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Valuing Personal Injury: How Much for How Long?

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In any event whereby some form of economic damage must be measured, whether lost business profits in the context of commercial litigation or lost individual earnings or earnings capacity in the context of insurance litigation, there are certain unambiguous considerations. Essentially, in all cases, a competent economic damages expert will begin by evaluating this most basic of factors: But-for the injurious event, how much would the business or individual have earned during the damage period?

Despite the apparent simplicity of this question, the way in which the expert evaluates the relevant issues, and ultimately reaches a supportable conclusion, will depend upon the nature of the economic damage. The authors have chosen to address, through this article, the perceived issues that must be considered by an expert when evaluating the lost earnings or earnings capacity of an individual as a result of a personal injury. We have selected this narrow subset of economic damages because of the disparity of approaches that we have seen applied in these types of cases. Unfortunately, in our opinion, many of the methods used to measure personal injury economic damages have been inconsistently applied, often with little regard to sound economic theory. While there are various ways to evaluate these damages, they are most often considered within a "But-for" model.

METRICS USED IN The But-For Model

Although circumstances differ between cases, a reliable calculation of economic damages consistently depends upon an accurate assessment of the following metrics: actual earnings, but-for earnings, additional expenses, and the present value of lost earnings and additional expenses[1].

Actual Earnings

The reason CPAs are often called upon in personal injury cases is because we have a knack for noticing financial trends. In quantifying personal injury damages, the expert must assess the historical earnings pattern for the injured individual.

[1] It is important to note that in many instances the CPA must be assisted by a qualified medical and/or vocational expert. Relying on additional experts in other areas of specialty enhances credibility and shifts the burden of proof for some of the necessary assumptions from the CPA to other, more qualified, experts.

If the individual had worked in the same job for the past 30 years and had risen steadily and predictably through the corporate hierarchy, this assessment would be relatively simple. In many cases, however, the injured individual generally has a more volatile employment history, sometimes with an earnings history that fluctuates both up and down. This observation often becomes more convoluted when the injured individual was self-employed.

Actual or historical earnings refer to the earnings history of the injured individual during the period from the injury date through the trial date. When assessing the actual earnings of the injured individual, particular attention must be directed towards the following:

1) Reconstructing accounting records
   a) What financial records are available to calculate historical earnings?
   b) How reliable is this information?
2) Identifying historical earnings patterns
   a) What was the earnings level during the period from the injury date through the date of trial?
   b) How do these earnings compare to the earnings in periods prior to the injury date?
   c) What assurances did the expert have that the earnings levels in the accounting records are accurate?
3) Analyzing mitigation issues and their impact on actual earnings
   a) What might the injured individual have done to minimize the lost earnings capacity attributed to the injurious event?
   b) To what extent, if any, did the injured individual undertake these mitigating actions?
   c) If the injured individual could have mitigated a portion of their lost earnings, and if the injured individual, for whatever reason, did not undertake actions to mitigate lost earnings, then it may be necessary to reduce the calculated losses.

But-For Earnings

But-for earnings refer to the earnings that the injured individual would have received had it not been for the injurious event. Depending on the applicable damage scenario, but-for earnings should generally be characterized as pre-trial and post-trial. Pre-trial but-for earnings refer to the earnings that would have been achieved by the injured individual, during the period from the injury date through the trial date, but-for the injurious event. Post-trial but-for earnings refer to the earnings that would have been achieved subsequent to the trial date, either into perpetuity or for a fixed period of time, but-for the injurious event. When assessing and quantifying the but-for earnings of the injured individual, particular attention must be directed towards the following:

1) Projecting unimpaired earnings

   a) What level of earnings could the injured individual have achieved had they not been damaged by the injurious event? What if the injured individual had not yet reached a working age and therefore had no historical earnings history?
   b) Absent the injurious event, would the injured individual have had the capacity and resources (based on pre-injury existing or anticipated family position, lifestyle, education, career progression, and other factors) to achieve the projected but-for earnings?

2) Assessing the damage period
   a) At what point, if at all, did the injured individual recover, either fully or partially, and resume pre-injury or adjusted earnings levels?
   b) If permanently injured and unable to return to the work force, a perpetuity projection is generally called for in which the economic damages to the injured individual are projected.
      i. For what period of time should such a perpetuity projection continue?
         1. Until the life expectancy of the injured individual?
         2. Until the expected date of retirement?
      ii. How should this projected period be modified, if at all, for the probability that the injured individual would have been subject to accidental death or disability even if the injurious event had not taken place?

3) Verifying that projected historical but-for earnings levels are consistent with projected future but-for earnings levels
   a) The assumptions used to project pre-trial but-for earnings should be similar if not the same as those assumptions used to project post-trial but-for earnings.
   b) This does not necessarily mean that pre-trial and post-trial earnings should be linear but, rather, that the logical conclusions observed in post-trial projections should relate in some meaningful way to the pre-trial projections.

Additional Expenses

In some cases the individual's injury affects more than just their ability to work, and may affect other areas of the individual's life. In some instances, these injuries can cause the individual to incur additional expenses that would not normally have been incurred. Such expenses might include additional medical expenses and the hiring of domestic help to complete household chores that would have been performed by the injured individual but-for the injurious event. Once again, this is an area that may be beyond the expertise of the CPA, and which may require additional insight from a qualified medical or vocational expert.

Present Valuing Losses

The actual and but-for earnings discussed above are measured in past or future dollars. For example, if the injurious event took place in Year 0, the trial date is in Year 2, and the projected but-for earnings extend through Year 10, then the projected lost earnings from Year 2 through Year 10 must be adjusted to account for inflation and for the risk that the projected level of earnings may not be achieved. By contrast, historical but-for earnings from Year 0 through Year 2 are generally not adjusted for present value through the trial date but rather are often adjusted for state-mandated pre-judgment interest, which in Utah is applied at 10 percent on a simple interest basis.

The theory behind bringing future losses to present value is based upon the premise that the individual, given a lump sum as of the date of trial, can earn some form of future income from the investment of the lump sum amount. However, the discount rate that is used is typically a relatively low or risk-free rate. This allows the defendant to offset some of the lump sum award by the amount that the plaintiff might earn on the award while avoiding the transference of unreasonable risk to the injured individual based upon their ability to earn additional income.

In most present value situations, an expert uses a discount rate that is congruent with the ability to achieve the projected growth in the model. However, in this situation, that risk is typically built into the earnings projection (using the volatility in the cash flows and the estimated worklife), and therefore the discount rate used to bring the cash flows to present value is typically a relatively low rate.

TAX IMPACT

It should be noted that taxes are generally not considered in deriving the present value of lost earnings. One of the rationales is that personal injury economic damages are taxable to the recipient; therefore, to tax effect the earnings used in the determination of personal injury economic damages would result in an inequitable double-taxation.

Causation

The connection between the injurious event and the lost earnings incurred by the injured individual is commonly referred to as the causal link. Proving that the injurious event was the proximate cause of the lost earnings to the injured individual is known as proving causation. While in many personal injury cases the expert is asked to assume that causation exists, the expert should not ignore the concept of causation altogether since, depending on the circumstances, causation could have a bearing on the existence and quantification of damages.

In proving causation, the injured individual must demonstrate that the claimed lost earnings were not caused, in whole or in part, by intervening factors either wholly or partially separate from the injurious event. For example, if an injured individual claims that the injurious event caused them to lose earnings when, pre-injury, they were on the verge of being downsized or demoted, the injured party must prove in

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the process of establishing causation that they did not lose earnings that would have been lost even had the injurious event not occurred.

Damage calculations and causation issues must be addressed simultaneously. They should not be developed independently, since doing so may lead to a theoretical disconnect in associating the appropriate level of economic damages to the injurious event. In all cases, economic damages must flow from the injurious event, which inevitably points to the fact that causation should be the starting point for all of the economic damages scenarios discussed herein.

Summary and Conclusion

While there may not be any one particular "correct" way to estimate the lost earnings suffered by an injured individual, the authors' experiences have led them to observe that there are a large number of "incorrect" ways to perform such calculations. If experts take the time to learn, understand, and comprehend the factors discussed in this article, we believe that the issues contested at trial can be significantly reduced to testimony regarding the variables and assumptions used by the individual experts, which in our opinion is much more productive than arguing the merits of two disparate economic damage calculations, particularly when both may be inadequate.