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COMPUTING LOST FUTURE EARNINGS IN LIGHT OF *JONES & LAUGHLIN STEEL CORP. V. PFEIFER*

PATRICK J. MAXWELL

I. INTRODUCTION

When an individual has been wrongfully injured, he is entitled to be compensated for his loss.¹ A personal injury victim is entitled to recover damages not only for losses suffered prior to litigation, but also for any future losses he may be expected to incur.² The principal type of prospective damage is an injured plaintiff's loss of earning capacity. Courts have discovered, however, that calculating a disabled plaintiff's lost future earnings is no simple task.³ One of the most troublesome questions which has plagued courts involved in "lost earnings" computations is whether the damage award should be adjusted to account for inflation.⁴ The issue of future inflation arises because damage awards normally take the form of a lump sum payment at the conclusion of the litigation.⁵ If there is a subsequent inflationary rise in prices, it decreases the purchasing power of the money and reduces the present value of the damage award. Normally, periodic "cost of living" wage increases act as a hedge against inflation.⁶ Thus, since wage increases generally follow in the wake of inflation, a lump sum tort damage award for impaired earning capacity will undercompensate an injured plaintiff unless it accounts for future inflation in some manner.

Traditionally, courts have refused to adjust awards based on prospective damages to account for the impact of inflation on a victim's lost future earnings. The principal rationale for this view is that estimates of future inflation are too speculative to include

1. RESTATEMENT (SECOND) OF TORTS § 901 comment a (1979). A tort damage award should provide an injured plaintiff with a sum of money sufficient to return him to the position he would have been in had there been no disabling injury.

2. 2 F. HARPER & F. JAMES, *THE LAW OF TORTS* § 25.8, at 1316 (1956).

3. In *Feldman v. Allegheny Airlines, Inc.*, 382 F. Supp. 1271, 1295 (D. Conn. 1974), Judge Blumenfeld, while engaging in an attempt to calculate a victim's lost future earnings, was moved to state: "Nothing is more conclusively established by the instant memorandum of decision than the difficulty of ascertaining the amount of damages due in this case. . . ."

4. Inflation is defined as "an increase in the volume of money and credit relative to available goods resulting in a substantial and continuing rise in the general price level." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 1159 (1976).

5. See 2 F. HARPER & F. JAMES, *supra* note 2, § 25.2, at 1303. See also R. POSNER, *ECONOMIC ANALYSIS OF LAW* § 4.10, at 79 (1973). In theory more flexible approaches to awarding damages, such as periodic payments, could be utilized. See generally Elligett, *The Periodic Payment of Judgments*, 46 INS. COUNS. J. 130 (1979); Comment, *Variable Periodic Payments of Damages: An Alternative to Lump Sum Awards*, 64 IOWA L. REV. 138 (1978).

6. See L. REYNOLDS, *LABOR ECONOMICS AND LABOR RELATIONS* 225 (6th ed. 1974).

as factors in computing damages.⁷ In recent years, however, this traditional view has been replaced; the modern trend is for courts to recognize the necessity of including an inflation estimate in the computation of lost future earnings in order to avoid undercompensating an injured plaintiff. The present willingness of courts to consider inflation in awarding damages for impaired earning capacity is due in large part to their realization that the inflationary spiral is not a "temporary phenomenon on the American scene."⁸ But predictably, the acceptance of inflation as a proper component in the calculation of lost future earnings has posed another difficult question: how to incorporate inflation into the damage calculus.

In the past, the United States Supreme Court has avoided the questions of whether a damage award for lost future earnings should be adjusted because of inflation and, if so, what method should be employed to accomplish this task.⁹ In *Jones & Laughlin Steel Corp. v. Pfeifer*,¹⁰ however, the Court granted certiorari and for the first time directly addressed the problem of incorporating inflation into a prospective damages award. With the Supreme Court's decision in *Pfeifer* as the focal point, this study will provide an overview of the mechanics involved in computing a damage award for future earnings, a comprehensive discussion of the various approaches to the future inflation issue, and an assessment of the significance of the *Pfeifer* opinion.

II. CASE HISTORY

In January of 1978, Howard E. Pfeifer, employed by the Jones & Laughlin Steel Corporation, was injured on the job while working as a loading helper on a coal barge.¹¹ He subsequently instituted a negligence action against his employer pursuant to section 5(b) of

7. See, e.g., *Johnson v. Penrod Drilling Co.*, 510 F.2d 234, 241 (5th Cir.), cert. denied, 423 U.S. 839 (1975). *Penrod* was later overruled by *Culver v. Slater Boat Co.*, 688 F.2d 280 (5th Cir. 1982) (en banc), rev'd on rehearing on other grounds, 722 F.2d 114 (5th Cir. 1983).

8. *Pfeifer v. Jones & Laughlin Steel Corp.*, 678 F.2d 453, 460 (3d Cir. 1982), vacated on other grounds, 103 S. Ct. 2541 (1983).

9. The Supreme Court has avoided the inflation issue by denying certiorari a number of times. See *Doca v. Marina Mercante Nicaraguense, S.A.*, 634 F.2d 30 (2d Cir. 1980), cert. denied, 451 U.S. 971 (1981); *Higginbotham v. Mobil Oil Corp.*, 545 F.2d 422 (5th Cir.), cert. denied, 434 U.S. 830 (1977), rev'd on other grounds, 436 U.S. 618 (1978); *Johnson v. Penrod Drilling Co.*, 510 F.2d 234 (5th Cir.), cert. denied, 423 U.S. 839 (1975); *In re United States Steel Corp.*, 436 F.2d 1256 (6th Cir.), cert. denied, 402 U.S. 987 (1970).

10. 103 S. Ct. 2541 (1983).

11. *Id.* at 2544. Pfeifer slipped and fell on snow and ice which had accumulated on the gunnels of a barge.

the Longshoremen's and Harbor Workers' Compensation Act.¹² The United States District Court for the Western District of Pennsylvania held that the personal injuries sustained by Pfeifer resulted from Jones & Laughlin's negligence. Further, the district court found that the injury rendered Pfeifer completely disabled from the date of the accident until July 1, 1979 and thereafter severely restricted his capacity for performing any type of physical labor.¹³ The district court awarded damages in the amount of \$275,881.36.¹⁴ In arriving at this figure, the court did not discount the award to present value,¹⁵ nor did it increase the award to compensate for future inflation. Instead, the court applied the "total offset" method of computing damages. Under this method it is presumed as a matter of law that the rate of future inflation equals and therefore offsets the market interest rate, making adjustments for these factors unnecessary.¹⁶

The United States Court of Appeals for the Third Circuit affirmed the district court's decision. Recognizing the need to consider inflation in future damage calculations, the Third Circuit held that the "total offset" method was the proper federal rule when measuring damages for lost earning capacity.¹⁷ Subsequently,

12. *Id.* As his employer, Jones & Laughlin was already obligated to compensate Pfeifer for his injuries under § 4 of the Longshoremen's and Harbor Workers' Compensation Act (LHWCA). Pfeifer also claimed that Jones & Laughlin, as the owner pro hac vice of the barge, was liable for negligence under § 5 of the LHWCA. Section 5(b) of the LHWCA allows a longshoreman to institute a third-party negligence action against a vessel when the injuries are "caused by the negligence of a vessel." 33 U.S.C. § 905(b) (1982).

13. The district court stated that Pfeifer could have obtained light work after July 1, 1979 and assumed he would have earned the minimum wage for the rest of his working life. *Pfeifer*, 103 S. Ct. at 2545.

14. The district court arrived at the award by taking the amount of money Pfeifer would have earned at his present wage until the date of his retirement had he not been injured (\$325,312.50), subtracting his projected earnings at the minimum wage (\$66,352) and the compensation payment he had already received under § 4 of the LHWCA (\$33,079.14), and then adding \$50,000 for pain and suffering. *Id.*

15. *Id.* Since damages are awarded in a lump sum at the conclusion of the litigation, a compensated plaintiff can be expected to invest the award and earn additional money. As Judge Posner explained: "[T]he object of discounting lost future wages to present value is to give the plaintiff an amount of money which, invested safely, will grow to a sum equal to those wages." *O'Shea v. Riverway Towing Co.*, 677 F.2d 1194, 1199 (7th Cir. 1982).

The necessity of discounting future damages to present value was recognized by the Supreme Court in *Chesapeake & Ohio Ry. v. Kelly*, 241 U.S. 485 (1916).

16. *Pfeifer*, 103 S. Ct. at 2545. The particular "total offset" method adopted by the trial court was set forth by the Pennsylvania Supreme Court in *Kaczkowski v. Bolubasz*, 421 A.2d 1027 (Pa. 1980). For a discussion of the "total offset" approach to calculating lost future earnings, see *infra* notes 107-21 and accompanying text.

17. *Pfeifer v. Jones & Laughlin Steel Corp.*, 678 F.2d 453, 461 (3d Cir. 1982), *vacated on other grounds*, 103 S. Ct. 2541 (1983). See generally Note, *Torts—Damages—Procedure of*

the United States Supreme Court granted certiorari to review the Third Circuit's decision.¹⁸ The *Pfeifer* case presented the Supreme Court with three significant questions concerning the proper measure of damages for lost future earnings: (1) Should inflation be considered in awarding damages for loss of earning capacity? (2) If inflation is a proper component of the prospective damage calculus, is the "total offset" method a permissible means of accounting for the inflation factor? Specifically, does the "total offset" method violate the mandate of the Supreme Court in *Chesapeake & Ohio Railway v. Kelly*,¹⁹ in which the Court held that future damage awards must be discounted to present value? (3) Should there be an exclusive federal rule for calculating an award for lost future earnings in an inflationary economy?

III. CALCULATING LOST FUTURE EARNINGS IN AN INFLATION-FREE ECONOMY

The Supreme Court in *Pfeifer* began its analysis of the damages issue by reviewing the manner in which lost future earnings should be measured in a hypothetical inflation-free economy.²⁰ The first step in calculating an award for impaired earning capacity is ascertaining the amount of money the victim would have earned in his lifetime had he not been injured. At first glance, it appears that predicting this lost stream of income should be relatively simple. But, as the Supreme Court in *Pfeifer* emphasized, computing a victim's pecuniary loss over the duration of his career can be an extremely complex endeavor, even without considering inflation.²¹ As the *Pfeifer* opinion noted, the many different variables involved in making such a prediction encourage both courts and litigants to keep the lost earnings computation within manageable proportions.²²

First, the length of time in which the victim would have continued to work cannot be determined with certainty. For example, the

Discounting Damage Awards to Present Value Abandoned Under Federal Law in Order To Account for the Effect of Future Inflation, 28 VILL. L. REV. 253 (1983).

18. The Supreme Court granted certiorari to decide two issues: (1) Whether Jones & Laughlin could be subject to liability under both § 4 and § 5 of the LHWCA; and (2) Whether the Third Circuit correctly upheld the trial court's calculation of the damage award. *Pfeifer*, 103 S. Ct. at 2543. This comment will only address the Court's treatment of the damages issue.

19. 241 U.S. 485 (1916).

20. *Pfeifer*, 103 S. Ct. at 2550-51.

21. *Id.*

22. *Id.* at 2549 n.11.

victim could have been disabled in another manner at any time in the future.²³ As the Court in *Pfeifer* pointed out, in order to simplify matters, the parties usually stipulate a date to which the victim would have continued to work.²⁴ The figures used in computing the annual income of the victim for each year of future employment are also usually the result of a compromise between the parties in the name of judicial efficiency. In addition to the victim's actual wages, he also may have been entitled to certain fringe benefits, such as insurance coverage, a pension, and retirement plans. On the other hand, the victim most likely would have incurred certain unreimbursed costs in the course of his employment, such as transportation, meals, and other incidental expenses, which now are avoided. Also, since damage awards are tax-free, a lost earnings computation should be an after-tax estimate.²⁵ The Supreme Court noted that the parties in *Pfeifer* avoided the necessity of computing each of these variables by agreeing to presume that these miscellaneous elements involved in the future lost earnings estimate would offset each other. Only the gross wages of Mr. Pfeifer were considered in computing his lost future earnings.²⁶

The Supreme Court emphasized, however, that the task of calculating lost future earnings was still complicated despite the many simplifications made by the *Pfeifer* litigants. Even in an inflation-free economy, wages tend to increase over time because of what the Court labeled "real" wage inflation.²⁷ "Real" wage inflation encompasses a number of factors connected either to the specific individual or broader societal forces. The principal "individual" factors

23. The Court pointed out, "The probability that [the disabled worker] would still be working at a given date is constantly diminishing." *Id.* at 2548. The Court noted that it is possible to account for the "diminishing probability" doctrine in computing lost future earnings. *Id.* at 2548 n.10. See generally Hanke, *How To Determine Lost Earning Capacity*, 27 PRAC. LAW. 27, 29-33 (1981).

24. In *Pfeifer*, the parties agreed that the plaintiff would have continued to work until his retirement date (12½ more years). 103 S. Ct. at 2549.

In other situations, the plaintiff's prior health record or other individualized circumstances may indicate that the plaintiff may not have worked continuously until retirement. See *Feldman v. Allegheny Airlines, Inc.*, 524 F.2d 384, 388 (2d Cir. 1975) (female plaintiff planned on working only part-time for an eight-year period so as to enable her to raise a family). See also Comment, *Inflation, Productivity, and the Total Offset Method of Calculating Damages for Lost Future Earnings*, 49 U. CHI. L. REV. 1003, 1004 nn.3-5 (1982) (commentator criticized the practice of calculating earnings until the expected retirement age because the "actuarial probability of survival" doctrine indicated that members of certain demographic groups will not survive until their retirement date).

25. *Norfolk & W. Ry. v. Liepelt*, 444 U.S. 490 (1980).

26. *Pfeifer*, 103 S. Ct. at 2549.

27. *Id.*

which tend to increase the worker's wages are experience and productivity.²⁸ The Supreme Court in *Pfeifer* explained the impact of these interrelated factors upon a worker's wages as follows: "With the passage of time, an individual worker often becomes more valuable to his employer. His personal work experiences increase his hourly contributions to firm profits. To reflect that heightened value, he will often receive 'seniority' or 'experience' raises, 'merit' raises, or even promotions."²⁹ The Court in *Pfeifer* neglected to point out, however, that wages do not always increase in direct relation to the worker's maturity.³⁰ When a person reaches a certain age his abilities diminish and, as a result, his wages may decrease.³¹

The Supreme Court in *Pfeifer* defined the "societal" factors which may inflate a worker's wages as those "macroeconomic forces that influence wages in the worker's particular industry."³² Increased industrial productivity, for example, often leads to higher wages for the worker.³³ Other macroeconomic forces recognized by the Court as possibly affecting the future wages of a worker are gross national product increases and favorable collective bargaining agreements.³⁴

After completing its illustration of the complex and potentially cumbersome process of calculating the victim's lost income, the Supreme Court focused upon the second and final step in computing a damage award for lost future earnings in an inflation-free economy.³⁵ The Supreme Court has long recognized that an award for future damages must be discounted to present value so as to

28. A third personal characteristic which may also affect the future wages of the victim is education. See Henderson, *The Consideration of Increased Productivity and the Discounting of Future Earnings to Present Value*, 20 S.D.L. Rev. 307, 312 (1975); Comment, *supra* note 24, at 1004.

29. *Pfeifer*, 103 S. Ct. at 2549. The Court noted that while these "merit" increases may be difficult to prove they can be demonstrated in some cases. *Id.* Other courts have also remarked on the difficulty of ascertaining such "merit" or "productivity" gains. See *Feldman*, 524 F.2d at 392-93; *Beaulieu v. Elliott*, 434 P.2d 665, 672 (Alaska 1965).

30. See Henderson, *Income over the Life Cycle: Some Problems of Estimation and Measurement*, 25 FED'N INS. COUNS. Q. 15, 22-26 (1974).

31. *Id.* For an example of a "wage and age" profile used to measure such life cycle variations within particular occupations, see Comment, *supra* note 24, at 1004.

32. *Pfeifer*, 103 S. Ct. at 2549 n.13. See also *Grunenthal v. Long Island R.R.*, 393 U.S. 156, 160 (1968) (Supreme Court upheld trial court's adjustment of a damage award for impaired earning capacity upon convincing evidence of steady wage increases within the particular class of workers).

33. P. SAMUELSON, *ECONOMICS* 738-56 (10th ed. 1976).

34. *Pfeifer*, 103 S. Ct. at 2549-50.

35. For further discussion of this basic two-step process for computing lost earnings in the absence of inflation, see Comment, *supra* note 24, at 1004-05.

avoid overcompensating the victim.³⁶ This reduction to present worth is necessary because damages are awarded in a lump sum at the conclusion of the litigation, enabling the plaintiff to earn interest on that amount in the future.³⁷ In *Chesapeake & Ohio Railroad v. Kelly*, the decision in which the Supreme Court issued its mandate for a reduction to present value, the Court expressly refused to lay down a precise rule or formula.³⁸ *Kelly* specified only that the rate of interest used to reduce the award to present value should be one which could be earned on safe and unsophisticated investments.³⁹ In *Pfeifer*, the Supreme Court added that since the future earnings are estimated in after-tax terms, the discount rate also should represent an after-tax rate of return.⁴⁰

The *Pfeifer* Court appears to have had a two-fold purpose for examining the manner in which damages for lost future earnings should be measured in a hypothetical inflation-free economy. First, the *Pfeifer* opinion provided lower courts with an official guideline to the mechanics involved and the factors to be considered in a proper calculation of damages for impaired earning capacity. Second, and more importantly, the Court in *Pfeifer* laid the groundwork for its subsequent consideration of the inflation issue. The Court effectively illustrated that the computation of lost future earnings, even without considering inflation, requires predictions of future events which cannot be known with certainty. In sanctioning the computation of earnings in this manner, the court indicated that the speculative nature of predicting future inflationary trends should not be sufficient reason for refusing to include an inflation estimate in the prospective damage calculus.

IV. ACCOUNTING FOR INFLATION

A. *The Traditional Approach*

Traditionally, courts have refused to consider the impact of future price inflation in calculating prospective damage awards.⁴¹

36. See *Chesapeake & Ohio Ry. v. Kelly*, 241 U.S. 485 (1916).

37. "[I]n all cases where it is reasonable to suppose that interest may safely be earned upon the amount that is awarded, the ascertained future benefits ought to be discounted in the making up of the award." *Id.* at 490.

38. *Id.* at 491.

39. *Id.* at 490-91.

40. *Pfeifer*, 103 S. Ct. at 2550. The Court noted that the arithmetic required for discounting future earnings to present value can be simplified through the use of present value tables. *Id.* at 2550 n.21.

41. See, e.g., *Johnson v. Penrod Drilling Co.*, 510 F.2d 234 (5th Cir.), cert. denied, 423

Until recently, the Fifth Circuit Court of Appeals was a staunch proponent of this traditional approach. The Fifth Circuit's opinion in *Johnson v. Penrod Drilling Co.*⁴² illustrates the justifications typically advanced by courts refusing to consider inflation in awarding future damages. The principal argument set forth by *Penrod* and other traditionalist courts is that predictions of future inflationary trends are too speculative to include as factors in calculating damages.⁴³ The Fifth Circuit in *Penrod* recognized that the rate of inflation had been accelerating but maintained that there was no proof that this inflationary trend would continue in the future. The *Penrod* court reasoned that the "worsening of inflation might as readily foretell a recession or a depression as its continuity."⁴⁴ The court also cited the possibility that proposed government countermeasures might halt the spiraling inflationary trend.⁴⁵ Finally, the court stated that even if the rate of inflation continued to increase, any resulting loss of purchasing power would be mitigated by the higher interest rates on investments which usually accompany inflation.⁴⁶

The traditionalists' refusal to account for inflation in future damage awards has been described as a policy choice which emphasizes predictability and efficiency over accuracy.⁴⁷ It cannot be disputed that, by ignoring inflation, traditionalist courts have sacrificed accuracy by undercompensating injured plaintiffs.⁴⁸ But the extent to which the traditional approach furthered predictability

U.S. 839 (1975); *Magill v. Westinghouse Elec. Corp.*, 464 F.2d 294 (3d Cir. 1972); *Williams v. United States*, 435 F.2d 804 (1st Cir. 1970); *Sleeman v. Chesapeake & Ohio Ry.*, 414 F.2d 305 (6th Cir. 1969). In some cases evidence of individual and societal factors which may have led to future wage increases was allowed, but the plaintiff had to prove that these factors were in no way influenced by predictions of future price inflation. See, e.g., *Higginbotham v. Mobil Oil Corp.*, 545 F.2d 422, 434-45 (5th Cir. 1977), *rev'd*, 436 U.S. 618 (1978).

42. 510 F.2d 234 (5th Cir. 1975).

43. See, e.g., *id.* at 241; *Magill*, 464 F.2d at 300; *Williams*, 435 F.2d at 807.

44. *Penrod*, 510 F.2d at 236.

45. *Id.* One commentator noted the irony involved in such an argument: "While refusing to acknowledge the inevitability of inflation, traditionalist courts seem more than willing to speculate upon the effectiveness of government efforts to offset its adverse effects." Comment, *Future Inflation as a Factor in the Determination of Damages*, 12 U. Tol. L. Rev. 369, 375 (1981).

46. *Penrod*, 510 F.2d at 236. See also *McWeeney v. New York, New Haven & Hartford R.R.*, 282 F.2d 34, 42-43 (2d Cir.), *cert. denied*, 364 U.S. 870 (1960).

47. See Comment, *Future Inflation, Prospective Damages, and the Circuit Courts*, 63 VA. L. REV. 105, 108 (1977).

48. See Comment, *supra* note 24, at 1011-13 (commentator illustrated how a hypothetical accident victim in 1960 would have been grossly undercompensated under the traditional approach to computing lost future earnings).

and judicial efficiency is questionable. Regarding predictability, as the Supreme Court illustrated in the *Pfeifer* opinion, even without considering inflation the lost future earnings computation involves the prediction of a number of uncertain variables. In terms of judicial efficiency, calculating a lost future earnings award in a hypothetical inflation-free economy is already an extremely complex task. Thus, courts wishing to continue to adhere to the traditional approach must question whether the minimal amount of predictability and efficiency gained by ignoring inflation is worth the cost to injured plaintiffs.

B. Modern View

In recent years, a majority of courts have chosen to reject the traditional approach and recognize inflation as a proper component of the future damage calculus.⁴⁹ The principal reason for this shift is the courts' recognition that inflation is a continuing reality of modern economic life. Therefore, failure to incorporate inflation into prospective damage awards results in victims being undercompensated.⁵⁰ In *Doca v. Marina Mercante Nicaraguense, S.A.*,⁵¹ the Second Circuit admitted that economists are not in agreement on the question of whether inflation has become an inherent feature of our economy, unable to be erased by government action. The court noted, however, "[T]here is broad agreement that our economy, by its very nature, is subject to strong and persistent inflationary pressures, and that the complete elimination of inflation would require Draconian measures, at the very least."⁵²

Under the "modern" view, courts now realize that they can "no longer maintain their ostrich-like stance" and ignore the impact of inflation on lost future earnings.⁵³ The principal purpose in award-

49. See *Culver v. Slater Boat Co.*, 688 F.2d 280 (5th Cir. 1982) (en banc), *rev'd on rehearing on other grounds*, 722 F.2d 114 (5th Cir. 1983); *O'Shea v. Riverway Towing Co.*, 677 F.2d 1194 (7th Cir. 1982); *Doca v. Marina Mercante Nicaraguense, S.A.*, 634 F.2d 30 (2d Cir. 1980), *cert. denied*, 451 U.S. 971 (1981); *Steckler v. United States*, 549 F.2d 1372 (10th Cir. 1977); *United States v. English*, 521 F.2d 63 (9th Cir. 1975); *Riha v. Jasper Blackburn Corp.*, 516 F.2d 840 (8th Cir. 1975); *Bach v. Penn Cent. Transp. Co.*, 502 F.2d 1117 (6th Cir. 1974); *Beaulieu v. Elliott*, 434 P.2d 665 (Alaska 1967); *Schnebly v. Baker*, 217 N.W.2d 708 (Iowa 1974); *Kaczowski v. Bolubasz*, 421 A.2d 1027 (Pa. 1980).

50. See *Pfeifer v. Jones & Laughlin Steel Corp.*, 678 F.2d 453, 460-61 (3d Cir. 1982), *vacated on other grounds*, 103 S. Ct. 2541 (1983); *Bach*, 502 F.2d at 1122; *Beaulieu*, 434 P.2d at 671.

51. 634 F.2d 30 (2d Cir. 1980), *cert. denied*, 451 U.S. 971 (1981).

52. *Id.* at 37.

53. *Kaczowski*, 421 A.2d at 1033.

ing tort damage awards is to compensate an injured plaintiff for his loss. The dollar's continuing decline in purchasing power renders full compensation for the victim impossible unless the impact of future inflation is taken into account.⁵⁴ The traditionalist courts' argument, that increased investment returns which accompany inflation provide a hedge against any decline in purchasing power of the damage award, is not persuasive because undercompensation of the victim still results.⁵⁵ The Supreme Court of Alaska in *Beaulieu v. Elliot*⁵⁶ also expressed another concern with the practice of relying on interest rates to counter inflation and provide just compensation. Compensated victims might seek to counter the inflationary effect on their lump sum award by making risky investments. "Thus," maintained the court, "instead of being assured of earnings at rates greater than the annual rate of inflation, the injured plaintiff stands a chance of entirely losing his future earnings by unlucky or unwise investments."⁵⁷

Courts which now adjust future damage awards to account for inflation are not blind to the uncertainties involved in predicting future inflationary trends.⁵⁸ But this concern with speculation is no longer viewed as a sufficient reason to continue ignoring inflation in computing future damages. The Second Circuit Court of Appeals in *Doca* pointed out that a degree of uncertainty exists in many facets of future damage calculations.⁵⁹ The court noted that estimates of the future earnings of the victim and the assumption that interest rates will continue at or above their present level in discounting to present value both involve predictions of future events which cannot be known with certainty.⁶⁰ More importantly, however, the *Doca* court highlighted the fact that inflation already was being considered in one phase of the computation of damage awards for lost earning capacity.⁶¹ Discounting future earnings to reflect their present value "necessarily includes a prediction about

54. The Third Circuit noted that the consumer price index rose by more than 130% from 1969 to 1980 and that the Hourly Earnings Index, which reflects wage rates in the private, non-farm economic sector, also rose by more than 130% during the same time period. *Pfeifer*, 678 F.2d at 460 (citing The Report of the Commission on Executive, Legislative and Judicial Salaries (Dec. 1980)).

55. See *O'Shea*, 677 F.2d at 1199.

56. 434 P.2d 665 (Alaska 1967).

57. *Id.* at 671.

58. See, e.g., *Doca*, 634 F.2d at 38.

59. *Id.* See also *English*, 521 F.2d at 75; *Kaczkowski*, 421 A.2d at 1034.

60. *Doca*, 634 F.2d at 37-38.

61. *Id.* at 38. See also *O'Shea*, 677 F.2d at 1199.

inflation."⁶² The market value interest rate, which traditionally has been used in the discounting process, is comprised not only of the lender's desired rate of return on the investment but also includes an estimate of inflation anticipated over the term of the loan. Thus, "modern" courts view the traditionalists' continued refusal to consider the impact of inflation on an injured plaintiff's lost earnings as both illogical and inequitable in light of the fact that predictions of future inflation already are being utilized in discounting those future earnings to present value.⁶³

C. The Supreme Court's View

Before its decision in *Jones & Laughlin Steel Corp. v. Pfeifer*, the Supreme Court never had confronted directly the question of whether future inflation should be considered in awarding prospective damages. Dictum in two previous cases, however, indicated that the Court did approve of including inflation estimates in future damage calculations. In a 1968 opinion, *Grunenthal v. Long Island Railroad*,⁶⁴ the Supreme Court upheld an award based on anticipated wage increases that may have been attributable to inflation. The *Grunenthal* decision had little, if any, impact upon the traditionalist refusal to consider inflation, which at that time was still clearly the majority view.⁶⁵ One commentator explained the *Grunenthal* decision's lack of precedential impact by pointing out that the Court did not distinguish between future price inflation and "real" wage inflation, which may also increase a worker's wages.⁶⁶ It was further posited that the Court's failure to differentiate between the two types of inflation could be attributed to the Court's failure to realize the significance of its dictum. The *Grunenthal* decision was rendered before the inflation issue had gained prominence within the federal judiciary.⁶⁷

In *Norfolk & Western Railway v. Liepelt*,⁶⁸ however, the Supreme Court unquestionably indicated its approval of including inflation estimates in future damage awards. In *Liepelt*, the Court

62. *Doca*, 634 F.2d at 38.

63. *Id.* See also *O'Shea*, 677 F.2d at 1200.

64. 393 U.S. 156 (1968).

65. *But see Doca*, 634 F.2d at 36 (Second Circuit cited the *Grunenthal* decision as support for its decision to include inflation in future damage calculations).

66. Comment, *supra* note 47, at 111-12. For a discussion of "real" wage inflation see *supra* notes 27-34 and accompanying text.

67. Comment, *supra* note 47, at 111-12.

68. 444 U.S. 490 (1980).

held that the trial court erred by excluding evidence offered by the defendant to show the effect of income taxes on estimated future earnings. In rejecting the argument that a reduction for future income taxes would be too speculative, the Court expressly recognized that trial courts have learned how to effectively deal with "future inflation" and other "matters of estimate and prediction" involved in damage computations.⁶⁹

By the time the Supreme Court directly addressed the question of whether inflation should be considered in computing future damages in *Pfeifer*, there existed little doubt as to how the Court would rule. Predictably, the Supreme Court in its *Pfeifer* opinion officially recognized inflation as a proper component of a damage award for lost future earnings. "Inflation," the Court stated, "has been a permanent fixture in our economy for many decades, and there can be no doubt that it ideally should affect both stages of the [lost earnings] calculation. . . ."⁷⁰ The Supreme Court in *Pfeifer*, as have other courts, noted the inequity under the traditionalist approach of discounting to present value by the market interest rate which includes "an allowance for anticipated inflation" but refusing to measure the impact of inflation on the worker's future earnings.⁷¹

The Court in *Pfeifer* rejected the traditionalist argument that the higher interest rates accompanying inflation would sufficiently mitigate the decrease in value of the damage award:

Although the plaintiff in such a situation could invest the proceeds of the litigation at an "inflated" rate of interest, the stream of income that he received provided him with only enough dollars to maintain his existing *nominal* income; it did not provide him with a stream comparable to what his lost wages would have been in an inflationary economy.⁷²

The *Pfeifer* Court observed that the high rates of inflation existing in today's economy have led to a consensus among courts that this inequitable undercompensation of injured plaintiffs is no longer tolerable.⁷³

69. *Id.* at 494.

70. *Jones & Laughlin Steel Corp. v. Pfeifer*, 103 S. Ct. 2541, 2551 (1983).

71. *Id.* at 2552 n.24 (quoting *O'Shea*, 677 F.2d at 1199).

72. *Pfeifer*, 103 S. Ct. at 2552 (emphasis in original).

73. *Id.*

V. METHODOLOGY

While courts now generally agree that inflation should be taken into account in computing lost future earnings, there is definitely no "consensus" regarding the manner in which the inflation estimate should be incorporated. Courts employ a number of different methods to account for future inflation. In *Pfeifer*, the Supreme Court divided the various approaches for measuring the impact of inflation on a future damage award into three basic categories. These methods can be referred to as follows: (1) the "inflate-discount" method; (2) the "real interest rate" approach; and (3) the "total offset" method.

A. *The Inflate-Discount Method*

The "inflate-discount" method seeks to avoid undercompensating the victim by increasing his expected future earnings to account for inflation and then discounting to present value by the market interest rate.⁷⁴ The extent to which the lost future earnings should be adjusted to compensate for inflation is a factual issue. Courts which employ the "inflate-discount" method, however, disagree on the manner in which the fact finder should predict the effects of future inflation on the victim's earnings. Some courts require limited expert testimony on the question of future inflation while others insist that the future inflation rate selected by the fact finder be supported by competent economic evidence introduced at trial.

1. *Evidentiary Limitations*

*Bach v. Penn Central Transportation Co.*⁷⁵ was a wrongful death case brought under the Federal Employer Liability Act. In *Bach* the Sixth Circuit Court of Appeals confronted a case in which the trial court had excluded an economist's projection of future inflation during the time the decedent could have been expected to work. In addition, the trial court had instructed the jury not to consider the impact of inflation in awarding damages.⁷⁶ The Sixth Circuit held that inflation was a fact of life which the jury must be allowed to consider in order to prevent the plaintiff from

74. See, e.g., *Turcotte v. Ford Motor Co.*, 494 F.2d 173, 187 (1st Cir. 1974). See also Comment, *supra* note 24, at 1014-15.

75. 502 F.2d 1117 (6th Cir. 1974).

76. *Id.* at 1122.

being undercompensated. The court, however, questioned the ability of economists to project inflation over an extended period of time. Consequently, the Sixth Circuit ruled that such expert testimony "on the exact income that the decedent would have received through the year 2002 is so speculative . . . that it is inadmissible."⁷⁷ The court left the prediction of the rate of future inflation, a task it felt was too speculative to be handled by experts, to the "common experience" of the jury.⁷⁸

While the Sixth Circuit's opinion may have seemed illogical to some,⁷⁹ the Eighth Circuit Court of Appeals approved of the *Bach* decision. In *Riha v. Jasper Blackburn Corp.*⁸⁰ and *Johnson v. Serra*,⁸¹ the Eighth Circuit followed in the footsteps of *Bach* by supporting a jury's consideration of inflation but refusing to allow expert testimony on the issue. The Eighth Circuit prohibited expert testimony on the question of inflation "not only because it is speculative and uncertain, but because it opens up a myriad of collateral and remote considerations."⁸²

Subsequent decisions by both the Sixth and Eighth Circuits, however, have revealed that these courts will not exclude all expert testimony relating to the issue of future inflation. In *Morvant v. Construction Aggregates Corp.*,⁸³ the Sixth Circuit held that the trial court erroneously rejected an economist's testimony regarding the impact of inflation on the victim's future earnings. The Sixth Circuit in *Morvant* explained that its *Bach* decision only excluded expert testimony which sought to measure future inflation by specifically projecting an exact figure of the victim's lost future earnings.⁸⁴ In *Taenzler v. Burlington Northern*,⁸⁵ the Eighth Circuit enunciated a similar approach. In *Taenzler* the court allowed expert testimony on wage increases which the victim might have obtained in the future even though the prediction may have involved

77. *Id.*

78. *Id.*

79. See Comment, *supra* note 47, at 119-20 (commentator stated that the rule announced in *Bach* "poses the anomaly of allowing the trier of fact to consider inflation but refusing to guide that consideration with expert evidence").

80. 516 F.2d 840 (8th Cir. 1975).

81. 521 F.2d 1289 (8th Cir. 1975).

82. *Riha*, 516 F.2d at 844 n.4.

83. 570 F.2d 626 (6th Cir.), *cert. denied*, 439 U.S. 801 (1978).

84. "What *Bach* aimed at preventing was a projection of statistical data so attenuated as to be *reductio ad absurdum*, thus allowing damages to be ballooned beyond all rational experience." *Morvant*, 570 F.2d at 632 n.5.

85. 608 F.2d 796 (8th Cir. 1979).

“some indirect consideration of anticipated future inflation.”⁸⁶ The *Taenzler* court, however, appeared to restrict such testimony to future pay increases within a particular job classification.⁸⁷ Further, the Eighth Circuit emphasized that expert testimony projecting a specific rate of inflation would not be allowed.⁸⁸

2. *No Limitations on Expert Testimony*

Understandably, most courts which recognize the “inflate-discount” method allow expert testimony regarding the anticipated rate of future inflation.⁸⁹ The decision of the Ninth Circuit Court of Appeals in *United States v. English* illustrates the rationale for this view. In *English*, the court recognized that inflation should be considered in awarding future damages but held that it would not allow the fact finder to “arbitrarily draw an estimate of inflation out of thin air.”⁹⁰ Instead the court maintained that an estimated rate of future inflation must be supported by competent economic evidence.⁹¹ Contrary to the view held by the Sixth and Eighth Circuits, the Ninth Circuit obviously felt that the speculative nature of predictions involving future inflationary trends would be minimized, not increased, by the introduction of expert testimony as to the specific rate of future inflation. Thus, the Ninth Circuit in *English* placed no restrictions on the utilization of expert economic evidence in attempting to ascertain the impact of inflation on a victim’s lost earnings.

B. *The Real Interest Rate Approach*

A second method of incorporating inflation into a future damage award is the “real interest rate” approach.⁹² Courts employing this

86. *Id.* at 800.

87. *Id.* at 801.

88. *Id.* The Eighth Circuit in *Taenzler* set forth three reasons for refusing to allow expert testimony predicting a specific rate of future inflation: (1) such evidence is “more precise than present knowledge warrants”; (2) a specific rate of inflation “may present a foreshortened picture that puts future earnings out of perspective,” thereby possibly resulting in an outrageously large damage award; (3) such expert testimony “tends to open up collateral matters which may create unmanageable trials.” *Id.*

89. See, e.g., *Culver v. Slater Boat Co.*, 688 F.2d 280, 298 (5th Cir. 1982) (en banc), *rev'd on rehearing on other grounds*, 722 F.2d 114 (5th Cir. 1983); *O'Shea v. Riverway Towing Co.*, 677 F.2d 1194, 1200 (7th Cir. 1982); *Steckler v. United States*, 549 F.2d 1372, 1378 (10th Cir. 1977); *United States v. English*, 521 F.2d 63, 75-76 (9th Cir. 1975); *Tenore v. Nu Car Carriers, Inc.*, 341 A.2d 613, 620-21 (N.J. 1975).

90. *English*, 521 F.2d at 75.

91. *Id.* at 75-76.

92. The Supreme Court pointed out that this method of accounting for the impact of

method focus upon the economic concept that the market interest rate is comprised of two components: (1) the market's own estimation of anticipated rates of inflation over the life of the investment; and (2) the "real" rate of return a lender would demand if no inflation were anticipated.⁹³ The "real" interest rate is perceived as remaining virtually constant, somewhere between one and three percent. Any shift in market interest rates is said to result from fluctuations in the "inflationary expectation" component. Applying these economic principles, courts adhering to the "real interest rate" approach conclude that the inflationary impact on an injured plaintiff's future earnings will be perfectly offset by the "inflationary expectation" component of the market interest rate.⁹⁴ Thus, in computing the future damage award, the estimated future earnings are discounted only by the "real" interest rate.

The leading proponent of the "real interest rate" method is the Second Circuit Court of Appeals. In *Feldman v. Allegheny Airlines, Inc.*,⁹⁵ a diversity wrongful death action brought under Connecticut law, the Second Circuit affirmed the trial court's use of a 1.5% "inflation adjusted" discount rate.⁹⁶ However, the court refused to endorse this method of accounting for inflation over other methods; the court stated only that it agreed "with the district court's interpretation of Connecticut law as leaving open the question of how inflation may be accounted for in such damages."⁹⁷

The Second Circuit was not as restrained in *Doca v. Marina Mercante Nicaraguense, S.A.*⁹⁸ *Doca* was a personal injury action arising under the federal Longshoremen's and Harbor Workers' Compensation Act. In *Doca*, the Second Circuit approved use of the "real interest rate" method. Expressing concern with the speculative nature of future inflation estimates, the court cited the *Feldman* decision as an example of how to account for inflation without making any prediction of specific future inflation rates.⁹⁹

future inflation is utilized by other common law countries. *Pfeifer*, 103 S. Ct. at 2552.

93. *Id.* at 2553.

94. See *O'Shea*, 677 F.2d at 1199; *Doca v. Marina Mercante Nicaraguense, S.A.*, 634 F.2d 30, 39 (2d Cir. 1980), *cert. denied*, 451 U.S. 971 (1981).

95. 524 F.2d 384 (2d Cir. 1975).

96. The expert, upon whom the trial judge in *Feldman* relied, arrived at this discount rate by subtracting the average yearly inflation rate set out in the Department of Labor's Consumer Price Index over the prior 18-year period (2.87%) from the annual interest to be derived from a prudent, nonsophisticated investment (4.14%). The 1.27% difference was rounded off to 1.5%. *Id.* at 387.

97. *Id.*

98. 634 F.2d 30 (2d Cir. 1980), *cert. denied*, 451 U.S. 971 (1981).

99. *Doca*, 634 F.2d at 39.

The court pointed out that the "real interest rate" approach of *Feldman* focused only on the relationship between the inflation rate and the interest rate. In addition to minimizing speculation, the Second Circuit noted that utilizing an inflation adjusted discount rate enhances judicial efficiency by simplifying the future inflation issue.¹⁰⁰

The Second Circuit in *Doca* recognized that considerable disagreement exists among economists as to the validity of the basic premise underlying the "adjusted discount rate" approach. The assumption is that the "real" rate of interest is constant and therefore independent of inflation.¹⁰¹ But the court relied on the fact that "substantial opinion" supports the view that the "real" yield of money remains relatively constant at approximately two percent during periods of stable inflation.¹⁰² The Second Circuit suggested, therefore, that a two percent discount rate would "normally be fair to both sides."¹⁰³

While expressing approval of the "real interest rate" approach, the Second Circuit in *Doca* did not require its use, allowing litigants to account for inflation through other means.¹⁰⁴ Other courts which have recognized the legitimacy of the "real interest rate" method also have refused to establish this approach as the exclusive means of accounting for inflation in awarding future damages.¹⁰⁵ The primary consideration of the Second Circuit, as well as

100. *Id.*

101. *Id.* at 39 n.10.

102. *Id.* at 39. In *O'Shea*, 677 F.2d at 1199, Judge Posner stated that the "real" interest rate should normally remain between one and three percent.

103. *Doca*, 634 F.2d at 39. The Second Circuit expressed the view that a two percent discount rate would be fair not only in periods of stable inflation but also during times of unusually high inflation rates:

It may well be that during periods of unusually high inflation rates, interest rates will lag somewhat behind the inflation rate, at least temporarily, with the result that the interest return on a discounted lump sum award will not fully keep pace with inflation. But in such periods of high inflation, wages too will not keep pace with inflation. . . . [A] present value discount rate normally need not be reduced below 2% just to compensate for unusually high inflation. To do so would ignore the basic objective of selecting a present sum of money that will replace what the future wages would have been.

Id. at 39-40 (footnote omitted).

104. *Id.* at 40. The Second Circuit did, however, authorize trial courts to utilize a two percent inflation adjusted discount rate if the litigants elected not to introduce evidence on the questions of inflation and reduction to present worth. *Id.*

105. See *Culver*, 688 F.2d at 308-10 (Fifth Circuit on rehearing recently reversed its view in *Culver* in light of the Supreme Court's *Pfeifer* decision and established the "real interest rate" approach as the exclusive method absent a stipulation by the parties. *Culver v. Slater Boat Co.*, 722 F.2d 114 (5th Cir. 1983)); *O'Shea*, 677 F.2d at 1200.

other courts which allow litigants a choice of methods, appears to be that inflation be considered in computing future damages, not that it be accounted for in any particular manner.¹⁰⁶

C. *The Total Offset Method*

The third and final method of accounting for inflation is the "total offset" approach. The "total offset" method departs from the long-recognized practice of discounting future earnings to present value. This approach assumes as a matter of law that the market interest rate, normally used to discount damage awards, is completely offset by certain elements involved in computing a victim's lost stream of future income. All courts which have employed this method agree that future price inflation contributes to this offset. Courts differ, however, on the question of which other elements in the lost future earnings computation, if any, should be included in the offset.

The "total offset" approach was first enunciated by the Supreme Court of Alaska in *Beaulieu v. Elliott*.¹⁰⁷ In *Beaulieu*, the court held that the market interest rate was totally offset by price inflation and "real" wage inflation, thereby making it unnecessary to discount the victim's future earnings to present value.¹⁰⁸ Sensing future criticism of its abandonment of the widely recognized practice of discounting to present value, the Alaska court argued that its "total offset" method would not overcompensate, and, in reality, might even undercompensate an injured plaintiff by eliminating all sources of future wage increases from the prospective damage calculus.¹⁰⁹ Perhaps realizing that its "total offset" formula may lean too much toward undercompensating injury victims, the Alaska court slightly altered its *Beaulieu* approach in *State v. Guinn*.¹¹⁰ In *Guinn*, the court held: "Automatic step increases keyed to [the victim's] length of service are by their very nature certain and predictable at the time of trial, and they should be considered in a judicial estimation of lost future earnings."¹¹¹ Thus, after *Guinn*, "certain and predictable" individual wage in-

106. The Second Circuit in *Doca*, 634 F.2d at 34, noted that computations of lost future earnings utilizing either the "inflate-discount" or the "real interest rate" approach should yield nearly identical results.

107. 434 P.2d 665 (Alaska 1967).

108. *Id.* at 671-72.

109. *Id.* at 672.

110. 555 P.2d 530 (Alaska 1976).

111. *Id.* at 546.

creases such as seniority gains are not included to offset the market interest rate.

Initially, other courts rejected the "total offset" method set forth by the Supreme Court of Alaska.¹¹² Their skepticism concerning this approach primarily was attributable to two factors: (1) a belief that the "total offset" method was an imprecise oversimplification;¹¹³ and (2) sentiment among the courts, especially federal courts, that the "total offset" method's failure to discount to present value violated the mandate of the Supreme Court in *Chesapeake v. Ohio Railroad v. Kelly*.¹¹⁴

In 1980, thirteen years after the *Beaulieu* decision, another court finally was persuaded to endorse the "total offset" approach. In *Kaczkowski v. Bolubasz*,¹¹⁵ the Pennsylvania Supreme Court followed the example set by its Alaskan counterpart and adopted the "total offset" method as the exclusive means of accounting for inflation in awarding future damages. The court, however, refused to embrace the particular formula advanced by the Alaska court. The *Kaczkowski* decision was especially critical of the Alaska court's refusal to consider future "merit" increases, maintaining that such a position "unfairly discriminates against those victims whose salary is dependant on their skill, experience, and value to their employer."¹¹⁶ The Pennsylvania court in *Kaczkowski* advanced the view that future inflation alone should completely offset the market interest rate.¹¹⁷ *Kaczkowski*, therefore, stands for the proposition that an injured plaintiff should be able to introduce evidence bearing on all sources of future wage increases except for price inflation.

Unlike the Supreme Court of Alaska in *Beaulieu* and *Guinn*, the Pennsylvania court in *Kaczkowski* sought to support its selection of the "total offset" method with economic theory.¹¹⁸ Relying

112. See, e.g., *United States v. English*, 521 F.2d 63, 75 (9th Cir. 1975); *Meier v. Bray*, 475 P.2d 587, 590 n.1 (Or. 1970).

113. See *Feldman v. Allegheny Airlines, Inc.*, 382 F. Supp. 1271, 1292 n.26 (D. Conn. 1974) (*Beaulieu* decision was characterized as reflecting "exceptional conditions of inflation in a 'frontier' state"), *aff'd*, 524 F.2d 384 (2d Cir. 1975). See also Comment, *supra* note 47, at 128.

114. See *Taenzler v. Burlington N.*, 608 F.2d 796, 802 (8th Cir. 1979); *English*, 521 F.2d at 75; *Sleeman v. Chesapeake & Ohio Ry.*, 414 F.2d 305, 307 (6th Cir. 1969).

115. 421 A.2d 1027 (Pa. 1980).

116. *Id.* at 1037.

117. *Id.*

118. As one commentator has observed, the Alaska court's decision to adopt the "total offset" method "was based on a common sense understanding of the economy, rather than on careful economic exposition. . . ." Comment, *supra* note 24, at 1018 n.69.

upon the economic concept known as the "Fisher effect," *Kaczkowski* maintained that future inflation rates and future interest rates "co-vary significantly."¹¹⁹ Thus, the court concluded that "since over the long run interest rates, and, therefore, the discount rates, will rise and fall with inflation, we shall exploit this natural adjustment by offsetting the two factors in computing lost future earning capacity."¹²⁰ The *Kaczkowski* court noted that the economic soundness of the "total offset" method assured as much, if not more, accuracy than the "real interest rate" method of measuring future inflation. Further, the court pointed out that the "total offset" method is superior in terms of judicial efficiency and predictability because it eliminates the need to predict future inflation and future interest rates.¹²¹

VI. Pfeifer

A. The Third Circuit

In *Pfeifer v. Jones & Laughlin Steel Corp.*,¹²² the Third Circuit became the first federal court of appeals to sanction the use of the "total offset" method. Citing the need for a uniform federal rule in cases arising under the admiralty and maritime jurisdiction of the federal judiciary, the court of appeals held that the district court properly applied the "total offset" method as the federal rule of damages.¹²³ Relying heavily on the Pennsylvania Supreme Court's decision in *Kaczkowski*, the Third Circuit declared that the "total

119. *Kaczkowski*, 421 A.2d at 1037. Modern-interest theoretician Irving Fisher set forth the economic theory upon which the *Kaczkowski* court relied to support its selection of the "total offset" method:

[W]hen prices are rising, the rate of interest tends to be high but not so high as it should be to compensate for the rise; and when prices are falling, the rate of interest tends to be low, but not so low as it should be to compensate for the fall.

Id. (quoting I. FISHER, *THE THEORY OF INTEREST* 43 (1930)). For further discussion of the "Fisher effect" as it relates to the "total offset" method, see Comment, *supra* note 47, at 128-33.

120. *Kaczkowski*, 421 A.2d at 1037-38.

121. *Id.* at 1038.

122. 678 F.2d 453 (3d Cir. 1982).

123. *Id.* at 461. The trial court's opinion in *Pfeifer* is unclear as to whether it erroneously applied the state law of Pennsylvania, specifically the *Kaczkowski* decision, rather than federal law by utilizing the "total offset" method. See *Pfeifer v. Jones & Laughlin Steel Corp.*, Case No. 79-1597 (W.D. Pa. 1981). The Third Circuit dismissed Jones & Laughlin's argument on this point, holding that the issue had not been preserved for review. The court of appeals did, however, express the view that the district court had in fact decided the case under federal law, maintaining that "[i]t is not unusual for a federal court to borrow substantive state law and adopt it as federal law." *Pfeifer*, 678 F.2d at 456-57.

offset" method allows a court to account for inflation without succumbing to speculation: "The total offset method avoids the danger of speculating as to the future rate of inflation by making what we consider a very sensible accommodation: it assumes that in the long run the effects of future inflation and the discount rate will co-vary significantly with the other."¹²⁴ The Third Circuit in *Pfeifer* maintained that the "total offset" method's basic assumption, that the rate of future inflation will equal future interest rates, is "no better or no worse than the varying prognostications of expert witnesses."¹²⁵ In addition, the court was impressed with the manner in which the "total offset" approach furthered the goals of judicial efficiency and predictability. Finally, the court advanced the view that the "total offset" method embodies "the continued requirement of reduction to present worth" and, therefore, does not violate the requirement of discounting future damages to present value set forth in *Chesapeake & Ohio Railway v. Kelly* by the Supreme Court.¹²⁶

B. *The Supreme Court*

The *Pfeifer* case presented the Supreme Court with the opportunity to resolve the confusion existing among the lower federal courts regarding the proper method on incorporating inflation into a damage award for lost future earnings. Each of the litigants and amici in the case attempted to persuade the Court to adopt a particular method. Jones & Laughlin Steel Corporation, as the petitioner, and various amici sought to convince the Court to reject the "total offset" method in favor of one of the other approaches.¹²⁷ They argued that the "total offset" method violated the *Kelly* requirement of discounting future damage awards to present value,

124. *Pfeifer*, 678 F.2d at 461.

125. *Id.*

126. *Id.*

127. Brief for Petitioner at 7 (argued that the Court should adopt the "inflate-discount" method as set forth by the Eighth Circuit in *Taenzler*; see *supra* notes 85-88 and accompanying text); Brief Amicus Curiae of Alcoa Steamship Company at 13-14 (set forth a hybrid method which combines characteristics of the "real interest rate" and "inflate-discount" approaches); Brief for the United States as Amicus Curiae at 12 (argued that the Court should accept either the "real interest rate" or the "inflate-discount" approach); Brief for South-eastern Pennsylvania Transportation Authority as Amicus Curiae at 19 (argued that all evidence in regard to inflation and its impact on lost future earnings should be limited to the particular plaintiff, occupation, and geographic area and that no evidence of general nationwide inflationary trends or rates be allowed).

thereby providing the plaintiff with an unwarranted windfall.¹²⁸ On the other hand, the respondent, Howard Pfeifer, maintained that the "total offset" method of computing future damages did not violate the Supreme Court's discounting mandate in *Kelly* and in fact provided a more favorable result to a defendant than the "real interest rate" approach.¹²⁹ Further, Pfeifer advocated that the Court endorse the "total offset" approach as the proper means of computing future damages under federal law as the most efficient and predictable method of incorporating inflation into the future damage award.¹³⁰

After reviewing the various approaches proposed by the parties and amici, the Supreme Court concluded that it should not establish one method as the exclusive federal rule for incorporating inflation into a damage award for lost future earnings. The Court was convinced that the complexity and uncertainty involved in computing a future damage award dictated against requiring one particular approach. The court made three observations which led to this conclusion:

First, by its very nature the calculation of an award for lost earnings must be a rough approximation. . . . Second, sustained price inflation can make the award substantially less precise. . . . Third, the question of lost earnings can arise in many different contexts. In some sectors of the economy, it is far easier to assemble evidence of an individual's most likely career path than in others.¹³¹

While the Supreme Court in *Pfeifer* refused to select one method as the mandatory federal rule, the Court did assess the various approaches and rendered an opinion as to the desirability of employing each. The first approach analyzed by the Court was

128. It was maintained that utilization of a "total offset" approach would result in overcompensating an injured plaintiff for two reasons: (1) interest rates on safe investments are generally higher than the rate of inflation, and (2) wage increases do not usually keep pace with rises in the Consumer Price Index. See Brief for Petitioner at 22; Brief Amicus Curiae of Alcoa Steamship Company at 11; Brief Amicus Curiae for Southeastern Pennsylvania Transportation Authority at 15. Petitioner and supporting amici derived these criticisms of the "total offset" method from the Fifth Circuit's opinion in *Culver v. Slater Boat Co.*, 688 F.2d 280, 297-99 (5th Cir. 1982), *rev'd on rehearing on other grounds*, 722 F.2d 144 (5th Cir. 1983).

129. See Brief for Respondent at 21.

130. *Id.* at 5.

131. *Pfeifer*, 103 S. Ct. at 2555. The Court did not express any concern for uniformity in the federal law of damages in maritime cases with regard to the method of accounting for inflation in computing a victim's lost future earning.

the "inflate-discount" method, whereby the victim's expected future earnings are increased to account for inflation and then discounted to present value by the market interest rate. The Court concluded that the specific forecasts of future inflation rates employed by this approach are "too unreliable to be useful in many cases" and therefore that attempts to make such predictions will normally be "costly and . . . unproductive."¹³² Thus, for efficiency and accuracy reasons, the Court "discouraged" both litigants and courts from utilizing the "inflate-discount" method.¹³³

The Supreme Court also was unenthusiastic about the "real interest rate" approach, in which the plaintiff's lost future earnings are calculated without considering inflation and then reduced to present worth by an "inflation adjusted" discount rate. The Court was unconvinced of the validity of the essential premise underlying this method—that the "real" interest rate is relatively stable over time.¹³⁴ Nevertheless, the Supreme Court maintained that a court adopting this approach would not be reversed if it used a discount rate "between one and three percent and explain[ed] its choice."¹³⁵

The third and final method of computing future damages in an inflationary economy discussed by the Court in *Pfeifer* was the "total offset" approach. Remarking that "such an approach has the virtue of simplicity and may even be economically precise," the Supreme Court appeared to find the "total offset" method the most attractive means of incorporating inflation into a damage award for lost future earnings.¹³⁶ The Court, however, did not agree with the

132. *Id.* at 2556. "The average accident trial should not be converted into a graduate seminar on economic forecasting." *Id.* (quoting *Doca v. Marina Mercante Nicaraguense, S.A.*, 634 F.2d 30, 39 (2d Cir. 1980), *cert. denied*, 451 U.S. 971 (1981)).

133. *Pfeifer*, 103 S. Ct. at 2556. The Supreme Court appears to have ignored the variation of the "inflate-discount" method which forbids expert testimony seeking to predict specific rates of future inflation. See *supra* notes 75-88 and accompanying text. The Court may have had a more favorable view of such an approach excluding expert testimony.

134. *Pfeifer*, 103 S. Ct. at 2556. In questioning the economic soundness of the "real interest rate" approach, the Court noted that economist Irving Fisher advanced the view that the "real" interest rate is not stable because changes in the "anticipated inflation" component of the market interest rate lag behind actual changes in inflation. The Court pointed out that Fisher had computed the "real" rate of interest in 1917 and found it to have fallen below minus 70%. *Id.* at 2556 n.30.

135. *Id.* at 2556.

136. *Id.* at 2557. In the *Pfeifer* opinion, the Court focused upon a "total offset" formula set forth by Professor Carlson in which the market discount rate would be deemed offset by price inflation and the societal factors contributing to "real" wage inflation. (This "total offset" formula is similar but not identical to the one set forth by the Supreme Court of Alaska in *Beaulieu and Guinn.*) The Court went on to note that "a substantial body of literature suggests that the Carlson rule might even *undercompensate* some plaintiffs." *Id.*

Third Circuit's view that this approach should be established as a mandatory federal rule. Noting that litigants could stipulate to the use of a "total offset" formula before trial, the Court emphasized that it was "not prepared to impose it on unwilling litigants, for we have not been given sufficient data to judge how closely the national patterns of wage growth are likely to reflect the patterns within any given industry."¹³⁷ Congress, according to the Court, was better equipped to undertake the comprehensive economic analysis needed before establishing a mandatory federal rule.¹³⁸ Since the record revealed that the parties had not agreed to utilize the "total offset" method, the Court vacated the judgment of the Third Circuit and remanded the action back to the trial court for recomputation of the plaintiff's lost future earnings.¹³⁹

The Supreme Court's decision in *Pfeifer* clearly evidences the continuing vitality of the *Kelly* mandate. A defendant is still entitled, at least in the federal court system, to discount any ascertained future damages to present value. A litigant cannot be forced to accept the "theoretical" reduction to present worth embodied in the "total offset" method. While the *Pfeifer* decision clearly prohibits lower federal courts from imposing the "total offset" on unwilling litigants, it does give courts the discretion of employing one of the two approaches which involve an actual discounting to present value. The only requirement set forth by the Supreme Court in *Pfeifer* regarding utilization of the "inflate-discount" or "real interest rate" methods is that "the discount rate should be chosen on the basis of the factors that are used to estimate the lost stream of future earnings."¹⁴⁰

at 2557 n.31 (emphasis in original).

137. *Id.* at 2557. In *Culver v. Slater Boat Co.*, 688 F.2d 280 (5th Cir. 1982), *rev'd on rehearing on other grounds*, 722 F.2d 114 (5th Cir. 1983), the Fifth Circuit Court of Appeals expressed a similar concern in refusing to embrace the "total offset" method. The Fifth Circuit noted that "the purpose of the award for future lost wages is not to protect the plaintiff from future inflation" but rather "to replace for future wages actually lost." *Culver*, 688 F.2d at 307. Recognizing that the wage increases of many workers do not keep pace with inflation, the court felt that the application of an inflexible "total offset" formula would result in overcompensating plaintiffs and unnecessarily penalizing defendants. *Id.* at 297-99.

138. *Pfeifer*, 103 S. Ct. at 2557.

139. *Id.* at 2557-58.

140. *Id.* at 2556. The Supreme Court in *Pfeifer*, 103 S.Ct. at 2555, expressly limited its decision to suits arising under § 5(b) of the Longshoremen's and Harbor Workers' Compensation Act. Clearly, however, the broad language and rationale employed by the Court in regard to the proper method of incorporating future inflation estimates into damage computations should be applicable to all actions involving awards of lost earnings. See Murdock, *Pfeifer: The Supreme Court on LHWCA and Inflation*, 25 FOR DEF., Sept. 1983, at 14.

VII. CONCLUSION

Prior to the Supreme Court's decision in *Pfeifer*, most courts which had addressed the issue recognized the necessity of considering inflation in awarding future damages. Thus, the *Pfeifer* Court's official recognition of inflation as a proper component of future damage awards should have little impact on the manner in which lost future earnings are calculated. The *Pfeifer* decision should, however, have a significant effect on the procedure by which courts incorporate inflation into the damage calculus. Clearly, after *Pfeifer* the "total offset" method cannot be utilized by federal courts unless the parties stipulate to its use. Although the Court in *Pfeifer* was not overly enthusiastic about either of the remaining two alternatives, it was especially critical of the "inflate-discount" approach. The Court went so far as to expressly discourage litigants and courts from employing this method. Thus, it is likely that the "real interest rate" approach will enjoy more widespread use within the federal judiciary.

The impact of the *Pfeifer* decision, however, should extend beyond the federal court system. The Supreme Court in *Pfeifer* clearly implied that, when compared to the other available methods, a "total offset" formula is the best method of computing damages for lost future earnings in an inflationary economy. Although the Supreme Court refused to impose such an inflexible method upon unwilling litigants, the Court's favorable view of this approach could conceivably induce state courts to adopt a "total offset" formula.

State courts wishing to embrace a "total offset" formula for computing lost future earnings should have little difficulty in dismissing the Supreme Court's stated rationale for its refusal to do so. The Supreme Court in *Pfeifer* expressed concern with the fact that it could not determine how closely the national patterns of wage growth, utilized by the "total offset" approach, parallel wage increases within a particular industry. The Court, however, appears to have ignored its own description of the lost earnings damage calculus. In the *Pfeifer* decision, the Court stated: "Throughout this opinion we have noted the many rough approximations that are essential under any manageable approach to an award for lost earnings."¹⁴¹ It is not unreasonable to assume that national wage growth patterns bear "rough approximation" to those within

141. *Pfeifer*, 103 S. Ct. at 2558 n.34.

the particular industry of an injured plaintiff. For some unstated reason, the Supreme Court in *Pfeifer* felt that official recognition of the "total offset" method would result in one approximation too many.