CIVIL LITIGATION/MEDICAL MALPRACTICE LAW SEMINAR

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MEDICAL MALPRACTICE: LIABILITY AND DAMAGES
PRESENT VALUE LUMP SUM AWARDS AT TRIAL

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Introduction

Since the 1978 Supreme Court of Canada trilogy of personal injury cases damage awards in such cases are in accordance with the principle of *restituto in integrum*. Thus, the pecuniary general damages awarded to a plaintiff should put him/her in the same position as she/he would have been in if the injury had not occurred to the extent that money can do so. In keeping with this basic principle that underlies every such award, the courts and later the Legislature, have developed a concept of discount rates to ensure these damage awards properly compensate for economic loss, i.e., loss of income and an allowance for extraordinary expenses for future care related to activities of daily living, by reflecting the affects of investment rates and inflation rates.

Recently, the legislated discount rate in Ontario was adjusted from the long-standing discount rate 2-**2** to 3% for awards up to 15 years and 2-**2** % thereafter by Rule 53.09. In accordance with the new Rule, commencing January 2001, the discount rate will be further adjusted to 2.75% and 2.5%. This initial Rule change decreased the damage awards assessed to plaintiffs although the extent of the decrease has been reduced for 2001.

Nonetheless, factors such as management fees and productivity may serve to reduce the discount rate, which minimizes such reduction in damage awards.

History

Prior to the late 1970's the courts assessed damage awards in a global amount, only hinting at the factors accounted for in arriving at a sum.[1] The effects of inflation and interest on a plaintiff=s award were usually ignored, under the presumption that the plaintiff could invest the award and thus offset any increase in the cost of living with increases in interest rates, return or capital appreciation.[2]

The problem with the Athe global sum award@ approach was recognized by the Supreme Court of Canada in the trilogy of personal injury cases of 1978. Since that time, the approach to the principle of *restituto in integrum* has been to provide a detailed assessment of damages under separate heads of damages.

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[1] Earl A. Cherniak and Mary Anne Sanderson, ATort Compensation - Personal Injury and Death Damages@ (1981) Developments in the Law of Remedies 198 at 198.

[2] Earl A. Cherniak and Mary Anne Sanderson, ATort Compensation - Personal Injury and Death Damages@ (1981) Developments in the Law of Remedies 198 at 203.

Also, in the personal injury trilogy cases, the Supreme Court of Canada recognized that both interest on invested awards (which reduced awards - the higher the interest rate projected, the smaller the current sum required) and the increased future cost of the services to be purchased with awards (inflation) must be accounted for. In *Andrews and Grand & Toy Alberta Ltd*., Dickson J. stated as follows:[3]

> Stable, non-inflationary economic conditions do not exist at present, nor did they exist in the recent past, nor are they to be expected in the foreseeable future. In my opinion, it would be better to perceive from what known factors are available rather than to ignore economic reality. Analytically, the alternative approach to assuming a stable economy is to use existing interest rates and then make an allowance for the long-term expected rate of inflation...

Thus, the Court advocated subtracting the projected rate of future inflation from the rate of investment return to determine a discount rate[4] (also referred to as Acapitalization rate@ or Anet discount factor@). The Discount rate should reflect the real rate of return that a plaintiff will receive on the invested lump sum damage award. Since the investment interest rate is almost always higher than the inflation rate, consideration of these two factors leads to a reduction in the damages awarded.[5] The plaintiff will, as nearly as possible, be returned to the position

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[3] *Andrews v. Grand & Toy Alberta Ltd.*, [1978] 2 S.C.R. 229 at 254-255.

[4] The trilogy decisions have been criticized for articulating a discount rate that is Anumerically too high@; see e.g. Michele Braniff and Alan Pratt, Tragedy in the Supreme Court of Canada: New Developments in the Assessment of Damages for Personal Injuries@ (1979) U. of T. Fac.L.Rev. 1 at 25 and Earl A. Cherniak and Mary Anne Sanderson, ATort Compensation - Personal Injury and Death Damages@ (1981) Developments in the Law of Remedies 198 at 213-214.

[5] Ken Cooper-Stephenson, *Personal Injury Damages in Canada,* 2nd Ed. (Scarborough: Carswell, 1996) at 394.

she/he would have been in had the injury not occurred, but not a better position if the discount rate achieves its intended purpose.

While the approach to inflation and investment was welcomed, the 7% figure arrived at by the Supreme Court of Canada was criticized as being numerically too high.[6] Further, there was ambiguity in the case law as to whether the figure or merely the approach was to be considered binding.[7] These criticisms were put to rest in Ontario in 1980 when Rule 267a was introduced:

> AThe rate of interest to be used in determining the capitalized value of an award in respect of future pecuniary damages, to the extent that it reflects the difference between estimated investment and price inflation rates, is 2**2** per cent per annum@.

As indicated, recently the legislature has adjusted this figure from 2 **2**% to 3% (over the first 15 years and 2**2**% thereafter) to account for today=s economic conditions. This coincides with the historical difference between the two rates.[8]

The Discount Rate

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[6] See e.g. Michele Braniff and Alan Pratt, Tragedy in the Supreme Court of Canada: New Developments in the Assessment of Damages for Personal Injuries@ (1979) U. of T. Fac.L.Rev. 1 at 25 and Earl A. Cherniak and Mary Anne Sanderson, ATort Compensation - Personal Injury and Death Damages@ (1981) Developments in the Law of Remedies 198 at 213-214.

[7] Earl A. Cherniak and Mary Anne Sanderson, ATort Compensation - Personal Injury and Death Damages@ (1981) Developments in the Law of Remedies 198 at 216.

[8] Studies indicate that over the 1964-1998 period, the real rate of return on trust company certificates fluctuated between 2% and 6%, with an average of approximately 3.6%, see Christopher Bruce, *Assessment of Personal Injury Damages*, 3rd Ed. (Toronto and Vancouver: Butterworths, 1999) at 229-231.

The current discount rate in Ontario is encompassed in Rule 53.09:

Calculation of Awards for Future Pecuniary Damages

Discount Rate

53.09 (1) The discount rate to be used in determining the amount of an award in respect of future pecuniary damages, to the extent that it reflects the difference between estimated investment and price inflation rates, is,

(a) for the 15-year period that follows the start of the trial, the average of the value for the last Wednesday in each month of the real rate of interest on long-term Government of Canada real return bonds (Series B113911), as published in the *Bank of Canada Weekly Financial Statistics* for the 12 months ending on August 31 in the year before the year in which the trial begins, less 1 per cent and rounded to the nearest 1/4 per cent; and

(b) for any later period covered by the award, 2.5 per cent per year,

Gross Up

(2) In calculating the amount to be included in the award to offset any liability for income tax on income from investment of the award, the court shall,

(a) assume that the entire award will be invested in fixed income securities; and

(b) determine the rate to be assumed for future inflation in accordance with the following formula:

Ag@ rounded to the nearest 1/4 per cent where,

$$g = \frac{1 + i}{1 + d} - 1$$

Ai@ is the average of the value for the last Wednesday in each month of the nominal rate of interest on long-term Government of Canada bonds (Series B113867), as published in the *Bank of Canada Weekly Financial Statistics*, for the 12 months ending on August 31 in the year before the year in which the trial begins;

Ad@ is

(a) for the 15-year period that follows the start of the trial, the average of the value for the last Wednesday in each month of the real rate of interest on long-term Government of Canada real return bonds (Series B113911), as prescribed in the *Bank of Canada Weekly Financial Statistics* for the 12 months ending on August 31 in the year before the year in which the trial begins, less 1 per cent, and

(b) for any later period covered by the award, 2.5 per cent per year.

In every case, counsel must be sensitive to changes in ss (1)(a) and ss (2)(d)(a) because both the discount rate for present value and the mandated future rates of inflation for 15 years following the valuation date (the start of trial) will vary when the relevant data for 12 months ending August 31 is known. This does introduce a very unfortunate feature of potential added expert costs for an actuary when a pre-trial is conducted in one calendar year with the specified rate and another rate is published in the next calendar year when the case reaches trial.

Purpose of the Legislated Discount Rate

Dickson J., in *Lewis and Todd* summarised the function of the discount rate as follows:[9]

> ...[T]he court is endeavouring to compensate the dependants of the decreased for loss of a future stream of income which the dependants might have expected to receive but for the death of the decreased...[T]he dependants receive immediately a capital sum roughly approximating the present value of the income they would have received had the decreased survived. They are able to invest this capital and earn interest thereon. A proportion of the interest received may be offset by the effective inflation. To the extent that the interest payments exceed the rate of inflation, there is a conferred on the dependants, through payment today of a stream of future income, a benefit which can be expressed as the Areal rate of return@. There would clearly be enrichment of the plaintiff at the expense of the defendant if the court did not take this benefit into account in making an award. Accordingly,

[9] *Lewis v. Todd,* [1980] 2 S.C.R. 694 at 709-710

> the court applies a so-called Adiscount factor@, *i.e.,* the real rate of return which the plaintiff can expect to receive on the damage award.

However, as indicated above, the Discount Rate, as originally conceived, was not fixed, but dependent upon the facts of a particular case. The result of this flexibility was a lack of uniformity in the discount rates being applied and extra litigation costs associated with the use of actuaries, economists, forensic accountants and investment advisors. Legislation has attempted to remedy these defects. Accordingly, as stated by the Ontario Court of Appeal, the *legislated* discount rate serves two basic purposes[10]:

> One of them is to avoid the expense incurred by parties in calling economic and actuarial evidence relating to future investment and price inflation rates in every case where future pecuniary damages are in question in order to establish the discount rate to be used. The other purpose is to avoid the general injustice of similar cases decided at the same time having different results because of the use of different discount rates in the calculation of the award.

Changes in Approach

a) The Multiplier

[10] *Giannone v. Weinberg* (1989) 68 O.R. (2d) 767 at 777.

The most notable change brought about by the increased discount rate is the change in multiplier. By definition, increasing the discount rate applicable will affect the multiplier used and affect the size of awards. The chart below demonstrates the significance of a change of 0.5% on the multiplier to be used in determining what present value will best represent future earnings.[11] If it was determined that a plaintiff would lose $45,000 income annually over fifteen years, at a 3% discount rate the defendant would have to pay $544,566.60. With a discount rate of 2 **2** %, the defendant would pay $557,163.00. Thus, plaintiffs= damage awards will generally be lower than what they were under the previous discount rate. In the case of Rule 53.09(2)(a) dealing with the mandated rate of inflation for gross up, the .5% is much more sensitive and creates a much greater difference in result.

Since a discount rate spread over a longer period of time, may significantly reduce an award, it is significant that the legislature confined the discount rate to 2.5% per year for awards to be assessed beyond a fifteen year period.

YEARS	**0%**	**2.5% ($1000 award)**	**3% (award)**	**Difference**
1	1.00	0.9756	0.98415	0.00855
5	5.00	4.6458	4.64238	-0.00342
10	10.00	8.7521	8.647	- 0.1051
15	15.00	12.38140	12.10148	- 279.92

[11] Adapted from McKellar Group Discount Rate Chart (649 Scottsdale Drive, Suite 100, Guelph, Ontario, Canada N1G 4T7, 1-800-265-8381) and Henderson Structured Settlements Inc., Discount Rate Chart (Coronado: Lawyers and Judges Publishing).

Consistency in Approach

Even though the discount rate has increased, other factors affecting damage awards have not changed. Thus, although Ontario has set a new statutory discount rate, arguably, the new rule allows for variation for matters other than inflation and interest rates, such as for management fees and general productivity. These considerations are external to the provisions of the rule regarding discount rates. Cooper-Stephenson notes[12]:

> [i]n any event, the majority of Provinces use the phrase Athe capitalized value of an award@ rather than Adiscount rate@, and that clearly refers to matter effecting the *nominal* amount of the award, not its *real* value - to which general productivity factors speak.

[12] Ken Cooper-Stephenson, *Personal Injury Damages in Canada,* 2nd Ed. (Scarborough: Carswell, 1996) at 402

Similarly, the Ontario Court of Appeal in *Dziver v. Smith* stated as follows[13]:

> [the rule] deals only with estimated investment and price inflation rates. It does not prevent the parties from showing that there are other factors which, in particular circumstances, ought to be taken into consideration. Thus, it may be shown that investment income will be subject to the cost of professional investment advice because the plaintiff is incapable of managing the fund himself. And, just as it may be shown that a plaintiff's income, barring the accident, would have increased at a greater rate than the rate of inflation, so to, it may be shown that the cost of future care will increase at a greater rate than the rate of inflation.

Later, in *Giannone v. Weinberg*, the Court of Appeal stated[14]:

> We think the short answer to the appellant's contention is that, in so far as future investment and price inflation rates are concerned as factors, the discount rate must be 2.5%. When these are the only factors which are being taken into account rule 53.09 does not allow the use of a different discount rate.
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> In so far as other factors may bear on the calculation (such as future wage increases over general price inflation, or the relevant individual's income from employment increasing at a faster rate than the general increase) and it is felt that they may reasonably be given effect to in the discount rate, then the 2.5% starting point may be adjusted.

a) Management of damage awards

[13] (1983), 146 D.L.R. (3d) 314 at 317-318

[14] *Giannone v. Weinberg* (1989), 68 O.R. (2d) 767 at 777 (C.A.)

In order to properly manage a large award, the courts have accepted that plaintiffs will require management services.[15] Cooper-Stephenson notes that the statutory rate assumes prudent investment and that this may not be possible without assistance of financial advice, particularly in the case of large sums of money.[16] The fact that a plaintiff cannot realistically be expected to have the expertise to properly invest the lump sums awarded to them has not changed because of the change in the discount rate.

[15] See e.g. *Arnold v. Teno*, [1978] 2 S.C.R. 287 at 328

[16] Ken Cooper-Stephenson, *Personal Injury Damages in Canada*, 2nd Ed. (Scarborough: Carswell, 1996) at 406; to cover the management of a fund invested in long-term government bonds costs approximately one-half of 1% of the balance of the fund under administration per annum *Giannone v. Weinberg* (1989), 68 O.R. (2d) 767 at 771 (C.A.)

In light of the necessity of management fees, it has been suggested that the discount rate in the rules should be subject to a further reduction for a management fee. For instance, it was argued in *Giannoni and Wineberg* that if the plaintiff were to pay more for investment management, she/he would benefit from a higher rate of return, and that the discount rate should be reduced accordingly. The Court of Appeal rejected that argument stating that it is appropriate that such awards, given the purpose they are to serve, be placed in low risk portfolios such as long-term government bonds.[17] Since damages in a personal injury action are often intended to replace the plaintiff=s entire lifetime of earnings, or provide the plaintiff with sufficient funds to obtain medical care for the rest of her or his life, the investment selected must offer a secure rate of return.[18] Accordingly, accounting for management fees can reduce the discount rate.[19]

Notably, Bruce argues that Ontario=s mandated rate is below the long-run return on a secure portfolio of investments, and there is no need to reduce the discount rate further to incorporate management fees.[20]

b) Productivity and wages

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[17] *Giannone v. Weinberg* (1989), 68 O.R. (2d) 767 at 785-786 (C.A.)

[18] Christopher Bruce, *Assessment of Personal Injury Damages*, 3rd Ed. (Toronto and Vancouver: Butterworths, 1999) at 228.

[19] In *Giannone v. Weinberg* (1989), 68 O.R. (2d) 767 at 771 (C.A.) the discount rate was only reduced by 1/2% per annum.

[20] Christopher Bruce, *Assessment of Personal Injury Damages*, 3rd Ed. (Toronto and Vancouver: Butterworths, 1999) at 234.

General productivity reflects growth in the economy, either within a particular sector or within the economy as a whole.[21] It relates to the *real* value of an individual=s anticipated earnings, and therefore her or his progressive prosperity in terms of material assets which could have been acquired from those earnings as they were received over a period of loss. General productivity effects the level of earnings in the future, and thus should effect damage awards. In *Lewis and Todd*, the Supreme Court recognized that productivity is Aan appropriate component of a damage award in a proper case,@.[22]

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[21] Ken Cooper-Stephenson, *Personal Injury Damages in Canada*, 2nd Ed. (Scarborough: Carswell, 1996) at 396

[22] *Lewis v. Todd*, [1980] 2 S.C.R. 694 at 712

Incorporating productivity into the discount rate will serve to increase the award given to a plaintiff. If a plaintiff, before injury, was in a field where her/his real income would increase by a given percentage a year, then this percentage, to the extent it exceeds inflation, arguably should be subtracted from the discount rate. For instance, while there is little to not growth in real wages in low-skilled, non-unionized occupations, there is significant growth in real wages in high-skilled occupations.[23] Accordingly, in *Ligate and Abick* the Ontario Court of Appeal upheld the use of a discount rate of 0.5% on evidence that wage increases for correctional officers (the plaintiff=s previous employment) would exceed inflationary increases by 2%.[24]

The principle of *restituto integrum* requires that the income prospects of a plaintiff be accounted for.

c) Productivity and health care costs

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[23] Peter Ross, AA Review of Recent and Important Legal Developments@ (1996) 14 Can. J. Ins. L. 93

[24] *Ligate v. Abick* (1996), 28 O.R. (3d) 1 (C.A.)

Productivity can also be incorporated to reduce the discount rate for the present value of lump sum awards as an allowance for extraordinary costs of future care referable to activities of daily living. For instance, in *Osborne and County of Bruce,* Justice O=Connor accepted that the cost of medical services the plaintiff will require in the future would increase at about 1% more than inflation generally, *i.e.* these medical services will increase by about 6% in the future whereas inflation was projected to be 5%.[25] A governmental shift to homecare services would increase demand for homecare providers and thus increase the cost of the people providing those services - nursing care, medical equipment and supplies, medications, massage therapy and other professional services would rise more rapidly than the rate of inflation. In *Osborne,* the court adjusted the discount rate for future care costs to 2.0% to reflect the facts exigent in the medical delivery field.[26]

Conclusion

While the legislature has adjusted the discount rate to reflect past, current, and projected future economic reality, it has left open the issue to contest matters of management fees and productivity associated with wage increases (relevant to loss of income and future care awards). These two areas have been developed by the courts, and there is no reason the changes to the discount rate rule should cause this jurisprudence to change.

Since it is in the interests of plaintiffs and defendants in malpractice cases to reduce the costs of experts, the matter of the discount rate and the multiplier could be the subject of

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[25] *Osborne v. County of Bruce* (1999), 39 M.V.R. (3d) 159 at **&**69-72 (Ont. Gen.Div.)

[26] *Osborne v. County of Bruce*, (1999), 39 M.V.R. (3d) 159 at **&**69-72 (Ont. Gen.Div.)

agreement to reduce the considerable expense of the actuaries. It is suggested the parties agree no actuarial evidence need be presented as expert evidence until the court has made the relevant findings covering loss of income and future care costs. In such circumstances, counsel should be able to agree on the lump sum awards and the respective heads of damage and if not, an actuary retained by both parties could undertake the calculations representing a considerable cost saving for both parties.