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Harman: Loss Of Future Earnings: Present Worth Versus Wage Growth

# LOSS OF FUTURE EARNINGS: PRESENT WORTH VERSUS WAGE GROWTH

Steven J. Harman

## INTRODUCTION

In a tort action, the plaintiff is generally entitled to compensation for all losses sustained at the hands of the defendant.<sup>1</sup> Because the plaintiff is awarded a single lump sum, the award must reflect not only past and present damages, but also damages expected to be incurred in the future. Where the injury results in death or permanent disability, future damages more than likely will include loss of future earnings. The doctrine of reducing future earnings to their worth plays a significant role in determining the present amount that the plaintiff will receive for the estimated loss of future earnings.

The scope of this note is to examine the concept of reducing future earnings to their present worth in Montana and its validity in light of the current rate of wage growth. *Resner v. Northern Pacific Railway*,<sup>2</sup> a recent Montana supreme court case in which the jury was allowed to consider the possibility of future wage growth in computing the loss of future earnings, will be discussed in some detail.

## REDUCING FUTURE EARNINGS TO PRESENT WORTH

### ILLUSTRATION

"It is self-evident that a given sum of money in hand is worth more than the like sum of money payable in the future."<sup>3</sup> This is the premise upon which reduction of future earnings to present worth rests. The following illustration will aid the economic neophyte in understanding the mechanics of reducing an estimated future loss to a present value.<sup>4</sup>

Suppose a plaintiff is permanently disabled, and is unable to work for the remainder of his life. If prior to his injury he earned \$20,000 per year and assuming that he would have earned that salary for another 20 years, he sustained at least \$400,000 in future damages.<sup>5</sup> Should he be awarded a \$400,000 lump sum? The answer is no. The rational is

<sup>1</sup>REVISED CODES OF MONTANA, § 17-401 (1947).

<sup>2</sup>*Resner v. Northern Pacific Railway*, ..... Mont. ...., 505 P.2d 86 (1973).

<sup>3</sup>*Chesapeake and Ohio Railway v. Kelly*, 241 U.S. 485, 489 (1916).

<sup>4</sup>*See*, D. DOBBS, REMEDIES § 8.7 (1973); R. LEASURE, HOW TO PROVE REDUCTION TO PRESENT WORTH, 21 Ohio St.L.J. 204 (1960), reprinted in S. SCHEIBER, DAMAGES 472 (1965).

<sup>5</sup>In reality a person would not be expected to earn a constant income. For example, for the estimated average annual earnings, including fringe benefits of all males with one to three years of college, by age, see, U.S. BUREAU OF CENSUS, CURRENT POPULATION REPORTS, Series P-60, No. 74, ANNUAL MEAN INCOME, LIFETIME INCOME, AND EDUCATIONAL ATTAINMENT OF MEN IN THE UNITED STATES, FOR SELECTED YEARS 1956 to 1968, (U.S. Government Printing Office, Table 9, Page 35).

that the plaintiff, if presently awarded the entire sum, could safely invest it at 5% annual interest thus producing \$20,000 income per year leaving the principal intact after 20 years. Double recovery? It certainly is. Common sense dictates that the plaintiff ought to receive a sum which is capable of producing \$20,000 per year by using both principal and interest so that at the end of 20 years neither principal nor interest remains.<sup>6</sup> In order to accomplish this result, it is necessary to discount (reduce) the estimated future earnings by a figure which represents the interest which would accumulate on a "safe" investment.<sup>7</sup> The discounted figure would represent the present worth of the plaintiff's future earnings. Based on a discount figure of 5%, an estimated future earnings loss of \$400,000 would be presently worth \$254,600.<sup>8</sup>

#### MONTANA LAW

Montana is in accord with the generally accepted rule that damages for loss of future earnings must be reduced to their present worth.<sup>9</sup> This rule applies in both personal injury<sup>10</sup> and wrongful death<sup>11</sup> actions. Intangible future damages such as future pain and suffering are not reduced to a present value since they are incapable of being ascertained by a fixed standard.<sup>12</sup> Montana courts recognize the importance of providing a guide or formula by which the jury can calculate the present worth of future damages.<sup>13</sup>

The stock instruction given by the judge concerning reduction of future earnings to present worth first requires the jury to find the

<sup>6</sup>See, *Hollingsworth v. Davis-Daley E. C. Co.*, 38 Mont. 143, 99 P. 142, 149 (1909); *DOBBS*, *supra* note 4 at § 8.7.

<sup>7</sup>In *Chesapeake and Ohio Railway v. Kelly*, *supra* note 3 at 490, the United States Supreme Court stated: ". . . we do not mean to say that the discount should at what is commonly called the 'legal rate' of interest as the rate of interest on a 'safe' investment." However, some courts use the "legal rate" of interest as the rate of interest on a "safe" investment. *Kitchens v. Hall*, 116 Ga.App. 41, 156 S.E.2d 920, 922 (1967); *Troncatti v. Smereczniak*, 210 Pa.Super. 329, 231 A.2d 886, 889 rev'd on other grounds, 428 Pa. 7, 235 A.2d 345 (1967). In Montana the court allows the jury to select an appropriate interest rate. *Resner v. Northern Pacific Railway*, *supra* note 2 at 89.

<sup>8</sup>P. WENDT and A. CERF, TABLES FOR INVESTMENT ANALYSIS at 53 (1966).

<sup>9</sup>*Resner v. Northern Pacific Railway*, *supra* note 2 at 89; *Cornell v. Great Northern Ry. Co.*, 57 Mont. 177, 187 P. 902, 904 (1920); *Hollingsworth v. Davis-Daley E. C. Co.*, *supra* note 5 at 149, *Bourke v. Butte Electric and Power Co.*, 33 Mont. 267, 83 P. 470, 476 (1905).

<sup>10</sup>*Fulton v. Chouteau County Farmer's Co.*, 98 Mont. 48, 37 P.2d 1025 (1934).

<sup>11</sup>*Olson v. Montana Ore Purchasing Co.*, 35 Mont. 400, 89 P. 731 (1907).

<sup>12</sup>*Bourke v. Butte Electric and Power Co.*, *supra* note 8 at 476. In this case the court stated: ". . . [H]owever, the elements of physical and mental pain and suffering are entirely uncertain, and no fixed standard can be established for ascertaining the damages occasioned by them."

<sup>13</sup>In *Zanos v. Great Northern Ry. Co.*, 60 Mont. 17, 198 P. 138, 140 (1921) the court noted: ". . . but, in the instruction no rule or guide or suggestion was made to the jury as to how it was to comply with this requirement (reduction to present worth). This matter was one before this court . . . and we go no farther here than to call attention to those decisions." citing *Bourke v. Butte Electric and Power Co.*, *supra* note 8 at 476.

"dollar value" of the future damages.<sup>14</sup> Determining the "dollar value" involves two separate findings by the jury: 1) the amount of the loss (\$20,000 above) and 2) the length of the loss period (20 years above). Each calculation involves its own considerations.

In determining the amount of the loss, evidence of past salaries<sup>15</sup> and certain wage agreements indicating wage growth<sup>16</sup> is admissible. In some cases where the plaintiff is only partially disabled, thus able to earn only a fraction of his previous salary, the courts hold that ". . . he is entitled to an annuity equal to the difference between his annual earnings before his injury, and the amount, if any, he might be able to earn thereafter."<sup>17</sup> In one case the loss of a left hand reduced a railroad worker's earning capacity to half his previous annual salary.<sup>18</sup> Also, advancing age should be considered especially where the plaintiff's earning ability depends on his physical condition.<sup>19</sup> In *Krohmer v. Dahl*<sup>20</sup> the decedent was not earning a steady income as he was attending college at the time of his death. The court held that evidence of an expert in the field of economics was admissible to provide the jury with a guide or basis upon which to estimate the loss of future earnings.<sup>21</sup> As evidenced by the following quote, the court in *Krohmer* recognized the difficulty in determining the amount of the loss:

No general rule can be formulated that would control the admission of evidence to prove a man's future earning capacity. It must be arrived at largely from probabilities; and any evidence that would fairly indicate his present earning capacity, and the probability of its increase or decrease in the future ought to be admitted.<sup>22</sup>

The second determination which the jury must make in arriving at the "dollar amount" of the future earnings loss is the length of the period of the loss. Of the few Montana courts which discuss the figures considered by the jury in estimating the loss period, the life expectancy of the injured person or decedent was often used.<sup>23</sup> Often mortality tables were presented as the sole basis in determining life expectancy.<sup>24</sup> Later cases indicate that while mortality tables are competent evidence in determining the life expectancy of a person, they are not to be con-

<sup>14</sup>MONTANA JURY INSTRUCTION GUIDES, § 34.01.

<sup>15</sup>*Lewis v. Northern Pacific Ry. Co.*, 36 Mont. 207, 92 P. 469, 475 (1907).

<sup>16</sup>*Resner v. Northern Pacific Railway*, *supra* note 2 at 89, 90.

<sup>17</sup>*Lewis v. Northern Pacific Ry. Co.*, *supra* note 15 at 475, 476.

<sup>18</sup>*Id.*

<sup>19</sup>*Id.* at 475.

<sup>20</sup>*Krohmer v. Dahl*, 145 Mont. 491, 402 P.2d 979 (1973).

<sup>21</sup>*Id.* at 981.

<sup>22</sup>*Id.* at 982.

<sup>23</sup>*Cornell v. Great Northern Ry. Co.*, *supra* note 9 at 904; *Lewis v. Northern Pacific Railway*, *supra* note 15 at 475; *Robinson v. Helena Light and Ry. Co.*, 38 Mont. 222, 99 P. 837, 846 (1909); *Moyse v. Northern Pacific Railway Co.*, 41 Mont. 272, 108 P. 1062, 1069 (1970).

<sup>24</sup>*Boyle v. Bawls Electric and Power Co.*, *supra* note 9 at 476.

sidered as conclusive guides to the jury.<sup>25</sup> Determining life expectancy is not an exact science. As one court noted:

Even with the aid of these tables, therefore, the finding of the jury must necessarily be based upon considerations more or less speculative in character, and they must be left the exercise of their discretion unlimited by any fixed standard . . . there is no standard by which to determine the amount of damages to be awarded other than the intelligence of the jury. . . .<sup>26</sup>

After determining the loss period, this figure is multiplied with the loss amount and the resulting figure represents the "dollar amount" of the loss of future earnings. The next step is to reduce this amount to present worth. As to how to make this reduction, a Montana jury would probably be instructed as follows:

Present cash value is determined by a method of discount. It is a present sum of money which, together with what money may reasonably be expected to earn in the future for the period you have determined (name of person) will suffer such loss, when invested at a reasonable rate of return, will produce the dollar equivalent of such future damage. Because of this discount requirement, the present cash value of future damage will be a lesser sum than the amount you have found to be such a future damage.<sup>27</sup>

Expert testimony may be presented to determine what constitutes a "reasonable rate of return."<sup>28</sup> In Montana the trend appears to be at least 5 per cent.<sup>29</sup> The 5 per cent figure will then be used to reduce the future earnings to their present worth.

In Montana, future earnings are currently being reduced to a present value, although it appears that recently some erosion of the rule is taking place. The erosion is stemming from the field of economics.

### WAGE GROWTH AS AFFECTING THE PRESENT WORTH RULE THE ECONOMIST

Economists have concluded that the earnings of an individual will increase rather than remain constant as was assumed to be the case in the illustration above. Therefore, in order to fully compensate the plaintiff, allowance ought to be made for normal wage growth. The effect of this conclusion is that rate of the future wage growth may offset the discount rate, thus leaving the loss amount unchanged. In order

<sup>25</sup>Moyse v. Northern Pacific Railway Co., *supra* note 23 at 1069; Robinson v. Helena Light and Ry. Co., *supra* note 23 at 846.

<sup>26</sup>Cornell v. Great Northern Ry. Co., *supra* note 9 at 905. In *Robinson v. Helena Light and Ry. Co.*, *supra* note 9 at 846, the court relied on the following statement from Morrison v. McAtee, 23 Or. 530, 32 P. 400: ". . . the constitution, habits, and health of individuals differ essentially, and must be taken into consideration in estimating the probable length of life of any given person, and therefore no ordinary table of expectation of life . . . can be taken as the correct rule for estimating the value of the life of any particular individual."

<sup>27</sup>MONTANA JURY INSTRUCTION GUIDES, § 34.01.

<sup>28</sup>Resner v. Northern Pacific Railway, *supra* note 2 at 88; Krohmer v. Dahl, *supra* note 20 at 981, 982.

<sup>29</sup>Resner v. Northern Pacific Railway, *supra* note 2 at 89.

to better understand this proposition, the following brief explanation provided by Dr. John P. Henderson<sup>30</sup> will be helpful.

Dr. Henderson concludes that:

In general, productivity and inflation are the two primary causes for the increase in money earnings. Of the average annual increase in hourly compensation of 54 per cent between 1946 and 1971, approximately 2.2 per cent results from increases in productivity, and 3.2 per cent results from inflation. During the recent period of marked inflation, 1968-1971, the influence of productivity has diminished. From 1946 through 1966, the average annual increase in compensation was 5.2 per cent, of which 50 per cent was due to the increase in productivity (2.6 per cent) and 50 per cent to inflation (2.6 per cent).<sup>31</sup>

Increased productivity and inflation were the reasons for wage growth in the past and Dr. Henderson believes that both causes of wage growth will continue in the future.<sup>32</sup> The rate of increase appears to be roughly 5 per cent.<sup>33</sup> By increasing the estimated future earnings loss by 5 per cent to allow for future wage growth, one can readily deduce that this computation would offset discounting the same amount by 5 per cent, thus leaving the future loss amount unchanged.<sup>34</sup> This is the situation

<sup>30</sup>John P. Henderson, Professor of Economics, East Lansing, Michigan.

<sup>31</sup>Henderson, *The New Economics and the Law of Damages*, EXPERTS IN LITIGATION 105, 106 (1973).

<sup>32</sup>*Id.* at 108, 113. At page 113, Dr. Henderson concludes: ". . . [I]nflation is undeniably a controversial topic, but the controversy centers not on the issue of whether the price level will rise, but on the rate of increase of prices . . . [T]he Nixon economic policy would be considered a huge success if the increase in prices were held to 3 to 4 per cent per annum; no one foresees the current structure of the economy providing an increase below this rate."

<sup>33</sup>Henderson, *supra* note 32 at 105, 106. See also *Eesner v. Northern Pacific Railway*, *supra* note 2 at 89.

<sup>34</sup>"The idea that a 5 per cent increase in the earning capacity of an individual offsets a 5 per cent reduction to present value was demonstrated by the decision of Judge Noel P. Fox of the United States District Court in the Western District of Michigan in *Pierce v. New York Central Railroad Company*, 304 F. Supp. 44 (W.D. Mich. 1969) . . . The court of appeals vacated the award and remanded 'for clarification as to the findings and a clear statement of whether and how the Michigan rule requiring reduction of future damages was applied.' 409 F.2d 1392, 1399 (6th Cir. 1969). In his supplemental opinion on the cause of the vacated award, Judge Fox discussed his reason for not discounting to present value:

In the oral opinion rendered, the court attempted to show that it was offsetting a consideration of inflation against the present worth rule. At page 14 of the oral opinion it was said, 'Now, we have in Michigan a rule that future damages should be brought down to present worth. But we do also know that inflation and the ever climbing gross national product has pretty well balanced out reduction of damages of future earnings, or loss of future earnings to present worth.' The mathematics of the computation are quite simple. Using the element of loss or earning capacity, which the court concluded to be \$2,500 for 35 years, or \$87,500, a reduction to present worth would have resulted in a figure of \$49,775 . . . . However, assuming an average inflationary trend of five per cent a year, any reduction to present worth was offset . . . . Therefore the court, fully mindful of the Michigan present worth rule, took into consideration the inflationary trend of our nation's economy and merely made an appropriate offset. The amount of damages should remain the same . . . .

For example, if one assumes that an invested dollar will earn five per cent interest per annum then that dollar will increase to \$2.30 after 26 years. However, if the purchasing power of a dollar is reduced five per cent per annum, 26 years hence it will require \$2.30 to purchase what it presently costs \$1.00 to buy. 304 F. Supp. at 46. (Notes omitted)." Henderson, *supra* note 32 at 118,

that the Montana supreme court was faced with in *Resner v. Northern Pacific Railway*.<sup>35</sup> A brief discussion of this case and an interesting Alaskan case<sup>36</sup> will provide insight into how courts have reacted to evidence of wage growth and its affect on reduction of a future value to its present worth.

#### RESNER V. NORTHERN PACIFIC RAILWAY

Herbert T. Resner was killed as a result of the negligence of his employer, Northern Pacific Railway. The jury returned a verdict for Resner's widow in the amount of \$175,000. In answer to several special verdict questions, the jury found that 5 per cent was a reasonable rate of increase in wages and prices and considered this figure in determining the loss of future earnings. The jury also found that 5 per cent was a reasonable figure with which to discount future earnings to present worth. Both figures were based on the expert testimony of Dr. George B. Heliker.<sup>37</sup>

The defendant filed a motion for entry of judgment requesting that the award be reduced. Defendant contended that the jury ought not be allowed to speculate on future wage increases and to offset those increases against the discount to present worth figures. The trial judge agreed with the defendant's contentions and reduced the award to \$91,740.49; nearly half of the original verdict.

In determining whether or not the trial judge erred in admitting evidence of future wage growth, the court looked at some length at the testimony of Dr. Heliker. Dr. Heliker testified that wages could be expected to increase approximately 5 per cent in the future for the same reasons that Dr. Henderson concluded above: 1) man's productivity has increased between 3 and 3½ per cent in the past, and 2) prices have increased at a rate of between 1 and 1½ per cent over the same period.<sup>38</sup> Dr. Heliker commented that when these two percentages are added together they produce ". . . just about exactly the rate of increase from wages, about 5 per cent or a little more . . . here is what happened in the past and, as far as I can see, this same thing is going to happen in the future."<sup>39</sup> He also testified that 5 per cent was a reasonable discount figure. The end result was that the wage increase figure offset the discount figure, leaving the estimated future loss amount unchanged. After discussing Dr. Heliker's testimony, the court held that it was properly admitted because it provided a basis upon which the jury could estimate the loss of future earnings.<sup>40</sup>

<sup>35</sup>*Resner v. Northern Pacific Railway*, *supra* note 2.

<sup>36</sup>*Beaulieu v. Elliot*, 434 P.2d 665 (1967).

<sup>37</sup>George B. Heliker, Professor of Economics, University of Montana, Missoula, Montana.

<sup>38</sup>*Resner v. Northern Pacific Railway*, *supra* note 2 at 89.

<sup>39</sup>*Id.*

The court next rejected the defendant's contention that future wage increases were "speculative" and "conjectural." In support of this rejection the court relied on the following passage from *Lavender v. Kurn*,<sup>41</sup> a United States Supreme Court case:

It is not answer to say that the jury's verdict involved speculation and conjecture. . . . Only where there is a complete absence of probative facts to support the conclusion reached does reversible error appear. But where . . . there is an evidentiary basis for the jury's verdict . . . the appellate court's function is exhausted.<sup>42</sup>

Here, Dr. Heliker's testimony provided the basis for the jury's verdict. Furthermore, the court discussed cases where evidence of inflation had been considered by juries in determining future wage increases.<sup>43</sup> More specifically, *Scruggs v. Chesapeake and Ohio Railway Co.*<sup>44</sup> was cited with approval for the following proposition:

The question before the jury was the pecuniary loss which would be suffered by the plaintiff . . . in the future. The probability of increases in decedent's income was certainly relevant to that issue. It seems unlikely that their conclusion will be any less valid from having heard the testimony objected to, and they may be much more correct than otherwise. Inflation is a topic of almost universal discussion and it seems improbable that the jury could avoid taking it into account even in the absence of any testimony about it. . . .<sup>45</sup>

In short, the *Resner* court held that the jury may consider wage growth in determining loss of future earnings and expert testimony is admissible to indicate the rate of wage growth.

Does this mean that the defendant has no recourse but to pay more where loss of future earnings are involved? *Resner* indicates this result, although the court did recognize that the defendant could bring in experts of his own to testify as to the rate of wage increases.<sup>46</sup> But is there any need to undertake this battle of experts? If, as it appears to be the case, the wage growth rate and the discount rate are fairly equal, it would be meaningless to have both sides produce experts to predict the foregoing figures. Reducing future earnings to present worth would be an exercise in futility. Yet, Alaska appears to be the only state which has abandoned the concept of reducing future earnings to their present worth.<sup>47</sup> The rationale of the Alaskan court in *Beaulieu v. Elliot*<sup>48</sup> is particularly appealing in its logical simplicity as the following passage indicates:

. . . we believe that the rule for reducing awards . . . ignores facts which should not be ignored. Annual inflation has been with us for many years. There is no reason to expect that it will not be with us

<sup>41</sup>*Lavender v. Kurn*, 327 U.S. 645 (1946).

<sup>42</sup>*Id.* at 653.

<sup>43</sup>*Grunenthal v. Long Island Ry. Co.*, 393 U.S. 156 (1968); *Scruggs v. Chesapeake and Ohio Railway Co.*, 320 F. Supp. 1248 (W.D. Vir. 1970).

<sup>44</sup>*Scruggs v. Chesapeake and Ohio Railway Co.*, *supra* note 42.

<sup>45</sup>*Id.* at 1250, 1251.

<sup>46</sup>*Resner v. Northern Pacific Railway*, *supra* note 2 at 91.

<sup>47</sup>*Beaulieu v. Elliot*, *supra* note 37.

in the future. . . . This rate of depreciation offsets the interest that could be earned on "safe" investments. As a result the plaintiff . . . must, in order to realize his full earnings and not be penalized by reduction of future earnings to present value, invest his moneys in enterprises, other than those which are considered "safe" investments, which promise a return in interest or dividends greater than the offsetting rate of annual inflation.<sup>49</sup>

The court would not ask the plaintiff to put himself in a risky investment situation. The court held that justice could only be accomplished by allowing the jury to determine loss of future earnings without reduction to present worth.<sup>50</sup> This rule has been praised for its simplicity and criticized for its rationale.<sup>51</sup> The *Resner* court quoted the same passage as the one from *Beaulieu* above, yet refused to accept it.<sup>52</sup> Therefore, one can safely conclude that Montana judges will continue to instruct juries to reduce loss of future earnings to present worth.

### CONCLUSION

The rule of reducing loss of future earnings to present worth was formulated to avoid overcompensating the plaintiff. More specifically, the estimated loss of future earnings had to be reduced to a present amount which would produce a predicted income for the plaintiff by using both the principal amount and the interest it would accumulate. This reasoning, however, completely ignores the fact of normal wage growth due to increases in productivity and inflation. This fact ought to be considered in order to adequately compensate the plaintiff for his future damages. Moreover, as the court in *Beaulieu* reasoned, since it appears that the discount rate and the rate of increase of money earnings will remain fairly equal, there is no need to reduce loss of future earnings to their present worth.<sup>53</sup> Also, if the *Beaulieu* approach is followed the burden on the jury would be considerably lightened. With the present Montana rule set out by *Resner*, the jury could conceivably have to make four separate determinations: 1) the amount of the loss; 2) the length of the loss period; 3) the discount figure; and 4) the rate of wage growth. If *Beaulieu* were followed in Montana, the jury would have to determine only the amount of the loss in the base year and the loss period.

The rule of reducing loss of future earnings to present worth ought to be eliminated for two reasons: 1) the rule ignores the rate of wage growth, thus risking undercompensation of the plaintiff, and 2) the jury's burden would be considerably lightened.

<sup>49</sup>*Id.* at 671.

<sup>50</sup>*Id.*

<sup>51</sup>DOBBS, REMEDIES, *supra* note 4 at § 8.7.

<sup>52</sup>*Resner v. Northern Pacific Railway*, *supra* note 2 at 91.

<sup>53</sup>Beaulieu v. Kirk, 1974 Mont. 1, 535 P.2d 1001, 53 Mont. 275 (1974) as a flat projection of base earnings.