

Discount rates

When a court awards damages for future economic loss (which include lost future income; expected medical and care costs; home or vehicle modifications to accommodate wheelchairs or other special needs), it assumes that the plaintiff will invest the lump sum and earn income from the investment.

Discount rates are percentages used to reduce the total amount of lump-sum compensation awarded to an injured person. The rationale for discount rates is that since the injured person will invest their lump sum, interest earned will increase the total amount of their damages award.

To ensure that the plaintiff is not 'better off' as a result of receiving money now – which they would otherwise receive only over time – the court applies a discount rate to reduce the lump sum. The higher the discount rate, the lower the lump sum awarded to a plaintiff.

The discount rate is intended to take into account:

- the expected rate of return on investments;
- real growth in wages/inflation; and
- likely future tax rates. (Tax rates are relevant because although the lump sum is not taxed, any income earned from the investment is taxed as income.)

In 1981, 3% was the appropriate discount rate determined by the High Court in *Todorovic v Waller*.

In recent years different states and territories have legislated various discount rates, some as high as 7%. Tort law reform applied these higher statutory rates to medical negligence and public liability cases on the pretext of ensuring consistency. This was an easy way to cut the cost of claims.

In March 1983 the NSW Motor Accidents Authority commissioned a report from two senior actuaries on the appropriateness of a 5% discount rate. They noted that the long-term real rate of return on investments was 2.6%, and that once tax is taken into account, the actual discount rate should be -1%. They concluded that the 5% discount rate was a totally inappropriate means of calculating an equivalent lump sum, which will satisfy the requirements of indemnity.

In 2001 in the UK, following investigations and economic research, the Lord Chancellor reduced the discount rate from 3% to 2.5%.

The difference that a few percentage points makes in the life of an injured person is best illustrated by an example.

A woman is seriously injured. She has a life expectancy of 44 years and has assessed expenses of \$5,000 a week for the rest of her life. At a 3% discount rate, if her award were invested 50% in fixed interest and 50% in fully franked shares, the \$5,000 could be drawn for about 44 years before the funds run out. With the proposed 6% discount rate, the funds would run out after about 23 years.

The Australian Lawyers Alliance opposes excessive discount rates and will continue to lobby for their reduction to the reasonable levels mandated by the High Court.