Ontario's Mandated Discount Rate - Rule 53.09(1)

By Ian Wollach CA•IFA, MBA, CFE, and
Daniel Giovannone B.Sc. (Hons), ASA
Rich Rotstein, Chartered Accountants

Once a plaintiff's stream of future costs and losses has been determined, and adjustments made for contingencies, it becomes necessary to calculate the value of future costs and losses in today's dollars. This is the process of discounting to present value and involves applying a factor, the discount rate, to the stream of projected costs or income losses, in order to adjust for the expected impact of price inflation and investment returns, to arrive at a lump sum award. The end result should be that if the plaintiff were to invest their award at today's investment rates, and draw from it a stream of cash flows sufficient to replace the income stream required or forgone then, once the final withdrawal has been made at the end of the relevant loss period, he or she should have nothing left.

There are two methods of calculating the present value of future losses. The first method is to discount the projected cash flow by the market (or nominal) rate of interest. The second is to remove the inflationary component from the projected loss, and then discount that loss by the real rate of interest (i.e., the market rate of interest net of the rate of inflation). Although the two methods provide identical results, the latter method is, for the following reasons, generally preferred -

(1) real interest rates tend to be more stable, and therefore, much more easily predictable, than either price inflation or market interest rates.[1] Historical fluctuations in market interest rates far exceed that of real interest rates. This stability follows from the fact that market interest rates generally increase and decrease in line with inflation. Therefore, periods of high inflation will usually be associated with high market interest rates. Similarly, times of low inflation, will usually be associated with low market interest rates. Historically, differences between the two has remained relatively constant, averaging approximately 2% to 3% per annum.

(2) the second reason for preferring the use of real interest rates is practicality, as it allows for the calculation and use of present value multipliers. The term multiplier refers to the factor representing the present value of $1 per annum, from the start of the plaintiff's relevant loss period to a specific age or date in the future. With the use of a multiplier, computation of the lump sum award is simplified, as it only requires knowledge of the plaintiff's annual loss at the start of the relevant loss period. The lump sum award is then just the annual loss times the present value multiplier.

---

[1] Economica Ltd., The Expert Witness Newsletter, Autumn 2000 Vol. 5, No. 3

Analysis Of Rule 53.09(1)

Rule 53.09(1) of Ontario's Rules of Civil Procedure considers both inflation and interest rates. In summary, Rule 53.09(1) states that 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, for the initial 15 years from trial commencement is equal to the 12-month average rate on Government of Canada real rate of return bonds, for the period ending August 31 of the most recent year, minus 1% and rounded to the nearest ¼%. Thereafter, for all subsequent years the discount rate is 2.5% per annum.

It should be noted that these mandated rates only consider inflation and interest rates, and do not consider general productivity increases (i.e., increases in real earnings which vary from general price inflation), the cost of financial management and administration, or the impact of taxation. As will be illustrated in the latter part of this article, expert evidence can be used to show that the use of the mandated rate in Ontario should be varied, particularly in the cases of required professional services, and younger persons with lengthy income loss streams.

Historical Background To Ontario's Mandated Discount Rate

Previously, and since 1980, Rule 53.09(1) prescribed the use of a real interest rate of 2.5% in all years when discounting future losses. The current rule, implemented in 1999, divides future loss into two periods, the first 15 years from the trial commencement date, and thereafter. The new rule bases the rate, applicable to the first 15 years, on the average rate on Government of Canada real return bonds less 1%, rounded to the nearest 1/4%. For subsequent years the discount rate is set at 2.5%, which approximates the average long-run difference between price inflation and market interest rates, which was noted earlier to be historically between 2% and 3% per annum. The change in the rule, for the most part, arose from the need to have mandated rates that provided a more realistic reflection of prevailing economic conditions in the short term, to the extent that they differ from the long term average estimated at 2.5%.

While the 1998 report of the Subcommittee of the Civil Rules Committee on the Discount Rate and Other Matters, headed by Mr. Justice Sydney Robins, agreed that empirical evidence confirmed that average wages and salaries have historically increased at a rate faster than general price inflation when measured over extended periods of time, they also held that it was not practical to mandate a specific wage productivity rate.

Because plaintiffs often have to rely on the investment of their awards to provide a significant portion of their future income, the courts assume that they will either purchase a structure or place their awards in relatively risk-free investments. The use of real return Government of Canada bonds for setting the prescribed mandated rate, within the first 15 years from trial commencement, provides a rough estimate of what a plaintiff can expect in terms of a risk-free rate of return net of inflation.

Does Rule 53.09(1) Include A Productivity Factor?

For the first 15 years from the trial commencement date, the wording of Rule 53.09(1) clearly indicates that the discount rate is obtained by deducting 1 percent from the rate of real return on Government of Canada bonds. Though it is often thought that this reduction reflects an adjustment for productivity improvements, it does not. The reason for this reduction lies in the view of the subcommittee that because Government of Canada real return bonds are not traded frequently, and because they receive unfavorable tax treatment, that their reported rate of return is biased upwards.[2]

In order to compensate investors for this additional risk, it was the subcommittee's view that a risk-free investment would have a lower rate of return – by 1 percent – than that reported for Government of Canada real return bonds.[3] Presumably to confirm this, the wording "to the extent that it reflects the difference between estimated investment and price inflation rates" was specifically included in Rule 53.09(1).

Variation Of Ontario's Mandated Discount Rate

Ontario's mandated discount rate arose for the most part out of a need to promote uniformity and to diminish the expenses of litigation, and therefore may not be appropriate for all cases.[4] An argument for variation from the mandated rate may arise when it is felt that the mandated rate does not reflect current economic predictions. Alternatively, inclusion of productivity improvements may be required or there may be a need to reflect particular circumstances of the plaintiff that would justify using a value that differs from the legislated rate. Per the Court of Appeal decision in Martin v Listowel Memorial Hospital, the applicability of such arguments would be considered on a case by case basis, based on the evidence provided.

In Giannonne v Wainberg [(1989), 68 O.R. (2d) 767 (C.A.)] the court held that where price inflation rates and future investment returns were the only considerations then Rule 53.09(1) must be adhered to.

The court stated that Rule 53.09(1) has two basic purposes. One of them is to avoid the expense incurred in calling economic and actuarial evidence relating to future investment and price inflation

---

[2] The Expert Witness Newsletter, Autumn 2000, Vol. 5, No. 3
[3] The Expert Witness Newsletter, Autumn 2000, Vol. 5, No. 3
[4] Cooper Stephenson, 2nd Edition p. 400

rates in every case in order to establish the applicable discount rate. The second is to avoid the general injustice of similar cases, decided at the same time, having different results solely because of the use of different discount rates.

As was previously noted , Rule 53.09(1) specifically addresses two items, those being future investment rates and inflation. To the extent that investment rates tend to move in-line with inflation rates, and the purpose of the mandated rate is to reflect the difference between the two, arguments for variation from the mandated rate on the basis of prevailing economic conditions will be difficult to support.

For example, in the case of *Arnold v. Teno*[5] the defendants pointed to the very high prevailing interest rates, and argued that the prevailing interest rates should be used in conjunction with long-term predictions for inflation in order to arrive at an appropriate discount rate. The Ontario Court of Appeal clearly pointed out why this approach was unacceptable:

"*The defendants, therefore, seek to take advantage of the high interest rates generated by inflation without acknowledging that the same inflationary pressures will cause a rise in future wages and costs of care. Surely the defendants are not entitled to the best of two worlds; high interest rates on the one hand and on the other, costs and incomes that do not increase.*"

Rule 53.09(1) can be interpreted as permitting variations from the mandated rate based on arguments unrelated to projected investment and inflation rates. The most common reason for variation would be productivity increases and its impact on both future wage increases and required professional services.

Productivity improvements reflect the extent to which the projected growth in a plaintiff's future earnings will exceed the rate of inflation. A real interest rate, as prescribed by Rule 53.09(1), assumes that a plaintiff's wages will increase in line with inflation, and does not account for productivity increases. Though accounting for productivity improvements is not needed in quantifying the value of future costs of care other than professional services, assessing damages for future loss of earnings, should accommodate the effect of productivity increases.[6]

In Dziver v. Smith,[7] the Ontario Court of Appeal held that evidence of other considerations may be introduced to warrant the use of a discount rate other than the mandated rate. Specifically it was noted:

[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.

---

[5] (1976), 67 D.L.R. (3d) 9 at 25 (Ont. C.A.) varied on other grounds (1978), 83 D.LR. (3d) 609 (S.C.C.).

[6] Of the jurisdictions in Canada that have legislated or mandated rates, only British Columbia has specifically incorporated general productivity as a factor.

[7] (1983) 146 D.L.R. (3d) 314 at 317-318 (Ont. C.A.)

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 too, it may be shown that the cost of future care will increase at a greater rate than the rate of inflation. But the existence and value of these factors must be proved by evidence.

Similarly, in Martin v Listowel Memorial Hospital, [2000 CanLii 16947 (ON C.A.)] the trial judge's decision to reject the plaintiff's submission that in calculating an infant plaintiff's future wage loss that he reduce the discount rate provided by Rule 53.09(1) by a 1% productivity factor.

In his decision the trial judge held that "*Although the court has a discretion to depart from this discount rate if justified by the evidence and circumstances, I am not convinced that it should be done in this case*." While the Court of Appeal endorsed the judge's decision, the court contemplated the introduction of evidence that might affect the appropriate discount rate employed.

In Walker v Ritchie, [2005 CanLii 13766 (ON C.A.)], the defendants appealed the judges decision to modify the discount rate set out in Rule 53.09(1) of the Rules of Civil Procedure. In its decision the Court of Appeal wrote:
"*In this case, evidence called before the trial judge established that the costs of professional services are increasing faster than the rate of inflation, thus justifying the variation to a 1.5% discount rate. Accordingly, the trial judge did not err in accepting evidence supportive of an adjusted discount rate for professional fees*."

Conclusion

The use of a discount rate of 1% lower than that prescribed by Rule 53.09(1), in the costing of the required professional services portion of future care cost awards, is common. It thus appears to be simply a matter of time before a similar approach, in the case of wage inflation, is endorsed . This variation will more likely occur in the case of children or younger workers with lengthy future income loss streams. Assuming that a wage inflation rate of 1% lower than the mandated rate is endorsed, then the discount rate applicable to wage inflation for trials in Ontario commencing in 2007, would decline from a mandated 0.75% for the first 15 years, and 2.5% thereafter to +0.25% for the first 15 years and 1.5% per annum thereafter.