THE DISCOUNT RATE:

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Just remind me – what is the discount rate?

The fundamental aim underlying the assessment of damages for personal injury is to put the person as closely as possible in the same position as they would have been if they had not been injured. If damages for future loss are to be awarded on a lump sum basis, this involves assessing the likely annual losses or expenses and multiplying them up to produce a capital award. The starting point is to look at the number of years over which the loss will run (whether life expectancy, years to retirement age or some other term). However, using the actual number of years as the multiplier would ignore two factors. The first is the effect of the lump sum being invested to produce additional income to supplement the capital award. If that is ignored, the claimant would be over-compensated. The second factor is the effect of inflation meaning that future annual costs are likely to increase over time. If this factor is ignored, the claimant will be under-compensated.

This notion of aiming for a position where the claimant is neither under or over-compensated was summarised in the classic statement of Lord Oliver of Aylmerton in Hodgson v Trapp [1989] AC807:

"Essentially what the court has to do is to calculate as best it can the sum of money which will on the one hand be adequate, by its capital and income, to provide annually for the injured person a sum equal to his estimated annual loss over the whole of the period during which that loss is likely to continue, but which, on the other hand, will not, at the end of that period, leave him in a better financial position than he would have been apart from the accident. Hence the conventional approach is to assess the amount notionally required to be laid out in the purchase of an annuity which will provide the annual amount needed for the whole period of loss."

To arrive at the capital sum needed for that purpose, we must apply a multiplier. The multiplier has built into it an assumption about the rate of return that can be expected if the lump sum is invested and the interest on it is then compounded with it to meet the future annual losses. Traditionally, the position was that:

"A discount must be given for the fact that money is being paid now for a loss which will not arise until some date in the future." (Lord Hope of Craighead in Wells v Wells.)

In this context the term "discount rate" makes sense and is a convenient shorthand term. It becomes slightly more confusing when, as currently, the chosen rate is a negative one. The rate in fact no longer produces a discount; it gives rise to an uplift. What has happened is that a shift in the economic climate means that the likely impact of future inflation is considered to be greater than the assumed impact of investment.

It is not the case as has (perhaps disingenuously) been suggested that a negative discount rate assumes that claimants will actually lose money on their investments. It is still assumed that nominal interest will be received but when this is netted down to take account of tax and inflation it will produce a negative rate.

So in simple terms, the "discount rate" may be seen as the net allowance that must be made for the return on investment balanced against inflation. If the rate used is positive the multiplier will be discounted compared to the number of years over which it is assumed the loss will run. If a negative rate is used the multiplier will be higher than the number of years it represents. Higher discount rates lead to lower damages overall. Lower discount rates lead to higher damages. Negative discount rates can produce significantly higher awards where any substantial future losses are to be met by a lump sum.

History of the Discount Rate

Looking back at the seminal cases, it is striking how much the quantification of personal injury damages has changed in a relatively short time. In 1972, Sachs LJ observed in George v Pinnock [1973] 1 WLR 118 that the 'modern practice' of assessing heads of loss separately had only really taken hold since 1970. Even then the assessment of damages was very 'rough and ready' with quantification being seen as an art rather than a science. There was an underlying acceptance that it was impossible to be precise. In Lim Poh Choo Respondent v Camden and Islington Area Health Authority Appellants [1980] A.C. 174, Lord Scarman famously said:

"There is really only one certainty: the future will prove the award to be either too high or too low."

He continued:

"Perfect justice is not attainable: nor would it be wise in the search for the nearest approximation to justice to abandon principles already judicially determined, whatever one's "saucy doubts and fears." If your Lordships can lay down, by decision in this case, an intelligible and moderate way of assessing damages for catastrophic, but not fatal, personal injuries under the law as it now is, there will have been achieved all that the judicial process can offer towards the improvement of this area of the law."

The use of multipliers and the underlying assumption of a 'discount rate' developed in a rather ad hoc way. There was a conventional ceiling of 18 for the lifetime multiplier and generally a whole number was selected, often around 11 or 12 for an adult. In <u>Cookson v Knowles</u> [1979] AC 556, Lord Diplock observed that:

"In times of stable currency the multipliers that were used by judges were appropriate to interest rates of 4 per cent. to 5 per cent. whether the judges using them were conscious of this or not."

The Ogden Tables were first published in 1984. The purpose of the tables was said to be *"to help the courts in determining upon what lawyers describe as the multiplier."* There were only 6 tables, compared to the current 28. In the explanatory notes, the Working Party concluded that while the courts were then conventionally using multipliers implicitly assuming a discount rate of between 4% and 5%, it was difficult to argue that a plaintiff should be required to speculate and therefore that the fairest approach would be to work on the basis of multipliers calculated by reference to returns on Index-Linked Government Stock (ILGS). At the time that would have suggested a discount rate of between 2.5% and 3.5%.

<u>Index-Linked Government Stock</u>

The Government introduced index-linked gilts in 1981. They are government bonds that pay interest at a rate that is fundamentally driven by the prevailing rate of inflation (by way of reference to the Retail Prices Index, or RPI). The term 'gilts' reflects the security of the investment. The British Government guarantees to make the interest and principal payments as they become due. Index-linked gilts offer a very safe vehicle for investment with the advantage of protecting against inflation. In theory, they provide a good means of investing personal injury damages without risk. However, there are significant limitations.

ILGS are only released periodically and in fairly random tranches. The stock has a fixed life at the end of which repayment of the initial investment together with the rise in RPI is guaranteed. There is no consistent stream of ILGS maturing each year. ILGS currently in issue will mature between 2017 and 2068 but there are gaps so that there are years where none will mature. Only institutions and not individuals can buy the stock at issue. Therefore personal injury claimants are only able to access ILGS on the re-sale market where there can be fluctuations in value.

Although setting the discount rate has evolved around the idea that personal injury claimants will invest in ILGS this is perhaps better seen as a theory rather than a reality.

In 1994, the Law Commission recommended, following a consultation, that the time had come for court to take actuarial evidence into account in selecting multipliers and that:

"In determining the return to be expected from the investment of the sum awarded, the court shall, subject to and in accordance with rules of court made for the purposes of this provision, take into account the net return on an index-linked government security but it shall be open to any party to show that a different rate of return is more appropriate in the case in question."

It was further suggested that provision should be made for the Lord Chancellor to prescribe an alternative indicator of real rates of return, essentially to cover the situation if the practice of issuing ILGS came to an end. This would have allowed the courts to vary the appropriate discount rate in line with changes in the returns on ILGS.

The Damages Act 1996

This Act followed the report of the Law Commission but its recommendations were not wholly adopted. In particular, the Act gave the Lord Chancellor power to set the default discount rate. Section 1 provided:

(1)In determining the return to be expected from the investment of a sum awarded as damages for future pecuniary loss in an action for personal injury the court shall, subject to and in accordance with rules of court made for the purposes of this section, take into account such rate of return (if any) as may from time to time be prescribed by an order made by the Lord Chancellor.

(2) Subsection (1) above shall not however prevent the court taking a different rate of return into account if any party to the proceedings shows that it is more appropriate in the case in question.

(3) An order under subsection (1) above may prescribe different rates of return for different classes of case.

(4) Before making an order under subsection (1) above the Lord Chancellor shall consult the Government Actuary and the Treasury; and any order under that subsection shall be made by statutory instrument subject to annulment in pursuance of a resolution of either House of Parliament.

The Act therefore requires the courts to take into account the rate set by the Lord Chancellor but does not prescribe how the Lord Chancellor should set the rate. The Act came into force in September 1996 but no order was immediately made to set the rate.

Wells v Wells

In 1999, the House of Lords considered how multipliers for future loss should be calculated in three linked appeals, Wells v Wells; Thomas v Brighton Health Authority; Page v Sheerness Steel Co. PLC [1999] A.C. 345.

The House of Lords concluded that the lump sum should be calculated on the basis of the rate of return available on ILGS. Explaining the conclusions leading to this position, Lord Lloyd said:

"(1) Investment in I.L.G.S. is the most accurate way of calculating the present value of the loss which the plaintiffs will actually suffer in real terms.
(2) Although this will result in a heavier burden on these defendants, and, if the principle is applied across the board, on the insurance industry in general, I can see nothing unjust. It is true that insurance premiums may have been fixed on the basis of the 4 to 5 per cent. discount rate indicated in Cookson v. Knowles [1979] A.C. 556 and the earlier authorities. But this was only because there was then no better way of allowing for future inflation. The objective was always the same. No doubt insurance premiums will have to increase in order to take account of the new lower rate of discount. Whether this is something which the

country can afford is not a subject on which your Lordships were addressed. So we are not in a position to form any view as to the wider consequences.

(3) The search for a prudent investment will always depend on the circumstances of the particular investor. Some are able to take a measure of risk, others are not. For a plaintiff who is not in a position to take risks, and who wishes to protect himself against inflation in the short term of up to 10 years, it is clearly prudent to invest in I.L.G.S. It cannot therefore be assumed that he will invest in equities and gilts. Still less is it his duty to invest in equities and gilts in order to mitigate his loss.

(4) Logically the same applies to a plaintiff investing for the long term. In any event it is desirable to have a single rate applying across the board, in order to facilitate settlements and to save the expense of expert evidence at the trial. I take this view even though it is open to the Lord Chancellor under section 1(3) of the Act of 1996 to prescribe different rates of return for different classes of case. Mr. Leighton Williams conceded that it is not desirable in practice to distinguish between different classes of plaintiff when assessing the multiplier.

(5) How the plaintiff, or the majority of plaintiffs, in fact invest their money is irrelevant. The research carried out by the Law Commission suggests that the majority of plaintiffs do not in fact invest in equities and gilts but rather in a building society or a bank deposit.

(6) There was no agreement between the parties as to how much greater, if at all, the return on equities is likely to be in the short or long term. But it is at least clear that an investment in I.L.G.S. will save up to 1 per cent. per annum by obviating the need for continuing investment advice.

(7) The practice of the Court of Protection when investing for the long term affords little guidance. In any event the policy may change when lump sums are calculated at a lower rate of return.

(8) The views of the Ogden Working Party, the Law Commission and the author of Kemp & Kemp, The Quantum of Damages in favour of an investment in I.L.G.S. are entitled to great weight.

(9) There is nothing in the previous decisions of the House which inhibits a new approach. It is therefore unnecessary to have resort to the Practice Statement (Judicial Precedent) [1966] 1 W.L.R. 1234 .”

The House set a guideline rate of 3%, deriving this from the net average return of ILGS, the majority considering that the average should be taken over the past 3 years although Lord Lloyd would have only used 12 months. It was suggested that “only a marked change of economic circumstances should entitle any party to re-open the debate in advance of a decision by the Lord Chancellor.

My reading of this is that the House of Lords was not intending to tie the hands of the Lord Chancellor as to how the rate was set under section 1 of the Damages Act 1996. However, it is interesting to note that the last Lord Chancellor appears to have accepted that any change in the methodology adopted in setting the discount rate under the powers conferred on her by section 1 would require primary legislation. It remains to be seen how this may play out.

Lord Lloyd also noted that the Ogden Tables were to be regarded as a starting point rather than (as previously) a check. In future, judges should be slow to depart from the relevant actuarial multiplier on impressionistic grounds or by reference to earlier decided cases. This, of course, is something that has now become so well established that the use of the Ogden Tables to select multipliers is second nature.

The Damages (Personal Injury) Order 2001

Finally, on 25th June 2001, the then Lord Chancellor, Lord Irvine, exercised his powers and made an order, setting the rate at 2.5%.

That rate was based on the three-year average yield on ILGS up to 8th June 2001. The rate was subject to immediate criticism suggesting that it was in fact too high. No doubt with an eye to possible Judicial Review, the Lord Chancellor reconsidered the decision afresh and on 27th July 2001 restated that 2.5% was the appropriate rate, giving more detailed reasons for that. The Lord Chancellor's statement of that date may be found in full at page 125 of the 2016/17 edition of "Facts and Figures".

The statement indicated that the Lord Chancellor had applied the appropriate legal principles laid down authoritatively by the courts and in particulars in Wells v Wells. It noted the desirability of setting a single rate to cover all cases and one that was easy for all parties and their lawyers to apply in practice across a range of different circumstances over a period of time. It also referred to the detrimental effect (particularly on settlements) of frequent changes to the discount rate.

The rate was set by taking the three-year average yield over all ILGS rather than by excluding stock with less than 5 years to maturity as the House of Lords had done in Wells v Wells.

The Lord Chancellor concluded that yields were artificially low at the time but that there was a reasonable prospect of a return to higher rates (a prospect that has not been realised). He also noted that the Court of Protection had continued to invest in multi-asset portfolios even in the wake of Wells v Wells. This he said, suggested that there are sensible, low-risk strategies available to claimants which would allow them to comfortably achieve a real rate of return of 2.5% or above, without being unduly exposed to risk in the equity markets. Finally, the Lord Chancellor highlighted that it remained open to the courts to adopt a different rate in any particular cases if there were exceptional circumstances to justify that.

Challenging the 2.5% rate – exceptional circumstances

In Warriner v Warriner [2002] 1 W.L.R. 1703, the Court of Appeal rejected an attempt to rely on accountancy evidence to justify the use of a rate of 2% on the basis that the Claimant's long life expectancy and the size of the claim were special circumstances that justified the court considering whether there was a "more appropriate" rate than the one set by the Lord Chancellor.

The term "more appropriate" comes from section 1(2) of the Damages Act 1996. The Act itself makes no reference to "exceptional circumstances" although that was what appeared in the Lord Chancellor's statement. The Court of Appeal considered though that this meant no more than "special circumstances" and was a helpful explanation of the relevant sub-section of the Act. No special circumstances had been identified such as to potentially justify invoking that provision. Therefore, the expert accountancy evidence was to be excluded.

In Cooke v United Bristol health Care [2003] EWCA Civ 1370, the Court of Appeal heard conjoined appeals in which the claimants again sought to introduce expert accountancy evidence. It was argued that since care costs were rising at a greater rate than the RPI the claimants would be grossly undercompensated if the conventional method of calculating a lump sum was adopted. The claimants sought to argue that in order to account for the shortfall that would result from the application of the 2.5% discount rate multiplicands should be revised to allow for stepped increases over time. The Court of Appeal rejected this as an illegitimate rate to subvert the Lord Chancellor's discount rate. The Court also confirmed, following Warriner that cases involving long life expectancy and high damages were not special cases such as to fall within section 1(2) of the Damages Act 1996.

The advent of Periodical Payments Orders

The power for the court to order periodical payments under section 2(1) of the Damages Act 1996 did not come into force until 1st April 2005. After an initial slow start, the NHS have embraced PPO's and most settlements of high value claims in recent years have included periodical payments for care and case management. My experience recently has been that even where a liability split has been agreed, the NHSLA have pressed for periodical payments.

This stance has been in marked contrast to most of the leading insurers who have remained resistant to PPO's. It is my view that an artificially high discount rate has encouraged insurers to make offers of settlement only on a lump sum basis, requiring claimants to run the risks of going to trial on all issues in order to secure periodical payments.

The position is different for the Medical Protection Society (MPS) and Medical Defence Union (MDU). The nature of these organisations is such that they cannot provide "reasonably security" for the purpose of a periodical payments order. Save for a few cases where insurance was in place for a while, this means that periodical payments cannot be ordered in cases where the damages are to be met by the MPS or MDU.

The availability of periodical payments and the use of PPO's in large clinical negligence claims has mitigated the impact of the 2.5% discount rate.

Thompstone v Tameside and Glossop Acute Services NHS Trust [2008] 1 WLR 2207

Under section 2(8) of the Damages Act 1996 *"An order for periodical payments shall be treated as providing for the amount of payments to vary by reference to the retail prices index"*. However, section 2(9) allows for sub-section (8) to be disapplied or modified. The claimants successfully argued that periodical payments for future care should vary by reference to the Annual Survey of Hours and Earnings for the occupational group of care assistants and home carers (ASHE 6115) produced by the Office of National Statistics. This was despite the defendants arguing that the same principles should apply as for the calculation of lump sum damages (as in Cooke). The Court of Appeal accepted that a periodical payments order was a wholly different creature from a lump sum and that using an earnings based index to uplift future periodical payments could not be compared to the illegitimate attempt to get round the discount rate.

Thompstone highlighted that a link to the RPI was unlikely to accurately reflect the changes in the cost of care year on year. The use of the RPI will probably be negatively biased in respect of earnings-based needs (although note that immediately after Thompstone the RPI rose faster than earnings growth and it appears that this may be the case again). As already noted ILGS are linked to the RPI so that there is a significant risk built into a lump sum that there will be a shortfall if earnings rise faster than inflation. When the discount rate was in fact failing even to keep up with the RPI the risk of a shortfall was increased.

Following Warriner and Cooke, it seemed that the discount rate set by the Lord Chancellor was virtually unchallengeable through the courts. The cases confirmed that the discretion to use a different rate should only be exercised in circumstances which were not within the contemplation of the Lord Chancellor when setting the rate. There are no reported decisions where a different discount rate was used. Truly exceptional circumstances such as a claimant living abroad and being subject to a different tax regime might have justified a departure but the prospect of persuading the courts to use a different rate otherwise was virtually non-existent.

Helmot v Simon

This case from the Court of Appeal in Guernsey decided in September 2010 attracted much attention. Jonathan Sumption QC, as he then was, assessed damages in a personal injury claim. Guernsey applies the common law of England and Wales. It did not have an equivalent to the Damages Act. Therefore, the court had to determine the appropriate discount rate. Wells v Wells was followed. The judge found that the real rate of return on index-linked gilts in Guernsey had fallen to around 0.5%. Starting from the position that returns on index-linked gilts were the basis for the discount rate, the judgment took account of different tax rates and the difference in price and earnings related inflation, resulting in a discount rate of -1.5% for care and earnings related losses and 0.5% for other future losses.

The setting of different rates for different heads is an approach that had been mooted in this country but rejected both in Wells v Wells and by the Lord Chancellor.

Lord Chancellor's review of the discount rate

Following repeated calls for the rate set in 2001 to be reviewed and intimation of a claim for Judicial Review by the Association of Personal Injury Lawyers, the Lord Chancellor (then Ken

Clarke) announced a review. This did not materialise and led to the issue of a claim seeking J.R. in April 2011. The application for permission was dismissed on the basis that a consultation paper was said to be imminent. Finally, on 1st August 2012, the first consultation paper was launched, entitled *"Damages Act 1996: The Discount Rate and how should it be set".* This was followed in 2013 by a second paper *"Damages Act 1996: The Discount Rate -Review of the Legal Framework".* In 2015, the Lord Chancellor appointed a working party comprising Richard Cropper and Ian Gunn of Personal Financial Planning Limited (Independent Financial Advisers); Dr Paul Cox, Senior Lecturer of Finance at Birmingham Business School and an Investment Adviser at The National Employment Savings Trust (NEST) and Dr John Pollock, a Consulting Actuary. They provided their report on 7th October 2015. A year later, no outcome had been announced. Following the further threat of Judicial Review and with Liz Truss now in the role of Lord Chancellor, an announcement was made on 7th December 2016 to the effect that the outcome of the review would be made public by the end of January 2017. The Association of British Insurers attempted to challenge this by way of Judicial Review but their challenge failed and on 27th February 2017 the Lord Chancellor announced a new rate of -0.75% to take effect from 27th March 2017.

It is fair to say that was a far more dramatic swing than was generally anticipated. The new rate was greeted with great excitement on the claimant side and with undisguised disdain from the insurance lobby. However, initial commentators may have overlooked the small print. The announcement also contained this promise:
"the government will launch a consultation in the coming weeks to consider whether there is a better or fairer framework for claimants and defendants, with the government bringing forward any necessary legislation at an early stage".

Despite the controversy caused by the dramatic drop from a rate of 2.5% to one of -0.75%, in fact all the Lord Chancellor had done was to essentially repeat the exercise performed in 2001 in a very different economic climate. The methodology was not changed. The Lord Chancellor stated *"I am clear that this is the only legally acceptable rate I can set."* She was merely applying the principles laid down in <u>Wells v Wells</u>, in particular she approached the setting of the discount rate on the basis that the governing principle is as identified by Lord Hope: *"[The discount rate] is the rate of interest to be expected where the investment is without risk, there being no question about the availability of the money when the investor requires repayment of the capital and there being no question of loss due to inflation."* That involved assuming that a claimant would invest wholly in ILGS.

The new consultation opened on 30th March 2017 and closed on 11th May 2017. That allowed 23 working days to respond to wide-ranging questions calling for detailed and evidenced based responses. The Ministry of Defence have undertaken to publish their response to the consultation by 11th August 2017. Whether the General Election will have any impact on this timetable remains to be seen. If the conclusion is that primary legislation is required, that would have to be fitted in around Brexit. That may produce a substantial delay, even despite the lobbying power of the insurance industry.

So where are we now?

The new discount rate of -0.75% is now in force. For cases coming on for trial, that is the rate that will be used. For cases where a trial will not take place this legal term, there is unfortunately uncertainty. Defendants generally are anticipating that there will be either a change in rate or a change in methodology that will benefit them. There is therefore a reluctance to settle claims, certainly on the basis of a discount rate of -0.75%.

There are possible solutions. Variation clauses were employed by the NHSLA in the past and may be resurrected. There may be opportunities to settle some claims where liability is in dispute or where there are particular uncertainties over quantum. For some claimants, securing a sum that can be made to work may well be preferable than waiting until we have a clearer view of where we will end up. The appropriate approach to any settlement is very fact specific and calls for creative thinking and a sensible approach in my view. In some respects, it may be useful to move away a little from our way of thinking that there is a single “right” valuation of a claim. For adult claimants with capacity, they may choose to take what they can get now. In the climate of uncertainty, my opinion is that it is useful to have good financial advice prior to settlement, allowing clients to really see the options and recognise the choices available to them.

What is the impact of the changed rate?

There are, in my view, legitimate concerns about the impact of the change on the NHS. According to the Office for Budget Responsibility, “the Government has set aside an extra £1.2 billion a year to meet the expected costs to the public sector (notably to the NHS Litigation Authority).”

At a time when many think the NHS is already underfunded, this has caused concern in all sections of the press. Some of the reporting though misunderstands the true position. The Guardian reported a case of a 10 year old girl, for whom damages of £3.77 million had been agreed as recently as January, which had now 'tripled' to £9.29 million. However, it was almost certainly the case that that award included a periodical payments order.

As noted above, the NHS has enthusiastically adopted periodical payments. Further, from about late 2015 or early 2016 HM Treasury required the NHS Litigation Authority to reduce the discount rate used in setting the (notional) accounting provision for their future obligations to make periodical payments of damages, from +2.20% to -0.8%. In other words, from that time the Government were working on the basis that if they were to capitalise up the liability of the NHS to make periodical payments they should do so using a discount rate of -0.8%, in fact slightly lower than the revised rate to be used by the courts.

When an award is made or a settlement is agreed in a high value claim, what tends to happen is that claimants' lawyers will report a notional overall value of that award / settlement. To do that periodical payments are capitalised using the life multiplier that has been used to arrive at the lump sum element. If the lump sum has been calculated using a 2.5% discount rate, the periodical payments are capitalised on the same basis. However, if the lump sum element has employed a -0.75% discount rate, so the periodical payments are capitalised with the new multiplier. This notionally results in a huge increase in the value of awards. However, this is a fiction. The lump sum element will indeed increase but the periodical payments are completely untouched by the change in the discount rate. If this represents the largest element of the award then the overall increase in value is nowhere near as significant.

To put this into context, I recently obtained approval of a settlement for a boy aged nearly 9. Prior to the change in the discount rate, we had agreed that an appropriate settlement based on a discount rate of 2.5% would be a lump sum of £4,345,000 and periodical payments of £160,000 to age 16; £205,000 to age 19 and £230,000 for life. Further PP's of £22,000 per annum from 21 to 68 or earlier death were also agreed for loss of earnings. Using the 2.5% discount rate produced a total capitalised award in the region of £11 million. The life multiplier at 2.5% was 29. At -0.75% it is over 62. Therefore, the multiplier had increased by 2.13 times. Applying that factor to all future loss appeared to uplift the value of the claim to about £22 million. On the face of it, therefore the claim has been doubled by the change in discount rate. However, the periodical payments have not changed at all. They will continue to be paid at the same rate and with the same indexation regardless of the discount rate. We agreed a variation clause in relation to that part of the lump sum that related to general future loss. In doing so, we removed the accommodation claim on the basis that the impact of the discount rate on Roberts v Johnstone claims was unclear. This left us with £2,000,000 out of the lump sum that would vary with the discount rate. We have agreed that this will be recalculated with the applicable discount rate as at 31st October 2017. If it remains at -0.75%, there will be an additional sum payable of £2.4 million.

From this it can be seen that the impact of the change in the discount rate which crudely appears to have doubled the claim, that is adding £11 million, has in real terms only resulted in an additional payment (if the rate remains unchanged over the next few months) of £2.4 million. I say "only". This is of course a significantly increased liability. However, it is nothing like the sort of impact that might be spun by changing the multipliers used to notionally capitalise the periodical payments. I think we must be on our guard against misleading reporting and also be conscious of our responsibility not to add to it by the way in which we report the outcome of our own cases.

Other consequences of a negative discount rate

(1) Impact on parties' preferences as to the form of the award

As noted above, it had become the norm to have a periodical payments order in a high value personal injury claim. Generally, this was the form offered by the NHSLA. This is in marked contrast to the position with RTA insurers, who rarely offered periodical payments as a first choice. In my view, the 2.5% discount rate offered a strong incentive to insurers to settle claims on a lump sum basis. The position was somewhat different within the NHS because of their accounting methods.

I have already noticed that the stance of insurers has changed since the variation of the discount rate. The balance has shifted. I believe that insurers would rather see as much as possible of future loss accounted for by way of periodical payments than put all future losses into a lump sum using a discount rate of -0.75%.

By contrast, claimant's representatives are now questioning whether a claimant would be 'better off' with a lump sum calculated by reference to a -0.75% discount rate. It is clear that far greater potential now exists to better the underlying assumption. There is therefore an opportunity for claimants to profit from investments. However, it must not be forgotten that doing so still carries risk. The investment risk has been mitigated but remains; the risk of a claimant living longer than their life expectancy continues as does the risk of an imbalance between earnings growth and RPI. Contrary to what some defendants may think, I find that claimants continue to be very risk averse. Generally, they are not interested in being able to make a 'quick buck' but prioritise the security of payments for future care above all else. In full liability cases, I believe that periodical payments for care and case management remain appropriate. To positively argue that a lump sum would be better for a claimant in such circumstances probably undermines the new discount rate. It seems clear from the consultation paper that the Ministry of Justice is keen to increase the take-up of periodical payments. If the new discount rate it seen to deter claimants from seeking or accepting periodical payments I believe that this will strengthen the case for raising the discount rate.

The position has become more nuanced for claims involving a liability split and those where future annual costs are less certain. In such circumstances, a preference for a lump sum to offer greater flexibility may well be legitimate. Whether the NHS are likely to agree to lump sum settlements is a different matter and remains to be seen. I suspect that anything that sees the use of periodical payments in NHS cases fall off will be likely to be used as a basis to question the assumptions used in setting the discount rate.

(2) Accommodation claims and the Roberts v Johnstone calculation

I do not propose to say a great deal about accommodation claims here as this important subject is the topic of a separate lecture. However, a review of the impact of the change in the discount rate would not be complete without noting the link between Roberts v Johnstone claims and the discount rate. The law underpinning the Roberts v Johnstone claim was recently reviewed by the High Court in JR v Sheffield Teaching Hospitals NHS Foundation Trust [2017] EWHC 1245 (QB).

It is a long-established principle, stemming from George v Pinnock [1973] 1 W.L.R. 118 that the Claimant is not entitled to claim the full capital cost of alternative accommodation. The solution identified in Roberts v Johnstone [1989] Q.B. 878 was recently described by Lord Justice Tomlinson in Manna v Central Manchester University Hospitals NHS Foundation Trust [2017] EWCA Civ 12 as "imperfect but pragmatic". It is worth noting that it was decided at a time when property prices were much lower and therefore accommodation was a less contentious head of claim than it is now. Even before the change in the discount rate, questions had been raised as to whether the Roberts v Johnstone method remained fit for purpose.

In Roberts v Johnstone, the Court of Appeal decided that the appropriate way to compensate a claimant for the loss associated with the need to purchase a more expensive property was to allow for the loss of use of the capital tied up in the property by reference to the tax-free yield which could otherwise have been anticipated in risk-free investments (essentially the same basis as used to calculate the discount rate). At the time, this led to using a multiplicand of 2% of the additional capital tied up. Following Wells v Wells the rate used for the multiplicand was increased to 3% to match the discount rate and this was revised to 2.5% in 2001 when the Lord Chancellor set the discount rate at that level.

It is therefore important to appreciate that the use of 2.5% in calculating the Roberts v Johnstone award is linked to the discount rate (see pp. 379H – 381A of Wells v Wells, in which it was stated that there were two advantages in fixing the rate at the average net rate of return on ILGS – it was the rate used for calculating future loss and *"it will be kept up to date by the Lord Chancellor when exercising his powers under section 1 of the Damages Act 1996".*) Of course, what was not envisaged then was a negative discount rate. Does this mean there is no loss? That was the view taken by William Davis J in JR, leading to him making a nil award for the capital cost of accommodation.

The judge was not unsympathetic to the claimant's argument that Roberts v Johnstone was merely a pragmatic solution to the problem of providing necessary accommodation while not leaving the estate with a windfall and that an award should be made even when the discount rate is a negative one. However, he concluded that he was not in a position to find "a fair and proper solution" in that case, having regard to the facts and the evidence before him. He rejected the notion of continuing to take a multiplicand of 2.5% and capping the claim at the full capital cost when (as inevitably will happen in any case involving a long life expectancy) applying the multiplier on a -0.75% discount rate produced more than 100%. He suggested that evidence might be placed before the court as to the current cost of borrowing, say by way of an interest only mortgage and that such might not offend against the principles in George v Pinnock in the current economic climate. I believe this has been seized upon as an encouragement to obtain financial evidence as to the cost of borrowing as a ready solution to the Roberts v Johnstone conundrum. For what it is worth, I am not persuaded that it will provide an easy answer. I believe that any such evidence is likely to produce a rate that when coupled with the revised multipliers will still usually produce a sum in excess of the 100% capital cost. Another possible solution floated in JR was the idea of the defendant taking a reversionary interest in the property. William Davis J described this as "superficially attractive" while noting that no such solution was proposed in the instant case.

JR is, I understand, being appealed. The current backlog of appeals in the Court of Appeal makes it unlikely that the case will be heard before the outcome of the discount rate review is known. Other first instance decisions may emerge in the meantime. I suspect that NHS Resolution will be reluctant to include Roberts v Johnstone awards in settlements at this stage. Alternative solutions have to be carefully considered and evidenced where appropriate. However, claimants can be reassured that overall they are likely to be in a better position with a settlement using the new -0.75% discount rate and care should be taken not to cause undue concern to clients in relation to the difficulty the new discount rate poses when dealing with accommodation claims.

What comes next?

The Consultation Paper released on 30th March 2017 says this:

"Following the consultation, which will consider whether there is a better or fairer framework for claimants and defendants, the Government will bring forward any necessary legislation at an early stage."

It might be observed that we thought the original consultation looked at the framework and methodology and was considering how the discount rate should be set not merely what the rate would be under the method used in 2001. However, this process appears to have been started again. The Lord Chancellor considered herself bound by Wells v Wells and therefore concluded that -0.75% was the only rate she could set. However, the House of Lords was clearly not purporting to rule out the possibility that the Government would take a different view.

Lord Lloyd said this:

"No doubt insurance premiums will have to increase to take account of the new lower rate of discount. Whether this is something which the country can afford is not a subject on which

your Lordships were addressed. So we are not in a position to form any view as to the wider consequences."

Lord Hutton made a similar point:

"The consequence of the present judgments of this House will be a very substantial rise in the level of awards to plaintiffs who by reason of the negligence of others sustain very grave injuries requiring nursing care in future years and causing a loss of future earning capacity, and there will be resultant increases in insurance premiums. But under the present principles of law governing the assessment of damages which provide that injured persons should receive full compensation plaintiffs are entitled to such increased awards. If the law is to be changed it can only be done by Parliament which, unlike the judges, is in a position to balance the many social, financial and economic factors which would have to be considered if such a change were contemplated."

Lord Steyn's judgment contained an important warning for claimants:

"It must not be assumed that the 100 per cent principle is self-evidently the only sensible compensation system."

However, the Lord Chancellor appeared to commit to the principle of 100% compensation in the consultation document, expressly stating:

"We are not reviewing the underlying principle of the law of damages that the award of damages should, as far as it is possible for an award of a sum of money to do so compensate the claimant fully for all the losses caused to him or her by the injury inflicted by the defendant. The 100% rule will continue to apply."

Once the principle of 100% compensation is accepted, it seems to me that the real issue is whether the assumption that claimants are to be treated as a special category of investor who will invest only in ILGS should remain. Paragraph 24 of the consultation paper addresses this as follows:

"In practice claimants will pursue a range of investment strategies, but if on average they adopt a higher risk profile than ILGS and as a consequence have the potential for higher returns, then on aggregate the current law is at risk of overcompensating claimants. A different balance could be struck by altering the underlying assumption that claimants adopt a degree of investment risk. By reducing or eliminating the potential for overcompensation, this could achieve a fairer balance between claimants and defendants on aggregate. The degree of investment risk would need to be calibrated appropriately so that claimants are not exposed to such unacceptably high risks that they are not able to meet their expenses over time."

Whether a different solution can be found which still meets the 100% principle remains to be seen. There is much speculation that the discount rate will be brought back up, perhaps ending up at around 1%. I am not sure that this speculation is always underpinned by any particular analysis though. I question what additional information is going to emerge from the latest consultation, particularly bearing in mind that the Ministry of Justice has already had a detailed report from the very experienced Working Party briefed to assist with the last review.

The Working Party paper has been published on the Ministry of Justice website. It is not particularly easy to locate but may be found with this link:
https://consult.justice.gov.uk/digital-communications/discount-rate/results/discount-rate-report.pdf
At Chapter 4, the Working Party considered a "financial economics approach to the discount rate". The Working Party explain that:
"The financial economics approach to setting the discount rate in a personal injury context is to use the long-run rate of return on a very low risk investment portfolio."

Whether or not such an approach would still be consistent with the principles adopted in Wells v Wells and by the Lord Chancellor in 2001 is debatable. The Lord Chancellor appeared to conclude that it was not in indicating that the rate set in February 2017 was the only legally acceptable rate open to her.

The panel went on to explain that:

"A financial economics approach can arrive at a range of discount rates, depending on appetite for non risk-free assets."

Two possible portfolios were considered. The panel were unanimous that any portfolio involving less than 50% in ILGS and more than 50% in an optimal mix of more risky investments would be inappropriate for a very low risk investor. However, even a very low risk tolerant investor may be expected to assume some investment risk. The panel concluded that a portfolio of 50% ILGS and 50% mixed riskier investments would produce a discount rate of 0.75%. A portfolio of 75% ILGS and 25% other investments would produce a discount rate of 0%. So far, I have not seen any other analysis leading to a suggestion for specific alternative discount rates. At the time the Working Party reported, it was assumed that any rate would be rounded up or down to the nearest 0.5%. However, having set a rate of -0.75% the Lord Chancellor appears to have set a precedent for being more precise.

Until the review is complete and the outcome is known, we will continue in a climate of uncertainty. It is important for practitioners to be aware of the principles underlying the setting of the discount rate and to think sensibly, and at times creatively, about what we are seeking to achieve. Settling personal injury claims has become more difficult; the unthinking application of multipliers sometimes without really understanding their basis cannot continue. However, armed with a good understanding of how the discount rate operates, sensible lawyers will find opportunities to achieve good results for their clients.

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