

**EARNING CAPACITY: Highest and Best, or Something Else?**

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### ABSTRACT

A person's earning capacity is an important element in choosing occupations, personal financial decision-making and lifestyle planning. Earning capacity is also an important issue in the litigation of economic damages. At a point in time, individuals may have the ability to succeed at a variety of occupations, each with a varying set of perceived effort and reward expectations. The highest and best use of a worker's earning capacity can be defined as those legal and attainable occupations that maximize the worker's economic rewards. Earning capacity can also be defined as the application (use) of the person's mental and physical assets toward the acquisition of pecuniary and lifestyle rewards and goals. This definition requires consideration of the person's perceptions of self and the world of work, as well as past, current, and future opportunity cost and utility choices. Thus the highest and best use of a worker's earning capacity is found to have four elements that must be understood in order to reasonably determine that person's earning capacity. Two sources are suggested for determination of highest and best use of earning capacity: fact (evidence) and opinion (research and evaluation analyses). Both are supported by economic theory.

### INTRODUCTION

Earning capacity loss is often the centerpiece of economic damage claims in personal injury, wrongful death, and employment litigation. Economic and vocational analysts must routinely employ valid and reliable methods to determine a person's pre and post-incident earning capacity. These measures should include consideration of the most possible and probable occupational choices and the related compensation for the worker.

This article presents a definition for earning capacity that is believed to be valid and reliable because it includes consideration of all the elements that determine a worker's most likely and best application of personal assets toward the attainment of pecuniary rewards. If the worker has but one use of labor that is legal, feasible, acceptable to the worker, and which given those constraints promises the highest compensation, that determination can reasonably be defined as the highest and best. If the worker's choices are in fact limited in this manner, then determining the worker's pre and post-injury earning capacity on this basis will usually lead to defensible opinions.

Highest and best use is a concept generally associated with real estate valuation theory. In that context highest and best use is the legal and feasible use of property that maximizes the income and hence its value is maximized (Boyce & Kennard 1984). Of course, humans are not property and their perceptions, beliefs, and choices have a great influence upon their highest and best earning capacity at a point in time. Adam Smith recognized this even as early as his first edition of *THE WEALTH OF NATIONS* (Smith 1776).<sup>1</sup>

The proper determination of pre-incident earning capacity must often include consideration of the worker's (or potential worker's) past choices regarding the

development and pursuit of economic opportunities and personal utility. Those past choices may necessarily modify the purely “historical evidence” determination (not including the element of worker choices) of the pre-incident and post-incident earning capacity. The determination of a worker’s post-incident earning capacity should include assessment of the worker’s, now changed, understanding of possible economic opportunities, mental and physical assets, the perceived cost of pursuing those opportunities, as well as the changed perception of personal utility related to those possible opportunities. In this manner the reasonably accurate or proper determination of earning capacity becomes much more complex.

Most people possess the capacity to work and earn pecuniary rewards as compensation for their labor. A worker’s pecuniary compensation for his or her labor is determined by the market based upon the assets the person possesses and the manner in which the person is willing, or has chosen, to utilize those assets toward the performance of legal, feasible and acceptable work.

### ANALYSIS OF THE ISSUE

Most people attempt to maximize their ability to earn money through preparing for, and working at, the type of occupation that they believe will maximize their pecuniary and lifestyle opportunities – their “highest and best” type of work. Younger persons in their formative years have an inchoate set of personal assets, opportunities, and choices that will ultimately determine their future earning capacity. Personal injury often results in physical and/or mental impairments that diminish or terminate an individual’s capacity to labor and earn at a number of historical and potential occupations.

Any event or incident that reduces a person’s marketable assets, ability to apply personal assets toward pecuniary reward, or choices related to economic opportunities – often also reduces that person’s earning capacity. If a person has experience working in a field or occupation, that usually becomes the focus of analysis. The lost or diminished wages (or potential wages) in a particular occupation thus becomes a measure of economic damages claimed in a lawsuit. However, generally it is the loss or impairment (difference between pre and post-incident) of the capacity to earn rather than the loss of earnings that is compensable. In most states, it is the loss of earning capacity, not “earnings or wages” that is the basis for a claim of pecuniary damages (for example, *Richmond v. Zimbrick Logging*, 1993, and *W.R. Grace & Co. V. Pyke*, 1995).

Analysis of this form of economic damage generally contrasts two scenarios: The existing or inchoate capacity at the date of injury versus the diminished or complete loss of residual capacity that follows the injurious event. In some states (for example, Florida and New Jersey) recovery is allowed for loss of earning capacity even though a higher paying different earning capacity is developed post-injury (*Allstate Insurance Co. v. Shilling* 1979, *Dombroski v. City of Atlantic City* 1998). While economic losses are often assumed to end at a point post-incident that the injured worker’s earnings equal or exceed the pre-incident earnings – there also reason to believe that this is not always the case. That assumption is predicated upon the limited concept that the “highest” demonstrated earnings is the only necessary component for determining a person’s

highest and best earning capacity. Such a limited view or assessment of earning capacity is not believed to result in the “best” (most reliable) determination the person’s earning capacity.

The damages expert’s opinions concerning earning capacity and related pecuniary losses must meet the test of reasonable economic probability – of being more likely than not to occur. This requires that both the prior and residual earning capacity be set at the highest and best use of the worker’s skills, effort and time. Opinions based upon lesser criteria would lead to invalid and unreliable conclusions about the economic loss.

#### CASE EXAMPLE WHERE HIGHEST AND BEST MIGHT HAVE MATTERED

An illustrative case example is provided by *Sestich v. Long Beach Container Terminal* (2002). Mr. Sestich’s claim was originally made under the Longshore and Harborworkers Act. Pertinent economic facts included prior work and earnings as a Longshoreman that was no longer feasible because of his injuries and permanent impairments. In his job as a Longshoreman he had earned an average weekly wage of \$921. Post-injury Mr. Sestich developed and secured a new occupation as Crane Operator paying more than double that amount. He thus demonstrated that a more rewarding (higher and better) use of his time and skills was feasible. After a period, Mr. Sestich’s residual impairments and limitations made it impossible for him to continue with this (higher and better capacity) occupation because of its physical demands. Eventually Mr. Sestich secured a Marine Clerk job that also paid more than the original longshoreman’s position, but less than the crane operator position.

Worker Sestich contended that his benefit amount should be equal to 2/3 the difference between his current (post-injury) actual earnings as a Marine Clerk and the average weekly wage amount as a Crane Operator he could be earning but for the injury. Because his post-injury “wage earning capacity” as a Marine Clerk exceeded his actual pre-injury “average weekly wages” as a Longshoreman, the Benefits Review Board held that he was not entitled to benefits. This decision may have addressed Mr. Sestich’s loss of earning capacity as Longshoreman, but it did not mitigate his loss of earning capacity as a Crane Operator vs. employment as a Marine Clerk. Note that all three occupations might be viewed as Mr. Sestich’s highest and best earning capacity at the time he engaged in them. For each job he had: the required credentials, the right to be employed, opportunity to be employed, made the choice to pursue that occupation, and then became employed in each occupation.

One reasonable view of the worker’s losses could be any negative differential between the marine clerk job compensation and the prior longshoreman job’s compensation (here none). However, an alternative and more reasonable measure of future loss of earning capacity would be the compensation differential between the demonstrated earning capacity as a crane operator and the final marine clerk job.

In performing the economic analysis of lost earning capacity the damages expert must strive to assure that the pre and post-injury earning capacities most reasonably reflect the highest and best use of the worker’s time and skills. In *Sestich*, the projection of

economic losses into the future under this standard would have been contingent upon the assumption that compensation as a crane operator is a reasonable measure of Mr. Sestich's pre-injury earning capacity, and that compensation as marine clerk is a fair measure of his residual post-incident earning capacity.

Clearly, the worker's mental and physical assets, and the worker's choices and use of those assets in pursuit of legal, possible, and acceptable work should determine the pre-incident earning capacity. The most probable highest and best use of the worker's time and assets is associated with the choices the worker made and followed through upon, and may not only be only the current use of those assets at any moment in time. Through his pre and post-incident decisions and actions, Mr. Sestich clearly demonstrated his pursuit of occupations that maximized the use of his original and residual assets toward the realization of pecuniary and life goals.

Had Mr. Sestich not pursued and demonstrated his earning capacity as a crane operator it might have only been discovered through the assessment and opinion of a vocational expert. Following post-incident assessment of Mr. Sestich's pre and post-incident assets and perceived acceptable possibilities, that expert might have opined that with interest and training, Mr. Sestich could reasonably have been expected to function successfully as a crane operator. In order to form such an opinion, the vocational expert would have to not only thoroughly assess Mr. Sestich's pre-incident assets and work related decisions, but also how his residual assets and post-incident perceptions, choices and goals had the more likely than not result of him successfully becoming a crane operator. Vocational experts routinely conduct this type of thorough and inclusive assessment. Just as the determination of the highest and best pre-incident earning capacity requires assessment of both the person's assets and life choices – an accurate opinion concerning a worker's post-incident earning capacity must include knowledge about how the person's assets have changed and how the person now believes the residual assets can best be applied regarding future occupational possibilities and decisions.

#### HIGHEST AND BEST EARNING CAPACITY DEFINED AND EXPLAINED

Highest and best use is: the most economically productive and acceptable use of the individual's time and assets at a point in time - from that individual's perspective. This is not necessarily the actual current use, which could well be a different, or even a non-use of the capacity to labor. Highest and best use earning capacity is that: (1) legal, (2) feasible, (3) acceptable (or likely to be acceptable and sought after by the worker) use of a worker's time and assets that (4) maximizes the potential compensation given the three prior elements.

**LEGAL USE:** This element would preclude consideration of those activities defined by law as criminal and those for which proper certification or licensure is not available to the worker.

**FEASIBLE USE:** A feasible use is one, which is legal, and that the worker can implement as practical matter. A feasible use is one in which the worker's time and

personal assets can be marketed for pay. A feasible use is one for which the worker has, or can acquire, the requisite personal assets (mental and physical abilities and attributes). A feasible use is also one for which a market demand exists in the labor market the worker chooses to enter.

**ACCEPTABLE USE:** To be considered as reasonable highest and best uses of a person's earning capacity, legal and feasible uses must be acceptable to, and sought after by, the worker. Personal beliefs and goals will influence or determine the choice of occupation. Thus, unless the worker is willing to pursue employment in a certain occupation, that occupation and its potential compensation is not usually part of that worker's set of possible highest and best uses. This can present a problem when the litigation process "expects" that a reasonable post-incident earning capacity is only based upon the highest paying job or jobs that the worker "can" reasonably be expected to perform, without consideration of the acceptability of those jobs to the worker. Acceptable choice also assumes that the worker has adequate information upon which to make a reasoned choice. The self-serving nature of individual choice as an element in selection of occupation has been long recognized, and was also addressed in *Wealth Of Nations* (Smith 1776). The nature of human choice and decision-making arguably permeates every aspect of life – including the development and use of a person's earning capacity. (Gariety & Shaffer 2007, Toppino & Male 2003)

Individual choice and decision-making is grounded in personal self-knowledge, tastes and preferences, risk tolerance or avoidance, financial motivation, self-image, ego and other factors and is unique to every human. For that reason not all legal and feasible occupations will be part of the set of potential highest and best uses for a particular worker's earning capacity. Although some persons would probably rather not work at all, the necessity of pursuing an occupation and engaging in work is implicit in the definition and the litigation process.

Thus some workers may reject relatively high paying jobs as too dirty, too difficult, too undignified, or just basically a bad match with their tastes and personality even though they are physically fit and have, or could likely obtain, the required skills.<sup>2</sup> A legal and feasible occupation that is not acceptable to the worker, and therefore not sought after for personal reasons, should not be considered a highest and best use of the worker's earning capacity.

Highest and best use of earning capacity is defined finally as the legal, feasible, and acceptable use of the worker's time and mental and physical assets that maximizes the pecuniary and lifestyle rewards for the individual. Thus, if a worker agreed that either clerking at a retail store or bookkeeping in an office were legal, feasible and acceptable, then the reasonable economic determination of the highest and best earning capacity would be for that occupation which paid the most.

#### IMPLEMENTING THE CONCEPT: IDENTIFYING THE HIGHEST AND BEST EARNING CAPACITY

Economic theory assumes that individuals are free to choose among legal and feasible economic alternatives and will do so in a manner that maximizes their perceived rewards. In this context a thorough and proper analysis should result in a fair opinion concerning the injured party's lost or diminished earning capacity within a reasonable degree of economic probability. The appropriate assessment, identification, and projection of pre-injury and post-injury highest and best earning capacity is necessary to achieve the desired result.

As a practical matter two general approaches are available to the pecuniary damages expert. The first is an evidence-based approach relying solely upon the documentation in the file regarding the worker's history of preparation for, and engagement with, work. Pre and post-injury work is identified and the consequent earning capacity determined by documented (or at least reported) compensation for engaging in those occupations. Reliance on this approach is predicated upon the basic economic assumptions of freedom of choice between all legal, feasible and acceptable occupational alternatives and the informed individual's demonstrated selection of those choices that maximize the perceived rewards to the worker.

The worker's own labor market activity thus defines the worker's earning capacity before and after the injury. This approach minimizes conjecture on other legal and feasible alternative occupations that might be better compensated by assuming that the worker has made informed personal choices that removed those occupations from the set of possible highest and best uses. It does not matter if the choices include limitations stemming from personal constraints. The assumption is that this worker has effectively limited the set of potential highest and best earning capacity uses to those chosen and engaged in.

However, as the Sestich example illustrates, at a point in time the current occupational choice may be transitory and not necessarily the person's highest and best. Sometimes alternative occupations with greater compensation may merely have been deferred pending acquisition of skills, seniority, growing up of children, changes in labor market opportunities, or other reasonable factors. Such factors may foster or foretell change in earning potential and render the current occupation and its compensation levels less definitive as a measure of the worker's actual highest and best earning capacity. Unless the pecuniary damages expert knows of planned, pending or probable changes in the person's assets or decisions, a competent analysis and forecast by a vocational expert may be needed to resolve concerns about future changes in the highest and best earning capacity.

The second general approach is based predominately upon the opinions of a vocational expert. This expert's opinions is normally based upon vocational evaluation and assessment to determine the occupations a worker can perform following an analysis of personal and labor market factors (Boyd & Toppino 1995, Toppino & Male 2003). These factors would include the worker's age, education, work experience and training, marketable skills, aptitudes, work personality, physical and mental capacities, access to the labor market, and the workers perspective on all of these factors. Very likely the

vocational expert will review the worker's actual employment and earnings history, as well as conducting a personal interview of the worker in the process of forming opinions. That process also often involves testing of the individual, a review of medical records and opinions, and review of employment and school records.

The vocational expert should provide an opinion regarding the pre and post-injury employment scenarios with specific reference to types of occupations and compensation rates. In addition to necessary changes in occupation, the vocational expert may also find the injured worker to have suffered reduced earning capacity due to only being able to work a reduced number of hours per week. With these opinions, the pecuniary damages expert would then project the probable highest and best earning capacity in the before and after scenarios through the worklife, and present the differences in present value.

If a pecuniary damages expert's opinion is to be based upon the opinion of a vocational expert, it is prudent to make certain that the vocational expert's opinions are clearly stated, well supported, and well understood by the damages expert. The damages expert must make the effort to study the vocational expert's opinions and the foundations for those opinions before accepting them as basis for the pecuniary damages opinion. It is problematic if the vocational expert's opinions do not explicitly address the highest and best earning capacity issue, or if the assessment process and conclusions contain errors or flaws.

While the damages expert may not be trained or experienced in the vocational assessment process, it is useful and necessary to have a basic understanding of foundations for the vocational expert's opinions in order to properly apply them in the projection of pecuniary losses. For example, if the vocational expert conducted a labor market access analysis, it is important that the damages expert understand how the results can be appropriately used toward determining a highest and best earning capacity. This type of analysis is often computer generated and matches the injured worker's pre and post mental and physical assets with a database containing the job requirements of various legal and feasible occupations. The result generally indicates that post-incident the injured worker is qualified for a certain reduced set of occupations, presumably not including many or all of the pre-injury occupations. The average wage rates are usually reported for the individual occupations as well as the groups of pre and post-injury occupations. It is important to keep in mind that a reduction in the number of job titles that the worker can perform does not directly equate to a decreased earning capacity or a significant reduction in the number of actual jobs the worker has access to in the labor market.

Simply identifying the possible set of occupational choices does not provide the basis for identification of the highest and best use of earning capacity. Using an average potential income may obscure probable other higher or lower incomes in occupations most likely to be chosen by the injured party. This problem should not arise if the final objective of the vocational evaluation is to determine feasible vocational choices based upon vocational assets, interests, goals, and behavior (Roessler & Baker 1998, Deutsch



1990, Field 1993, Toppino & Male 2003). In order to provide the most relevant information about the worker's highest and best earning capacity, the vocational expert should determine which occupational choices are acceptable to, and most likely to be sought after by, the worker.

### CONCLUSIONS:

Meaningful economic analysis requires the identification and measurement of the highest and best use of a worker's earning capacity. The highest and best use of a person's assets and time in the workplace has three objective elements determined by whether it is: legal, feasible, and compensated at the highest rate among alternatives. The highest and best earning capacity also has a subjective element: only those legal, feasible uses that the worker finds acceptable for actual employment can be considered.

There are two commonly employed approaches to determining the highest and best use of a worker's earning capacity. One, essentially an observational or evidentiary method, assumes that the worker's demonstrated or projected employment defines that worker's highest and best earning capacity (often without consideration of the subjective element). A second approach employs a professional opinion of highest and best earning capacity by a vocational expert. This approach assumes the vocational expert has considered all four elements of the definition and applied those in the determination of the worker's highest and best earning capacity.

### END NOTES:

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<sup>1</sup> See especially Chapter X "Of Wages and Profit in the Different Employments of Labor and Stock": " -- in a society where things were left to follow their natural course, where there was perfect liberty, and where every man was perfectly free both to chose what occupation he thought proper and to change it as often as he thought proper."

<sup>2</sup> Adam Smith on the subject: " - circumstances which -- make up for a small pecuniary gain in some employments, and counter-balance a great one in others:" "First. The wages of labour vary with the ease or hardship, the cleanliness or dirtiness, the honourableness or dishonourableness of the employment." Chapter X, Part I, *Wealth of Nations*.

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