

Small Business Owners
Making Big Business
Damages Claims

By Krista Fowler Acuña

Detailed and thorough discovery regarding a plaintiff, the plaintiff's business, and the plaintiff's role in the business are vital to a successful motion in limine.

Defending Lost Earning Capacity Claims

The U.S. Small Business Administration reports that more than 26 million small businesses operated in the United States in 2011. Litigators defending personal injury and wrongful death lawsuits can, therefore, anticipate cases

involving the owners or co-owners of small businesses and other self-employed plaintiffs. Crafty plaintiff attorneys will attempt to muddy the waters of lost earning capacity claims, arguing that they are synonymous with lost profits to the businesses. This “what the company earns, I earn” theory can result in over-inflated lost earning capacity claims.

Defense litigators must, therefore, aggressively and thoroughly investigate the nature of a plaintiff's economic claims in discovery when dealing with small business owners. The goal is to lay the ground work to prevent the presentation of lost business profits to a jury. This article discusses the general status of the law on this issue and presents effective pretrial strategies.

To exemplify the issue, let's consider the following case example: when a plaintiff in a personal injury claim experienced a herniated disc injury in 2006, he was the sole owner of a mortgage brokerage company that employed approximately 50 employ-

ees. He alleged that due to his significant back pain he was unable to operate his business effectively or work in the office. Profits declined significantly over the first half of 2007, and the business eventually closed. The plaintiff's damages claim was premised on net-income projections, which historically fluctuated between net profits and net losses. He claimed that lost profits of the business, due to his inability to effectively manage it, equaled his lost earning capacity.

In some ways this may seem logical, and a jury certainly may think so, but it is based on a significant misunderstanding of lost earning capacity. Quite simply, it confuses damage to the business with damage to the individual plaintiff. Thus, a defense litigator must focus on the actual losses experienced by the plaintiff.

Generally, lost earnings are determined by subtracting earning capacity after an injury from earning capacity before the injury. *Black's Law Dictionary* defines “earning capacity” as

the capability of a worker to sell his labor or services in any market reasonably accessible to him, taking into consideration his general physical functional impairment resulting from his accident, any previous disability, his occupation, age at the time of injury, nature



■ Krista Fowler Acuña is a shareholder of Houck Anderson, PA, based in Miami, Florida. She defends and counsels consumer and recreational product manufacturers and retailers and construction companies in all aspects of products and general liability matters. She is an active member of the DRI Trial Tactics, Product Liability, and Women in the Law Committees.

of injury and his wages prior to and after the injury... refers to that, which, by virtue of the training, the experience, and the business acumen possessed, an individual is capable of earning.

Evidentiary Standard and Factors

The purpose of a jury's award of damages for the loss of future earning capacity is to compensate a plaintiff for the loss of *capacity* to earn income as opposed to the actual loss of future earnings. Generally, an award of damages for loss of earning capacity requires a plaintiff to present evidence of a reasonable certainty of injury and proximate causation between that injury and the loss of earning capacity. A jury must have evidence that will allow them to calculate lost earning capacity reasonably.

To demonstrate a reasonable certainty of injury, a plaintiff must show an inability to perform tasks that he or she could perform before an accident. Without proof of consequent diminishment of earnings, however, this evidence would not sufficiently support an award for lost earning capacity. A plaintiff must prove both elements to support a lost earning capacity award. The majority of jurisdictions dictate that it is proper for a jury to consider the following items in determining whether a plaintiff has experienced a diminished earning capacity due to an injury (rather than other due to causative factors): age; health; habits; surroundings; life expectancy; talents; skills; experience; training; the plaintiff's business, profession, or occupation; the extent of his or her injuries; his or her physical capacity to perform work, both before and after the injury; and earning before and after the injury.

A defense strategy can challenge damages directly through four general avenues: (1) demonstrate that a plaintiff did not have an earning capacity to lose, or he or she had less earning capacity than claimed; (2) demonstrate that the injury sustained did not affect the plaintiff's capacity to earn, or that it had less effect than claimed, either because the injury was not as serious as claimed or because it did not impair faculties for or abilities to work as claimed; (3) demonstrate that the injury did not proximately cause the alleged loss of earning capacity; and (4) demonstrate that the plaintiff based the values claimed for potential diminution of earning capac-

ity on too much speculation or conjecture or they involved too many improbabilities to warrant consideration.

Plaintiff's attorneys too frequently focus on comparing earnings before and after an injury. A defense litigator must develop and evaluate all of the factors that could account for changes in earning.

The Role of Businesses and Lost Profits

Evidence of the profits and loss of profits of a business in which a plaintiff has an interest is typically inadmissible to prove lost earning capacity when the nature of the business, for the most part, depends on the employment of capital, the labor of others, or similar variable factors. The reason for this rule is that the loss of business profits from a business featuring these qualities is not necessarily due to a plaintiff's injury, profits based on that business model are uncertain, and assigning a value to losses under those conditions involves great speculation.

Courts have relaxed the rule against admitting evidence of loss of profits in a business when the evidence has *not* positively shown that the employment of capital, use of the labor of others, or similar variable factors predominated in the operation of the business and principally contributed to the production of income. In these circumstances the courts have taken the position that evidence of the lost business profits can assist in calculating damages (when a plaintiff has also demonstrated the requisites elements of proximate cause and certainty).

In short, when the returns from someone's business depend almost wholly on his or her own personal efforts, labor, skills, talents, knowledge of his or her business, initiative, and business services, or the business relied on only small amounts of invested capital, or some combination of these, then courts mostly will view lost profits of the business as relevant and probative and permit juries to have the data, not as a measure of damages, but to consider in determining the loss of earning power of the injured party. Most jurisdictions have accepted this exception to the general rule, and it is stated in the Restatement Second Torts §924.

Because some level of subjectivity is

involved in determining whether a business depends "almost wholly" on a plaintiff's personal efforts, a defense litigator must explore the details of the plaintiff's business, its structure, and its financials; the details of plaintiff's specific day-to-day role in that business; and all collateral factors that may have affected business profits other than the injury to the plaintiff. Collateral factors are particularly important now in light of the downturn of the U.S. economy since 2008, which has had a significant impact on small businesses.

In an extremely wide variety of factual settings, courts have considered whether the personal skill, initiative, and endeavors of an injured plaintiff in operating a business warranted admitting evidence of lost business profits. Collectively, the factors that courts consider when making this decision fall into six general categories:

- The nature of ownership or organization of the business;
- The character of the injured party's work, that is, the amount of personal direction and labor that he or she contributed;
- The industry-specific market conditions;
- Hiring of a substitute;
- A change of professions after experiencing the injury; and
- Whether the injury proximately caused the lost profits.

The Nature of Ownership or Organization of a Business

The more closely an injured plaintiff is involved in the operations and workings of the plaintiff's business, the more likely it is that a court will determine that it was through his or her own personal endeavors that a business achieved profits. Relevant factors considered and inquiries undertaken by courts to discern a business' organization and ownership makeup include:

- What type of business is it—corporation (and what type of corporation) partnership, or sole proprietor?
- What is the plaintiff's role in the operations—CEO, president, sole or partial shareholder, franchise owner, incorporator, or manager?
- How does the plaintiff receive income—salary, all or portion of the profits, commissions, or undefined?
- Were company earnings paid to the business or directly to the plaintiff?

- How much capital was invested?
- How many employees were necessary? How vital were they to the successful operation of business? What did they do?
- Can business earnings be attributed to specific employees or capital? If so, how? What portion may be attributed to each employee?

The more closely an injured plaintiff is involved in the operations and workings of the plaintiff's business, the more likely it is that a court will determine that it was through his or her own personal endeavors that a business achieved profits.

- How long had the business operated? Was it new or well established? Had the business successfully operated for such a period of time that would give it permanency and recognition?

The Character of an Injured Party's Work

This factor, the character of an injured party's work, focuses on the extent of a plaintiff's direct involvement with the business's productive activity. Relevant factors and inquiries include:

- How was business generated—through personal relationships, unique skills of the plaintiff, mailers, general advertising, or a combination of these?
- Why did customers choose the plaintiff's business? Did this have anything to do with the plaintiff's personal skill, initiative, and endeavors?
- Who made up the customers—repeat customers, one-offs, or referrals?
- How long had the plaintiff been in the business? Did his or her reputation have anything to do with generating business?

- Before the accident, when business came in, who did the actual work? How involved was the plaintiff? Did he or she have a hands on or supervisory role? After the accident, how did this change?
- Does the evidence demonstrate that the plaintiff has personal entrepreneurial skills, a particular work ethic, or consistent success growing businesses? Did he or she take part in trade associations or was the business a participating franchise?
- At the time of the accident was he or she in the middle of executing expansive business plans?

The Industry-Specific Market Conditions

In some cases the fluctuating market conditions of the particular business has affected the admissibility of business profits in determining loss of earning or lost earning capacity. The more volatile the market conditions, the less likely a court appears willing to admit the evidence. Relevant functions and injuries include:

- Were there unexpected fluctuations, less or more competition, changes in the plaintiff's habits and modes of living, sources of supply, and increased or decreased demand?
- Was the company's loss directly attributable to an injured party's failure to work or to a downturn in the market?
- Were there changes in government regulations or industry standards' that made the operation of the business more difficult?
- Were the market conditions affecting the pre-injury and postinjury periods so similar that a plaintiff can show that the defendant's negligence alone accounted for the damages and proximately caused the damage?

Hiring a Substitute

Small business owners commonly forego drawing a regular or set salary, thus, issues of salary and the costs of hiring substitutes often become central issues in these types of damages claims. Courts frequently admit evidence of the cost of hiring a substitute during the incapacity of an injured person as proof of, or partial proof of, damages resulting from loss of earning power or decreased earning capacity. Courts generally will admit it as evidence to prove

the extent of disability or impairment in the carrying on of a business and to determine the worth and loss of a business owner's time. The evidence is typically restricted to serving as proof of the substitute employment for only those tasks that a plaintiff would have done had the injury not occurred. The cost of hiring a substitute may also be admissible when a plaintiff does not receive a set salary or wage to demonstrate the market value of the plaintiff's earning capacity.

Relevant inquiries are:

- How does the plaintiff receive income: from a regular salary, all or a portion of the profits, commissions, or some undefined means?
- Was a substitute hired? What was the cost?
- Could a substitute have been hired and still maintain the business? What would the cost have been?
- If the plaintiff did not hire a substitute, what was the increase in labor costs after the accident? Did this increase affect the plaintiff's income?

A Change of Professions

Defense practitioners should also stay alert for information that a plaintiff changed professions after an injury or asserted a business failed due to an injury, but he or she did not subsequently attempt to remain in that industry or line of business. Generally, if a plaintiff elects to change professions after an accident for reasons unrelated to the accident, a jury may not consider evidence of alleged lost earnings from his or her former profession following his or her accident in assessing damages for his or her injuries.

Returning to the case example, there the plaintiff seemed an entrepreneurial sort: he had "dabbled" in other business ventures, including music and movie production, telemarketing, and real estate. He never attempted to diversify his mortgage business, he did not attempt to re-open the same or a similar type of business, and he never even returned as a salaried employee to the same type of business. These facts would belie the argument that a jury should determine the plaintiff's lost earning capacity by considering losses allegedly corresponding to the period between the business' closing to the time of the trial.

If a plaintiff elects to change professions after an accident for reasons unrelated to the accident, a jury may not consider evidence of the plaintiff's alleged lost earnings from his or her former profession following his or her accident in assessing damages for the injuries because the plaintiff has not satisfied the causation element. Inquiries should focus on the following:

- What was the plaintiff's pre-injury profession?
- What was the plaintiff's post-injury profession?
- Why did the plaintiff change professions after experiencing the injury?
- Is the post-injury profession less physically demanding than the pre-injury profession?
- Did the change in professions have anything to do with the injury?

Whether the Injury Was the Proximate Cause of the Lost Profits

To be admissible, the lost profits of a business must proximately result from an alleged injury, and the evidence must provide sufficient certainty to allow a jury to reasonably estimate the amount of the plaintiff's loss. While they overlap with the above inquiries, relevant inquiries include:

- Does the plaintiff have evidence that the injury directly affected profits? Did the plaintiff become unable to perform specific tasks due to the injury? For instance did the injury
 - prevent him or her from honoring existing contracts,
 - prevent him or her from forming new contracts or generating new business, or
 - prevent him or her from doing the things that that plaintiff did before to generate business?
- Did a substitute or could a substitute have performed the things that the plaintiff did before to generate business?
- Did the plaintiff reduce the pay amount that he or she received from the business?
- How did the "book" of the business compare before and after the injury?
- How did the plaintiff's "book" compare before and after the injury?

Case Examples

In several specific cases courts have ruled evidence of lost business profits admissible

as one factor for a jury to consider, but not that the lost profits equaled the lost earning capacity award. In one case a plaintiff was an opera singer and the sole shareholder of an "S" corporation. The plaintiff drew an annual salary and filed tax returns separate from the corporation, but all the earnings and the royalties from performances went to the corporation. The court ruled the lost profits of the corporation admissible to assist the jury because the plaintiff exclusively earned all the monies, and the corporation did not receive an infusion of capital. In another case, a court ruled lost profits of a refrigeration and air-conditioning business admissible because the partnership required little capital investment and used the full-time services of the plaintiff and his brother but did not employ anyone else. In a third case, a court ruled the profits from the management of a grocery store admissible as a measure of the plaintiff's earning power when the plaintiff was the sole owner and manager of the store.

In contrast, courts have ruled lost profit evidence inadmissible to support a lost earning capacity claim in the other circumstances. A court, for instance, refused to admit evidence of the plaintiff's earnings from a wrecking company when the plaintiff was the sole shareholder, the company had significant capital investment, and it used the labor of others to perform critical functions of the company. Another court rejected a plaintiff's theory that "what the company earns I earn" where the plaintiff was the incorporator, the president, and the manager of an industrial power tool corporation and holder of 69 percent of the stock. The court ruled the earnings of the corporation inadmissible because the business was newly established and earnings were internally inconsistent.

Pretrial Strategies and Discovery

The issues discussed in this article all turn on the admissibility of the lost profits of a plaintiff's business as evidence of the plaintiff's lost earning capacity. The goal, therefore, is to prevent or limit the introduction of this evidence to a jury using motions in limine. Detailed and thorough discovery regarding a plaintiff, the plaintiff's business, and the plaintiff's role in the business are vital to a successful motion in limine. More often than not, you will also require

the expertise of a forensic accountant, an economist, and depending on the nature of the business, an expert in that industry. Retain experts early, and use their expertise to formulate and flesh out the discovery plan early in a case to shape appropriate discovery requests, to identify all nonparty sources of information and documents, and to craft suitable deposition questions. Experts can also assist in resolving discovery disputes, such as objections to obtaining financial and other corporate records of a business. An expert, for instance, can establish the necessity and relevance of the documents to the formulation of opinions that the expert will form in a case.

From the defense perspective, you can pursue challenges in four different avenues:

- Demonstrate that a plaintiff possessed no earning capacity to lose, or it was less than claimed;
- Demonstrate that the injury sustained did not affect a plaintiff's capacity to earn at all, or it affected the plaintiff less than claimed, either because the plaintiff experienced a less serious injury than he or she claimed or because it did not impair his or her faculties or ability to work as her or she claimed;
- Demonstrate that there is no proximate cause between the injury and the alleged loss of earning capacity;
- Demonstrate that a plaintiff has based the values claimed for any potential diminution of earning capacity on too much speculation or they involve too many improbabilities to warrant consideration.

The admissibility of lost company profits turns largely on the character of an injured party's day-to-day work in his or her business, especially the extent of his or her direct involvement with productive activity. Discovery to explore regarding a plaintiff individually includes:

- What is the plaintiff's education, experience, training and work history, particularly as it relates to the nature of the business at issue?
- Could some other member of the company or a temporary manager have assumed the plaintiff's role in the company?
- How was the plaintiff involved in the growth of the business, procurement of new business, and the like?
- How did the plaintiff participate in planning and implementing business

- growth, and expansion, and did he or she or the business undertake business diversification to address economic or industry changes?
- Was the plaintiff involved in industry associations or groups related to the business?
 - Had the plaintiff previously delegated or depended on other employees to perform management tasks essential to the business?
 - Which specific day-to-day tasks could the plaintiff *not* perform due to the injury at issue, and which can the plaintiff perform?
 - Did the plaintiff hire a substitute during the period of incapacity?
 - Does the plaintiff draw a regular salary?
 - Does the plaintiff track or allocate vacation and sick and personal days similar to a typical employee, or can he or she otherwise quantify the specific time missed from work during the period of disability?
 - With accommodations, such as using the phone, Skype, or other electronic communications, could the plaintiff still fulfill his or her role in the business from home?
- Discovery to explore regarding plaintiff's business includes:
- Is the business a sub-S corporation?
 - How long has the company existed? Has it actively engaged in business long enough to establish patterns and trends regarding profitability, or does its youth mean that the lost profits figures rely on speculation?
 - Has the plaintiff contributed to the capital, and if so, how much?

- How many employees does the business have?
- What is the overall company structure and plaintiff's role within that structure?
- Does the plaintiff perform actual services that produce income to the company, or is plaintiff's role strictly managerial?
- Where does the business income come from?
- Which fluctuating market conditions are involved in this particular business?
- How would you describe the business's market sector, industry, customers, geographic participation, suppliers, and necessary raw materials?
- How does the business compare to other similarly situated business in similar markets? Did other businesses lose profits due to shared market conditions during the period in question? If not, did other businesses succeed by diversifying, seeking new market shares or customers, or by finding capital investments?

Also investigate the following nonparty sources for relevant information:

- IRS returns for both the individual and the corporation
- Accounting and financial records of the corporation held by any nonparty accountants or bookkeepers
- Licensure records with state or county agencies, if applicable
- Bankruptcy records

Conclusion

In the case example at the beginning of this article, the plaintiff attempted early in discovery to premise his lost earning capacity claim on his tax returns before and after the accident, which suggested a loss of over

\$2 million. His attorney's theory was that the plaintiff's back injury made it impossible for the plaintiff to run his business properly and it failed.

This "what my company earned I earned" theory was rebutted through a multifaceted approach in discovery. The defense attorney retained a forensic accountant and mortgage broker expert early, and they assisted with discovery to establish key facts such as (1) the plaintiff had no particular background, experience, education or training in the business beyond a brief two-year employment as a mortgage processor; (2) the plaintiff took advantage of market conditions at the time that allowed him with little start-up capital and experience to start a subprime mortgage brokerage that grew quickly from 2004–2007; (3) the top five lenders with which the plaintiff's company did business went bankrupt in early 2007, several months before the business closed; and (4) the plaintiff's role in the company was purely managerial, and he had established a corporate structure with department heads that removed him from the physical labor of servicing and placing mortgages. The defense attorney explored all of the factors discussed in this article with the help of experts, in written discovery through production requests, and most importantly, with the plaintiff during deposition. Taking this approach, the defense attorney then prepared an effective motion in limine that put significant pressure on the plaintiff and his attorney. In the end, the defense attorney achieved a settlement in an amount favorable to the defendants.

