

## INQUIRY INTO PERSONAL INJURY COMPENSATION LEGISLATION

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**Subject:**

**Summary**

Tabled 6/06/05  
by Mr Andrew Morrison SC



**Personal injury compensation legislation  
NSW Parliament – Legislative Council  
General Purpose Standing Committee Number 1**

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**Supplementary Tabled Documents**

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## Discount rate

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Most of a very seriously injured person's award of damages will be for their lost earning capacity into the future, and the costs of medical treatment and care services.

Courts estimate the ongoing costs for care and treatment on a weekly basis, and then assess the likely life expectancy of the injured person. The damages award is then calculated on the basis of the weekly requirements and the life expectancy. Damages are then paid to the injured person as a lump sum.

Usually, in cases involving very serious injury, the injured person will invest the money through a private trust fund, or perhaps through a government agency such as the Public Trustee. The trust fund will then manage the lump sum and ensure that a regular income is available from which to meet care and medical treatment needs.

Insurers have argued that injured people receiving large lump sum damages awards gain a windfall because they can invest the money and earn interest which, in the long term, will substantially inflate the real value of the amount awarded by the court.

To counteract this windfall, insurers have argued that the lump sum award should be discounted to reflect the annual real return on investment that the damages award will earn. The current discount rate for most personal injury compensation schemes in NSW – excepting claims in the Dust Diseases Tribunal – is 5%. Effectively, this means the court assumes that after tax and inflation, an injured person will be able to invest their lump sum and earn a real rate of return of 5%.

Of course, the 5% discount rate is not calculated by simply reducing the damages awarded by a flat 5% discount. \$1,000,000 is not discounted to \$950,000. Instead, actuarial tables are used. The tables tell the court how much money they need to award now, so that a regular income of X dollars per week will last for Y years.

### Illustration 1

Suppose that a quadriplegic child has a life expectancy of 50 years and real weekly care costs of \$4,000. The table set out below shows what the appropriate lump sum would be, assuming a discount rate of 5%, of 3% and of zero.

	Ref.	<u>No</u> <u>Discounting</u>	<u>Discount Rate</u>	
			<u>3%</u>	<u>5%</u>
Weekly Cost	A	4,000.00	4,000.00	4,000.00
Number of Years	B	50.00	50.00	50.00
Number of Weeks	C	2,600	2,600	2,600
Discount Rate	D		1,362.8	976.1
Calculation				
- No Discounting	E = A x C	10,400,000		
- 3% Discount Rate	F = A x D		5,451,200	
- 5% Discount Rate	G = A x D			3,904,400
Difference to No Discounting			4,948,800	6,495,600
Difference between 3% and 5%				1,546,800

As the example clearly illustrates, the size of the initial lump sum award is profoundly affected by the discount rate applied.

### Illustration 2

In some circumstances the calculation of damages will also take account of predictable future costs that occur on a one off or periodic basis. The regular replacement of a wheelchair is a good example. The discount rates applied to this kind of cost have an even more dramatic effect.

Suppose the same quadriplegic discussed in Illustration 1 will need a new wheelchair every ten years. For these expenses the court will adopt the deferred discount rates. Here are the calculations for a \$5,000 wheelchair using the 5%, 3% and zero discount rates.

	Ref.	<u>No</u>	<u>Discount Rate</u>	
		<u>Discounting</u>	<u>3%</u>	<u>5%</u>
Cost of Wheel Chair every 10 years	A	5,000.00	5,000.00	5,000.00
Number of Years	B	50.00	50.00	50.00
Discount Rate				
- 10 years	C		0.744	0.614
- 20 years	D		0.554	0.377
- 30 years	E		0.412	0.231
- 40 years	F		0.307	0.142
- 50 years	G		0.228	0.087
Sub-total	H = sum of C to G		2.245	1.451
Calculation				
- No Discounting	I = A x B	25,000		
- 3% Discount Rate	J = A x H		11,225	
- 5% Discount Rate	J = A x H			7,255
Difference to No Discounting			13,775	17,745
Difference between 3% and 5%				3,970

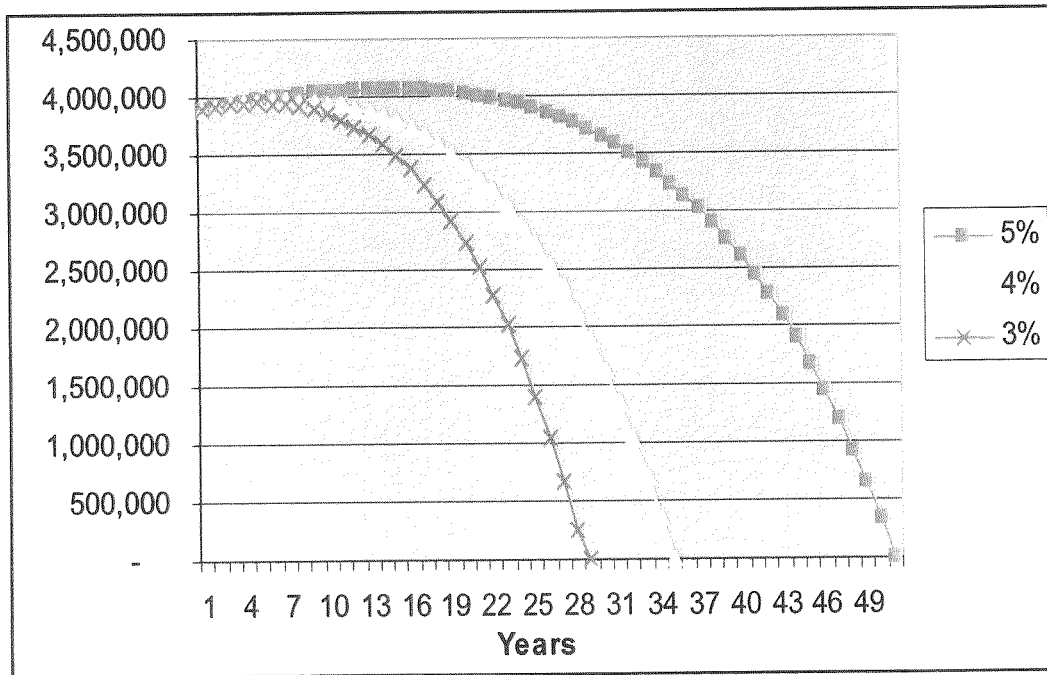
Again, the difference in the amount awarded is stark. The difference between the 3% and 5% rates is almost the price of one wheelchair.

### The impact of discount rates

While the difference in lump sum awards is clear in both illustrations, the lump sum difference is not what affects the injured person.

The current discount rate, under the laws this committee is considering, is 5%. To reiterate, this assumes that the injured person will invest the damages award, and earn a real rate of return, after tax and inflation, of 5%. What happens if they don't achieve that rate of return?

The graph over leaf sets out the life of the managed fund for the damages award considered in Illustration 1.



As you can see, if the injured person does achieve a real return of 5%, then their fund will pay care costs of \$4,000 per week as intended, and eventually run to zero dollars after 50 years, exactly as the court had intended.

If, however, the actual rate of return is 4%, then the fund will expire after 35 years, and after only 29 years if the return is 3%.

The pink line in the graph is calculated by assuming that the discounted award of \$3,904,400 is invested and earns 10% investment return, the investment earnings are taxed at an average rate of 40% and that inflation is at 1%. The assumptions informing the other projections are set out in the table below, along with figures more accurately reflecting today's investment and economic outlook.

	3%	4%	5%	Today
<b>Earnings</b>	10%	10%	10%	7%
<b>Tax</b>	40%	40%	40%	40%
<b>Inflation</b>	3%	2%	1%	1.5%
	3.00%	4.00%	5.00%	2.70%

The published rate for ten year Commonwealth Treasury bonds on 1 June 2005 was 5.128%. Injured people investing to support themselves for a lifetime are advised to adopt conservative investment strategies, and the Commonwealth Bond rate is a reasonable barometer of available returns for conservative investment.

The 7% rate we have allowed in our calculation is perhaps too generous. The taxation and long term inflation rates assumed are accurate. The result is clear. A person with 50 years of care needs at the rate of \$4,000 per week will – under the 5% discount rate – receive and award of damages that will expire at least two decades earlier than intended.

## **Conclusion**

Because the discount rates are calculated on the basis of compounding interest, they affect managed funds in an exponential way. The larger a fund, or the longer the life expectancy of the injured person, the greater the reduction affected by the discount rate. The result then is that discount rates are most destructive in the case of very seriously injured people, and particularly children.

The High Court considered discount rates in *Todorovic v Waller* ((1981) 150 CLR 402), and found 3% to be appropriate.

The Ipp Review recommended 3%.

The Lord Chancellor – who is responsible for periodically adjusting the rate in the UK – has kept it at or below 3% for many years.

The expressed intention of current government policy is to limit compensation for those with minor injuries, while ensuring that the seriously injured can receive adequate compensation. Retaining a 5% discount rate runs in direct contradiction to that policy.

## Fund management fees

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### NSW Office of the Protective Commissioner compared to Public Trustee

The following two tables were prepared by consulting actuaries Cumpstone, Sarjeant Truslove. We are authorised to reproduce them here.

The tables provide actuarial projections of the total cost to maintain and manage funds held in trust by the respective government entities. The total fund management fee charged is expressed as a percentage of the total lump sum initially taken under management.

#### 7.2 Award for OPC charges as % of initial funds

Life expectancy	Initial fund \$0.5m	Initial fund \$1m	Initial fund \$2m	Initial fund \$5m	Initial fund \$10m	Initial fund \$20m
10	8.6%	7.8%	7.1%	6.8%	6.7%	6.6%
20	15.9%	14.8%	13.8%	13.3%	13.1%	13.1%
30	23.0%	21.9%	20.7%	20.0%	19.7%	19.6%
40	29.7%	29.3%	27.7%	26.7%	26.4%	26.3%
50	36.0%	37.1%	34.8%	33.6%	33.2%	33.0%
60	41.9%	45.0%	42.1%	40.5%	40.1%	39.8%
70	47.5%	52.9%	49.4%	47.5%	46.9%	46.6%
80	52.7%	60.9%	56.8%	54.5%	53.8%	53.5%

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#### 8.2 Award for PT charges as % of initial funds

Life expectancy	Initial fund \$0.5m	Initial fund \$1m	Initial fund \$2m	Initial fund \$5m	Initial fund \$10m	Initial fund \$20m
10	4.1%	3.2%	2.5%	2.1%	2.1%	2.0%
20	6.6%	5.4%	4.2%	3.8%	3.6%	3.6%
30	8.8%	7.3%	5.9%	5.4%	5.2%	5.2%
40	10.7%	9.2%	7.5%	6.9%	6.8%	6.7%
50	12.4%	10.5%	9.0%	8.4%	8.2%	8.1%
60	13.9%	11.9%	10.5%	9.8%	9.6%	9.5%
70	15.2%	13.3%	11.9%	11.2%	10.9%	10.8%
80	16.3%	14.6%	13.2%	12.4%	12.2%	12.1%

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### Conclusion

The OPC fees are clearly out of all proportion to those charged by the Public Trustee. While arguably beyond the scope of the present inquiry, in the context of personal injury compensation it is hard to ignore such a stark disadvantage for those placed under the care of the OPC.

## Legal costs under the LPA

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The *Legal Profession Act 1987* (LPA) contains limits on the right to recover legal costs at the conclusion of litigation. If damages less than \$100,000 are awarded, a claimant's right to recover legal costs from the losing party is severely limited.

Suppose an injured person is potentially entitled to non-economic loss (pain and suffering) of \$32,000 for an injury assessed as 26% of the most extreme case under section 16 of the *Civil Liability Act 2002*. Assuming that their case is moderately complex and vigorously defended by an insurer, their own legal costs could come to \$40,000. In such a scenario most lawyers will advise their client that despite having real injuries worthy of compensation under the Civil Liability Act, they are best advised not to take action as their real return will be negligible and they will risk losing and paying costs.

This illustration provides a very strong reason to reconsider the costs limits, which act contrary to the intention expressed in s16 of the *Civil Liability Act*. However, in making the illustration many people are surprised to find how expensive it can be to run litigation for such a, comparatively, small claim.

By way of explanation we have set out below some sample costs involved in litigating a very simple personal injury case which undergoes a typical two day hearing.

Solicitor's professional costs (40 hours @ \$250 p.h.), inclusive of GST:	\$11,000.00
Barrister's fees, (research, preparation, witness conferences, court time) inclusive of GST:	<u>\$4,950.00</u>
	\$15,950.00

Expert on liability, inclusive of GST:	\$3,850.00
Treating general practitioner's medical report fee, inclusive of GST:	\$220.00
Treating specialist's report fee, inclusive of GST:	\$660.00
Medico-legal specialist's consultation and report fee:	\$880.00
Expert witness court attendance fee, inclusive of GST:	\$1,650.00
Medical expert court attendance fee, inclusive of GST:	<u>\$1,100.00</u>
	\$8,360.00

District Court fee on filing statement of claim:	\$438.00
Process server's fee in serving statement of claim:	\$55.00
District Court subpoena fees x 3:	\$165.00
Subpoena conduct monies x 3:	\$150.00
Process server's fee in serving 3 subpoenas:	\$165.00
District Court arbitration fee:	\$425.00
District Court hearing allocation fee:	<u>\$468.00</u>
	\$1,866.00

Total:	<u>\$26,176.00</u>
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Under the current system, the injured person who wins such a case would be limited to recovering \$10,000.00 for the solicitor's professional costs and barrister's fees. The balance of the disbursements would be subject to a restricted recovery. The shortfall in the professional costs, barrister's fees and disbursements are met by the injured person from their verdict monies. In this simple case scenario, one would expect the injured person to recover \$16,048.00 from the insurer out of the total \$26,176.00, being only 61% of the total costs.



However, if the insurer could be convinced to accept liability (partially or totally) and participate in a successful informal settlement conference, the same case would involve the following costs:

Solicitor's professional costs (15 hours @ \$250 p.h.), inclusive of GST:	\$4,125.00
Treating general practitioner's medical report fee, inclusive of GST:	\$220.00
Treating specialist's report fee, inclusive of GST:	<u>\$660.00</u>
Total:	\$5,005.00

In this case scenario, the injured person would recover most, if not all costs from the insurer.

### **Conclusion**

Costs in personal injury cases can be high, where the injured person is forced to prove every part of their case. Of course, in some cases, this can be necessary and fair. But in many cases liability and injury are clear, and there is no reason why cases could not be settled.

The rules in the LPA do nothing to lower the costs involved in contested claims, they only limit the amount the injured person recovers. The only person really affected is the injured person.

Moreover, because insurers know how much legal fees can eat into damages awards, they are encouraged to fight claims. Where damages are likely to be less than \$100,000 defendants have an incentive to fight rather than settle. The result is an across the board increase in fees for all stakeholders.

The usual common law rule – that costs follow the event, or loser pays - is more effective. With these rules in place there is no incentive to fight meritorious claims. In fact doing so guarantees a bad costs outcome. Defendants are encouraged to settle claims, which lowers costs.

The changes rules have introduced scope for tactical game playing that is opposed to the interests of all stakeholders, the premium paying public, the courts and the injured. The intention of these provisions was to lower costs. They do precisely the opposite.