Loss of Future Income In Actions for Damages

I

Four judgements assessing the loss of future income were rendered by the Supreme Court of Canada in 1978.[1] In three cases the plaintiff had sustained serious injuries, and in the fourth a widow had submitted a claim under *The Fatal Accidents Act* of Ontario.[2] The Court's approach to the capitalization rate [3] in these cases has led to a more flexible method of assessing damages, and it is now possible to review how lower courts have applied the judgements of the Supreme Court in this regard.

In principle, persons who suffer total loss of earning capcity, or persons who lose the benefit of their spouse's earning capacity, are entitled to compensation for their loss. Since 1978 the courts have attempted to measure the loss of earnings for the victim's entire estimated working life. The loss is capitalized on the assumption that the capital amount will be spent by the victim or his survivors during their lifetimes. If, during the victim's life expectancy, salaries increase at a faster rate than returns on investment, there would be a negative discount rate; but in recent economic history salaries have increased at a lower rate. Hence, to arrive at the discount rate, the courts have predicted the future rate of return and deducted from that an estimated rate of inflation.

Speaking for a full and unanimous bench in the *Andrews* case, Dickson J. summarized the Supreme Court's method in these matters as follows:

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[1] *Andrews* v. *Grand & Toy Alberta Ltd* [1978] 2 S.C.R. 229; *Thornton* v. *Board of School Trustees of School District No. 57 (Prince George)* [1978] 2 S.C.R. 267; *Arnold* v. *Teno, Jackson* v. *Teno* [1978] 2 S.C.R. 287; *Keizer* v. *Hanna & Buch* [1978] 2 S.C.R. 342.

[2] R.S.O. 1970, c. 164.

[3] It may be predicted that in this area of the law of damages courts will increasingly use such phrases as "capitalization rate", "discount rate" and "net discount rate", though at present there is some ambiguity in these terms. The "capitalization rate" is the rate of return on a portfolio fully invested, less a percentage for investment expenses, portfolio distribution and the like, which in some cases is referred to as a "discount rate". But in most cases, including several Quebec cases discussed below [*infra*, notes 10, 11-15], the "discount rate" contemplated is a *net* discount rate, which is determined by deducting a rate of inflation from the rate of return on investments.

> The approach which I would adopt ... is to use present rates of return on long-term investments and to make some allowance for the effects of future inflation. Once this approach is adopted, the result, in my opinion, is different from the five per cent discount figure accepted by the trial judge. While there was much debate at trial over a difference of a half to one percentage point, I think it is clear from the evidence that high quality long-term investments were available at time of trial at rates of return in excess of ten per cent. On the other hand, evidence was specifically introduced that the former head of the Economic Council of Canada, Dr. Deutsch, had recently forecast a rate of inflation of three and one-half per cent over the long-term future. These figures must all be viewed flexibly. In my opinion, they indicate that the appropriate discount rate is approximately seven per cent. I would adopt that figure. It appears to me to be the correct result of the approach I have adopted, *i.e.*, having regard to present investment market conditions and making an appropriate allowance for future inflation. I would, accordingly, vary to seven per cent the discount rate to be used in calculating the present value of the awards for future care and loss of earnings in this case. The result in future cases will depend upon the evidence adduced in those cases.[4]

The prediction of 3½% for long-term inflation was originally advanced in 1973 by the Commission of Inquiry which the Minister of Labour had appointed to study an agreement between the unions and the railway companies on increased pension benefits. In his report the Commissioner, the late J.J. Deutsch, stated that

> in order to determine the expected long-run average rate of earnings on the new funds that will be required to finance the pension improvements, and also the future rate of increase in wages on which pension contributions and benefits will be based, it is first necessary to make an assumption about the long-run future rate of inflation. I have taken the assumption of an average annual rate of increase in consumer prices of 3½ per cent a year as a reasonable working basis over the next several decades.[5]

Dr Deutsch estimated a 3% cost average annual rate of increase in real output *per* employee in the industrial composite for Canada, and 3% as an average annual rate of inflation. With these assumptions he estimated that the long-run average rate of increase in earnings *per* employee would be 6½% *per annum*.[6]

Dr Deutsch used a rate of 7% to estimate the long-term return on money invested in Canada bonds.[7] He then increased this to 8%

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[4] *Andrews, supra*, note 1, 258-9.

[5] Report of the Commission of Inquiry, Appointed by the Minister of Labour relating to an Agreement reached on Increased Pension Benefits by the Unions and the Railroad Companies, Presented to the Honourable John Munro, Minister of Labour, 27 December 1973, p. 5.

[6] *Ibid.*, 7.

[7] *Ibid.*, 9.

by assuming that private pensions would continue to invest in a diversified portfolio of equities, premium corporations, municipal bonds, provincial bonds, real estate and mortgages. He believed that such a portfolio could be expected to earn a net rate of return on new money at about one percentage point higher than the estimated Canada bond rate. For other reasons he concluded that one could expect 9% in the net rate of earnings on new money and, while keeping the assumed rate of increase in employee earnings at 6½%, he arrived at a margin of 2½% between the annual average rate of increase in employee earnings and the net rate of return on new money.

While some courts have continued to apply Dr Deutsch's principles, albeit varying the discount rate as the predicted inflation rate rose, few have taken notice of the following quoted passage in his report:

> Whatever the official text of the pension plan may say, the long term purpose of the pension fund is not to provide so many paper dollars many years hence but to provide a slice of the country's productive capacity; so much food, clothing and shelter when the employees are too old or too disabled to produce goods and services themselves. The real problem is how to accumulate the purchasing power of the contributions made at any time by employer and employee as purchasing power to be utilized many years hence. With these considerations in mind, money should be regarded as a medium of exchange rather than a store of value.
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> It is here that so much conflict arises with the concept of the "trust". The trustee of public imagination is somebody who protects *dollars* with miserly care. The modern trustee applies his energy to protecting *purchasing power.* This may be achieved either by purchase of equity in some form or fixed securities with a sufficiently high yield to offset probable long term inflation and still give an attractive real return.[8]

II

Since 1978 several judgements in the Superior Court of Quebec have been rendered using a variety of discount rates, on the strength of Mr Justice Dickson's statement in *Andrews* that the appropriate discount rate in calculating awards for future care and loss of earnings should depend upon evidence adduced in each case.[9]

In *Daoust* v. *Bérubé*[10] Ryan J. awarded $126,000 for loss of future income in a total award of more than $400,000 to a paraplegic of

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[8] *Ibid.*, 10, quoting from Mercer and Coward, *Canadian Handbook of Pension and Welfare Plans,* 4th ed. (1972), 84-5.

[9] *Supra,* note 4.

[10] [1978] C.S. 618 [under appeal].

twenty-one years. While the Court referred to the *Andrews* judgement,[11] no actuarial evidence was tendered; an arbitrary retirement age of sixty was postulated and the working years multiplied by a presumed annual salary of $6,000, from which 40% was deducted for the contingencies of life. Similarly, in *Dugal* v. *Le Procureur général de la province de Québec*[12] Letarte J. awarded $1,015,315.14 for the loss of future revenue in a total judgement of $1,575,301.40 to a paralyzed twenty-five-year-old male student. The Court in this case used a capitalization rate of 3%, but the parties had previously agreed to this figure. However, notwithstanding the trend in Quebec courts to use a capitalization rate of 3%, Johnson J. gave judgement in *Gendron* v. *Lignes Aériennes Canadien Pacifique Ltée* which rejected actuarial evidence in support of that figure and returned to the rate of 7% which was approved by the Supreme Court in the *Andrews* case.[13] Actuarial evidence concerning the assessment of future earnings was accepted by Nolan J. in *Therrien* v. *Therrien & Paquette,*[14] in so far as it related to the cost of an annuity which would compensate the plaintiff for the loss of wages he would suffer as a result of his disability. But, even where a fixed capitalization rate is agreed or accepted, obvious difficulties in the evaluation of actuarial evidence arise when expert witnesses submit markedly different figures for the capital amount necessary to replace lost earnings, as was the case in *Campeau* v. *La Société Radio Canada.*[15] Another jurisprudential incident of this question, which may affect the disposition of awards in Quebec, is illustrated by the dictum of Nadeau J. in *Lapierre* v. *Le Procureur général de la province de Québec* that judgements such as the damage awards rendered by the Supreme Court in 1978 do not have the same binding effect as the Court's decisions on matters arising under the Civil Code, though they may have a persuasive influence in the provincial courts.[16]

In Ontario, the High Court of Justice gave judgement in *Cobean* v. *Northern & Central Gas Corp. Ltd* with heavy reliance on the evidence of an actuary, Ron Walker, who has testified in some fifteen cases of this kind.[17] Callaghan J. adopted economic studies showing that approximately 70% of the net income of a man with a

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[11] *Ibid.*, 623.

[12] [1979] C.S. 617.

[13] C.S. (Montreal, 500-05-024226-761), 17 March 1980; in appeal, 500-09-000 410-803.

[14] C.S. (Montreal, 05-013-843-766), 8 May 1979.

[15] [1979] C.S. 637.

[16] [1979] C.S. 907, 919-20.

[17] Unreported judgement, 3 July 1979.

family is allocated to the support of his wife and home, with an additional 4% for the support of each child up to the age of three.[18] Mr Walker projected an increase of 7% *per annum* in the deceased's salary, which he described as a conservative prediction of long-term inflation in Canada,[19] but this prediction was challenged by two academic economists. Professor Parkin of the University of Western Ontario opined that a rate of inflation of 2 to 3% could be achieved in the 1980's, and Professor Carr of the University of Toronto claimed that monetary and fiscal trends can only be accurately predicted over a period of two or three years. He was of the opinion that current investment rates were in the region of 10% *per annum* and, since historical real interest rates were 3%, an inflationary premium was charged in the marketplace in order to guarantee investors a real interest rate of 3%: accordingly, said Professor Carr, the marketplace was trading on the expectation of 7% as the long-term rate of inflation. Clearly, this nearly doubles the rate projected by Dr Deutsch and accepted by the Supreme Court in the *Arnold* and *Jackson* cases.[20] However, Professor Carr added that if Dr Deutsch had had the historical rates for 1969 to 1978 instead of only those for 1963 to 1972, he would have arrived at the same conclusion, and Callaghan J. accepted this opinion.

There was also an issue in this case as to whether the courts should consider an investment portfolio of mixed bonds and selected Canadian common stocks of the blue-chip variety, or whether it should restrict itself to what could be expected as a total return from Canadian or government bonds. Despite evidence that the market was ripe for investment in equities in order to hedge against inflation, because of rising dividends and capital appreciation of common stocks, the court rejected this suggestion, claiming that it would not be without risks.

In summary, the court accepted that 10% was an appropriate long-term interest rate, less 1% for investment expenses and portfolio distribution. Callaghan J. also analyzed the possibility of marriage breakdown, of re-marriage, of the plaintiff widow's premature death, and of the deceased retiring or becoming incapable; he ruled that none of these possibilities was likely to be realized, and thus that no amount should be deducted for contingencies. In conclusion he awarded $697,077 to the widow and two children of a thirty-year-old optometrist with average earnings of $40,000.

A discount rate of 3% was applied by the Ontario Court of Appeal in two other cases, but in a more recent decision, *Julian* v.

[18] *Ibid.*, at p. 21 of the transcript of reasons.
[19] *Ibid.*, 14.
[20] *Supra*, note 1.

Northern & Central Gas Corp.,[21] the Court applied a rate of 2%. In this case, Morden J.A. awarded $470,000 to the widow of a thirty-year-old dentist whose net income was assessed at $41,250. Once again Mr Walker appeared for the plaintiff and argued for a 7% long-term inflation rate and a 9% gross discount rate. Deducting one from the other, the Court ruled that a 2% net discount rate would be reasonable; a deduction of 20% was made for contingencies of marriage breakdown, early retirement and the additional risk of the dentist being a part-time pilot, but no order was made that the widow invest in common stocks. Morden J.A. noted that the expert evidence given by actuaries and economists appeared to describe economic conditions existing at the time of the trial in 1978, but their calculations were applied to conditions at the time of the accident. The Court recommended the approach taken by the House of Lords in *Cookson* v. *Knowles*,[22] and described it as follows:

> This approach involves splitting the damages into two parts: (1) the pecuniary loss which it is estimated the dependents have already sustained between the date of death and the date of the trial; and (2), the loss which it was estimated they would suffer from the trial onward. If this approach had been followed in the present case, there would have been no need to reach back to the date of death to see to it that the fund contemplated in the evidence is actually established. There are other obvious advantages in approaching the assessment in this realistic and logical way.[23]

The Court took the present value of the loss of earnings as calculated by the actuary and used a discount rate of 3% and, rather than deducting a percentage from the rate of return for investment expenses, awarded a lump sum of $26,222.48 under this heading.

In the Supreme Court of British Columbia, Ruttan J. gave judgement in *Malat* v. *Bjornson (No. 2)*[24] to award $260,201.97 for the loss of a fifty-one-year-old fishing skipper whose assessed annual earnings were $21,500, after careful analysis of expert advice submitted by actuaries and investment counsellors. The Court concluded that it should use a long-term interest rate of 10.5% and a long-term inflation rate of 6.5%, thus arriving at a discount factor of 4%. Then, deducting a productivity rate of 1.5% (allegedly an average figure over the entire work force), the Court assessed the loss of future earnings using a net discount rate of 2.5% and deducted 10% for contingencies.

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[21] (1979) 11 C.C.L.T. 1 (Ont. C.A.).
[22] [1979] A.C. 556 (H.L.).
[23] *Supra*, note 20, 30.
[24] [1979] 4 W.W.R. 673 (B.C.S.C.).

III

The long-term inflation rate of 7 to 8% which has been accepted by various courts is, according to many economists and most historical analyses of inflation, a very pessimistic figure; but others predict double-digit inflation for some years to come. The future rate of inflation will depend on developments in three main areas: the Bank of Canada's monetary policy, the measure of the federal government's budgetary deficit, and the rate of productivity. Widespread public concern over high inflation rates has compelled governments and the Bank of Canada to adopt more restrictive monetary policies. There is also broad public support for a reduction in the federal government's large budgetary deficit, which enhances the growth of inflation. The rate of inflation, therefore, may not continue to grow and the predictions presently being made by the courts may turn out to be exaggerated. Certainly, the courts' insistence on restricting the total return that can be expected on money to the total return on government bonds is unrealistic. If the courts are going to allow a percentage point for investment counselling or money management, then surely it should be assumed that that counselling will be wisely given. It does not take an expert to teach us that few today, with a portfolio in the order of $200,000 and more, would consider investing solely in long-term government bonds.

It is generally recoguized that by investing in a combination of short-term securities and long-term government and corporate bonds for income and high-growth common stocks, a portfolio manager would create the best hedge against inflation.

As interest rates or dividends from equity stocks vary, and as economists predict different rates of inflation, the theories will change. But, if the courts continue to assess damage on the basis of actuarial expert opinion, the principles set out in the *Andrews* and *Keizer* cases will have to be re-examined in order to reduce the multitude of imponderables and unscientific predictions now entering into judicial calculations.

From an analysis of the aforementioned cases, there appears to be a consensus of the judicial opinion in at least three provinces that a discount rate of 3% at the present time is reasonable. How long such a rate will remain depends on the ingenuity or sophistication of lawyers, actuaries, economists and investment counsellors.

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