

# But Do You Really Need an Economist?

By Howard A. Kapp

There is a widely-held assumption in cases claiming future economic losses (usually future loss of earnings or medical costs) that an economist is necessary for the plaintiff's case. This assumption is commonly wrong, subject to important exceptions, which are addressed below. In fact, the result of economic testimony may even be *damaging* to the plaintiff.

## The Economist as Expert

These days, prepaid no-refund retainers of \$2500 or so are common, if not industry standard, for an economic expert. The general rate for an economist varies from \$200 to \$275 per hour.

The economist's retained time is charged for only two billable events – preparation of the report and trial testimony – since the deposition charge is borne by the opposing party. Economists are well-educated people deserving of appropriate fees for services; the question is whether an economist is really needed, or even potentially helpful, in a given lawsuit. The answer depends on the case.

## Consider an Accountant Instead of an Economist

Many plaintiffs and defense trial attorneys believe that it is good practice to hire an economist because they can “put big numbers in front of the jury.” This is a dangerous and frequently self-defeating trap.

Economists and accountants address different issues in litigation. An accountant is trained and qualified to evaluate and present data relevant to a *given individual or company*; an economist is qualified to discuss economic trends and facts, that is, statistics involving selected groups of people. These are fundamentally different things.

In virtually all substantial personal injury litigation, defense counsel routinely use economists out of habit; that habit commonly is compounded by using the same expert over and over again. The decision to use the wrong financial expert, however, can leave that counsel with expensive, but useless, testimony and create an important evidentiary gap.

If the case involves a plaintiff with little or no employment history (e.g., a child), an economist can make projections based on statistical evidence available from reputable, largely governmental, sources. An economist can thus opine on future wages by evaluating limited personal data. For example, if a small child has an injury which will preclude lifetime employment, the economist can, using such statistics and projections based on the parents' education or economic standing (or other available data), testify that the child probably would have earned at least a bachelor's degree, that, in present terms, the lifetime earnings of the average college graduate would be a certain number of dollars, and then reduce that to present value numbers.

On the other hand, if the plaintiff has a personal track record, is self-employed or has an unusual form of earnings, the accountant is best. In the case of the self-employed plaintiff, the accountant can evaluate records and determine net income. Even if the net income appears to be low, the accountant is ideally suited to explain that the plaintiff was building a business – that is, investing in the future – and that the plaintiff's business plan and projections were reasonable and probably would have generated a higher income over time.

One factor to consider is the complexity of the plaintiff's available records. Generally speaking, the more extensive the records, the more likely that the accountant



Howard A. Kapp practices in the mid-Wilshire area of Los Angeles where he specializes in medical and legal malpractice matters. Mr. Kapp can be reached at [malpractice@lawyers.com](mailto:malpractice@lawyers.com).

is the proper expert for several reasons. There are relatively few private-practice economists and many of them see legal testimony as their bread-and-butter; almost all accountants deal with extensive (and frequently disorganized) financial records. Thus, the accountant is not only better equipped to deal with detailed matter, but is generally less expensive and less vulnerable to a credibility attack as a “professional witness.” Secondly, of course, an economist can only speak in terms of overall *statistics*, but when a given plaintiff has a meaningful track record of employment, statistical projections are neither useful nor necessary.

Finally, consider using an accountant when the plaintiff's work history involves wild, but accepted, fluctuations in income. A textbook example of this form of income is that earned by actors. It is not uncommon for an actor to work only a few days a year during which a high income can be earned; the rest of the time the actor may be seeking further employment (e.g., attending “cattle calls”). During the latter time, the “unemployed” actor lives off this quickly-earned money (i.e., savings and possible residuals) and may even collect unemployment. To an outsider, this might appear to be laziness, pie-in-the-sky or a form of welfare dependence. An accountant can explain that this unusual income stream – or many other unusual earning formats – is not only acceptable, but surprisingly common.

## Determination of "Present Value" – Future Interest vs. Future Inflation

The determination of the value of future losses, which is solely the function of the economist, requires an adjustment – almost always a *reduction* – to "present value." The theory is that, if plaintiff were to be awarded the absolute value of a future loss, that would be a windfall since the awarded sum could be placed in a conservative (no or little risk) investment (commonly U.S. government securities; see, e.g., *Niles v. City of San Rafael* (1974) 42 Cal.App.3d 230, 243-244) and generate interest. The anticipated future conservatively-generated interest represents the "windfall."

In fact, deducting or "backing out" the anticipated future interest is only the first step in determining the present compensation due plaintiff, i.e., its present value. While defense lawyers love to talk of this future interest as "present value," that is just not so. To determine the true present value, or "net discount rate," you must counter the increase of future dollars through interest with the loss of value due to inflation. Future interest alone can radically reduce the plaintiff's recovery for future losses; the inexperienced or uninitiated counsel doesn't even see the sleight of hand.

In fact, present value *must be* determined by a "net discount rate" which, like "net income" is more accurate and useful (and legally required) than "gross income." You need both sides of the equation to generate a number useful to a jury, that is, the present value of the loss.

In the most straightforward case (i.e., a wage-earner with an established and perfectly stable work history), the net discount rate involves knowledge uniquely within the expertise of economists.<sup>1</sup> (*Niles v. City of San Rafael*, *supra*, 42 Cal.App.3d at p. 242-244.) By definition, this is the product of macro economics and not the individual plaintiff:

1. The imputed interest rate (which the defense loves since it always, by definition, reduces plaintiff's future recovery);
2. Inflation (which always *increases* the amount needed to insure that future dollars to be awarded match the present dollars to be awarded). This is

the flip side of interest, which adds value to conservatively-invested money, as inflation *always* depreciates value over time (except in the rare instance of deflation, a situation which always and only corresponds to an historic-level depression).

There are reliable and current governmental and publicly-available resources which track both interest rates (available from the Treasury, since U.S. government securities are generally used as conservative investment for legal purposes) and inflation (available from the Labor Department). Anyone with access to the Internet can quickly determine these factors, *in the past*.

All economists, more or less, rely upon past general economic performance and other statistics (e.g., life and work life statistics) to project future economic activity. Their projections, of course, are frequently at odds with each other even though the logic of their assumptions may appear to be internally valid.<sup>2</sup> Nonetheless, only an economist can opine, or should be allowed to opine, on future economic activity, including future interest rates and inflation even though the crystal ball is hardly a reliable predictor.

Any economist, or indeed student of modern history, can quickly surmise that these numbers are subject to easy manipulation. Interest and inflation rates radically fluctuate over time; compare the inflation rates during the Clinton and Carter years. By selecting the years and sources to be included in the very first level of analysis, the economist can manipulate the outcome (i.e., the present value) to favor the side that hired them. This assumption frequently is casually presented in some footnote to the report as if the use of this period of years or source was generally accepted or beyond dispute. In truth, this is the most common source of number manipulation by economists: they hide the truly biased assumptions from uninformed adverse counsel or jurors. After all, the seemingly benign decisions to use inflation numbers covering 5 or 10 or 20 years, or to use this inflation index or bank rate, may seem to be unimportant or preordained, but this is nothing more than sleight of hand, a follow-the-hidden-ball trick.

Nonetheless, modern economic history (and elementary common sense) has shown

that there is a historic link between the rate of interest and its opposite twin, inflation. In other words, it has been generally true that the higher the inflation rate, the higher the interest rate. Remember: both of these rates must be considered in determining the fair reduction of plaintiff's future losses to present dollars, and they largely offset each other.

The combined result of this offset is called the "net discount rate." Historically, most economists would agree that net discount rate has been roughly 1%, meaning, in lay terms, that a conservative interest-bearing investment should generally generate interest of 1% annually over the inflation rate. Thus, for example, a projected loss of \$10,000 next year should be reduced by 1% or \$100 to \$9900. (Since the reduction compounds, the second year reduction will be \$99, that is, to \$9801.)

Oddly, the "Present Value Table," supplied with BAJI as Appendix B, supplies numbers for the jury beginning at 3%, which is a number having no historical basis. (The numbers on the damage itself are the indisputable results of basic mathematical computation, as demonstrated above.) If used, a 3% discount rate would radically understate the plaintiff's damages. Thus, this table is totally useless and supplying the table to the jury should constitute reversible error. Perhaps, one day, the BAJI committee will substitute a chart beginning at a rate of one-half or one percent, which would be useful.

An unbiased economist must use the same net discount rate no matter the circumstances of the projection; any variation from this, no matter how well-explained, is an invitation to bias. In fact, if counsel has recent prior testimony from an economist (and a cadre of these professional experts testify a lot) using a different net discount rate, the testimony is not only presumably biased and manipulated, but may be excludable on the grounds that it lacks a reasonable scientific basis.

The net discount rate must never vary according to the party status of the hiring side; this is one reason why some economists limit themselves to one side. It is better to be attacked as being party-affiliated than to be shown to be an obvious manipulator of supposedly fixed numbers.

The beauty, from a trial standpoint, of jumping right to the net discount rate is

that the economist is not required to prognosticate *individually* as to future inflation and interest rates which individually may have little credibility in lay jurors' eyes; many lay people recognize that long term projection of money rates is as unreliable and non-scientific as palmistry. Moreover, such individual projections require a graduate thesis to explain, and even then are subject to legitimate attack, if not ridicule, as non-scientific nonsense: If you really had a good formula to project these future rates, you wouldn't need to testify for a living. Any competent cross-examiner ought to be able to convince the jury that such an economist has little credibility.

Thus, many experienced forensic economists will attempt to avoid this confusion by explaining the components of net discount rate (future interest vs. inflation), explain why they can be ignored for the purposes of the present value determination, and go into the meat of their testimony. This itself is potentially dangerous in the hands of a talented cross-examiner or an expert-weary judge.

The mathematical problem, using multiple years and a multiple of equations, quickly becomes tedious. Nonetheless, this is a problem that a diligent algebra student should be able to solve using an ordinary calculator and lots of time; forensic economists, however, use boilerplate computer spreadsheets with these formulae already programmed in by themselves or by another programmer.

Invariably, the compounding affect of the net discount rate is demonstrated by a multi-column table generated by a modern spreadsheet program for each relevant succeeding year. Yet, even at this stage, the numbers may be manipulated by changing some of the assumptions, e.g., the projected earnings or benefits. Commonly, a defense economist will omit benefits (which should be around 15%) or other "unproven" assumptions, such as promotions, bonuses, or change in career path to which the jury has already been exposed.

This table requires (usually) at least 4 more columns for an ordinary wage loss projection: (1) the anticipated future lost base salary *in current dollars*, (2) the anticipated future lost benefits (usually around 15% of the lost base salary) *in current dollars*, (3) the *present value* of the lost earnings (i.e., the net discount rate

for that year multiplied by the lost base salary) and, of course, (4) the *present value* calculation of lost benefits. The third and fourth columns, simply represent the results of a mathematical formula which is programmed into the economist's spreadsheet. Each of these individual columns are totaled on the last row and, usually, double-underlined; this represents, literally, the bottom line. These otherwise onerous calculations are a perfect use of a computer but may give the economist an aura of mathematical objectivity and precision.

### **Although They May Be Required in Some Cases, Present Value Determinations Never Help the Plaintiff**

I return to the basic legal theory that underlies the present value determination: the defense wants it to *reduce* the value of plaintiff's future losses. Remember this when it comes time to designate experts.

There are two times when an economist should be considered by plaintiff.

First, when the plaintiff has no meaningful earnings track record, it is necessary to have an economist (particularly one with training in labor economics) to opine on the statistically-probable future earnings. It is necessarily "part of the package" that the economist will present the future losses with the reduction for present value; this is the price of obtaining the valuable wage loss projection.

Second, if the defense designates an economist, the plaintiff is virtually compelled to supplementally designate an economist. (See Code Civ. Proc. § 2034(h).) Remember when you are doing a supplemental designation that the 20 days limitation is NOT extended for mailing. (See Weil & Brown, *California Practice Guide / Civil Procedure Before Trial*, "Discovery" ¶ 8:1687.) While the economist can, and invariably will, provide you with more extensive testimony, the real motivation is solely to keep the defense economist honest.

For example, defense economists may opine that the net discount rate is higher than 1% (which lowers the plaintiff's recovery, of course) and, without a plaintiff economist to rein in the most aggressive opinions, the rate will go higher still.<sup>3</sup> Moreover, economic testimony, while dry

and routine, can, in the hands of a knowledgeable examiner (or cross-examiner) be presented either as scientific gospel or pseudo-science; you simply cannot let defense counsel and their expert run all over the truth. Unchallenged economic testimony can undermine a damages case, costing the plaintiff thousands, or tens of thousands, of dollars.

In addition to the unnecessary cost and recovery-reducing effect of an unnecessary economic expert, there is the undeniable chance that a competent defense attorney can impeach your economist expert so badly that your credibility itself is at risk.

There is an "unavoidable" problem, for example, of projections of future actual dollar losses. Consider, for example, the projection of the lifetime cost of care for a severely damaged infant. No one, these days, would be surprised at a cost of \$15,000 per year for a half-time vocational nurse to provide respite care to the parents. However, if such a figure were to be provided as a projection for the year 2000 to a jury, say, in 1960, such an amount would be regarded as outrageous and absurd. The credibility of the presenting attorney, no matter how hard you explain the anticipated impact of inflation, will lose credibility. Likewise, future economic projections, especially decades in the future, always look ridiculous. Even when the column of actual future dollars is omitted as "irrelevant" (and inherently inflammatory), experienced defense counsel will ask the economist to pull out their calculator or records and give the jury these numbers. Unless the judge is experienced in these matters, and attuned to the inflammatory and misleading nature of such information, the information will come out. Moreover, the situation is now worse, since opposing counsel "exposed" the "ridiculous" assumptions of your expert.

Finally, whenever the case is large enough to require economic testimony, you must carefully evaluate your own ability to articulate these matters (which, in fact, are as simple in concept as they are complex in application) and deal with the unavoidable dangers at trial. If you have not used an economist before, you should consider a long (read: expensive) educational meeting with the expert, talking

(continued on page 21)

stronger negotiating position. How is this so? Most plaintiff attorneys/firms are evaluated by insurance carriers on the depth of their financial ability to litigate. A plaintiff attorney known to have depth of funding and an ability to use it effectively might consistently expect fairer settlements. Real strength, including financial strength, doesn't always need to be used in order to be felt. Perhaps most importantly, risk can be shared with the non-recourse funder, allowing an attorney to be more confident and aggressive in pursuing client settlements.

### Attorneys and Plaintiffs Better Served

Striking examples illustrate the value of non-recourse funding. John, a 22-year-old auto accident victim, needed \$5,000 for surgery. Without the surgery, which would help to identify further physical damage and the full extent of the defendant's liability, his case was expected to settle for only \$7,000. With the surgery, a settlement of \$40,000 was anticipated. A non-recourse funder advanced the funds for the surgery. The case settled for

\$40,000, and John received two-thirds of \$40,000 rather than two-thirds of \$7,000.

One married couple, James and Annette, were driving on the interstate near Santa Barbara when a construction vehicle pulled out of the center median directly into their path. The impact sent their compact car across several lanes of traffic and into a light pole. James' knee was seriously injured when it was crushed into the dashboard, and Annette received facial lacerations. Nine months after the incident, with the insurer playing hardball, the couple was in dire financial straits and pressed their attorney to advance them money or to immediately settle the claim. The attorney, who felt the insurers' offer was inadequate for the damages sustained, approached a non-recourse funder. An advance was provided to the couple, which enabled the case to go forward. Four months later, the parties reached a six-figure settlement.

In another case, an Orange County attorney represented a mother and son who were injured in an auto accident. The attorney needed an additional \$5,000 to hire an expert witness who would attest to psychological damages sustained by the

son. With funds in hand to hire this expert, the case was adjudicated for over \$75,000 – more than three times the initial sum offered.

### A Creative Solution

When facing powerful corporate defendants, the scales of justice are occasionally weighted by capital resources rather than by the merits of a case. Without ready capital, a plaintiff attorney can easily be at a disadvantage serving clients. Even winning attorneys with strong cases can find themselves involved in simple tests of financial resources.

In recent years, fewer personal injury claims are being settled out of court. Instead, many just claims are now challenged simply as a matter of corporate policy. Non-recourse litigation funding can help attorneys "swim the length and the depth of the pool" by offering a creative alternative to truly deserving plaintiffs.

In today's climate, plaintiff attorneys need this financial edge. Non-recourse litigation funding, properly used, can help attorneys maximize returns while minimizing risks. ■

## Economist

(continued from page 19)

with a more experienced litigator (usually at no expense) and/or associating that experienced litigator. Many very smart lawyers may simply not be able to grapple with the mathematical concepts underlying the "Dismal Science."

### Conclusion

Multi-year economic projections, while required by law in some cases, are largely speculative, non-scientific and inherently biased by a number of factors, both seen (e.g., an economist's affiliation with the defense or plaintiff's side) and unseen (e.g., the expert's personal political beliefs and school of training), which, in combination, can undermine the credibility of the opinion. The longer the projection, the more voodoo. Indeed, if anyone really could accurately project long term economic rates, that person would eventually gather all of the the investment wealth of the earth.

A plaintiff's economic damages can be of tremendous importance. Juries, of course, can and do give great weight to *bona fide* "hard" economic losses, and will invariably associate higher general damages with such claims. In some cases – most notably MICRA-limited medical malpractice cases – economic damages, which may be relatively easy to prove, may be the bulk of the probable recovery.

Consider, then, in selecting your experts, whether you really need an economist and, if so, carefully consider the risks and costs of your calculated decision and plan your trial strategy accordingly. ■

<sup>1</sup> Some accountants and other financial professionals claim expertise in these matters. Such claims are usually unfounded. Accountants, for example, are not trained in making *projections* of future economic activity, growth, labor markets, etc.

A given accountant may have specialized training in labor economics or another relevant field, but the accountant is no more qualified to opine on future economic activity than most attorneys would be qualified to opine on the exact date that the sun will go nova.

That is not to say that accountants do not have a potential role in litigation; however, that role, the proper role of a forensic accountant, is to determine *past* gross and net income. In many cases, the plaintiff's past earnings are easily determined (e.g., a wage earner whose employer kept good records); however, there are some cases where the accountant is vital, e.g., where the plaintiff's lost income came from a poorly-organized or -documented cash business with opportunities to over- or under-estimate income depending on the setting and the earner's presumed self-interest.

<sup>2</sup> One trick economists used in the years following the inflationary "Carter years" was to lengthen or shorten the number of past years to be considered. Thus, for example, if you wanted to project higher inflation numbers, the economist would incorporate the "Carter years."

■ Economic experts frequently are aware that their former testimony and/or reports can be used to impeach them later. Thus, at least among those economists who seek both plaintiff and defense business, their opinions on the macro economic issues should be the same. Of course, they can always make different assumptions as to the plaintiff's earnings potential, which is simply supplied to them by counsel.