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Offsets in Damages Calculations in Forensic Economics

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Abstract

The area of offsets in forensic economics is a minefield of questions that have not been adequately addressed in case law or in the literature of forensic economics. This short paper sets a framework for understanding how those questions relate to each other.

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I. Introduction--How Offsets Function in Forensic Economics

An offset in forensic economics carries the same meaning as a reduction in damages. Forensic economists are regularly called upon to project pecuniary damages to a plaintiff that result from either a tort, a contract violation or some other violation of existing law. While offsets are also an issue in various types of commercial damages, the focus of this paper is on damages to persons as they would apply in cases involving wrongful death, personal injury or wrongful terminations from employment. Damages are generally grouped in broad categories. Damages typically include both "tangible (economic, pecuniary)" damages and "intangible (non economic, non pecuniary)" categories and economists are typically limited to assessing losses in the tangible, economic, pecuniary categories. Commonly, those categories include: (1) lost money earnings; (2) lost job-related fringe benefits; (3) lost household (family) services; and (4) costs of a life care plan, if necessary. Wrongful death cases and wrongful termination cases would not be likely to include life care plans, though projections of educational costs required by terminated individuals to find future employment may be required are of a similar nature.
The first three of these categories are ex ante categories in the sense that they are losses of values that would have occurred in the absence of the harm being litigated, while the fourth category is an ex post category in the sense that additional expenditures have been made necessary to directly mediate the harm being litigated. In a certain sense, the fourth category is an offset category in that its purpose is to reduce the amount of harm suffered by the injured party.

This paper lays out a framework for considering the issues posed by various types of offsets within and between various tangible, economic, pecuniary categories of damages. The most obvious example would be that a worker is required to mitigate his or her damages by seeking alternative gainful employment. Earnings from that alternative employment are treated as an offset to the amount of earnings loss that would exist if the individual were completely unable to work again in the competitive labor market. Lost earnings are the damages element. Residual earnings are the offset to that damages element. Similarly, if the transfer between employments made necessary by the harm causes an individual to receive a lower valued package of job-related fringe benefits, the value of the post-harm package of job-related fringe benefits is treated as an offset to the value of the pre harm package of job-related fringe benefits. These examples are simple and straight forward, there are many complex problems buried within the offset issue. In this simple example, what if the post-harm package of fringe benefits is superior to the pre-harm package of fringe benefits. Does it follow that the net increase in the value of the fringe benefits after the injury should be subtracted from the value of the lost money earnings based on a comparison between pre-harm earnings and post-harm earnings. In other words, should the gain in the value of one element--fringe benefits--be subtracted from the loss in another element--lost money earnings? Both of these elements are part of earning capacity, so there may be an argument that the gain in value of fringe benefits should be subtracted from money earnings damages. However, would this extend to the point of suggesting that since an individual is totally disabled from work in the competitive labor market, there should be an offset for the additional household services the individual could produce? Forensic economists who might argue for the former might well argue against the latter. Other complexities will be considered below.

II. Offsets versus the Collateral Source (Benefits) Rule and Equivalents

Certain offsets are prohibited by the collateral source rule. The collateral source rule has a very specific meaning in the case of insurance purchased by an injured claimant. If a claimant purchased insurance to cover the type of injury in litigation, the fact of that insurance cannot be introduced in court and the proceeds of the insurance cannot be treated as an offset in a calculation of damages. There are several reasons why such a prohibition exists. First, one would not want the legal system to penalize those who purchase insurance coverages by giving lower awards due to the insurance offset. Second, to the extent that laws are designed in part to encourage care taking, it is useful to have tort malfeasors pay the full costs of the harms that they cause. However, California allows full consideration of collateral benefits from insurance to be introduced as offsets in medical malpractice circumstances and other exceptions to the collateral source rule also exist. However, when the collateral source rule applies, it often does have the effect of providing windfall gains to the claimant.

The application of the collateral source rule becomes even more complex when the collateral benefits can be regarded as in some sense "gratuitous" [Posner, 1998, p. 219-220]. This will often be the case with coverages that were provided by employers who may be the defendants in cases involving worker claimants. If a defendant employer provided disability insurance as a fully paid job-related fringe benefit, one like of logic would suggest that the defendant employer should be entitled to introduce the existence of ongoing disability insurance payments as an offset against lost earnings. Similarly, if life care of an individual is being provided by insurance purchased by an employer, this same logic would suggest that the insurance benefit should be treated as an offset to the costs of the life care plan. Posner, however, points out that such job-related fringe benefits are often paid for by the beneficiary indirectly. In Posner's words: "If an employer gives his injured employees medical treatment free of charge, this means only that the employer pays for their labor partly in money and partly in kind, so that the money wage would be higher if the “gratuitous” benefits were lower.

Coming back on the other side of this issue yet again, it could be that employers would want to purchase their own insurance against future tort claims by purchasing automatic coverages for their employees. Such coverages would provide benefits to employees, but also to employers for reasons unrelated to compensating employees. In other words, employers, because they could benefit directly from such coverages if allowed to claim them as offsets in tort actions, would provide more than a dollar of such benefits in lieu of a dollar of money wages. If a collateral benefit rule applies strictly, the employer would be induced to purchase tort insurance instead of disability insurance for workers as a way of insuring against future tort claims. It might be that the purchase of disability insurance for workers is a more efficient way of providing for such coverages if offsets are allowed. If so, this application of the collateral benefits rule would be socially inefficient.

However such questions are resolved, there are rules based on the collateral source rule that regulate which offsets can be considered and which cannot, and under what circumstances. Forensic economists must be aware of the possibility of such rules and make their calculations accordingly.

There are equivalents for the collateral source rule in other areas. In most states, but not Wisconsin, the fact of a remarriage cannot be introduced to allow offsets from the new marriage for lost financial support and lost services that would have been provided in the old marriage if a wrongful death had not occurred. A new spouse will provide a new source for financial support and a new source for services that would not have existed if the wrongful death had not occurred. However, most states have ruled that remarriage cannot be mentioned, let alone used as an offset. Indeed, several of state supreme courts have made rulings on the very narrow issue of whether a widow, having remarried, can be allowed to use her prior married name during a trial for damages from the death of her prior husband even though she has remarried and now has her new husband's legal name.[1]

This issue also arises within the context of marriage. The question is whether, in the event of the wrongful death of a spouse, the income of the surviving spouse should be considered in determining the reduction for personal consumption of the decedent. The collateral source argument is that monies being spent by the surviving spouse on the decedent were collateral benefits that should not be treated as an offset to losses of that spouse in a case of wrongful death. That argument has been accepted by the California Court of Appeals in *Overly v. Ignalls Shipbuilding, Inc*. (1999), but was rejected by the 9th Circuit Court of Appeals for federal applications in *Howard v. Crystal Cruises, Inc.* (1994). In most legal venues, this is an issue for which there are no ruling precedents.

III. What Offsets are Required as Mitigation

For lost earnings, most states require that a worker seek replacement employment if injured badly enough that they cannot return to their old jobs, but still retain residual earning capacity. This is called the "mitigation requirement." However, the requirement to seek mitigating employment is not unlimited. A worker who has been a bank president may not

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[1] Wood v. Detroit Edison Company, 409 Mich. 279 (1980); Watson v. Fischbach, 54 Ill.2d 498 (1973); and Dubil v. Labata, 52 N.J. 255 (1968).

expected to seek employment as a fast food worker to modestly mitigate his damages. Likewise, some states have requirements in termination cases that a worker is not required to mitigate his losses by traveling more than fifty miles from his home for alternative employment.

Mitigation can also play a role in lost services, though there is very little case law on how this should actually work. If, for example, a husband develops an allergy because of chemical exposure, the husband may not be able to cut the lawn. This represents a loss of the services the husband can provide, but it may not preclude him from taking on alternative tasks in the home that his wife formally provided so that she can now cut the lawn, with minimal loss of services to the family unit as a whole. In the absence of litigation, this is very likely to be what happens. However, it is an open question whether the family is responsible to mitigate the loss of services in this fashion.

A general conclusion is that mitigation requirements place important constraints on what may be considered as offsets, but this area is quite unexplored in law or forensic economic analysis.

IV. Offsets in Lost Money Earnings Damages

As a general rule, workers are expected to mitigate their lost money earnings damages. There are some limitations with respect to the types of employment they are expected to take, which varies with the type of litigation involved. Required mitigation is different in wrongful termination cases than it is in personal injury cases. Further, the requirement to mitigate may have unusual impacts on damages. Railroad workers who have twenty years (240 months) of railroad credits are eligible for occupational disability pensions from the Railroad Retirement Board. Case law is conflicting about whether such disability pensions are covered by collateral source prohibitions. However, if these pensions are covered by collateral source, they create an unusually bizarre environment for damage assessments. Both sides may hire both vocational and economic experts to calculate mitigation earnings, but both sides fully understand that the worker is already receiving an occupational disability pension and will not take mitigating employment once the trial over damages is concluded. The arguments are about the hypothetical earnings the worker would have if he chose to go to work. The present values of those hypothetical amounts will be offsets introduced by the parties as reductions to the value of lost money earnings.

Other offset issues involving money earnings include: (1) the types of work expenses should be subtracted as offsets to lost earnings, including such non monetary differences as travel time; and (2) the way taxes are affected by the nature of wards made for the harm, which directly affect the money amounts necessary to accomplish full compensation.

V. Offsets in Job-Related Fringe Benefits Damages

The valuation of job-related fringe benefits is rather casual in most forensic economic damages reports. Most fringe benefits take the form of various insurance coverages, which in their broadest perspective include all types of pension benefits as well as coverages normally thought of as “insurance.” An benefit that depends on a contingency for payment is an insurance benefit. This may include standard insurance forms such as medical, dental and vision coverage, disability insurance and life insurance, but it also includes all pension plans in which there are life contingent elements. The only fringe benefits that do not take insurance forms are benefits like heath club memberships, company provided automobiles, company paid vacations and so forth which depend only on the harmed persons continued employment. Typically, forensic economists like to rely on general percentages for fringe benefits, but there can be substantial differences between the value of fringe benefit packages before and after a harm has occurred. Further, these general percentages are often based on employer cost values rather than true values to employees. As such, they are not reasonable proxies for the job related-fringe benefits that an individual has actually lost as a result of a harm. However, to the extent that losses are to be claimed, some effort must be made at providing "before" and "after" valuations for fringe benefits.

There is also an "activation" issue. If a worker has activated an insurance coverage, which is providing ongoing benefits, it is hard to argue that the individual has "lost" the value of that fringe benefit. In other words, "activation" may constitute a one hundred percent offset to the lost value of the ongoing insurance coverage because the maximum benefit under the coverage has not only not been lost, but is providing more benefits than it would have provided in the future.

VI. Offsets in Family Service/Household Service Provision Damages

As indicated earlier, it is not clear how mitigation requirements work in the case of family/household services. If an individual has been injured in such a way that he or she cannot perform some family services, but retains the ability to perform others, there can be substitution of tasks among family members. Whether that is required is a matter of state law, but New York has largely limited recovery for household services to replacement services for which the family has actually purchased or is likely to replace in the future. Such a requirement implies that lost services are only compensable if they are lost to the family unit as a whole, and then only if the family unit expends or would be likely to expend money to replace them. In most other states, recovery is more general, but individual judges sometimes decide that calculations made by forensic economists involve assumptions that make those calculations too speculative to be admissible. In effect, that is applying the New York standard in other states. Mitigation is broadened to include not only those services that can be replaced by substitution among family members, but also those services the family demonstrates that it can do without by not purchasing replacements for them.

VII. Offsets in Life Care Plan Damages

Some of the most extensive discussions about offsets have involved the area of life care plans. Life care plans fall into the ex post category of expenses made necessary because of the harm, rather than the ex ante standard of losses of benefits that would have existed if the harm had not occurred. Life care plans provide remedial benefits and not replacement compensations. However, items provided for in life care plans replace functions that individuals would have provided for themselves if the injury had not taken place. The primary arguments among forensic economists have centered around wheel chair adapted vans, disability accessible housing, and food and shelter provided in institutions. The opposite sides of this debate are provided by Tinari (1995) and Feldman and Egge (1995).

Tinari argues that vans provide a transportation replacement for passenger automobiles, that disability accessible housing provides a housing replacement for non disability accessible housing and that food and shelter provided to an institutionalized individual replace income expenditures an individual would have made on these items if not institutionalized. Feldman and Egge, on the other hand, question whether the replacement items are enough like the pre injury items to be comparable in utility terms. Is transportation in a wheel chair adapted van really a legitimate substitute for a passenger automobile, particularly if the passenger automobile was a sports car with extra features designed to increase the utility of transportation. Similar questions can be asked about disability accessible housing when an individual was forced to give up a housing arrangement that provided a great deal of personal satisfaction. Food in an institutional environment is greatly different from food expenditures in a non institutionalized environment. People do not just go to restaurants to fuel themselves, but to enjoy ambiance which is not separable from the cost of food itself. The Feldman-Egge position can be summarized by saying that functional replacement is not the same thing as utility replacement, raising serious questions as to whether there should be offset reductions for any items included in a life care plan.

There are also extensive discussions of offsets in life care plans in the archives of the NAFE-L listserve.

VIII. Offsets between Damage Categories

The life care issue also poses a general question about offsets between damages categories are (1) legitimate and (2) allowed by law. Does the law really allow reductions in the form of offsets to lost earnings based on the fact that a life care plan provides for transportation, shelter, or food. If, for example, one carries the functional offset argument far enough, a catastrophically injured individual lying in a bed in an institution is provided with his or her food, shelter, entertainment, transportation (albeit none), and almost all other things on which individuals make expenditures from their incomes. At that extreme, damages would be awarded only for support the individual would have provided to family members if not in the institution. If the law does require offsets, it seems likely that the required offsets do not reach that level. However, there is no case law indicating appropriate boundaries, however hard they might be to use if indicated.

A similar problem with inter-category offsets is the situation mentioned at the outset of this paper. An individual’s injuries are sufficiently great that he or she is fully disabled from labor market employment. As a result, a large amount of time has been freed up during which household services could be provided. A husband who was a primary bread winner for his stay at home wife and mother could theoretically become the stay at home parent and be able to fill most of his wife's functions in that regard. Would the wife's potential earnings then become a legitimate offset to the lost earnings of the husband? Here again, the law is not clear, no one has ever mentioned an instance in which such a wife's earnings were treated as an offset to her husband's lost earnings.

VIX. Conclusion

The area of offsets is a minefield of unanswered questions.

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