself to valuations. When employment is mission-driven, nonpecuniary damages might be large, but once again, actual valuation is difficult.

The review of studies on unfair wages and unequal pay does not reveal nonpecuniary damages. Perhaps more information can be gained from longitudinal studies.

Nonpecuniary damages can be estimated in certain situations. Whether such estimates are allowable in court is another matter. In the meantime, a forensic economist, when questioned, can point out these areas. Nonpecuniary damages constitute a controversial issue among forensic economists. A more detailed look into specific employment situations will help to sort through this controversy.

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Endnotes

- ¹ Technically this would be a lease value, as the Mary Kay pink Cadillacs are leased.
- ² Of course, you can paint your Cadillac. Elvis Presley had a pink Cadillac in the 1950s. Bruce Springsteen wrote a song called “Pink Cadillac,” and Clint Eastwood starred in a 1989 movie called *Pink Cadillac*.
- ³ For example, if the cost of putting a flame arrester in a consumer gas can is \$0.25, and the probability of a serious accident or death is one in twelve million, then $.25 = 1/12,000,000 \times L$. Solving for L yields a Hand Rule award of \$3,000,000. In our work at Berkeley Engineering and Research, we have seen this being applied in settlements recently; one of these cases went to court with the same result.
- ⁴ Quoted by Auriol & Renault, 2002

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