## The Decision Of The House Of Lords In *Wells V Wells*: Implications For Insurers

*by Christopher Purchas Q.C. and Robert Stokell*

### Introduction

In May 1998 three appeals reached the House of Lords, and were heard together. The plaintiff in each case had suffered very severe personal injury and claimed damages for loss of future earnings and the cost of future care. It was decided that the basis on which such damages are calculated should be changed. The House of Lords commented that:

> *...the point which is common to all three appeals is of considerable importance, both for the plaintiffs themselves and for the insurance industry in general*
>
> per Lord Lloyd of Berwick

> *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.*
>
> per Lord Hutton

### The Facts

In *Wells v Wells* itself, the plaintiff was a 58 year old part-time nurse who had suffered serious brain damage in a car accident. As a consequence, she would never again be able to work, or to care for herself or her family. The plaintiff in *Thomas v Brighton Health Authority* was injured before birth by the maladministration of a drug intended to induce labour. He suffered from cerebral palsy and was very severely physically handicapped. Mr Page, the plaintiff in *Page v Sheerness Steel Co Ltd*, was working in a steel mill when a white hot steel bar buckled and went right through his brain. Negligence was admitted in all three cases.

### The court's task

The House made clear that a court assessing damages for personal injuries seeks to put the plaintiff in the same position, financially, as if he had not been injured. Two elements are used to calculate the lump sum for future loss: a multiplicand

and a multiplier. The multiplicand is the estimated annual loss of earnings or cost of care, which must be multiplied by a figure to provide for that loss over a number of years.

It is recognised that this approach is not exact. A plaintiff may die the day after a multiplier is calculated, or live beyond his projected expectation of life. As for the multiplicand, the cost of care may exceed estimates, or a less expensive form of treatment may be found.

Lord Lloyd explained why it is not a matter of simply multiplying the multiplicand by the number of years for which the loss would be suffered:

> *...to simplify the illustration one can take an average annual cost of care of £10,000 on a life expectancy of 20 years. If one assumes a constant value for money, then if the court were to award 20 times £10,000 it is obvious that the plaintiff would be over-compensated. For the £10,000 needed to purchase care in the twentieth year should have been earning interest for 19 years.*

The multiplier is adjusted to prevent this over-compensation. Using Lord Lloyd's example, the objective is to arrive at a lump sum which, by a combination of capital and interest, will provide exactly £10,000 a year for 20 years, and no more. Two main factors need to be considered:

(1) the rate of return on the capital: the higher the rate of return (in interest), the lower the initial lump sum will need to be;

(2) inflation: the value of the plaintiff's money will decrease year by year.

**The House of Lords' approach**

Before *Wells v Wells*, the courts assumed that the plaintiff would take care of future inflation in a 'rough and ready' way by investing the lump sum sensibly in a mixed 'basket' of equities and gilts. This led to an assumption that the rate of return on the invested damages would be between 4% and 5%. The House of Lords unanimously decided that this was no longer the correct approach. As Lord Lloyd held in the House of Lords:

> *The ordinary investor may be presumed to have enough to live on. He can meet his day-to-day requirements. If the equity market suffers a catastrophic fall, as it did in 1972, he has no immediate need to sell. He can bide his time, and wait until the equity market eventually recovers.*

*The plaintiffs are not in the same happy position. They are not "ordinary investors" in the sense that they can wait for long-term recovery...For they need the income, and a portion of their capital, every year to meet their current cost of care.*

The House held that the solution lay in index-linked government stock ("I.L.G.S."), for two main reasons. First, the return of income on capital invested in I.L.G.S. is fully protected against inflation. The purchaser of £10,000 of I.L.G.S. with a maturity date of 2010 knows that his investment will then be worth £10,000 plus x per cent of £10,000, where x represents the percentage increase in the retail price index between the date of issue and the date of maturity. Second, investing in I.L.G.S. is safer than an investment in equities. Lord Lloyd said that it was "a risk-free investment". Lord Hope did not go quite so far, but stated:

*This form of investment is, it should be added, not entirely without risk. The prices at which I.L.G.S. are available on the market from time to time rise and fall according to the market's expectation of the future pattern of inflation as against the movement of interest rates. If they are bought and sold in the short term these price movements may result in a gain or a loss of capital. In the long term however, particularly if held to the redemption date, they produce a return which is inflation-proof and can be relied upon. The same cannot be said, to the same degree of confidence, of investment in equities.*

Lord Lloyd went on to hold:

*(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...No doubt insurance premiums will have to increase in order to take account of the new lower rate of discount. Whether this is something the country can afford is not a subject on which your Lordships were addressed.*

**Rate of return**

Having decided that I.L.G.S. was the appropriate investment vehicle, the House had to decide what rate of return to assume. The net average return over the preceding three years had been about 3%, and it was held that this would be the correct rate to use in calculating multipliers. Lord Steyn pointed out that the use

of a 3% discount rate instead of 4.5% would increase the awards in the cases before the House by approximately the following sums: Wells: £108,000; Page: £186,000; Thomas: £300,000. He later held:

> *While this figure of about 3% should not be regarded as immutable, I would suggest that only a marked change in economic circumstances should entitle any party to re-open the debate in advance of a decision by the Lord Chancellor. The effect of the decision of the House on the discount rate, together with the availability of the Ogden Tables, should be to eliminate the need in future to call actuaries, accountants and economists in such cases.*

This reference to a decision by the Lord Chancellor arises out of section 1 of the Damages Act 1996:

"(1) In determining the return to be expected from the investment of a sum awarded as damages for a 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."

This section came into force on 24 September 1996, but no rate has yet been prescribed.

**The Ogden Tables**

The Ogden Tables are the means by which the rate of return decided upon by the House of Lords can be translated into an appropriately discounted multiplier. At the time of the House of Lords' decision in *Wells v Wells*, the Ogden Tables were in their third edition. They can most conveniently be found either in the booklet printed by HMSO or in Facts & Figures, published by the Professional Negligence Bar Association.

Section 10 of the Civil Evidence Act 1995 provides:

"10. **Admissibility and proof of the Ogden Tables**

The actuarial tables (together with explanatory notes) for use in personal injury and fatal accident cases issued from time to time by the Government Actuary's Department are admissible in evidence for the purpose of assessing, in an action for personal injury, the sum to be awarded as general damages for future pecuniary loss."

At the time of writing, this section has not been brought into force. However, Lord Hope commented that:

> *...the admissibility and relevance of the information contained in [the Ogden Tables] is now generally recognised.*

Tables 1 to 10 in the third edition of the Ogden Tables are based on the mortality rates experienced in England and Wales in the years 1990 to 1992, as published by the Government Actuary's Department in English Life Tables No.15 ("ELT15"). The accuracy of these tables was accepted by all the actuaries on the Working Party that produced the Ogden Tables, including the actuaries nominated by the Association of British Insurers ("the ABI"). Tables 11 to 20 take into account the improvement in life expectancy that can be expected in future. As explained in the Ogden Tables:

"...on the balance of probabilities, the mortality rates which will actually be experienced in future by those who are alive today will be lower than in ELT15, and increasingly so the further into the future one goes. This, of course, would imply the need for higher multipliers."

The actuaries on the Working Party, save for those representing the ABI, considered that Tables 11 to 20 may provide a more appropriate estimate of the value of future income than Tables 1 to 10. It remains to be seen how the courts will decide this question, but, since the majority of the Working Party stands behind Tables 11 to 20, it may well be that those tables will be adopted.

It should be noted in passing that there may be scope for challenging the applicability of Tables 11 to 20. One reason why mortality rates in the population as a whole have decreased is that a large number of people have stopped smoking, and smoking-related deaths have therefore dropped significantly. Clearly that improvement cannot happen again, and so there is no guarantee that life expectation will continue to improve in the future at the same rate as it has improved in the past.

To find the appropriate multiplier in a given case, the basic method is as follows:

(1) decide which group of tables to use (that is, Tables 1 to 10 or Tables 11 to 20);

(2) select the relevant table in the chosen group (e.g. Table 1: Multipliers for pecuniary loss for life (males));

(3) look down the 3.0% column until the row showing the plaintiff's age is reached.

**Discounting the multiplier**

At first instance in *Thomas v Brighton Health Authority*, Collins J decided that the multiplier in respect of 'loss for life' ought to be reduced by 20% "to cater for the hazards of life in such cases." The House of Lords held that this was incorrect on the facts of that case, where there was an agreed life expectation. Lord Lloyd stated:

> *There is no purpose in the courts making as accurate a prediction as they can of the plaintiff's future needs if the resulting sum is arbitrarily reduced for no better reason than that the prediction might be wrong. A prediction remains a prediction. Contingencies should be taken into account where they work in one direction, but not where they cancel out. There is no more logic or justice in reducing the whole life multiplier by 15 per cent or 20 per cent* ***on an agreed expectation of life*** *than there would be in increasing it by the same amount.* (emphasis added)

The same applies where, although the life expectancy is not agreed, there are no exceptional circumstances that will affect the particular plaintiff's life expectation. However, if the plaintiff is (for example) a very heavy smoker, or has heart disease, the estimated life expectation may need to be reduced. If, on the other hand, the plaintiff is exceptionally healthy, the expectation may need to be raised.

The tables for loss of earnings take no account of risks other than mortality. Accordingly, the multipliers in those tables may need to be discounted to reflect contingencies such as illness and unemployment, which the plaintiff would have faced if he had not suffered his injury. Guidance on the appropriate level of discount can be found in Section B of the Ogden Tables. It should however be noted that the ABI dissented on this issue: see Appendix C to the Tables.

**Structured Settlements**

None of the plaintiffs in the cases before the House had sought structured settlements. As pointed out by Lord Steyn, pursuant to section 2 of the Damages Act 1996 the court only has the power to order a defendant to make periodic payments if both sides agree to this course. Lord Steyn identified the following structural flaw in the present system:

> *It is the inflexibility of the lump sum system which requires an assessment of damages once and for all of future pecuniary losses...the lump sum*

*system causes acute problems in cases of serious injuries with consequences enduring after the assessment of damages. In such cases the judge must often resort to guesswork about the future. Inevitably, judges will strain to ensure that a seriously injured plaintiff is properly cared for whatever the future may have in store for him. It is a wasteful system since the courts are sometimes compelled to award large sums that turn out not to be needed...The court ought to be given the power of its own motion to make an award for periodic payments rather than a lump sum in appropriate cases...Only Parliament can solve the problem.*

**The effect of tax**

Lord Steyn dealt with tax as follows:

*The rate of 3 per cent takes into account tax at standard rates. But counsel for the plaintiffs argued that the rate should be lowered for individuals subject to higher rates of tax. The position is that index-linked government securities are free of capital gains tax if held for more than a year. My understanding is that an unusually high proportion of returns from index-linked government securities comes from capital gains rather than income...But the income is taxable. For my part I am content that the position regarding higher tax rates should remain...that in such exceptional cases the plaintiffs would be free to place their arguments for a lower rate before the court.*

Accordingly, it is likely that Counsel for plaintiffs claiming very high awards will in future argue that the multiplier should be calculated on the basis of a net rate of return lower than 3%. In the case of *Biesheuvel v. Birrell* (15.12.98, unreported) Eady J. did make an allowance for additional taxation, which was equivalent to applying a lower net rate of return.

**Conclusion**

Plaintiffs with serious personal injuries will receive substantially higher awards as a result of the decision of the House of Lords. Insurers can expect awards to rise again if Tables 11 to 20 are used by the Courts.

*Christopher Purchas Q.C. and Robert Stokell*
*Two Crown Office Row, Temple, London*