



Periodical Payments

A Defendant's Lawyer's Perspective

MICHAEL HARDMAN
PARTNER
BERRYMAN'S LACE MAWER
LIVERPOOL

PERIODICAL PAYMENTS

Introduction

The Courts Act of 2003 received Royal Assent on 20 November 2003. When it eventually it comes into force it will introduce a new section 2 to the Damages Act of 1996 providing the Court with the power to order payment of certain future losses by way of periodical payments.

Traditionally damages paid arising out of personal injury from the smallest claims to those where damages run into millions have been paid by a single lump sum in respect of all past and future loss.

The option for a Defendant to pay damages by way of periodical payments through a structured settlement has been available for some time. A structured settlement works by combining a lump sum payment to cover, for example, past losses and future capital expenditure with the purchase of an annuity or annuities which provide a stream of guaranteed tax free, index linked payments to the Claimant. Where the paying party is a government body, payments can be made direct from that body. These payment schemes are flexible enough to provide additional foreseeable future costs and are normally intended to cover the cost of future care and the Claimant's loss of earnings.

The first settlement to be structured was as long ago as 1989. The 1996 Act provided the Court with the power to make an order for payment of damages by way of periodical payments, but only where each party consented. Such orders have, however, been the exception rather than the rule, even for large settlements. For example in 2001 to 2002, the National Health Service Litigation Authority paid over 500 claims in excess of £100,000, yet fewer than 10% were subject to a structure.

The New Regime

In the absence of a structured settlement, damages for past and future losses have been made by way of one lump sum payment to a Claimant. Under the forthcoming periodical payments regime, compensation for pain, suffering and loss of amenity and past losses will continue to be paid by way of lump sum. There will however be an option with regard to damages for future losses, in as much as such damages can be ordered to be paid either by way of a lump sum, or by way of a periodical payments order. In short the periodical payments order will provide for payment of damages for future losses by way of regular instalments of set amounts of money. These payments will be index linked to the RPI so as to ensure that the payments increase with the costs for which they are paid to cover.

In short, therefore, rather than concluding a case, making a payment and then closing a file, insurers will finish a case, make a part lump sum payment, and then over the remainder of the Claimant's life, or for whatever shorter duration the Court determines periodical payments should apply, the insurer will have to make regular payments.

One important distinction between the new regime and the old regime relates to the Court's power to award periodical payments. Currently such an award, traditionally termed a structured settlement, is dependent upon the consent of both parties. Under the new regime this is set to change. Courts are now obliged to consider whether or not a periodical payments order should be made in all cases in which an award of damages for future pecuniary loss is made.

The most important distinction between the new regime and the old regime is that under the new regime the Court has the power to impose a periodical payment order even in cases in which the parties do not agree.

The Advantages

The following are usually said to be the advantages of periodical payments:

a) Life time guarantee

As periodical payments are usually guaranteed for the Claimant's lifetime, regardless of how long that may be, it means that this portion of the damages award can never run out. Periodical payments would provide the peace of mind of knowing that should a Claimant live longer than expected then he or she would continue to receive an income to provide for his or her needs.

b) Enhanced Security

Following the 1996 Damages Act, periodical payments were granted 100% protection under the Policy Holders Protection Act, now replaced by the Financial Services Compensation Scheme (FSCS) under the Financial Services and Markets Act 2000. This applies to payments (both self funded and annuity) made by authorised insurers,

This means that if the proposed provider of the periodical payments were to encounter financial difficulties and become insolvent then the Act would ensure that the payments would continue to be paid without deduction. No other investment vehicle has such protective guarantees.

However, note the potential problems which are discussed below when considering the funding of payments.

c) Tax Free Income

The income provided under periodical payments is completely free of taxation. With a conventional lump sum award, even though the award of damages is paid free of tax, the interest generated on the resultant investments are to be taxed in the usual manner.

d) Index Linking and increasing the future payments

The payments received under periodical payments may be guaranteed to increase in line with inflation (by indexing them to the RPI) for the Claimant's lifetime. Although this has been less of an issue in recent years due to a period of low

inflation, history indicates the levels of inflation that have been seen and that could return in the future. If high levels of inflation are encountered again in the future then RPI linking would stop the value of the fund being reduced in real terms.

e) Needs Based

Whereas a structured settlement could be calculated on a top down or bottom up basis, periodical payments will be calculated on a bottom up basis only. In other words they will be needs based and there should be no possibility of the Claimant not being able to afford the care that he requires.

f) Non Tangible Benefits.

All of the advantages set out above are measurable in some way or other. However, it is often simply the peace of mind afforded by the periodical payments that is the greatest advantage. The sense of certainty and security is impossible to measure or quantify and is often the greatest benefit to the Claimant's family.

The Disadvantages

The following are usually said to be the disadvantages:-

a) Inflexibility

Once the periodical payments have been agreed, they cannot be altered or encashed in anyway. Therefore, one has to ensure that there are sufficient monies available in more conventional investments, to provide for future changes in circumstances. In this way it should never be suggested that the entire award of damages be received by way of periodical payments. There should always be a significant non-periodical payments element, known as a contingency fund, to provide for unseen changes in the Claimant's needs.

b) Care Costs Inflation

It is argued that care costs do not increase in line with the increase in retail prices. An RPI linked stream of periodical payments increases in line with the general index of retail prices, which is generally recognised as the measure of inflation. However, it is argued that historically care costs have increased at a greater rate than the RPI, and are likely to continue to do so in the future. Accordingly, in a recent article Mr Rowland Hogg invites the Courts to index periodical payments by fixing them to a scale above the RPI. His argument is for RPI plus 2% (the annuity has to be linked to RPI to achieve full protection under the FSCS). This issue is discussed in more detail below.

c) Cost

When the periodical payment legislation was conceived the general understanding, including that of insurers, was that the periodical payments regime would be cost neutral. The reality is now somewhat different. As discussed below, the probability is that in general an order for periodical payments will mean that an individual claim will cost an insurer more.

d) Claimants do not want them

The major disadvantages are that a large number of Claimants do not want periodical payments. The bottom line is that they want their money so that can do with it what they want, when they want. If they want to save it for a rainy day they will; if they wish to invest in a different care regime, they are at liberty to do so; and if they want to spend it all on fast cars and fancy houses then they can do that too.

The other major reason that Claimants do not want periodical payments is that under such an order the element of damages that are awarded by periodical payments cannot pass to dependents on the Claimant's death. If the Claimant dies much sooner than expected then his or her husband or wife and/or children will lose all of that element of the damages.

Funding of Periodical Payments

Insurers have historically funded structured settlements by the purchase of an annuity. Undoubtedly one of the major reasons for the rarity of structured settlements under the old rules was the absence of suitable products in the annuity market place. Indeed it is arguable that the market place offers no suitable products at all at present, or at least no products that withstand rigorous scrutiny and are not in some way flawed. For example, Scottish Widows limits itself to a maximum premium of £1M, which would not produce sufficient income to satisfy many of the orders which are likely to be made.

Other products have been developed, e.g. Canada Life's Flexible Annuity, but there is little sign as yet of annuities being available which will fully meet the likely requirements of a periodical payment order.

Some general insurers are intending to provide annuities through their own life company. However, this is not an option for many insurers.

There are other problems with annuities. Life offices must hold assets to match their liabilities (the so-called "close matching" regulations). Index Linked Government Stocks (ILGS) provide the "close matching" asset for annuities linked to the RPI, but not to any other index (for which there is no suitable "close matching asset"), and in any event only until 2035.

Self funding, i.e. payment out of a Defendant's cash flow, has historically been a viable option only for government departments, for example the NHSLA or MoD, who are able to meet their future liabilities from future revenue. A number of the major insurers are now considering self funding. However, they will face difficulties, some of which government departments do not share: for example how the payments should be treated for reserving purposes, how they should be accounted for within the balance sheet; how they should be administered (monitoring payments, checking the Claimant is still alive, etc.).

The Courts Act entitles the court to award if appropriate, for example, periodical payments linked to an index other than the RPI, extending beyond 2035. To comply

with such an order, a general insurer may be forced into a contract that the FSA would not allow.

Government departments, of course, are not regulated by the FSA and so are not subject to the same restrictions.

There are also potential problems with security of payments. The court cannot make an order for periodical payments unless satisfied that continuity of payment is reasonably secure. The Court is entitled to assume this if the payments have FSCS protection, or are protected by a Ministerial guarantee, or are made by a government or health service body.

In other cases the court must be satisfied that payments are reasonably secure. It is difficult to envisage circumstances in which a Court will be easily satisfied of this.

It is doubtful whether Lloyds syndicates, the MIB and medical defence organisations are “authorised insurers”. Self funding by such an organisation would not attract FSCS protection. Unless they are able nevertheless to persuade a Court that continuity of payment is reasonably secure, they would have to purchase an annuity. A suitable annuity may well not be available.

The Cost

When the legislation was being conceived the widely held view was that periodic payments at worst would be cost neutral. Since that time the economic climate has changed as has the availability of products to fund periodic payments. There seems no doubt now that periodic payments will cost more than the traditional lump sum settlement. The current (anecdotal) view, based on discussions with a number of key players in the marketplace, is that reserves will need to be increased by between 25% and one third, and probably at the top end of that bracket.

Whether or not in reality the additional cost really is 25% to one third will depend upon investment performance. In theory insurers will have control of the money for a longer period than previously – they would have previously handed the whole amount over to a Claimant on day one by way of a lump sum. Those compensators that

choose to purchase annuities, however, will not be able to benefit from this investment income as the same way as those that choose to self fund.

Almost inevitably there will be a considerable increase in the legal costs incurred in dealing with cases where periodical payments become an issue. Additional advice needs to be sought from accountants, and there will be complex discussions and inevitable arguments and disagreements with re-insurers that will result in satellite litigation.

Taking matters one step further, it would be surprising if some Claimants did not make a claim for periodical payments as a tactic to persuade insurers to pay a premium for a lump sum settlement. Indeed, even if there is no ulterior motive, consideration of the possibility of periodical payments can be justified, and indeed is required, in the vast majority of cases in which there is an element of future loss.

Re-Insurers

There will be huge complications as far as re-insurers are concerned. Looking at the classical reinsurance position on a simplistic basis, if we analyse a claim that was worth £5,000,000, calculating which part of the claim was to be funded by re-insurance was a straightforward exercise. There would be a level at which the re-insurance applied. Anything above this point would be met by the re-insurer, and anything below it by the Insurer.

Periodical payments will mean that that reinsurance level will not be reached for a number of years. In fact the position is more complicated than this, since reinsurance levels are also frequently indexed. This creates a problem that has been phrased 'chasing the retention'. As an insurer's total payment level creeps up year on year, linked to RPI, so does the retention level, thereby delaying the point at which the insurer's level exceeds the reinsurance level.

Commutations are being worked on, but the reality is that re-insurers are seldom one body, and more often than not are comprised of panels. These panels can vary from risk to risk and it seems extremely unlikely that the various different panels will agree to the same commutation calculations being applied. The net outcome will inevitably

be complicated arguments in each case between insurers and re-insurers. This will also have an impact on any negotiations that take place with the Claimant, as the re-insurers will have to be on board before negotiations can take place. This has been far less of an issue in capital lump sum payment cases.

When Will Periodical Payments Be Ordered?

The rules are clear. The Court will have to consider making a periodical payments order in all cases in which an award of damages for future financial losses is made. The reality of course will be that periodical payments are not ordered in every such case. Many people argue that period payments will only apply to patient cases and other catastrophic injury cases in which damages exceed £500,000. This was the threshold level set for previous structured settlement cases.

Whilst this will probably be the initial position, it is likely that it will not be very long before periodical payments become very much more the norm. One only needs to look at what is happening across the Atlantic to see what is possible. Structured settlements are very much a matter of course in cases worth as little as £70,000. It is therefore likely that periodical payments will be a real possibility in all cases with a future loss period in excess of 10 years and a value of over £100,000. Beyond the short to medium term there is a real possibility that they will be extended even further than this.

Contributory Negligence

It has been argued that periodical payments will not be appropriate in cases where a significant apportionment for contributory negligence is made. Many believe that once an award of contributory negligence of 25% or one third is made, periodical payments will not be feasible. This is on the basis that care packages will not be affordable as periodical payments will reflect only a proportion of the cost required.

However, the Court's approach is that a claim should first be valued on a 100% basis before any deduction for contributory negligence is applied. Periodical payments

relate to how damages are paid, not how they are assessed. A Claimant may well prefer to receive periodical payments and to top up the care fund by the monies that he receives by way of lost income or general damages. It is likely that a Court would accede to this in appropriate cases.

Indexation

There is likely to be considerable dispute during the early stages of the new regime about the issue of which method of indexation is appropriate. Should the indexation of periodical payments be linked simply to the RPI; or as Mr Hogg has suggested, RPI plus a fixed percentage, in his view 2%? He argues that the cost of care increases year on year by more than the RPI. As a result of this unless periodical payments are indexed at RPI plus a percentage then there is a real risk that whilst a Claimant may be able to afford care in the first few years following the conclusion of a case, in later years he will not be able to afford the care that he requires.

There are numerous other issues which Mr Hogg does not specifically discuss in his article. For example what are the reasons for the historical differential, will these reasons be valid in the future and if so for how long, what other employees (including management and administrative grades which would not be relevant to care costs) were included when calculating NHS pay increases, etc. Further, if this particular issue is to be treated separately, then so should others. For example, many costs (particularly relating to new technologies) may well not rise in accordance with the RPI, and indeed may fall.

A far more detailed study, for which the courts are ill equipped, would have to be carried out before departure from the RPI can be justified in all but the most exceptional case.

Variation of Periodical Payments

The court will have the power to vary periodical payments in certain circumstances. These proposals are set out in the Damages (Variation of Periodical Payments) Order 2004.

The Order makes it clear that the power to vary orders will not be retrospective.

A variation will only be possible where the initial order for periodical payments included 'variable order' terms. A variable order will be made only if there is proved or admitted to be at some time in the future a chance that the Claimant will, as a result of the act or omission which gave rise to the cause or action, develop some serious disease or suffer some serious deterioration or enjoy some significant improvement, in his physical or mental condition.

Where a variable order is made the initial damages must be assessed or agreed on the basis that the disease, deterioration or improvement will not occur;

Only one application to vary a variable order may be made in respect of each specified disease or type of deterioration or improvement;

No appeal lies from an order refusing permission after reconsideration and no appeal lies from an order granting permission.

It is likely that the Courts will be reluctant to make variation orders. They will probably approach these orders in the same way that they have approached applications for provisional damages. In provisional damages cases the courts have held that the 'chance' must be measurable rather than fanciful. The deterioration must be 'serious' so that the initial award of damages would be wholly inadequate to compensate the Claimant in the event that the chance materialises.

From the Defendant's point of view, variation orders would be desirable in cases where there is some chance/possibility that there will be significant advances in medical science that would dictate a meaningful improvement to the Claimant's condition. Obvious examples would be advances in spinal cord treatments or prosthetics.

There are practical issues to be considered. For example, if a periodical payments order which the defendant has funded by purchasing an annuity is varied downwards, who has the benefit of the “extra” payments under the annuity? How is security of payments to be achieved for the possible increase of payments, perhaps years after the original order was made?

Conventional Settlements

One should not lose sight of the fact that a large number, and possibly the majority, of Claimants will prefer to have the traditional lump sum method of compensation, at least in the short term. Courts will only be able to consider periodical payments in those cases that go before them in a meaningful way.

With the exception of patient and minor cases, it seems unlikely that a Court will interfere too much with a Consent Order that is placed before it. Traditional lump sums may therefore continue to be the favoured method for cases that are settled prior to litigation commencing, and those that are settled after litigation has commenced but before trial.

Part 36 Offers

There will be new provisions that dictate the wording that will be required when Part 36 payments are made in periodical payment cases.

It will be very difficult to predict exactly what order a Court is likely to make and to frame a Part 36 offer accordingly. The Court may therefore have difficulty in assessing whether a Part 36 offer has been bettered. For example if a Claimant is awarded a lump sum of £500,000 and periodical payments of £50,000 p.a., has he done better than an offer of a lump sum of £600,000 and periodical payments of £45,000 p.a.?

It is to be hoped that the Courts will adopt a constructive approach and will favour the party who has made a genuine attempt to settle by putting forward a realistic offer

(even if the offer does not precisely match the ultimate award) over a party who has put forward no counter offer and shown no desire to negotiate.

Politics?

There is no doubt at all that periodical payments are in the interest of Claimants who have future losses and needs. However, there remains the (no doubt unworthy) suspicion that this is a rather convenient argument that has been wheeled out in what is essentially a political exercise. Periodical payments will be a huge benefit to the NHS and Government departments. These bodies work on budgets that are yearly based and revenue that is yearly generated. Raising the political issue as an argument against periodical payments, however, is a pointless exercise because of the strength of the argument in favour of periodical payments. There is no doubt that they are in the interest of Claimants with future losses.

Conclusion

The introduction of provisional damages was hailed as a significant moment in the development of litigation. Many then believed that the impact of provisional damages would be considerable. In reality they have been very rare indeed.

However, a very different future with regards to periodical payments is anticipated. The reality is likely to be that periodical payments will become the norm for cases involving awards of damages for future pecuniary losses in cases with a value of over £100,000, and possibly even cases of considerably less than this sum. In the short term we may see little change outside the realms of patient and catastrophic cases. Nevertheless we will all need to consider carefully those claims to which periodical payments might apply in the future. Those cases could prove to be considerably more expensive than they have traditionally been.