“Lost Earning Capacity” vs. “Expected Lost Earnings” in Wrongful Death Analysis 10/8/98

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Abstract

In the debate over “lost earning capacity” versus “expected lost earnings” in projections of economic losses to individuals, it is typically assumed that the issues are the same for wrongful death analysis as for personal injury analysis. Most of the debate over the meaning and application of the two loss recovery standards has been shaped in terms of personal injury analysis, with less thought having been given to differences that might exist when the concepts are applied to wrongful death circumstances. When rights to recover are examined carefully, however, there are important differences between personal injury actions and wrongful death actions that relate directly to distinctions that have been made between “lost earning capacity” and “expected lost earnings.” With the exception of “survival action” states that do not have true wrongful death statutes (Connecticut, Georgia, New Mexico and perhaps Mississippi), the standards for recovery in a wrongful death action do not use the “earning capacity” language that exists for personal injury litigation. Instead, the standard is what is lost by survivors of a decedent. That standard is most closely approximated by “expected lost earnings” and has implications for the meanings of personal consumption and lost nonmarket services of a decedent that are quite important, but seldom considered. This paper examines those differences.

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Introduction

The term “personal injury litigation” is often used to include both personal injury litigation involving surviving workers and either wrongful death or “survival action” litigation involving the estate of the decedent acting as representative for the decedent. However, substantial differences exist in the standards for loss recovery between personal injury litigation and wrongful death litigation. (Survival actions involve many differences that will not be treated in this paper.[1]) In a personal injury action, the loss recovery language often specifies that individuals may recover for the lost “earning capacity” that results from injuries and for lost ability to produce nonmarket services. In a wrongful death action, the standard for recovery is typically the loss by survivors of the decedent of financial support and the loss of nonmarket services the decedent would have provided to survivors.

The term “earning capacity” is a controversial term of art in forensic economics as well as a term of law. Its meaning in law is a matter of legal interpretation, but its meaning in forensic economics is a subject of controversy among those who draw important distinctions between “earning capacity” and “expected lost earnings.” This author offers an analytic perspective on this controversy as it applies to personal injury litigation without taking a strong position on either side of that controversy. The discussion then focuses on the differences that exist between the uses of these concepts in personal injury litigation and wrongful death litigation, particularly in the areas of the personal consumption deduction and projections of lost nonmarket services. The argument is made that even if some variant of an “earning capacity” analysis should apply in personal injury

litigation, the standard in wrongful death should probably be "expected lost earnings." It also suggests circumstances under which exceptions may exist. Finally, there is a discussion of issues relating to logical consistency between projections of lost financial support and lost nonmarket services, some of which would also apply to personal injury litigation.

"Expected Earnings" vs. "Earning Capacity"

The language of many state personal injury statutes suggests that injured persons may recover for "lost earning capacity" that results from their injuries. Many forensic economists understand that language to imply something like the "expected lost earnings" of the individual. Others argue that there are important differences between the "earning capacity" of a worker and the "expected earnings" of that worker. Thus, a controversy exists between those who believe that "earning capacity" and "expected earnings" refer to the same thing and those who believe that there are important differences between the two concepts. For those who perceive an important difference, "expected earnings" refers to the earnings an individual would have been expected to earn over that individual's probable work life, whereas "earning capacity" refers to earnings the individual could have earned if he or she had chosen to do so. In other words, it is a distinction between what an individual would be likely to earn and what an individual would have been able to earn if the individual had chosen to maximize earnings in some hypothetical sense.

A great deal of confusion stems from the fact that "capacity" is very hard to specify. Proponents of the distinction between "earnings capacity" and "expected earnings" do not carry the "earning capacity" concept to its logical extreme, which makes it hard to determine the exact meaning of "capacity" as it differs from the most probable expected outcome. In an extreme interpretation, “earnings capacity” would refer to the earnings an individual would receive if preoccupied with earnings to the exclusion of all other values an individual might possess. One would ask the question: How much could this individual have earned if maximizing labor market earnings was the only value the individual considered important? This might involve taking second or even third jobs at potentially lower pay rates than the individual’s primary employment. It might also involve working as late in life as possible and then shifting down to lower paying occupations late in life as old age gradually reduced the worker’s capability of continuing in his or her primary occupation. In this extreme interpretation, one imagines the worker doing part-time work at minimum wage at life’s end to add a few more dollars of earnings to the individual’s life goal of maximum earnings.

This is not, however, what most proponents of the “earning capacity” concept have in mind. It is something more than a worker is expected to earn, but something less than a hypothetical income maximizing caricature of the individual might be able to earn. The problem lies in defining that “something less.” At the other extreme, it seems intuitively obvious that most individuals *could* earn more income than they *would be likely* to earn. Further, it is very easy to come up with examples in which the expected earnings of an individual would be an unfair and inadequate replacement for the earnings capacity the individual lost because of an injury. The standard of loss is to put the injured individual back into an economic condition equal to the individual’s pre-injury economic condition.

Assume that a doctor had demonstrated prior earnings of $120,000 per year, but was working for $60,000 per year in a charitable endeavor at the time of his injury. It seems obvious that the value of the loss if the injury was totally disabling to the doctor should be valued at

$120,000 per year, not $60,000 per year. It also seems likely that legislators who drafted most personal injury legislation had such instances in mind in choosing to use the term “earning capacity” rather than “expected earnings.” Because it is demonstrable that the doctor chose to earn less than the doctor could have earned for reasons of the charitable endeavor, it seems fair and reasonable that the doctor’s injury recovery should be valued at $120,000 per year. Few forensic economists, even those who profess to believe that earning capacity really means expected earnings, would fail to value the doctor’s loss in terms of $120,000 per year. Within an “expected earnings” framework, doing so simply requires making the assumption that the doctor would have returned to working at $120,000. Making that assumption converts the “capacity” into an “expectation.”

Another example would be a young woman who was earning $40,000 per year as a clothing designer when she decided to cut back her work activity to nine months a year, after which she was earning $30,000. Having earned $40,000 per year in years prior to the injury, she had demonstrated the capacity to earn $40,000. Her decision to trade $10,000 for three months of leisure sounds less noble than the doctor’s decision, but no less credible. Her capacity to earn $40,000 per year is not a conjecture based on a hypothetical desire to maximize earned income to the exclusion of all other human values, but on her demonstrated record for having earned that amount. There may be no reason to “expect” that she would have earned more than $30,000 per year plus wage increases in the future, but her “capacity” to earn $40,000 per year was established in a way that any juror would find meaningful. Here again, it would seem that this is what legislators had in mind in choosing “earning capacity” language in preference to “expected earnings” language for personal injury litigation. Common sense suggests that the “true income” of this woman was $40,000 per year and that she chose to trade $10,000 of that amount for a three month period of "leisure" (though when this example is revisited later, it will become obvious that "leisure" is not a completely accurate characterization).

This is another case in which economists professing to believe that "expected earnings" is not a substantially different concept from "earning capacity" would very probably have used the woman's $40,000 in demonstrated past earnings to measure the loss. This could easily be justified by claiming that the decision to take a three month period of time off work each year was likely to be a short run phenomenon, so that the woman's "expected earnings" were really $40,000 per year. The woman would have a vested interest in supporting this interpretation since it would result in a larger amount of projected damages, whether in some more fundamental sense it was "true" or not. The real "truth" is that the injury and its consequences are such that it will never be known whether the woman would have continued working nine months a year for $30,000, or would have returned to full time work at $40,000 per year.

Capacity and Choice

These examples implicitly focus on situations in which the individual could be reliably shown to have exercised choice in earning fewer dollars of income than was possible. It is the issue of "choice" that is at the heart of the controversy over the distinction between "earning capacity" and "expected earnings." Choice lies at the heart of why the income maximizing automaton would seem absurd to a juror, but the doctor and the woman who took three months of vacation seem credible.[2] A claim that a living human being could have worked several jobs and could have continued working almost to the end of life in jobs with declining skill demands implies that the individual could have "chosen" to do so.

Common sense suggests that most real living human beings cannot indefinitely work multiple jobs, nor could they continue to show up to work year after year in their 80's to do jobs that were becoming less and less demanding as their physical capacities eroded with age. It is simply not believable that most individuals have such capacities or "desire." Most of us "need" more rest and recreation than is implied by such a course of life. Many jurors know people who are forcing themselves to go to work, just waiting for the day when they can retire. Common sense would tell them that these people do not have the "capacity" to continue working after that. Only in a hypothetical sense could such choices be made by most people. "Capacity" represents what people might actually choose to do and does not include choices that people almost surely would never make. It is easy to hypothesize that the doctor could go back to earning $120,000 per year, or that the woman could go back to earning $40,000. It is much harder to hypothesize that a typical worker could continue work several jobs with no leisure and then work at jobs requiring declining skills at ages in the 70's and 80's.

This is demonstrated most easily by the fact that it is quite easy for economists to project that workers who were working multiple jobs at the time of their injuries could reasonably be projected to continue to do so in the future. What might seem incredible for one worker who had not been doing so could seem quite credible for a worker who had demonstrated the capacity to do so in the past. While this element clearly does not fall within the bounds of economic theory, most forensic economists would consider the fact that a worker had maintained multiple jobs in the past to imply that it was reasonable to project that this would have continued in the future. And if a worker had told people for years that the only thing in life that he or she wanted to do was to maximize earned income, it might even be credible to employ the extreme version of earning capacity discussed earlier in that worker's case.

Here again, however, there would probably be little difference between a projection performed by an "expected earnings" forensic economist and an "earning capacity" economist. The "expected earnings" economist would argue that the worker was likely to have the earnings, while the "earning capacity" economist would argue that the worker had the capacity to do so, but both might well reach similar conclusions about the amount of damages. If the facts of the case indicate that it makes common sense to project that the worker might have chosen to do something, economists of both persuasions are likely to assume that the worker would have done so.

Applying "Earning Capacity" and "Expected Lost Earnings" to Wrongful Death Analysis

Loss must always be measured from the standpoint of the person, persons, or unit suffering the loss. Feldman and Egge (1995) suggest that any loss analysis must ask three fundamental questions in any loss analysis:

Whose perspective are we taking?

What is the question the jury is to answer?

What is the purpose of the award?

In a personal injury analysis, we are taking the perspective of the injured worker, the jury is asked to determine how much pecuniary value the injured person has lost, and the purpose of the award is to put the injured individual back into the same financial position, with the same alternatives, as before the injury. In a wrongful death analysis, we are taking the perspective of legally relevant survivors[3] of the decedent, the jury must determine how much pecuniary value has been lost by the legally relevant survivors, and the purpose of the award is to replace that pecuniary value.

With that difference in mind, it immediately becomes clear that the "choice" variable discussed above works differently in a wrongful death circumstance than in a personal injury circumstance. An injured worker would have been free to choose whether to convert an difference between expected earnings and earning capacity into greater earnings. The worker has clearly lost that choice because of the injury. But a survivor of a decedent worker could only indirectly influence the choices of the decedent worker to convert earning capacity into actual earnings. In effect, the survivor loses the *opportunity to try* to induce the decedent worker to convert earning capacity into actual earnings, but the *choice* would have remained with the decedent. The only choice lost to the survivor is the choice between whether or not to try to induce the survivor to convert earning capacity into actual earnings.

The question is then what that choice is worth. By comparison, the personally injured worker has lost a choice whose value is equal to 100 percent of the lost earning capacity. If the difference between earning capacity and expected earnings is as firmly established as in the case of the doctor working at half what he could have earned or woman who worked three fourths as long as she could have worked, the opportunity cost value of the foregone earnings must be greater than or equal to the earnings. This is not a speculative calculation under those circumstances. But what is the value of a widow's loss of the opportunity to try to persuade her husband to have worked longer than the number of years he would have been expected to work. Carried even further, if the decedent had left minor children as survivors, what is the value of the lost opportunity of the minor children to have tried to persuade their father or mother to have worked longer to generate more earnings? While the lost opportunity to persuade the decedent to convert excess earning capacity into additional earnings, placing a value on this lost opportunity to persuade would push any economist into areas far beyond the economist's expertise.

In this context, the typical language for damage recovery in a wrongful death case makes sense. There is no mention of lost earning capacity because the survivors did not lose that capacity. They have only lost the opportunity to try to influence the decedent to convert that capacity into more earnings, *which they may not have wanted in the first place*. In many families, the wife and children often wish their husband and father would work less and spend more time with them. In such cases, the value of a lost opportunity to persuade the decedent to work more hours may be negligible. As the next section will demonstrate, however, lost opportunities to influence the decedent's choice to convert excess earning capacity into actual earnings may have more value than this section seems to imply. The final section of this paper deals with the practical implications to the family that would have liked for the decedent to have worked fewer, rather than more hours. Ultimately, there is a tradeoff, even for survivors. Conversion of earning capacity into actual earnings would normally imply that survivors would receive fewer hours of nonmarket service production by the decedent.

The Insurance Value of Lost Opportunity to Influence the Conversion of Earning Capacity

In the above discussion, the value of the lost opportunity to try to persuade a decedent worker to convert excess earning capacity into actual earnings appeared to be negligible. In fact, while the value of a difference between the earning capacity and the expected earnings of a decedent is much smaller to survivors than to the decedent, the value is greater than the value of a persuasion opportunity. To see this, it is important to consider the circumstances under which a decedent worker might be influenced to convert an excess of earning capacity into larger expected earnings. Those circumstances would typically involve some kind of financial emergency faced by the family. It might be a fire that destroyed the under insured family home, perhaps an illness or injury to one of the surviving family member. Or, for one of the children, it might be a parent's decision to provide more support for a child's higher education than earlier anticipated. In all of these cases, the reason for decedent's decision to convert earning capacity to actual earnings is an unexpected need for finances.

In other words, any existing difference between earning capacity and expected earnings functions as a type of self insurance by the decedent. Under normal circumstances, the decedent would not convert this capacity to earnings, but might do so in the face of unexpected financial requirements. In these cases, it is not likely that the survivor who created the need would try to *persuade* the decedent to make this conversion, but the decedent would be *influenced by* the survivor's special financial requirements to make the conversion. And clearly this possibility would have value to each survivor who might later develop such special financial requirements. Since the value is really the value of the self insurance by the decedent to the survivor, one possible value to place on such self insurance is the cost of a life insurance policy with a payout equal to the value of the difference between the decedent's earning capacity and the decedent's expected earnings. The amount of insurance involved would have to be reduced to account for increases in necessary self consumption under some circumstances.[4]

The Impact of Converting Earning Capacity on Lost Nonmarket Services

There is an important interrelationship between estimates of lost earnings and estimates of lost nonmarket services. This interrelationship is often ignored in loss reports by forensic economists, but the amount of time spent in providing nonmarket services often increases when workers retire. Some of this increase takes the form of "hidden hobbies" in that retired persons may "putter around." Doing so means providing services that were not provided previously because time was more scarce and the services themselves are not greatly valued. Retired persons, for example, may put in a great deal more time gardening, for example. If so, gardening activity can be seen more as leisure for the gardener than as nonmarket service provision. Nevertheless, it is typical for persons not employed in the labor market to provide more nonmarket services after retirement than before.[5] For example, Martha Hill (1985) shows home oriented work by husbands who work full time in the labor market to be 12.7 hours per week, while husbands not in the labor market provide 20.0 hours per week. For women, the comparable figures are 24.6 hours with full time labor market employment and 40.9 hours without labor market employment.[6] When companionship, guidance, counsel and care are added to included service provision, the differences may be even larger.

The important issue here is that there must be logical consistency in how the lost earnings and lost nonmarket service provisions are treated. An individual starts with a 168 hours per week of time. Some part of that time must be used for sleep, exercise, medical and dental appointments and treatments, bathing and other necessary functions. For a typical person, this might leave 100 hours of time that can be used for labor market employment, nonmarket service provision, education and skill development, and true leisure. If an earning capacity concept is used to project earnings on a basis of presuming that a worker would work more hours than actually expected, the additional time must come from the remaining possible uses of the remaining 100 hours the individual had available to allocate. Only if the time is assumed to come exclusively from reduced leisure can it be argued that the extra earnings come at a cost in terms of sacrificed alternative uses of time that would have had an impact on survivors. If it came at the expense of education and skill development, it should imply a lower rate of growth in earnings in the long run. If it came from reductions in nonmarket service provision, it should imply reduced nonmarket service provision. Whatever are the assumed reductions, it is important that they be made explicit in the economist's report.

This implies that using an earning capacity concept for estimating lost earnings must logically require that estimates of lost nonmarket services be made lower than the amounts that would have been likely if the greater earning capacity earnings imply more hours in the labor market. This is not true if the earnings capacity difference is based on lower pay for the same number of hours, as in the case of the doctor who accepts $60,000 instead of the $120,000 he could have earned for the same number of hours. But it is certainly true of the woman who could have earned $40,000 per year, but chose to work nine months per year at $30,000 in order to have three months off work. To develop the significance of this point, it will now be useful to return to that example. The example was originally developed in the context of a personal injury, but it will now be redeveloped in the context of a wrongful death.

As before, the decedent was assumed to have demonstrated the capacity to earn $40,000 for full year earnings, but had chosen to work nine months a year at $30,000, giving her three months each year of non-labor market work activity. She is now assumed to have been wrongfully killed, rather than injured. The following details are also relevant. She is a single woman who has been spending $10,000 per year (along with two other siblings) to provide $30,000 in living expenses for a mentally disabled sister. Two of the three months of non-labor market work were being spent each year providing special attention to her disabled sister, after which she did go on a one month vacation by herself. During the two months with her sister, she provided almost constant companionship, guidance, care, counsel and comfort to her disabled sister, which became the high point of the disabled sister's year. The next sibling of the disabled sister is now bringing suit for wrongful death damages because of the death of the supporting sister.

In this case, it may be that the two months of special attention were worth far more than the additional financial contribution that might have been made to the benefit of the disabled sister if the supporting sister had worked full time. In passing, we also find the supporting sister's motives to have been just as noble as those of the medical doctor who accepted half pay as part of a charitable endeavor. Here, we might actually reduce the amount of damages to the disabled sister if we attempted to employ an earning capacity concept in preference to expected lost earnings. If we assume that time has equal value in labor market and nonmarket employments, only one third of the financial benefits of labor market time was being used to support the disabled sister, but two thirds of the $10,000 value of three months was being used for the benefit of the disabled sister.

Conclusion

This paper has advanced four major arguments relating to the difference between expected earnings and earning capacity:

(1) "Choice" is the central element in determining differences may exist between "earning capacity" and "expected lost earnings." "Choice" implies that individuals had demonstrated an ability to earn more than actual earnings and had chosen give up those demonstrated earnings in return for other personal objectives.

(2) Both proponents and opponents of the "earning capacity" concept would be likely to use earning capacity arguments in cases when earning capacity in excess of historical or expected earnings can be credibly demonstrated. A difference between earning capacity and expected earnings can be eliminated by assuming that the individual would have chosen to take full advantage of earnings capacity in the future.

(3) In wrongful death analysis, the "choice" element only involves a lost opportunity to have tried to persuade a decedent to have converted an excess of earning capacity over expected earnings into additional expected earnings. However, the fact that a decedent may have been influenced to convert earning capacity into expected earnings if unexpected financial requirements developed implies that excess earning capacity is a type of self insurance. Such self insurance would have some value to survivors, which may possibly be valued in terms of the life insurance cost of acquiring a similar amount of insurance.

(4) If an earnings capacity concept is used in wrongful death analysis, logical consistency requires that estimates of lost nonmarket production be made lower than actual expected amounts, given the fundamental time constraints faced by all persons. In the example of the sister supporting her disabled sister, using an earning capacity concept would unnecessarily reduce the total amount of damages.

Endnotes

1. A survival action is an action in which a death has occurred, but the action "survives" the death into a legal action in which the estate of the decedent may sue for damages on the same basis for recovery as if the decedent were still alive. In a wrongful death action, the standard for recovery is losses to survivors of the decedent. Although many states have paired wrongful death and survivor action statutes, only four states may rely exclusively on survival action statutes to the

exclusion of wrongful death statutes (Connecticut, Georgia, New Mexico and perhaps Mississippi). In paired actions, the survivor action is often limited to the period during which the decedent had been injured, but was still alive. Implicitly, that is treating the period from injury to death as a personal injury under the survival action and the period after death as a wrongful death. In the three or four states that rely exclusively on "survival action" language, the estate is deemed able to recover for the entirety of the decedent's expected life span as if the individual were still living and able to pursue his or her own recovery. Survival action language poses a variety of problems that are not a subject for this paper, but conclusions reached in this paper may not be valid for those states.

2. The sense of "choice" that is being employed here is the sense developed by James M. Buchanan in *Cost and Choice* (1969). Buchanan argues that cost only exists when choices are being made and that the true measure of opportunity cost is the value of the second best alternative at a point of decision. An individual doctor who had been earning $120,000, but had chosen to work for $60,000 is based on an underlying demonstration that a choice has been made. Likewise, the woman who had been making $40,000, but had reduced her work year to nine months at $30,000 had clearly demonstrated that a choice had been made. Conjecturing that a worker *could have chosen* to earn more income by working a second job is inherently speculative precisely because there is no evidence that such a choice was ever made. "Choice," by its nature, is an active process of decision making. Most workers who do not have second jobs have not made active decisions not to do so. They have never considered the possibility. And if they did not consider taking second jobs as possibilities, it becomes very hard to argue that they had true "capacities" to take second jobs.

3. In most states, some of the biggest losers because of a death are unmarried significant others, whether gay partners or unmarried heterosexual partners, and grandchildren. However, if the children of the decedent are living, losses to grandchildren that do not affect children are not compensable, nor do unmarried partners usually have valid claims for recovery. This can lead to the unusual circumstance that the personal consumption of the unmarried mother (or father) of the decedent's children must be subtracted from the decedent's income to determine financial losses to the decedent's children.

4. If a worker worked more years or in a second job, clothing, transportation and meals-at-work costs would rise. Since the reason for extra work is a special financial requirement, it is not likely that the decedent's expenditure on hobbies, travel or recreation would rise. These expenditures might even fall because work activity precluded expenditures in these areas during work periods.

5. This is particularly true if guidance, counsel, care, comfort and companionship are viewed as compensable nonmarket services, as argued by Ireland (1998), Tinari (1998) and Olson and Rodgers (1998). One of the most important services a retired worker may provide for spouse and children is increased companionship, guidance, and counsel, as well as greater opportunities to provide many other types of services, including "domestic" services of various sorts.

6. This is shown in Table 7, page 148 of Martha Hill's contribution to Juster and Stafford (1985).

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