The Politics and Economics of Tort Law: Judicially Imposed Periodical Payments of Damages

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Lump sum damages for personal injury are again under attack. Almost twenty years ago the concept of a structured settlement was imported into this country from the USA in order to provide continuing lifetime payments for seriously injured claimants.[1] However, the idea was slow to develop. Proposals for a structure were easily defeated if either of the parties objected. Now, after lengthy consultation,[2] that

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[1] R. Lewis, "Structured Settlements: An Emergent Study" (1994) 13 Civil J Q 18, R. Lewis, *Structured Settlements: The Law and Practice* (London: Sweet & Maxwell, 1993) chapter 4, and I. Goldrein and M. de Haas (eds), *Structured Settlements: A Practical Guide* (London: Butterworths, 2nd ed 1997).

[2] Lord Chancellor's Department, *Damages for Future Loss* (Consultation Paper CP 01/02, March 2002), and its *Analyses of the Responses* (CP (R) 01/02, November 2002). The Department made a shorter reference in its previous paper, *The Discount Rate and Alternatives to Lump Sum Payments* (Consultation Paper CP 3/00, March 2000). See also the Clinical Disputes Forum Discussion Paper, *Lump Sum Damages and Periodical Payments* (2000) and the report summarising the responses (April 2002). With structures in their infancy in 1994, the Law Commission considered it premature to give judges the power to impose periodical payments in *Structured Settlements and Interim and Provisional Damages* (1994, Report No 224) para 3.37 et seq. In a limited form periodical payments were recommended by the *Report of the Royal Commission on Civil Liability and Compensation for Personal Injury* (1978, cmnd 7054), chairman Lord Pearson (the Pearson report) vol 1 para 573. Earlier, reviewable periodical payments had been canvassed by the Law Commission (Working Paper No 41, 1971) but the response was so critical that the proposal was abandoned in its final report, *Personal Injury Litigation: Assessment of Damages* (1973, Report No 56).

veto has been removed by amendment of the Damages Act 1996.[3] Taking into account the needs of the claimant, a judge can make a periodical payments order (PPO) even if it is against the wishes of both parties. The increasing judicial direction of the course of litigation has thus been accentuated.

The tradition in tort damages is for there to be a clean break, with the defendant giving the claimant a once-and-for-all payment to end matters. In contrast, a PPO will produce an uncertain continuing relationship that may vary over time. This is because the periodical payments must be indexed against inflation - no matter what this eventually costs; and the payments can be set to continue for the claimant's lifetime - no matter how indefinite. In addition, judges have been given new powers to arrange for awards to be varied, if necessary, long after trial. It is therefore not only the form of damages that has been changed but also the way that compensation is assessed. The result has been described as marking

> "the most fundamental change in 150 years in the quantification of bodily injury claims involving continuing losses. The changes will affect not only the level of damages awarded but will also require a new approach to the quantification of claims."[4]

This article describes this new approach to claims, and analyses the needs of the claimant upon which the legislation sets such store. The changes are set in their practical context by looking at their effect upon the bargaining process which lies at the heart of personal injuries litigation. Even though settlements, rather than trials,

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[3] The changes were made by s100 and s101 of the Courts Act 2003, but these sections did not come into force until April 2005, and revision of the Civil Procedure Rules and of the relevant Practice Directions did not take place until later that year. The most important of the delegated legislation is the Damages (Variation of Periodical Payments) Order 2005 (SI No 841). The tax position was updated by the Income Tax (Trading and Other Income) Act 2005 s 731.

[4] London International Insurance and Reinsurance Market Association, *Third UK Bodily Injury Awards Study* (London: International Underwriting Association of London, 2003) 83. Colin Ettinger, the former President of the Association of Personal Injury Lawyers (APIL), goes a little further by describing it as "the most important development ever relating to the law of damages" in (2005) 155 New LJ 525.

account for the disposition of almost all personal injury cases, the effect of rule changes upon the negotiations between the parties has often been overlooked. In addition to this practical perspective, the article considers the wider economic and political context. In particular, it exposes as being seriously flawed the impact assessment upon which the legislation was founded. Although the changes will result in substantial cash-flow savings for the Exchequer and the National Health Service (NHS), they will cost insurers and premium payers dear. Those pressing hardest for the reform are revealed to be neither claimant nor defendant organisations, but Departments of State. By emphasising the effect upon public expenditure, the article thus exposes the political dimension of tort law, a feature which has often been overlooked.

In spite of their importance, these changes have been implemented without apparent detection by academics.[5] Tort scholarship is very partial. It is extraordinary how much attention is focused upon issues of liability as opposed to the quantum of damages. Practitioners are bemused by the pre-occupation of academics with the rules on fault: they are aware that liability is infrequently challenged by insurers - being raised as a preliminary issue in only about 20 per cent of their cases[6] - whereas the

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[5] By contrast, there have been a rash of notes from practitioners. They include N. Bevan and H. Gregory, "Periodical Payments" (2005) 155 New LJ 565, G. Exall (2005) 149 Sol J 469, W. Norris, "Periodical Payments: Why We Should Bother" [2005] 2 Personal Injuries Bar Association Newsline 7, C. Truscott [2005, March] Quantum 1, N. Bevan, "The New Periodical Payments Regime" [2005] 2 Civil Court News 36, R. Cropper and I. Gunn, "Periodical Payments: Financial Considerations" (2005) 155 New LJ 1160, J. Stone and A. Sands, "Periodical Payments: the Need for a Pragmatic Approach" (2005) 15 (5) PI Focus 18, D. Brahams, "Periodical Payments for Future Financial Loss" (2005) 73 Medico-Legal LJ 77, and R. De Wilde, "Periodical Payments – A Journey into the Unknown" [2005] J Personal Injury Law 320. See also the detailed treatment in Kemp and Kemp, *The Quantum of Damages* vol 1 chapter 23.

[6] T. Goriely, R. Moorhead and P. Abrams, *More Civil Justice? The Impact of the Woolf Reforms on Pre-Action Behaviour* (London: The Law Society and the Civil Justice Council, 2002) 103. However, liability was more readily denied in another survey conducted by APIL, *Potential Impact of the Threshold Limit for Personal Injury Cases within the Small Claims Court being raised to £5000* (2005).

amount of compensation is almost always open to some negotiation. This article is the first discussion by an academic of these recent reforms in damages, and it goes a little way towards redressing the imbalance in tort scholarship.

THE ATTRACTIONS OF PERIODICAL PAYMENTS

Until 1988 damages at common law were always paid by means of a lump sum, never a pension. It did not matter that the compensation was for losses that might be suffered in the future: both the monthly wage that the accident victim may have lost, and the continuing costs of care that would have to be met, were compensated by one large payment. In recent years this lump sum system has been subject to increasing criticism. In particular, the enormous responsibility for safeguarding the future that it imposes upon a claimant makes it a very worrying means of obtaining compensation. As a result, a new form of payment via a structured settlement has made limited inroads into the lump sum. Since 1988 there have been over fifteen hundred seriously injured people who have received part of their compensation in the form of periodical payments.[7]

The main advantages of a structured settlement, described in detail elsewhere,[8] form the rationale for the encouragement given to periodical payments by the new legislation. These payments offer claimants greater certainty and security compared to the traditional lump sum. They need not be eroded by the passage of time because they can be protected against inflation. They are not reliant upon uncertain forecasts of life expectancy because they can be devised to end only on the claimant's death. They can even be guaranteed to continue beyond that date if there are dependants still in need of protection. They can relieve a claimant from the stress of having to invest and be

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[7] This figure is estimated by the author on the basis of various statistics supplied over the years by the major intermediaries in the field.

[8] R. Lewis "The Merits of a Structured Settlement" (1993) 13 Oxford Journal of Legal Studies 530, and Lewis op cit n 1 chapter 6. See also *Structured Settlements: Report of the Master of the Rolls' Working Party* (2002, chairman B. Langstaff), paras 6 to 20, and B. Langstaff, "Structured Settlements: Past, Present and Future" [2003] J Personal Injury Law 237.

responsible for a lump sum greater than most people will encounter in their lifetime. The costs of obtaining financial advice concerning investment of the damages can be avoided. In addition, periodical payments can be a very tax efficient means of securing continuing compensation,[9] and they may preserve entitlement to means-tested benefits.[10] From the state's viewpoint, this form of payment is attractive because it encourages the spending of damages on the purposes for which they were awarded. The compensation is less likely to be dissipated as a result of mismanagement or the depredation of friends or relatives.[11] The injured are then less likely to find themselves reliant in the longer term on the limited resources of the welfare state. This article later analyses the cash-flow benefits that can accrue to the Exchequer where public bodies self-fund periodical payments instead of paying out lump sums. It has been for a variety of reasons, therefore, that periodical payments have received the support of Government, law reformers, judges and, to a lesser extent, practitioners and their clients.

However, further expansion of these payments in the form of structured settlements has been hindered in several ways. Some of these problems will continue to affect the use of PPOs, but one difficulty against which the new legislative regime mounts a frontal attack is the refusal by many lawyers to give proper consideration to the merits of the alternative form of payment. In part, this has been attributed to the innate conservatism of the legal profession,[12] together with ignorance or misconception

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[9] See now the Income Tax (Trading and Other Income) Act 2005 s 731 which replaced s 329AA of the Taxes Act 1988.

[10] Social Security Amendment (Personal Injury Payments) Regulations 2002, SI No 2442.

[11] See, for example, *The Times,* March 9, 2000, "Father used Half of Son's £400,000 Payout."

[12] "… lawyers and litigants are innately conservative, were wholly familiar with lump sum compensation and instinctively distrustful – and probably unfamiliar with – newfangled devices such as structures." W. Norris QC, "Structured Settlements: Past and Future Developments", paper delivered to the Legal Wales Conference, September, 2003. Similarly Lord Steyn could think of no substantial argument against judicial imposition of periodical payments other than "the distaste of personal injury lawyers for a change to a familiar system…." in *Wells v Wells* [1999] AC 345 at 384.

about what periodical payments actually involve. These doubts have proven especially troublesome when combined with reasonably held concerns about the value of structured payments compared to the anticipated returns on a lump sum when invested in equities. Although for some years it has been emphasised that lawyers have had a duty to consider setting up a structured settlement,[13] in practice they have been examined only in a minority of the cases in which they could have been sought. For example, in 2001 - 02 the NHS paid over 500 claims in excess of £100,000 and yet less than ten per cent involved a structured settlement.[14] For cases involving clinical negligence and dealt with by the Court of Protection in 2004-05 the take up was slightly higher, amounting to 26.5 per cent of the total.[15] Sometimes structures have been raised as a possibility only at a late stage in the proceedings, by which time the claimant has become used to the idea of receiving a lump sum, and is suspicious of the change in approach. Claimants have therefore objected to the award. Defendant insurers similarly have had various concerns, although again most of them have lacked foundation. The result has been that, largely through inertia, the lump sum has retained its dominance. A major factor in this has been the ability of either of the parties to object and thereby defeat with ease any proposed settlement based on periodical payments.[16] The recent legislation not only removes this veto but also forces lawyers to consider the merits of the new form of payment in any case likely to come to court. This does not mean that legal conservatism will no longer affect private settlements in the tort system, but it does constitute an attempt to change existing

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[13] R. Lewis, "A Lawyer's Duty to Consider a Structured Settlement" (1993) 9 (3) Professional Negligence 126.

[14] Lord Chancellor's Department, *Courts Bill: Regulatory Impact Assessment* (November, 2002) table 1.

[15] Personal communication to the author from Denzil Lush, Master of the Court of Protection.

[16] The need for the consent of both parties was affirmed as early as *Burke v Tower Hamlets* (1989) *The Times*, August 10, the case being criticised by Croxon in [1990] 3 AvMA Medical and Legal J 4. The point was reinforced by *R v Liverpool Health Authority et al ex parte Hopley* [2002] All ER 459 discussed in R. Lewis, "Clinical Negligence and the NHS Refusal to Structure Settlements With Profit" (2003) 19 Professional Negligence 297.

culture. It is to the scope for imposing an award against the parties' wishes that we now turn.

THE SCOPE FOR COMPULSORY AWARDS

If a personal injury case comes to court and involves future pecuniary loss, the judge has no choice but to consider making a PPO.[17] An order can be made even if not requested or wanted by the parties or where they envisaged alternative provision.[18] The cases affected will usually be those involving serious injury where claims for future earnings or the cost of care are made. Although relatively few in number, these are much more likely to come before a court and be in the public eye. They are also where the claimant is likely to be in the most need and in the greatest danger of being under-compensated.[19] Although the court's power to make a PPO is limited, the threat of its use affects the bargaining position of the parties in most major cases.

The power to make a PPO is limited in three particular respects. Firstly, it cannot be exercised in respect of damages for past pecuniary or non-pecuniary loss unless the parties agree. This means that only a minority of all claims in tort are in danger of having an order imposed because over ninety per cent involve only these two heads of damage and have no element of future loss.[20] The typical claim is for a very small sum

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[17] Damages Act 1996 s 2 (1) as amended by the Courts Act 2003 s 100.

[18] As illustrated by the early case of *Godbold v Mahmoud* [2005] EWHC 1002 (QB), [2005] Ll Rep 379. However, there was uncertainty about life expectancy, and neither counsel opposed the judge's suggestion that a periodical award for care costs be made.

[19] For example, there is a likelihood that certain claimants will be substantially under-compensated for loss of earnings. R. Lewis, R. McNabb and V. Wass, "Court Awards of Damages for Loss of Future Earnings: An Empirical Study and an Alternative Method of Calculation" (2002) 29 J of Law & Society 406 and [2002] J of Personal Injury Law 151 and, by the same authors, "Loss of Earnings Following Personal Injury: Do the Courts Adequately Compensate Injured Parties?" (2003) 113 Economic J 568.

[20] Future pecuniary loss was found in only 7.5 per cent of cases, and comprised only 8.3 per cent of the total damages paid in tort. See the Pearson Report op cit vol 2 para 44 and table 107.

of money[21] and it will continue to be disposed of by means of a lump sum. The preponderance of these small claims in the system is reflected in the fact that non-pecuniary loss accounts for about two thirds of the overall damages bill and past financial loss for about a further quarter.[22] However, these percentages change considerably in serious injury cases when future loss becomes much more important. For example, it has been estimated that, on average, 83 per cent of a claim exceeding £250,000 against the NHS comprises future loss.[23] In addition, it must be emphasised that these few serious injury cases are responsible for a substantial amount of the overall damages bill: in 2002 insurers estimated that although only one per cent of cases resulted in a payment of £100,000 or more, they accounted for 32 per cent of the total compensation received by claimants.[24] It is in cases involving this level of damages, albeit a minority of all claims, where the new rules will have the greatest effect.

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[21] £2,500 was the median figure in the survey of 81,000 cases receiving legal aid and closed in 1996 - 97 in P. Pleasence, *Personal Injury Litigation in Practice* (London: Legal Aid Board Research Unit, 1998) 40 fig 3.17. In 70 per cent of successful cases the damages were less than £5,000, although the overall average was £11,000. P. Fenn and N. Rickman, "Costs of Low Value Liability Claims 1997-2002" report average damages of only £3,000 for employers liability accident claims, although this study of almost 100,000 cases related only to claims for less than £15,000. See http://www.dca.gov.uk/majrep/claims/elclaims.htm .

[22] As found by the Pearson Report vol 2 table 107. The relative importance of non-pecuniary loss is reduced by two factors. First, as revealed by the report table 108, the larger the claim, the lower the proportion that is paid for non-pecuniary loss. Secondly, in more recent years it is likely that, at least in serious injury cases, the proportion of non-pecuniary loss has reduced because, for a variety of reasons, there has been a greater increase in the level of damages for pecuniary loss.

[23] Lord Chancellor's Department, *Courts Bill: Regulatory Impact Assessment* (November 2002) table 3. However, in table 8 the Association of British Insurers estimated that only 46 per cent of the value of claims between £100,000 and £250,000 comprised future loss.

[24] Ibid table 1.

The second limitation upon the court's power is that these new orders can only be made if the continuity of payment is "reasonably secure."[25] Legislation prescribes that the payments will be secure if either they are to be made by a Government or health service body,[26] or if they are protected by a compensation scheme which guarantees payment in the event of an insurer's insolvency.[27] In effect, this means that orders can be made in the overwhelming majority of personal injury claims. One exception is that the Motor Insurers Bureau is not covered, but it has already been able to demonstrate successfully to a court that it is sufficiently secure for a PPO to be made in cases in which it is involved.[28] Those against whom questions of security will be raised include Lloyd's syndicates,[29] the medical defence organisations, offshore insurance companies, and private self-insured defendants. Even in these cases, a PPO could still be made and the security requirement met if the payments were arranged via the purchase of an annuity from a life insurer which was covered by the scheme guaranteeing payment in the event of insolvency.

The third limitation on the power to impose periodical payments is more important in practice. It is that it can only be exercised if the case comes to court for the judge to make the order. Even though cases of serious injury are more likely to come to court,

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[25] Damages Act 1996 s 2 (3) as amended by the Courts Act 2003 s 100.

[26] As specified in the Damages (Government and Heath Service Bodies) Order 2005 (SI No 474). However, there is concern that that an NHS body which becomes a Foundation Trust will not receive the protection offered by the NHS (Residual Liabilities) Act 1996. Test litigation on this issue is expected early in 2006. Rodway, "Periodical Payments Update" [2005] 6 Kemp News 10.

[27] Financial Services and Markets Act 2000 s 213, discussed in detail in Annex C of the Department for Constitutional Affairs, *Guidance on Periodical Payments* (April, 2005). Also acceptable are Ministerial guarantees under the Damages Act 1996 s 6.

[28] *Thacker v Steeples and the MIB* (2005, May 16) (unreported) (Lawtell Quantum AM 0900821) and [2005] 3 Kerp News 5, and *Daniels v Edge and the MIB* (2005) 15 (4) PI Focus 23.

[29] Syndicates are covered by the insurer insolvency scheme, but only in respect of policies written after January 1st 2004.

it remains the case that only a minority of them do so.[30] It is true that the court will always be involved in cases involving children or patients unable to manage their affairs because then there must be formal approval of any settlement.[31] However, in such cases the parties are effectively seeking an order by consent, and the legislative requirements of PPOs need not apply.[32] This means, for example, that a wider range of annuities can be used. This is a tremendously important point, and one which hitherto many practitioners have failed to appreciate. Settlements out of court therefore can still take place in one of two ways. Firstly, there can still be private agreements to pay damages periodically. In effect, this means that much of the previous structured settlement regime survives, even though the use of that term has now been expunged from the legislation.[33] Alternatively, if neither party wants periodic payments to be considered, there is every incentive to settle privately for a lump sum. No matter what the court might have considered to be the needs of the claimant, the parties will get their wish for such a deal if they keep their negotiations behind closed doors and avoid judicial involvement.

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[30] Before being set down for trial 98 per cent of cases are settled and many more are concluded before any hearing takes place. The Pearson Commission op cit vol 2 table 12. Similarly P. Pleasence, *Personal Injury Litigation in Practice* (London: Legal Aid Board Research Unit, 1998) at 12 reveals that only 5 out of the 762 "ordinary" cases with costs of less than £5,000 went to trial. However, a much larger percentage of serious injury cases end up in court. In cases involving very substantial awards of damages ten per cent of payments were found to be the result of formal court orders by P. Cornes, *Coping with Catastrophic Injury* (Edinburgh: Rehabilitation Studies Unit, 1993) 20.

[31] Civil Procedure Rules 1998 Practice Direction 21 para 6.6. In 2004 the Court of Protection approved settlements for "patients" in about 440 cases. Of these 45 per cent involved clinical negligence. These figures do not include approvals in cases involving minors.

[32] As confirmed in *Day v Alexander* (2005) 15 (7) PI Focus 24.

[33] Contrast Kemp and Kemp, *The Quantum of Damages* vol 1 para 22-000 stressing that structures "no longer have a separate identity as a form of final disposal in personal injury claims," and that the chapter dealing with them is unlikely to appear in future editions. According to para 22–059 structures "are now seen as being too restrictive in concept and application." In several respects this is the opposite of what is argued here.

It would be a mistake to assume that because new legislation has been passed it will necessarily be used in the way intended by the draftsman. The legal rules provide a framework for bargaining between the parties, and the results can be very different from the picture of litigation envisaged by the black letter lawyer. Within the shadow of the new rules it is likely that a number of claimants will try to take advantage of the removal of the defendant's veto: they will threaten to take the case to court and burden the defendant with a PPO involving uncertain liabilities unless there is agreement to a higher lump sum than previously was on offer.[34] Exactly the same tactic has been used to obtain higher lump sums instead of provisional damages awards, as discussed below in relation to variation of payments. Somewhat less successfully, insurers may also use the threat of periodical payments to bargain harder with a claimant who is set on receiving a lump sum, or worried about whether the court's assessment of needs will correspond to his own. Can a judge be trusted to leave enough of a contingency lump sum fund to provide for unexpected events? Claimants may also be concerned that even an index-linked settlement may not be enough to pay for their future care costs. Because of these worries bargains will be struck to settle out of court. The experience of other countries is that these deals have undermined the power to make periodic awards to such an extent that "lump-sum settlements have like termites reduced the rent system to but a hollow shell."[35] Because negotiations between the parties will water down the effect of the reform we can expect lump sums to be commonly used even in the majority of serious injury cases involving future financial losses. But the possibility of imposing a PPO substantially influences the bargaining position of the parties, and it is in that sense that all serious injury cases are affected.

FACTORS AFFECTING THE TYPE OF AWARD: NEEDS DEFEAT WISHES

[34] Similarly W. Norris, op cit n 5: "… claimants' lawyers will recognise that periodical payments are an attractive means of providing compensation for long-term losses and a valuable bargaining tool even if there are good reasons for preferring a lump sum award."

[35] J. G. Fleming, "Damages: Capital or Rent?" (1969) 19 University of Toronto LJ 295.

In any case involving future pecuniary loss the court must consider making a PPO. Whether it imposes such an order lies within its discretion and depends upon the particular facts of the case. The legislation offers only limited guidance about what might affect this decision. The most important consideration is the claimant's needs.[36] Only in a Practice Direction is the court referred to the secondary issue of whether either of the parties prefers a lump sum and their reasons for doing so. The autonomy of the parties has thus been replaced by judicial assessment of what is good for the claimant. Introducing this measure of paternalism into this area of civil justice has raised no widespread concern given that, if it were not for the accident, the claimant would not have been able to have his future earning capacity capitalised into a lump sum.[37] Nor will a claimant find it easy to avoid the effect of a PPO once it is made: any attempt to assign the value of the payments in return for a lump sum will have no effect unless a court agrees to the arrangement and finds special circumstances to justify it.[38] The claimant is thus doubly protected against his own profligacy whether he likes it or not.

The emphasis upon the claimant's needs is novel: it is not to be found in earlier legislation dealing with damages. Need never affects compensation for lost earnings or pain and suffering, for example, although it is implicit in any assessment of housing or nursing care costs. Need is notoriously difficult to define,[39] but focusing upon it can produce a different perspective upon an award. It contrasts with the usual objective in

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[36] Civil Procedure Rules 1998 r 41.7 as amended by SI 2004 No 3129.

[37] Law Commission, *Structured Settlements and Interim and Provisional Damages* (1994, Report No 224) para 3.39, Lord Chancellor's Department, *Damages for Future Loss* (Consultation Paper CP 01/02, March 2002) para 24. In response to the latter, 57 per cent were in favour of giving the court the relevant powers and a further 14 per cent expressed qualified approval. Contrast R. Williams, "The Case against Periodic Payments" [1999] J Personal Injury Law 85 at 92.

[38] Damages Act 1996 s 2 (6).

[39] For the most recent assessment of the difficulties involved see M. Tibble, *Review of Existing Research on the Extra Costs of Disability* (Department of Work and Pensions, Working Paper No 21, 2005).

tort of returning the claimant to the pre-accident position. In particular, as we shall see below, need requires a more detailed analysis of the claimant's future than the tort system has previously attempted.

Apart from need, the court must also have regard to the nature of any financial advice received by the claimant, and "the scale of the annual payments taking into account any deduction for contributory negligence."[40] This financial advice will rarely be that of the claimant's own solicitor for the Financial Services and Markets Act 2000 prevents such advice from being given by those who are not authorised.[41] Instead the court will require the opinion of an independent financial advisor. This will have to be sought early in the proceedings because, as soon as is reasonably practicable, the court is required to give the parties a preliminary indication of which form of payment it considers the more appropriate.[42] Financial intermediaries will therefore have an even more important part to play than they did in the past with structured settlements, for then they were often involved only at a late stage. The financial projections of these experts concerning the extent that the lump sum will be eroded compared to the constant value of the periodical payments will be crucial in determining the form of the award, and the opinion will now be given at an early stage in the proceedings.

One area of uncertainty is the level of damages below which it might not be worthwhile to move towards a periodic award because its size may not merit the time and trouble involved. Under the old rules the court had to be satisfied that a structured settlement had been considered by the parties in any case involving damages for future

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[40] Practice Direction 41B 1 (1).

[41] A few large firms of personal injury solicitors do have their own authorised investment division. These firms might have a financial incentive to settle via a lump sum and continue to advise the claimant upon investment. Of course, this arrangement should only be made if it is in the best interest of the client.

[42] Civil Procedure Rules 1998 r 41.6. J. Stone and A. Sands, "Periodical Payments: The Need for a Pragmatic Approach" (2005) 15 (5) PI Focus 18.

loss of £500,000 or more.[43] However, for a periodical payment under the new rules Ministers concluded that the size of an award should not be the determining factor. Perhaps they had in mind the experience of the USA, where structured settlements have become commonplace even at damages levels below £100,000. Instead of setting a damages threshold, therefore, Government have left the court to assess only whether arranging the award in a new form might involve disproportionate effort.[44] Although in theory any award of future loss could therefore be paid periodically, in practice a PPO will be less appropriate in certain types of claim. For example, although there is nothing to prevent a court imposing an order no matter what the age of the claimant, the objection of an elderly person to being paid periodically might be expected to have more force given the shorter duration of the payments.[45]

Another factor affecting the level at which a PPO may be made and the extent they will be used is that, in most serious injury cases, the claimant should be left with a contingency lump sum fund to meet unexpected needs. It is essential that this element of flexibility exists to safeguard the future, even though it is not mentioned in the legislation.[46] There are fears that judges will not take it into account sufficiently.[47]

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[43] Former Practice Direction 21 para 6.4. The practice of the NHS was to consider a structure in any case having a minimum value of £250,000.

[44] Department for Constitutional Affairs, *Guidance on Periodical Payments* (April, 2005) para 9. http://www.dca.gov.uk/pubs/pps-guidance-final.pdf

[45] The life expectancy of the claimant is mentioned as a factor in Explanatory Note 356 to the Courts Act 2003, but is not referred to elsewhere. Of course, age does not prevent making a PPO as illustrated by a case involving a 78 year old claimant in *McDermott v North Cheshire Hospitals NHS Trust* (2005) 15 (7) PI Focus 25.

[46] Contrast the guidance given in the old *Practice Note (Structured Settlements)* [1992] 1 All ER 862, para 6 (v).

[47] N. Leech (2005) 10 Legal & Medical 25: "An enthusiastic judge with possibly little training on these changes, in what is a huge culture shift, may impose an order … that leaves the claimant short-changed on the contingency fund." The dangers are emphasised by the Master of the Court of

Capital may be needed not only to buy and adapt accommodation, but also to care for the claimant, for example, in the event of the unexpected death or divorce of his carer spouse. Capital might also be needed if care costs outpace price inflation, as discussed below. For structured settlements in the past, on average, only about half of the award was used to arrange the periodic payments. The remainder was accounted for by interim payments, the capital needed to discharge debts and pay for immediate purchases, and the contingency fund.[48] Will judges take a similar approach?

One area of concern with regard to when an order may be made is whether the award of damages is to be reduced for contributory negligence.[49] This may not become apparent until a late stage in the proceedings, and yet it could be crucial in influencing the financial advisor as to the form of the award. If there is to be a reduction in damages, a PPO may not then be enough to pay the cost of the claimant's immediate nursing needs. It might then be thought better to award a lump sum. Although that payment is more likely to be exhausted earlier if not within the tax shelter provided by periodical payments, it may be preferable for this to occur and for the claimant's actual needs to be met for only a short time, rather than leaving a permanently inadequate source of funds to offer insufficient protection against needs which have yet to occur.

"BOTTOM UP" ASSESSMENT OF NEEDS IRRESPECTIVE OF COST

Protection, D. Lush, "Damages for Personal Injury: Why Some Claimants Prefer a Conventional Lump Sum to Periodical Payments" (2005) 1 (2) London Law Rev 187 at 191.

[48] R. Lewis, op cit n 1 para 9-66 et seq where the factors affecting the size of the contingency fund are examined in detail.

[49] It is very difficult to analyse the effect of the defence of contributory negligence in practice upon the overall system because the parties need not agree whether and to what extent the defence is a factor in the final settlement. However, it was thought to be the cause of the reduction in damages in a quarter of all settlements studied by D. Harris et al, *Compensation And Support For Illness And Injury* (Oxford: Clarendon Press, 1984) 91. See also Pleasance op cit n 30 at 52. The Law Commission found at least 12 per cent of recipients of damages awards considered that the defence had been relevant in reducing their payments. See Report No 225, *Personal Injury Compensation: How Much Is Enough?* (1994) table 407.

Where periodical payments are thought appropriate, the court is required to make a fundamental change in the way that it calculates damages: instead of a "top down" it must adopt a "bottom up" approach,[50] thereby focusing more precisely upon the claimant's needs. The more familiar top down approach begins only after arriving at the traditional lump sum. It then calculates the income stream which can be derived from that capital, and this can be used to assess whether it will meet the claimant's annual needs. A common reason for rejecting a structured settlement in the past was that the periodical payments resulting from an annuity purchase did not meet these needs. This top down approach does not avoid the most serious criticisms made of lump sums: the need to forecast how long the payments will be required, and the rate of return, after taxation and inflation, which could be obtained from investment of the lump sum. In particular, the claimant's life expectancy is usually an element in estimating how long the payments will be required. The lump sum will reflect the compromises necessary in making these uncertain forecasts. It is usually only *after* the lump sum has been calculated using these traditional methods that it is used in a structured settlement to transfer, from the claimant to an insurer, the risk of the claimant living beyond his estimated life expectancy. This is usually achieved by the liability insurer using the compromised lump sum to purchase annuities from a life office to provide a stream of periodical payments for as long as the claimant actually lives, not merely the time he is expected to live. Structures, therefore, usually involve only changing the form of payment after the parties have gone through the traditional approach and, as a result, they retain many of the disadvantages of the lump sum.

By contrast, for a PPO the new legislation requires a bottom up approach. Unlike top down, this does not require the lump sum to be calculated at all. Instead, irrespective of the capital cost, the court assesses the periodical payments the claimant needs for the future. These payments do not have to be multiplied to take account of the speculative estimates of life expectancy or projected investment returns. Unlike under the traditional form of payment, it is the defendant who is burdened with these risks and thus exposed to an uncertain future liability. When making a PPO the court

[50] Lewis op cit n 1 para 9-10 et seq.

must specify the annual amounts payable, and sub-divide the award to distinguish loss of earnings from the costs of care and the recurring capital costs.[51] The court must also state at what intervals the payments are to be made, and state the amounts, at current value, of the recurrent costs. The periodical payments will then be indexed to guard against inflation. The risks that arise which relate to both the investment return and the longevity of the claimant are thus entirely transferred to the defendant.

In total a complex budget for life may be needed, and there is great pressure to "get it right."[52] Detailed planning of the claimant's future is encouraged by allowing the payments to increase in steps, or even decrease.[53] However, these variations in payment can only take place if the court specifies in the original order precise dates for the changes to take effect. The court is encouraged to plan for a variety of factors including those affecting earnings (the claimant ceasing to work, or gaining a promotional increase in pay); and affecting care (loss of the existing gratuitous carers, changes in the medical condition). Allowance can also be made for other types of factors such as a change in educational circumstances, perhaps leading to the claimant adopting a more independent, but expensive, lifestyle.

The crucial difference from previous practice is that the court is not concerned with the lump sum cost of providing for these needs. Nor does it have to speculate to the same extent about for how long there will still be such need. Clairvoyant estimates of how long the claimant will live, for example, are made redundant. Unlike under the traditional calculation, there is no place for the 'Ogden Tables.'[54] That is, multipliers and discount rates are otiose: no multiplier is required to reflect the period of years of the loss in order to convert it into an immediate capital amount; and no discount rate

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[51] Civil Procedure Rules 1998 r 41.8 (1) as amended by SI 2004 No 3129.

[52] Law Commission Consultation Paper No 125, *Structured Settlements and Interim and Provisional Damages* (1992) para 3.19.

[53] Practice Direction 41B para 2.2.

[54] Government Actuary's Department, *Actuarial Tables For Use In Personal Injury And Fatal Accident Cases* (London: The Stationery Office, 5th ed 2004).

is needed to convert the future stream of financial losses into a capital sum representing present day values. The discount rate, in particular, has operated harshly against claimants in the past. Now defendants will not be able to take advantage of the artificial estimates on investment returns offered by the discount rate in order to limit damages. They will be ordered to provide the annual sums, indexed to rise with inflation, irrespective of what it might cost them as a capital sum to make such provision. Furthermore, they will usually be ordered to make these payments for an uncertain period – the rest of the claimant's life.

Again it is crucial to return to what effect the power to make such an award will have upon bargaining between the parties. As already suggested, the move towards imposing an uncertain liability upon defendants will strengthen the claimant's hand. But how will the mechanics of making the deal be affected? In particular, for costs purposes, how is it to be determined whether offers to settle made by either of the parties are reasonable when one of them is based on the traditional lump sum, and the other partly on an assessment of the claimant's annual needs? In complex cases there could be a mixture of approaches depending upon different care regimes and earnings losses. How is the court to assess the reasonableness of the rejection of a periodical payments offer if it is not based on its capital value but on wider social and family reasons? It would be a matter of considerable concern if the new form of damages were seriously to impede the ability of the parties to arrive at an amicable settlement by using the present Part 36 procedures and making payments into court. Less than two per cent of personal injury cases are determined by a court at present; if the number were to double, considerable problems could be caused for the administration of civil justice. To avoid this and to reduce the potential uncertainty when offers are made the Civil Procedure Rules now specify what any offer involving periodical payments must include.[55] Costs consequences follow if the court judgement is not "more advantageous" than the party's offer. However, what may constitute an advantage is not specified amid the myriad of concerns which the parties may have about offers based on periodical payments. The rules have been left vague and there is

[55] Civil Procedure (Amendment No 3) Rules 2004 (SI No 3129) inserting the new Rule 36.2A.

much scope here for clever tactics from skilled litigators.[56] It remains to be seen whether the broad discretion given to the court as to costs will be further used to encourage litigants to negotiate on a periodical payments basis. The attitude and training of the judiciary will be crucial in determining the long-term success of the new provisions.[57]

VARIATION OF AWARDS: FUTURE NEEDS IGNORED?

If the insurer is to continue to make payments into the future, and increased emphasis is placed upon planning for the claimant's needs, what if those needs change? To what extent will the defendant be required to find further monies because of the change in circumstances? This was a potential reform which caused insurers' considerable concern, and they argued strongly against the court being given any extensive powers to revise an award. Considerable difficulties could be caused not only for insurers in having to keep open their files and set reserves for uncertain liabilities many years after the original injury, but also for courts in determining whether the injury continued to be a cause of the claimant's present needs.[58] The new legislation reflects these worries by severely limiting the grounds for review. However, it also encourages the awarding of stepped payments to cater for future

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[56] APIL, *Periodical Payments and Part 36: A Response* (14/04 2004) fears that the uncertainty introduced make it difficult for lawyers to advise their clients, and claimants will be unfairly disadvantaged. The Master of the Court of Protection, has recognised wide reasons for resisting a lump sum for they could be "not simply financial but extend across a much broader range of considerations – medical, social and personal – and more holistic insofar as they treat the claimant as a member of a family rather than in isolation." D. Lush, "Damages for Personal Injury: Why Some Claimants Prefer a Lump Sum to Periodical Payments" (2005) 1 (2) London Law Rev 187 at 203, (previously a paper delivered to the Common Law and Commercial Bar Association, April 2005).

[57] The guidance given to the judiciary to date contributes little to the debate on the contentious issues and merely summarises the relevant legislation. An updated version of the Judicial Studies Board *Civil Benchbook* is not expected to resolve matters.

[58] For these and other reasons the Law Commission rejected review in relation to voluntary structured settlements in *Structured Settlements and Interim and Provisional Damages* (1994, Report No 224) para 3.85.

changes. These two approaches to future payments are clearly distinguished in the two sub-headings below.

Traditionally the lump sum award has been seen as putting an end to litigation. In particular, the idea that a court could impose a continuing obligation to make reparation upon a defendant was considered in 1927 to be "quite improper and illegal."[59] Since that date the finality of the award of damages has largely been preserved, although it is subject to the following three exceptions:

Firstly, a structured settlement can be devised to create a continuing liability to make periodical payments. Structures still exist, although the terminology has been removed from the legislation. However, as we have seen, the "top down" approach to a structure merely converts the traditional lump sum into a series of payments, and does not require the addition of any more money than that envisaged in the original settlement. It therefore makes no difference to the structure that the claimant's needs unexpectedly increase over time. No variation of the pre-set payments is allowed, and insurers have therefore not had to face any later review of the settlement.

Secondly, interim awards constitute a limited move away from the once-and-for-all system by allowing a claimant to obtain some compensation while waiting for final settlement or the full trial of his action to take place. The procedure is of particular value where a period of time is required for the claimant's medical condition to stabilise before a firm prognosis can be made about his future needs. Successive awards can be made, although interim payments are limited to a reasonable proportion of the damages to which the claimant would be entitled at trial. Again, no variation of payment is allowed after trial or final settlement.

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[59] *Fournier v Canadian National Railways* [1927] AC 167.

Finally, a potentially more radical change was introduced in 1985 when the claimant was allowed to obtain a provisional damages order from the court.[60] This enables the claimant to return for more money if there is a chance that his medical condition will deteriorate. However, severe limits are imposed. The chance must be substantial not merely fanciful. The additional compensation can then only be obtained on one further occasion and only if there has been deterioration in the particular way foreseen and specified by the court when making its first award. The mere fact that the claimant is in need of greater care or has suffered a general or continuing deterioration will not suffice to trigger a review. Instead the deterioration must be "clear and severable" and correspond to that precisely anticipated by the court.

The procedure is especially useful as a form of protection against catastrophe in the form of an unlikely, but possible, severe deterioration in the claimant's condition. The most common example of the use of the order is with regard to the risk of developing epilepsy after suffering a head injury. Even in such cases orders have been sought infrequently, partly because formal resort to court is required. A total of only 450 orders were obtained in the two million personal injury cases settled in the three years from 2000.[61] However, in negotiations claimants have threatened to use this procedure somewhat more frequently in order to strengthen their hand. The threat is made to take advantage of the desire of insurers to close the file and avoid exposure to an uncertain liability. Claimants hope to increase the lump sum on offer. In this respect, as analysed above, there are clear parallels to be drawn between the effects on the bargaining process of provisional damages, on the one hand, and the new powers to order periodical payments, on the other.

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[60] Supreme Court Act s 32A as amended by the Administration of Justice Act 1982 s 6. See part 41 of the Civil Procedure Rules 1998 and D. Brennan, *Provisional Damages* (London: Legal Studies and Services, 1986).

[61] This is less than 0.03 per cent of the settlements recorded by the Compensation Recovery Unit. See Department for Constitutional Affairs, *Variation of Periodical Payment Orders and Settlements in Personal Injury Cases: Partial Regulatory Impact Assessment* (April, 2004).

a) Variable periodical payments orders

The new legislation, in effect, enables the provisional damages rules which have been used for lump sums to be applied to periodical payments orders.[62] The payments can be varied and, if necessary, a further lump sum can be sought. The limited grounds for variation are almost the same as those for provisional damages described above. In particular, unforeseen medical changes are excluded because of the high level of uncertainty and potential costs involved. Nor is review to lie if there are unforeseen life-changing circumstances even if these are exceptional.[63] Ministers therefore expect variable orders to be sought infrequently.[64]

However, the grounds for variation have been extended in one important respect. Apart from taking account of the possibility of deterioration in the claimant's physical or mental condition, judges may now also allow a variation if there is a chance of a significant *improvement* in the condition in the future. Previously there had been concern that this might hinder rehabilitation: whether as a result of malingering or because of the subconscious effect, the claimant may not improve if there is a financial penalty for doing so. This possibility has now given way to the more even-handed approach of allowing for both deterioration and improvement. The bargaining position of defendants has thus been slightly improved. After all, a claimant will not relish the prospect of being spied upon later in life to see if his medical condition has changed. However, because insurers wish to bring proceedings to a close, it is doubtful whether they will drive a case to court to secure this power of review except

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[62] Damages Act 1996 s 2B as substituted by the Courts Act s 100 and supplemented by the Damages (Variation of Periodical Payments) Order 2005 (SI No 841).

[63] As suggested by the Lord Chancellor's Department, *Damages for Future Loss* (Consultation Paper CP 01/02, March 2002) para 70, and supported by a number of respondents (CP (R) 01/02) 22. These included APIL in its *Response to the Lord Chancellor's Consultation Paper* (May, 2002) and *Response to the Draft Damages (Variation of Periodical Payments) Order 2004* (06/04, 2004).

[64] Department for Constitutional Affairs, *Guidance on Periodical Payments* (April, 2005) para 11.

in the most extreme cases and only if considerable improvement in a specific way is anticipated.

b) Non-variable but stepped orders

In planning for the claimant's future the court is encouraged to anticipate events which will increase, or even decrease, the need for compensation. It can then order that payments be changed, or 'stepped', at the specific dates in the future at which it forecasts that these changes will need to be made. In a Practice Direction,[65] the court has been given examples of when a stepped order might be considered appropriate. These include where it anticipates that the claimant's earnings will change, or where it considers that it will be necessary to revise the amount of care required. Similarly, provision can be made for changes in future medical costs or for recurrent capital costs. However, in all cases the court must state the specific dates and amounts by which the payments should be varied.

Unlike under a variable order, the increase or decrease resulting from a stepped provision can be made at the later date without any further involvement of the court. A second difference is that the change in payment takes place irrespective of whether the anticipated event giving rise to it actually occurs. There is no later review, only guesswork in advance as to what the claimant will require in the future. This requires the same crystal ball gazing as when a lump sum is awarded. Windfall increases can therefore occur when the need does not later materialise, and conversely, under-compensation will result if a new need is not anticipated. The precision in the court order is the enemy of flexibility and later need.

Overall, whether involving variable or stepped payments, there has only been a very limited departure from the traditional rule that awards are not subject to later review. The emphasis upon the claimant's future needs is therefore strictly time-limited: needs are of concern at the date of trial only, and generally not thereafter.

INDEXATION OF PAYMENTS: PRICES OR EARNINGS?

[65] Practice Direction 41B para 2.2.

One of the major advantages to a claimant of a PPO is that the payments specified will increase in the future to protect against the potential ravages of inflation. Claimants will not see their damages eroded as they have in the past when the value of the income arising from the lump sum was reduced by economic circumstances beyond the control of the average investor. Instead, the periodical payments are to be treated as varying in accordance with the Retail Prices Index (RPI).[66] This is a major attraction in applying for a PPO. Insurers have particular difficulties, described under the next heading, in meeting the open-ended commitments involved. Indexation is therefore a key feature in strengthening the claimant's bargaining position, and it would be improved further if an index higher than RPI were to be used. The legislation appears to make this possible because it empowers a court to depart from RPI where circumstances make it appropriate to do so.[67] However, no indication is given of what these circumstances might be.[68] The first test case litigation concerning the new payments regime is with regard to these provisions.[69] When will a court depart from RPI and adopt another index? This issue is of considerable importance to the level of damages and to the future of the tort system.

The immediate concern of claimants is that using the RPI will almost certainly under-compensate them for their future cost of care. There are various arguments based on the increasing costs of medical treatment, equipment and appliances, but the early focus of the litigation is upon the future earnings of carers. In general, for at least the past sixty years, earnings have exceeded prices by an average of about two per

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[66] An attempt by the NHS to pay less than RPI because of potential local authority support in later years failed in *Walton v Calderdale Healthcare NHS Trust* [2005] EWHC 1053 [2005] Ll Rep Med. 398.

[67] Damages Act 1996 s 2 (8) and (9) as amended by the Courts Act 2003 s 100.

[68] Para 354 of the Explanatory Notes to the Courts Act merely states that it is expected that RPI will be used in the great majority of cases. A first draft referred to a different index being adopted only in "exceptional" circumstances, but this was controversial and was later changed to "appropriate" circumstances.

[69] The application to strike out the claim was dismissed in *Flora v Wakom Ltd* [2005] All ER (D) 117 (Dec) [2005] EWHC 2822 and it is expected to be fully argued early in 2006.

cent a year.[70] If this difference can also be shown to apply to care workers and that it is likely to continue in the future, then damages awarded for care and based on the RPI will be insufficient in the longer term.[71] If costs exceed RPI by 2 per cent a year, after twenty years RPI linked payments will meet only two thirds of the care costs; after 35 years they will meet only half; and after sixty years only one third.[72] As a result actuaries acting for medical insurance companies commonly allow for indices for the cost of care or hospitalisation to exceed RPI.[73]

Although on the surface there appears to be strong arguments for departing from the RPI in relation to care costs, there are practical difficulties in setting an alternative and, more importantly, there are profound problems of principle for the tort system. The practical difficulties involve selecting alternative indices and relevant time periods. For example, over what period are rates to be studied to establish historic patterns to illustrate the potential impact of different indices? Which indices are to be used when different earnings figures can be derived from the likes of, firstly, local authority based rates of pay for carers, secondly, the British Nursing Association recommended rates for carers, and thirdly, Government annual figures of average

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[70] Government Actuary's Department, *Actuarial Tables For Use In Personal Injury And Fatal Accident Cases* (London: The Stationery Office, 5th ed 2004) (The Ogden Tables) Appendix A para 12: "Real earnings growth … has averaged 1.5 to 2 per cent a year more than growth in the RPI."

[71] R. Hogg, "Will Periodical Payments Provide Adequately for the Costs of Care?" [2004] J Personal Injury Law 209, and contrast W. Norris, "Periodical Payments: Indexation, Variation, Protection and Practice" [2005] J Personal Injury Law 59 with a reply by R. de Wilde at [2005] J Personal Injury Law 147. According to Lush, op cit n 56 at 192, in *Beattie v Secretary of State for Social Security* [2001] Ll Rep Med 297, between 1992 and 2004 the claimant's annuity rose by 35 per cent whereas his care costs rose by 60 per cent in line with average earnings. He is now unable to afford the care package he needs.

[72] Hogg op cit at 213. This is confirmed by the mathematics of another example: with inflation at 2.5 per cent, an indexed award of £10,000 pays out £20,975 after 30 years whereas an earnings-related award at 2 per cent above RPI would pay out £37,500 a year. This represents a shortfall of 44 per cent, and a cumulative deficit of £171,000.

[73] The Ogden Tables Appendix A para 6.

earnings for many different sections of the workforce? There are a range of possibilities.[74] However, a suggestion that a fixed percentage above the RPI should be used[75] appears to have been abandoned.

The wider problems of principle that result from a move away from RPI focus upon the disparity that would then exist between periodical payments and lump sums, and the implications for assessing damages for lost earning themselves. In *Cooke v United Bristol Healthcare*[76] the Court of Appeal, in effect, refused to depart from RPI when assessing a lump sum to compensate for the future loss. The award was to be calculated by establishing the real rate of return on the investments which could be obtained from early receipt of compensation in the form of an immediate lump sum. For this the appropriate discount rate was 2.5 per cent, as specified by the Lord Chancellor under the Damages Act 1996. This assumed real rate of return on investment was set after allowance not only for taxation on the income that arises, but also for inflation in the form of increases in the RPI.[77] The Court of Appeal rejected the challenge to the Lord Chancellor's set rate even though there might be evidence that care costs had increased above RPI and would continue to do so. It was seen as "an illegitimate attempt to subvert the Lord Chancellor's discount rate." However, the

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[74] There are a variety of inflation indices already in use to manage health service efficiency. They include a pay cost index and a health services cost index. See L. Curtis and A. Netten, *Unit Costs of Health and Social Care 2005* (Canterbury: University of Kent, 2005). http://www.pssru.ac.uk/uc/uc2005contents.htm

[75] Hogg op cit, and APIL, *Periodical Payments: An Assessment of Concerns and Solutions* (March 2004).

[76] [2004] 1 All ER 797. See also the earlier attempt to adduce evidence in *Warriner v Warriner* [2002] EWCA Civ 81 [2003] 3 All ER 447. In *Patel (Bhawesh) v Wright* [2005] EWHC 347, rather than preventing an increase in the multiplier, *Cooke* was applied to prevent it from being reduced to take into account an anticipated fall in the future cost of video telephone calls.

[77] Many recipients of lump sum damages are higher rate taxpayers on the income that arises with the result that the rate of return they must earn is 4.6 per cent plus RPI.

decision has already been severely attacked for being based on "specious grounds,"[78] and if PPOs were now to be indexed at a different rate, it is certain that *Cooke* would be subject to challenge.

If departure from the index were to be justified to take account of earnings when assessing care costs, it would be difficult to see where the argument might stop and where RPI would actually be used. In particular, it appears logical to extend the argument to the calculation of damages for the loss of future earnings themselves. At present the claimant's damages are frozen at the date of trial or settlement, and no allowance is made for the anticipated rise in the standard of living which all workers are expected to enjoy in the future.[79] This seriously limits the size of the damages award,[80] and gives the lie to the avowed tort objective of returning the claimant to the pre-accident position. However, if the limit were removed, there would be extremely serious consequences for insurers and premium payers, as well as for Government and especially the NHS.

The following example illustrates the extent that damages would increase if there were to be a departure from the RPI. It looks at various potential multipliers required to compensate a 20 year old man suffering a pecuniary loss for life. Using table 1 of the Ogden tables and applying the present 2.5 per cent discount rate, the current multiplier lawyers would use to apply to the annual loss is 31.3. However, if we take the Government actuary's view[81] that the true returns on investment after taxation and

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[78] R. de Wilde op cit n 71 at 157.

[79] P. Cane, *Atiyah's Accidents, Compensation and the Law* (London: Butterworths, 6th ed 1999) 133. Of course, allowance is made for the higher wages resulting from prospects of promotion, but not for the increases that might be expected because of the rise in living standards.

[80] For examples of its effect see R. Lewis, R. McNabb and V. Wass op cit n 19.

[81] Chris Daykin, "From Lump Sums to Periodical Payments and Beyond" (2005) a paper presented to a conference at the Institute of Actuaries, March 2005. The market at that time implied a return of 1.8 per cent but this was before any deduction for tax. In issuing new RPI linked gilts on behalf of Government in September 2005 the Debt Management Office used a discount rate of 1.25 per cent.

RPI inflation are such that the discount rate should be nearer 1.5 per cent this would increase the multiplier to 40.2. If we then suppose that health care costs will rise at say 1 per cent above RPI, then the discount rate becomes 0.5 per cent and the corresponding multiplier is 53.7. Finally, if we then allow for earnings to rise at say 1.5 per cent over RPI the discount rate is 0 per cent and the multiplier increases to 63.8. In effect, this means that moving to an earnings-based assessment instead of prices could double the amount of damages that can be claimed for the future loss.

If we put this in a historical context the increase in damages becomes even more pronounced. Six years ago the discount rate stood at 4.5 per cent where it had been fixed for the previous thirty years. It used to be conventional wisdom, reflected in the Ogden Tables, that even with regard to a youngest claimant suffering an injury, the effects of which would last for life, the multiplier would not exceed the low 20's. Using that figure as the baseline it can be seen that damages today for future loss have increased by 50 per cent and involve multipliers in the 30's. If allowance were to be made for a rise in earnings instead of prices the increase in damages will be threefold and the multiplier in the 60's. The indexation of periodical payments therefore has widespread implications for the level of damages in general and the eventual cost to society of the tort system.

PROBLEMS FOR DEFENDANTS: THE TRUE COSTS

Insurers are faced with a variety of technical and administrative problems as a result of the new legislation. These include keeping files open for very many years, and setting reserves to comply with regulatory requirements when future liability is so uncertain. A particular difficulty is the effect of liability to make continuing payments upon reinsurance treaties. A liability insurer might offset the risk of paying high awards by reinsuring liability above a certain threshold. This can affect cases as low as £500,000, although a common level for medium sized companies is around £2 million. No problems are caused where a lump sum is paid because the level which

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As noted in the introduction to the Ogden Tables op cit n 70 para 15, the Lord Chancellor's discount rate has never been within 0.5 per cent of the correct rate of return.

triggers the involvement of the re-insurer is clear. However, how is the threshold to apply where periodical payments are involved,[82] and who is to benefit if the payments decrease because the claimant's medical condition has improved?

The focus of this article is not upon these administrative problems, difficult though they may be, but upon the crucial issue of the cost of the changes. It is argued here that defendants will have to pay substantially more to fund a PPO than a traditional lump sum, and that Government failed to anticipate this. The regulatory impact assessment for the legislation argued that the reforms "would not materially increase the value of claims,"[83] even suggesting that liability insurers might save 4 per cent by purchasing annuities rather than using lump sums. This is far from the case, and the suggestion that there were savings to be made came as a shock to those with knowledge of the compensation industry: it was based upon "spurious assumptions."[84] The policy implications of the reforms must be looked at afresh.

To understand why the regulatory impact assessment was so very wide of the mark we must consider how most compensators will provide for their liability to make index-linked payments for an uncertain time and for an unknown total cost. Liability insurers will almost always fund PPOs by purchasing annuities from a life insurer. A possible alternative method open to large composite insurers is to self-fund the payments by using the facilities of their own life offices, but there is little enthusiasm

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[82] The International Underwriting Association in London has proposed revisions to reinsurance clauses and has suggested a new capitalisation clause to allow reinsurers to settle claims involving periodical payments. However, most reinsurance treaties on renewal to date have left the matter open. G. Carpenter, "Payment of Bodily Injury Claims" (2005) 183 Liability Risk and Insurance 17.

[83] Lord Chancellor's Department, *Courts Bill: Regulatory Impact Assessment* (November, 2002) para 25.

[84] See the views of Nick Leech of the leading structured settlement intermediary, Frenkel Topping, in "The Good, the Bad, and the Imposition!" a paper made available to the Legal Wales Conference, September 2003: "Generally the Regulatory Impact Assessment relies upon spurious assumptions, often without hard evidence to back-up the stated opinion, being that favouring imposition. It demonstrates poor understanding of the total personal injury marketplace…."

for this,[85] and in the past it was almost never done for structured settlements. Unlike insurers, public bodies are able to self-fund the payments from their own resources because they are able to satisfy the security requirement in the legislation. The main public body acting as a defendant is the NHS and it has insisted upon self-funding all payments in recent years. However, most defendants other than these public bodies will be forced into the annuity market to fund PPOs. This could prove difficult and very expensive for them because there are only a small number of suitable financial products available and only at a high cost.

There are two main reasons for this. Firstly, there is little competition in the market to provide annuities for tort claimants. This has the effect of making quotations less keen than, for example, in the USA where there are at least fifteen annuity providers. By contrast in this country, at the end of 2003 there was a real danger that there would be no life offices involved at all. This would have completely undermined the planned reforms. Fortunately, a couple of new providers have now emerged but the market remains fragile.[86] Life offices are deterred because few such annuities are sought, the market being of almost no significance compared to that for annuities for retirement pensions. There is a marked contrast with the £6 billion a year spent on structured settlements in the USA. Another discouraging factor is the particular difficulty of

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[85] However, because of the high price of annuities, a couple of general insurers have recently self-funded settlements even though they have no life offices and in spite of the resulting difficulties in setting reserves and complying with regulatory requirements. If this were to continue on an extensive basis the Financial Services Authority would be certain to take interest in the solvency issues that arise.

[86] The volatile life market was analysed in Lewis op cit n 1 chapter 11. Windsor Life and NFU Mutual were responsible for four out of five such settlements in the five years to 2003. However, both companies together with Scottish Widows withdrew from the market in 2003. Fortunately AIG, Canada Life, and Partnership Assurance have since taken their place, and there are rumours of others that are interested. For the recent history of providers see Kemp and Kemp, *The Quantum of Damages* vol 1 at 22-061.

underwriting annuities for the "impaired lives" of many of the injured claimants.[87] When there is only limited experience of the effect of injury on life expectancy, underwriting becomes far more an art than a science, and a miscalculated gamble can prove costly. As a result the market is limited, premiums have fluctuated widely, and the cost of annuities is high. Yet it remains of crucial importance to the future of PPOs, and the Government has been urged to intervene to stabilise matters.[88]

The second factor which drives up the cost of annuities is linking them to increases in the RPI. This results in regulatory restrictions being imposed upon the providers. The life offices are required by the Financial Services Authority (FSA) to meet their solvency requirements by providing assets which closely match their liabilities. In practice this means that, to fund RPI annuities, they have been forced to purchase index-linked gilts issued by the Government. These are expensive to buy, the market for them being dominated by pension funds anxious to meet their own statutory obligations to obtain matching funds for their index-linked returns. In addition, Government has made all too few of these gilts available to the market.[89] Because of the high demand and the limited provision the yields have been very low. In turn, this means that the RPI annuity rates offered by providers are poor value. Where the top down approach is used to arrange a settlement they make it difficult to ensure that the periodical payments derived from the traditional lump sum will meet all of the claimant's needs. With bottom up arrangements under a PPO, defendants can now be

[87] Lewis op cit n 1 para 11-28 et seq. It has been suggested that the lack of data held by UK insurers on impaired lives means that they may have adopted conservative life expectancy estimates, again leading towards lower annuity returns. However, data is available from linked North American companies and other sources.

[88] For example, APIL have asked that relevant discussion between the Department of Trade and the Department for Constitutional Affairs be given higher priority. APIL, *Periodical Payments: An Assessment of Concerns and Solutions* (March 2004).

[89] The first issue of these gilts was in 1982, and the last but one was in 2002 with a final date for redemption in 2035. Government was repeatedly urged by insurers, APIL and others to issue more gilts, and it eventually complied in September 2005 when it made available a new issue with a maturity date of 2055. The issue was immediately over-subscribed.

forced to make RPI linked periodical payments whatever the cost. If they do not self-fund, they will be forced to purchase annuities in this limited market. This will prove very expensive for them.

Matters could get worse. If the court were to adopt an index which exceeded RPI insurers would not be able to purchase any financial product in the market which would be guaranteed to match their liabilities.[90] The extent of their reserves would then come under close scrutiny from the FSA. That regulator is likely to prevent insurers from assuming long-term liabilities tied to increases in earnings rather than prices. In contrast, Government bodies are not subject to the same financial services regulation, and are free to self-fund payments without scrutiny of their methods or their reserves. The overall result for liability insurers is that it will be much more expensive to purchase annuities to fund the payments under a periodical payment order than to hand over the traditional lump sum. Anecdotal evidence suggests that the cost of these settlements has increased by as much as a quarter or even a third, and insurance reserves have been revised accordingly.[91] One QC has suggested that the PPO regime

[90] However, one product involving a non-RPI flexible annuity (similar to a drawdown pension) has been developed by Canada Life, and was approved by the FSA in July 2005. It has been used in a number of settlements where periodic payments are agreed and not ordered by a court. It was also used where the settlement required judicial consent in *Day v Alexander* (2005) 15 (7) PI Focus 24, but approval has yet to be sought for its use in a PPO under the new legislation. Previously a with profits policy was developed by NFU but it has now been withdrawn. See Lewis op cit n 16 at 300. These products allow some exposure to the equity market and offer a guaranteed minimum income which appears extremely attractive in securing future care costs compared to RPI linked annuities. However, they probably can only be obtained outside of the PPO legislative structure, and this gives the parties an incentive to settle privately.

[91] M. Hardman, "Periodical Payments: A Defendant Lawyer's Perspective," paper presented to a conference at the Institute of Actuaries, March 2005.

> "is going to cost insurers, both directly and indirectly, a lot more money and expense to service these damages. I do not believe that they have, as yet, appreciated the extent of their troubles."[92]

One case that was settled privately on an RPI basis illustrates this. If settlement had been based upon the traditional lump sum the multiplier would have been 29. However, funding RPI periodical payments in effect increased the capital sum need to purchase the annuities such that the corresponding multiplier rose to 45. The cost of future financial loss therefore rose by 55 per cent.[93]

POLITICS: THE NEEDS OF GOVERNMENT AND THE NHS

As we have seen, there are strong arguments to support the more widespread use of periodical payments. Many of these focus upon the needs of claimants and the desirability of providing compensation equivalent to that which has been lost. On the surface the Government can be seen to be supporting a fairer system which helps ensure that compensation meets needs and is used for the purposes for which it was awarded. These are the only reasons for the reform recently listed by the Department for Constitutional Affairs.[94] But if we look at the organisations that gave most support to the new legislation we get a different picture of the reasons why it was passed.

The Association of Personal Injury Lawyers is a claimant lawyers' organisation, very active in test case litigation and in lobbying the Government. Although generally in support of periodical payments as a means to ensure full compensation of victims, it opposed the imposition of PPOs against claimants' wishes unless there were exceptional circumstances.[95] Not surprisingly, insurers together with the defence organisation, the Forum of Insurance Lawyers, were not in favour of the reform. Nor

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[92] De Wilde op cit n 5 at 325.

[93] Details of this case must remain confidential. It must be remembered that the increase would not apply to the lump sum element of the damages which should form a contingency fund and be a substantial element in most settlements.

[94] *Guidance on Periodical Payments* (April, 2005) paras 6-8.

[95] APIL, *Response to the Lord Chancellor's Consultation Paper* (May, 2002)

was change sought by the intermediaries who arrange structured settlements. Frenkel Topping, the innovative firm responsible for arranging the great majority of such deals, has been influential in previous reforms. But it opposed PPOs on the ground that they would unduly interfere with the consensual approach. In total, only a bare majority (57 per cent) of respondents to the Lord Chancellor's consultation paper gave an unqualified welcome to imposition.

Instead the catalysts for the reform lay within Government itself. Although the legislation was the prime responsibility of the Lord Chancellor's Department, it had no enthusiasm to make the change urgently. However, both the Treasury and the Department of Health were keen supporters of immediate action, and they were the driving forces behind the sudden implementation of the enabling legislation. Parliamentary time was found by inserting the relevant provisions, rather anomalously, into a Bill dealing with criminal law and administration. Claimants' interests were very much secondary to those involving public finance and the demands of the NHS. Far from being what they appear on the surface, the reforms in fact were politically driven.[96]

The political and economic advantages to Government of periodical payments are as follows. In contrast to the problems faced by liability insurers, Government bodies such as the Ministry of Defence and especially the NHS will make immediate gains. This is because their budgets will no longer be denuded by the loss of large capital sums paid as damages.[97] Their cash-flow will be improved because they can self-fund the periodical payments and they are not required to enter the expensive annuity market. It was forecast that in the first year of the new regime the NHS could save as much as £245 million out of the £330 million they would otherwise have to pay for

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[96] Similarly, Hardman op cit n 91.

[97] In 2001-02 the MOD paid out £81 million in compensation according to the National Audit Office, *Ministry of Defence: Compensation Claims* (HC 957 2002-03). By contrast, in the same year the NHS paid out more than five times as much, amounting to £446 million according to the Department of Health, *Making Amends: A Consultation Paper Setting out Proposals for Reforming the Approach to Clinical Negligence in the NHS* (2003) table at 60.

the larger claims.[98] This cash-flow saving will continue at a diminishing rate for 24 years until the accumulated liabilities reach, and thereafter outgrow, what would have been the capital sums needed to dispose of the claims entirely. In the past, damages awards have had dramatic effects upon individual heath care budgets: major capital expenditure has been deferred and even wards closed.[99] At present, health trusts in England are running at a deficit which could reach a billion pounds at the end of the financial year.[100] It is not therefore surprising to find that the NHS has welcomed the new regime, and is much more likely than liability insurers to take advantage of it by forcing claimants to accept periodical payments. For many years it has self-funded all its structured settlements, and it now self-funds all its PPOs. It refuses to buy annuities from outside providers. The savings in cash-flow are too good to miss.

No matter what the short-term gains for the Treasury and the NHS, ultimately the taxpayer will have to pick up the total damages bill. There are at least two reasons to be concerned about this.[101] First, the payments eventually are likely to be higher than they would have been if the traditional lump sums had continued to be used. This is because the move towards bottom up assessments irrespective of the capital cost of providing the index-linked periodical payments drives up the ultimate cost of an

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[98] Lord Chancellor's Department, *Courts Bill: Regulatory Impact Assessment* (November, 2002) table 14. This is based on converting into periodical payments 80 per cent of all awards over £250,000 and 40 per cent of all awards between £100,000 and £250,000.

[99] R. Dingwall et al, *Medical Negligence: A Review and a Bibliography* (Oxford: Centre for Socio-Legal Studies, 1991) 55.

[100] *The Daily Telegraph*, January 18, 2006, "NHS told to cut costs as Hewitt confirms spending squeeze", and *The Times*, January 26, 2006, "NHS on critical list as cash crisis spirals." Up to fifty trusts were said to have lost control of their finances. Those in most difficulty revealed they had closed beds, wards or entire hospitals. Others had cancelled operations, and cut staff levels. However, in the last three years the overall expenditure upon the NHS has grown rapidly from £65 billion in 2002-03 to £87 billion in 2005-06.

[101] For detailed analysis of concern about the mortality risks being assumed by the NHS see Lewis op cit n 16 at 299.

award, and this will have an effect even upon those able to self-fund. Moreover, the tax and benefits savings made by the claimant in receiving payments in this way also occurs at a cost to the Exchequer. Secondly, the deferring of payments accumulates a debt which eventually will have to be met. The projection is that after 24 years the impact upon the cash-flow will be negative. That is, at that time not only will the good times come to an end and have to be paid for, but also there will be a real and increasing additional cost to the public purse. This cost may be relatively small in relation to the entire NHS budget, but Government finances should beware of these contingent liabilities, especially in the light of current concern about whether we should be paying more to fund future pensions in general. In effect, it will be our children who will have to find the money to pay for the full cost of today's medical negligence, and they will need to do so whilst keeping a disproportionately aged population out of poverty.

Finally, although the reforms were NHS driven, it must be remembered that clinical negligence comprises only a minority of claims even if attention is confined to serious injuries. Liability insurers remain the predominant paymasters. The NHS was responsible for only 11 per cent of all personal injury claims resulting in an award of over £100,000 in 2001-02. For claims of this size in that year liability insurers paid out more than over £2.26 billion, almost six times as much as the NHS's £0.4 billion.[102] This statistic reveals how the emphasis has been misplaced. In the great majority of cases it will be liability insurers and premium payers who will have to bear the increased costs resulting from the reforms, whilst in the minority of cases, in the short-term, it will be the taxpayer who benefits.

Here again changes have been made which result in an increase in tort damages but also transfer costs from the public to the private sphere. Insurers have recently been made to bear the cost of the removal of legal aid and the introduction of conditional fees. They now pay the claimant's costs, including the solicitor's success fee and the insurance premium against the possibility of losing. Insurers also have been required to pay for the cost of providing social security benefits to accident victims and, more

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[102] Lord Chancellor's Department, *Courts Bill: Regulatory Impact Assessment* (November, 2002)

recently, for the cost of their NHS treatment.[103] As a result of the present reforms they now must bear the brunt of further savings in public expenditure. Of course, the transfer results in a "stealth tax" which all premium payers and, ultimately, society at large must pay. Tort law, whether made by judges or Parliament, has always been influenced by politics in the wider sense,[104] and this is especially apparent in the recent and continuing struggles that are taking place over damages law.

CONCLUSION

Giving judges the power to award damages in a form other than that sought by the parties is a major reform. All serious injury cases are affected by the threat of imposition of a periodical payment order, whether or not they eventually come to court. This is because the potential exercise of the power affects the bargains that are struck in the tort system. In addition, the reform undermines the traditional approach to damages, firstly, by requiring "bottom up" assessments which focus upon claimants' annual needs; and, secondly, by guaranteeing that these needs will be satisfied no matter how long the claimant actually lives, and whatever the level of price inflation. These needs are to be met irrespective of the resulting lump sum cost. The parties must give early consideration to the form in which the damages are to be paid. A change is thus being sought not only in legal method, but also in the culture of personal injury practitioners.

However, the effect of the legislation may be less profound and certainly much harder to see if it is hidden in the settlement system, and predominantly results only in insurers paying higher lump sums than otherwise would be the case. There is every

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[103] For recovery of social security and NHS treatment costs see R. Lewis, *Deducting Benefits From Damages For Personal Injury* (Oxford: OUP, 1999) and "Recovery of NHS Accident Costs: Tort as a Vehicle for Raising Public Funds" (1999) 62 Modern LR 903. Recovery has been extended by Part III of the Heath and Social Care (Community Health Standards) Act 2003. Hypothecation returns the cost of treatment to the appropriate specific hospital trust or other NHS budget.

[104] R. Lewis, "Lobbying and the Damages Act 1996: 'Whispering in Appropriate Ears'" (1997) 60 Modern L R 230.

incentive for insurers to settle privately in this way in order to avoid the cost and difficulty of arranging the annuity payments usually required to satisfy a PPO. The new legislation failed to anticipate the problems insurers have in accommodating the new regime within their wider financial world. Because of the difficulties, insurers will be keen to maintain the traditional form of settlement.

In one way or another, the changes will result in many seriously injured claimants obtaining more money at the expense of insurance companies. Also to benefit from the legislation is one group of defendants – Government departments and public bodies, especially the NHS. Unlike insurers, they can self-fund the periodical payments and thereby retain within their budgets the capital sums they would otherwise have to pay. They can avoid paying for today's liabilities until tomorrow. This effect upon public expenditure was not among the main reasons put forward for the reform. However, in exposing the true costs and benefits of the legislation, this article has revealed a political dimension which could easily be overlooked by the casual observer. Such a perspective merits further study for it can also be employed to analyse other recent, or anticipated, changes in tort law. In particular, the impact upon personal injury law of concern about litigation against the NHS has yet to be given the attention it deserves.

The traditional tort textbook can leave the reader with a very misleading impression about how the compensation system operates in cases of personal injury.[105] In practice, the system is transformed into something which has but a limited relationship to the theoretical picture portrayed. But it is not only the experience of practice which throws down a challenge to tort scholars; it is also changes to the basic rules themselves. This article is concerned with reforms which have been ignored by the academic community even though they undermine the tradition of awarding damages in a once-and-for-all lump sum. They also expose the fragility of the conventional claim that the aim in tort is to return the claimant, in so far as possible, to the position enjoyed before the accident. As such they raise fundamental questions

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[105] R. Lewis, "Insurance and the Tort System" (2005) 25 Legal Studies 85.

concerning the rationale and future direction of the law of tort. Who really pays, how much, and in what manner, are questions that will not go away.[106]

[106] Cf P. S. Atiyah, “No Fault Compensation: A Question that will not Go Away” (1980) 54 Tulane Law Review 271.