Quantum Issues and The Discount Rate – Past, Present and Future

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The Purpose of this Talk

- Explores :-

- The legal historical background to recent developments.
- The significance of the recent change in the rate.
- The future possibilities.
- How we apply the DR to practical litigation.
- Quantum Issues disclosed.

What is the Discount Rate ?

- The rate set by the Lord Chancellor in July 2001 (see statement at page 125 of 2016/17 FF) and then in February 2017 (in force from March 20th 2017)
- It represents the net return on capital investment after :-

  (i) Inflation
  (ii) Tax
  (iii) Costs of Investment

The rate set in 2001 by Lord Irvine was **2.5%**.

The rate set in 2017 was **-0.75%** A higher rate will probably be set in 2018.

Future Loss

- Many larger injury claims involve future losses.
- These may be annual recurring claims such as earnings or care.
- Or they may be ‘one off’ items such as future surgery.

- Whether or not the claimant will have those needs and what the costs will be at present values is a matter for expert evidence.

- But once the need is established, the Court must decide how to provide for it in future.

The Problem

- Suppose the claimant will need surgery costing £1000 in 10 years' time.
- If the money is paid now and put 'under the bed' (not invested in anything), the £1,000 will be available after 10 years.
- This will pay for the surgery if the cost is still £1,000.
- If there has been inflation, the money will be insufficient.
- If there has been deflation, the money will be excessive.

- Inflation is more likely and most claimants will choose to invest.

The Uncertainty of Investment Return

- Suppose the claimant decides to ‘invest’ the £1,000 by gambling on a horse at odds of 3 – 1.
- If the horse wins, the £3,000 can the be put ‘under the bed’ and it will probably cover the cost of surgery in 10 years time even allowing for inflation.
- But if the horse loses, the claimant will have nothing.
- Equity investment is much safer than horse racing.
- But the claimant can still lose.

Secure Investment

- If the claimant can find a safe place to invest his £1,000, he may achieve a sufficient return to pay for the surgery in 10 years time without exposure to risk.
- This is the ideal outcome.
- The difficulty is that it is hard to predict the level of damages to be awarded now because we do not know over the next 10 years:-

  What inflation will be

  How investment will perform relative to inflation.

The discount rate seeks to rationalise this problem.

Wells v Wells [1999] AC 345

- The House of Lords held that the DR should be **3%** (as opposed to 4.5% set by the CA in this case). The best evidence as to ILGS returns.

- By this time, the use of the Ogden Tables (and “Facts and Figures”, first published in 1996), was starting to make the calculation of future loss more closely related to the DR.

Lord Irvine’s Statement

- June 2001, Lord Irvine set the DR at **2.5%**. He noted that the ILGS return at that time was on average 2.09%, but decided to round the figure up rather than down. Partly because he contended that claimants could and should pick a “basket” of investments.

Stock Market Investment

- Lord Irvine in 2001 said that one of the reasons he was setting the DR at 2.5% was his belief that those with damages awards would put some of their money into stocks and shares (‘equities’). This, historically, produces a higher level of return.
- Page 161 of FF shows that in January 2001, the FTSE 100 index stood at 6,297. In June 2016, it was at 6,230. So in 15 years, the capital appreciation (ignoring dividend interest) was nil.
- The right equity selection, however, may still provide good returns. In the last nine months, the market has risen by nearly 20%.

Returns on Investment

- Whereas in 2002, the return on gilts (safe government stock) was 2.01%, the return now is -1.55%.
- This means that, leaving aside the costs of investment, money invested safely will lose value at the rate of 1.55% per year. So even the new rate is insufficient at present gilt returns.
- Riskier investments may do better or worse.

The Pressure for Review

- The factors above meant that the Lord Chancellor came under increasing pressure to review the discount rate.
- Because the return from safe investment (and, perhaps, even riskier investment) bore no relationship to the damages awards.
- After pressure from APIL (including threatened and actual judicial review), the Lord Chancellor announced on February 27th 2017 that the new discount rate would be **-0.75%**
- Even this is still lower than some of the discount rate awarded in *Helmot* and it is less than the Gilt Index returns as above.

The Latest from the MoJ

- September 7th 2017, MoJ indicate that a rate will be set which will assume that investors achieve ‘low but not very low’ rates or return.
- Review at least every three years thereafter.
- The likely range of DR will be between 0% and 1%. Not retrospective.
- Significantly more than the present DR (but a lot less than the old 2.5% rate).
- It is unclear what parliamentary time will be allocated.
- DR unlikely to change this year.
- Judges must apply present DR (see *Cooke v UBHT* [2004] 1 AER 797.

What is the effect of DR on fixed term loss ?

- Whole life multipliers rise very substantially, especially for younger people. Boy aged 10 with normal lifex would have had a multiplier of 34.08 under 2.5% DR. Now has multiplier of 108.32.
- Fixed loss multipliers (table 28) are much greater:-

Term	-0.75%	2.5%	0%
20 years	21.58	15.78	20
30 years	33.66	21.19	30
40 years	46.68	25.42	40
50 years	60.71	28.72	50

How does a lower DR affect claims ?

- The greater the period of loss, the greater the effect as follows

M Claimant Age	2.5%	-0.75%	0%
10	34.08	108.32	78.31
20	32.10	88.96	67.22
30	29.60	71.43	56.34
40	26.52	55.66	45.76
50	22.69	41.44	35.45
60	18.30	29.19	25.92
70	13.44	18.85	17.32

Deferred receipt affected by DR

- With a 2.5% DR, if payment was delayed, the claim would fall because it was assumed that C would gain from investment. The opposite is true with a DR of -0.75%. A zero rate is neutral. See Ogden Table 27.

Period of Deferral	-0.75%	2.5%	0%
10 years	1.0782	0.7812	1
20 years	1.1625	0.6103	1
30 years	1.2534	0.4767	1
40 years	1.3514	0.3724	1

Roberts v Johnstone [1989] QB 878 HL

- Prior to RvJ, claimants were awarded the interest on the mortgage required to buy a suitable house.
- But by 1989 with rising interest rates, lifex and multipliers, this meant that the claim would exceed the value of the house.
- So HL awarded 2% of additional capital expended as the assumed rate of return on investment.
- With the DR set at 2.5% in 2001, this became the standard rate.
- But at -0.75% the DR means that the *RvJ* claim would nominally create a credit to D. At 0% the claim would be valueless.

Options to Replace *RvJ*

- Full funding of capital purchase by D with a charge over the property.

- Attractions – avoids present issues of investment and return issues.

- Disadvantages – who chooses the house ? What if C would rather pay more and live somewhere nicer ? Evicting C’s family after C’s death (unattractive for all) ? Who gets the capital gain/loss ?

Other Options For Housing

- Lump sum to cover interest only on the mortgage.

But this has the same problem of the original RvJ. If the rate of interest is (say) 3%, any multiplier exceeding 33 (ie about 30 years' loss) will create a claim bigger than the house.

Adapting PPO's. Possible but indexation may be difficult.

Rental costs. OK if C happy to rent.

Periodical Payments with the lower DR

- Probably more attractive to defendants.
- Will circumvent DR because not a capital sum.
- Practice Direction to Part 41 provides the court must consider D’s preferences as well as C’s.
- Government does not propose altering this (Sept 7 2017 paper).

- But PPO’s <u>cannot</u> be offered by insurers outside the FSA scheme, foreign insurers etc. Not available if insurance policy limits liability – no matter what the limit.

Thompson v Reeve (March 2017 Master Yoxall)

- Claimant offered to accept £340,000 in settlement by Part 36 offer dated August 25th 2016.
- Following announcement of reduced DR, Claimant sought to withdraw offer on February 28 2017 because claim now valued at £602,500.
- Although service of notice of withdrawal by email was defective, remedy of defect permitted and withdrawal deemed valid.

Damages Act exception from applying DR

- Subsection 1(2) of the 1996 Damages Act provides that the Court may set a different DR if "…*it is more appropriate in the case in question..*"

- This was successfully invoked in *Helmot v Simon* [2012] where the Privy Council endorsed Guernsey rates of -1.5% for earnings-related loss and 0.5% for other heads.

- Both parties may now seek to argue that cases justify a DR other than the one recently set. This sort of approach was discouraged by the Courts after the 2001 rate was set (eg *Cooke v Bristol HA*[2004] 1 WLR 251.

Future Uncertainties

- After the announcement of the new DR in February 2017, the insurance industry immediately sought a meeting with the Chancellor of the Exchequer (Phillip Hammond MP).
- The Lord Chancellor then announced a review of the DR with a closing date for that review of May 11th 2017.
- The proposals now published are not precise.
- We do not know when they will be implemented.
- We do not know what further review may then arise, although it appears that it may happen once every three years (cf no change 2001 to 2017).

Advising Clients

- Clients (claimant and defendant) must be WARNED of the risks that there may be significant and unpredictable changes to DR. This may affect the negotiating stance at JSM's.
- This will continue to be the case even after the present review process has been completed.
- Because there will continue to be competing pressures to vary the discount rate.

Practical Approaches to Settlement

- Claimants whose cases are unlikely to be heard until 2018 and beyond should be prepared to negotiate on the basis of a higher DR than minus 0.75%.

- Judges may be prepared to approve settlements on that basis where Part 21 approval is needed.

- There will always be uncertainty inherent in the process of awarding compensation for future loss. The DR issue is a manifestation of that difficulty – not a cause of it.