Scope of this paper

This paper looks at some of the statutory and regulatory provisions, at the reasons for and against periodical payments and at some contentious issues that have yet to be resolved. It must, however, be clear that these are still very early days and there remains considerable uncertainty about how the provisions will work in practice. An earlier version of it appeared in [2005] J.P.I.L 60. I have tried to bring it up to date in the light of the events of the last 6 months.

It was a long wait

Royal Assent was given to the Courts Act 2003 on 20th November 2003. The general understanding was that implementation would be within 12 months. A year came and went. The Department of Constitutional Affairs (DCA) was consistent only in its inability to give a firm date whenever asked. Eventually, those of us who had been consulted or made representations about the draft guidance received an email on 7th March “confirming” that the provisions of the Courts Act 2003 on periodical payments would come into force on 1st April 2005. It reads

“The power for the Courts to order periodical payments will apply in all cases where orders or settlements have not been made before 1 April. The power to order variable

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William Norris QC is General Editor of Kemp and Kemp and a member of the Serious Injury and Clinical Negligence Committee of the Civil Justice Council. This paper is written in a personal capacity and should not be taken to represent the views of the Kemp Editorial Board or that committee. I would like to acknowledge the helpful contributions of those who have commented on earlier drafts, particularly Richard Cropper of Personal Financial Planning in relation to issues of security and the effect of the close matching regulations and Douglas Hall of Smith and Williamson who provided much of the financial analysis that I consider on the question of RPI links for the future.
periodical payments will apply only to proceedings which are issued on or after 1 April”.

It should be remembered that the new power only applies to cases of compensation in respect of future pecuniary losses. Section 2(2), however, does allow for periodical payments to be made for past losses or compensation for non-pecuniary losses if the parties consent.

**A better way of compensating?**

The theory is that periodical payments provide a more reliable and just means of compensation particularly for those who need adequate provision to be made for long term needs for care and/or those who may have an impaired life expectancy. Those who expected the new regime to have little or no impact will certainly have been disappointed. Yet many claimants and lawyers still prefer lump sums and Courts – in those few cases where periodical payments have been an issue between the parties – have varied markedly in their level of understanding and approach.

**Judicial and Public Guidance: periodical payments to be the “norm”**

Practitioners must recognise that the Government and (if the guidance is followed, the Judiciary) expect periodical payments to become widely used, even the “norm”. One view is that, in effect, the CPR is drafted in such a way as to mandate a “bottom up” approach to all calculations of future loss.

There are two drafts of general guidance (the more recent of which is available on the DCA website). Each records that “Ministers expressed the hope that the use of periodical payments in appropriate personal injury cases will become the norm”.

Hence Section 100 of the *Courts Act 2003* obliges the court to consider whether periodical payments are suitable in all cases involving future pecuniary loss. Ministers, the Guidance advises, “considered that the size of the award should not be a determining factor in deciding
whether periodical payments are suitable and that it would not be appropriate to prescribe a fixed level of award below which periodical payments would not be appropriate”.

A further paper of guidance has been issued to the Judiciary. It is generally accepted that (no doubt deliberately) it contributes little to the debate on any contentious issues and is best regarded as a useful summary of the relevant provisions.

There is some further guidance in the civil benchbook issued to full and part-time judges by the JSB. Since I am its author (re-drafted August 2005) I can tell you that it does not seek to resolve those contentious issues in any particular way. But when it is issued is another matter. My previous draft, completed in August 2004 (which dealt with periodical payments as something that might happen in the future) was only finally issued on 5th April 2005, 4 days after the new regime came into force!

**Key criterion is need: relevance of cost to the defendant.**

The key criterion is the Claimant’s needs rather than his (or the Defendant’s) wishes. However, regard must be had to the factors set out in the Practice Direction which include

- the scale of the annual payments after taking deductions for contributory negligence into account
- the form of the award preferred by the Claimant including any financial advice
- the form of the award preferred by the Defendant and the reasons therefore

One may doubt whether any Court is likely to take much account of a Defendant whose objection to a periodical payments order is limited to the fact that it would be much more expensive than a conventional lump sum award or who complains about the state of the annuities market or the fact that he does not have the capacity to self-fund. However, it

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2  CPR Rule 41.7
3  Anecdotal evidence is that Field J, probably dealing with the settlement in *Cullen v O’Neill*,
should be recognised that the legislation was introduced against an expectation that it would be cost neutral for Defendants – see the Regulatory Impact Assessment published by the DCA in November 2002. That expectation has been entirely undermined by the subsequent changes in the annuities market.

In fact, the annuity market has been and remains fragile. In the early days of the new regime there were occasions upon which the parties and the Court accepted that a periodical payments order could not be made because either it was apparent that the Defendant could not be shown to be secure according to the statutory definition and because there was no available annuity. Now there are two providers of qualifying annuities: the Canada Life product which finally received FSA approval in July 2005 (which is a complicated product the details of which are best explained by a financial adviser but which provides more flexibility than a standard annuity) and the AIG product which offers an RPI linked product. But the premium required for the AIG product had fluctuated wildly since it was introduced. At first, perhaps because they were keen to attract business, some quotes were competitive as compared with the lump sum cost calculated on the basis of a conventional multiplier/multiplicand. But two recent quotes of which I am aware paint a very different (and more costly picture. In each case, the quote was in respect of £50,000 per annum, RPI linked where the ordinary multiplier would have been based on a life expectancy of 50 years. The only difference was that in the first case the 50 years was (the experts agreed) from age 15 to age 65. In the second, it was from age 30 to age 80. The first quote in mid-September 2005 was £3m (whereas the conventional lump sum award for that loss would have been just under £1.5m). In the second case, the quote was for £2.4m. Regardless of the difference in cost as

4 Paragraphs 3, 4: “...the proposal (will enable) ....Defendants to fund awards in the most cost-effective way ...Defendants would be free to choose how to fund the ward....major cash-flow benefits for public sector and other Defendants, particularly the NHS, who fund awards from their own resources” (that, of course, gives the game away as to the prime movers behind the new changes): Paragraph 25 “...we believe general insurers would achieve savings of around 4% by purchasing annuities compared to a lump sum. This is subject to changes in annuity rates” (it sure was!)

5 An example being Cullen v O’Neill in which the funder would have been Equitas.
against the lump sum figure, one may wonder what possible change in the market or actuarial analysis could justify a difference of £600k in a matter of weeks on – effectively – identical facts.

**The attitude of litigants: A new culture.**

In advance of the new regime, the attitude of many practitioners appeared to be that a periodical payments regime was beset by so many practical problems (particularly in view of the state of the annuities market and concerns about continuity and security of payments) that such orders would be unlikely to appeal to either side even in the highest value litigation. My own expectation was and is expect that periodical payments orders will become an increasingly important and popular basis for resolving personal injury litigation.6

Particularly, I am sure that claimants’ lawyers will recognize that periodical payments are an attractive means of providing compensation for long-term losses and are, at the very least, a valuable bargaining tool even if there are good reasons for the Claimant to prefer a lump sum award.

To date there has, I believe, been an instinctive distrust of and distaste for the new provision born of our familiarity with the old-style lump sum system. On the other hand, those who seek compensation for a claimant on the basis of providing for his or her actual needs for the future see many advantages in the new provisions principally because the claimant no longer has any concern about issues such as life expectancy or the management of his investment. A periodical payments order is certain, secure and permanent. On the other hand, the inflexibility of an annual income fixed to increase only by reference to RPI has its own obvious disadvantages, especially where the Claimant has (for example) a substantial ongoing

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6  Unlike orders for provisional damages which were hardly ever made in practice. Moreover, any significant reduction in the discount rate would tend to encourage people to opt for lump sums.
need for care over many years into the future. In such a case, the fear that such an RPI link may not sufficiently match the actual costs if they do accelerate at a faster rate will deter the wise Claimant from taking too much of his future loss in a periodical payments order with such a link. Rather such Claimants are likely to regard some part of the future loss as needing to be provided in that way – treating the periodical payments order, in effect, as one investment product within the overall investment package. But that is a different philosophy and not what the legislation set out to achieve.

It is also true that Claimants – at least those of full age and capacity - do not like the loss of the flexibility given by the lump sum. They like to have control of their own money. They like the idea that they can save up against the risk of unforeseen problems in the future or, as I have already noted, against the risk that care costs may increase at a faster rate than RPI if the payments order is fixed by reference to that index.

It is also clear that almost all Claimants and Defendants begin their assessment of quantum by looking first at what would be the value of the claim on a conventional, lump sum basis. In one sense, this is wholly unnecessary. With a bottom up regime you need only to identify an annual need and decide the period (usually, life) over which it will be paid. But most Claimants will want at least to consider the option of a lump sum settlement because of the flexibility and independence which it allows them. Many Defendants will have their own commercial imperatives for doing likewise. A Claimant who dismisses periodical payments without considering his options, perhaps without clear financial advice as to the respective merits of the competing options, is most unwise. A lawyer who fails to ensure that such advice is available and clearly understood (particularly for a claimant under a disability) does so at his peril.

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7 LC No 255 “Personal Injury Compensation: How much is enough” in 1994 referred to research showing that Plaintiffs with awards of more than £100,000 tended not to spend their money on the purposes for which it was intended but, rather, preferred to invest in funds like PO Savings Accounts or a Building Society notwithstanding the low rates of return and the fact that it was a time of high inflation.
Concerns about flexibility, the impact of contributory negligence, assignment, dependants

I have already recognised that claimants have always been attracted to lump sum awards because they like to control their money and enjoy the flexibility of so doing\(^8\) and because it provides a clean break\(^9\). A periodical payments order deprives them of that opportunity and (for example) of the opportunity to invest the fund as the claimant chooses whether it be to beat the 2\(\frac{1}{2}\)% discount rate for commercial reasons or because of a fear that an RPI tie will not enable him to meet his actual costs for the reasons that we have already discussed and, of course, a claimant is always able to preserve his entitlement to means-tested benefits if the lump sum is paid into a trust.

It is very likely that a lump sum order will be the norm for cases where there is any significant element of contributory negligence. A claimant who recovers only 50% of his damages and is able to justify a £100,000 per annum annual care regime may (because of the contributory negligence deduction) may feel that he cannot actually afford that regime throughout his lifetime. Instead, he may wish to manage with something very much more modest than that which was justified against the yardstick of reasonableness. He certainly will not want to risk the defendant turning up 4 years later on a variation application suggesting that there must have been a significant improvement because the claimant can be shown to be managing on less than half that which he claimed to have needed.

There are also real obstacles to assignment\(^10\). Perhaps more important is the fact that many claimants like to think that, should they die prematurely, their damages fund will be available to help their family. This may be a genuine concern but, of course, the whole rationale of the lump sum calculated by reference to a discount rate and a life multiplier is to provide for the

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\(^8\) It may seem more attractive still if the Lord Chancellor reduces the discount rate significantly.

\(^9\) Also an important consideration for Insurers.

\(^10\) For which Court approval will be required. Rule 41.10 and paragraph 4 of the new Practice Direction identifies the factors which the Court must take into account on such an application. The key question is whether the proposed order is in the Claimant’s best interests.
needs of the claimant but only so long as he is likely to live. If he dies unexpectedly early, that does simply constitute a windfall to his estate. Moreover, Rule 41.8 deals directly with circumstances where the court considers that any part of the award should continue after the claimant’s death for the benefit of his or her dependants. If that provision is made, the order must specify the relevant amount and duration of the payments and how they are to be made.\footnote{Note that paragraph 2.2 of the PD clarifies that this may include situations where a dependant would have had a claim under section 1 if the \textit{Fatal Accidents Act 1976} if the claimant had died at the time of the accident.}

Another concern is likely to be that a claimant who, like any party to a litigation enjoys finality and certainty, will be anxious lest some provision of the order enables the defendant later to apply to decrease the money awarded. That anxiety will be a possibility, even though it may not be justified, whenever a periodical payments order is made the quid pro quo of which may well be a defendant’s insistence on an “improvement in condition” variation provision.

Whatever the concerns, however, it must be right to say that a claimant will ordinarily stand to gain a great deal more than he risks losing by entering into such an order unless there is any significant\footnote{Say 25\% or more} element of contributory negligence. In that case, he made need to spend more than he would be entitled to receive annually if the order was made for life\footnote{Although it need not be: it could be made for a shorter period (but in bigger annual amounts) – see CPR 48.8(1) as drafted. Whether this entitles the court to order the defendant to pay annually a sum greater than the annual loss as assessed is open to argument. In \textit{Sowden v Lodge} [2004] EWCA Civ 1370 the court made it plain that damages are assessed on a 100\% basis. How they are paid may be a different matter but there would obviously be practical difficulties in identifying the correct period short of what is judged to be the claimant’s probable lifetime.} and therefore prefer a lump sum. But he may also be extremely keen to enjoy the long term benefits (and security) afforded by periodical payments.

\textbf{Secure for life and tax efficient, with no investment management: but does size matter?}
A periodical payments order provides a tax-free\textsuperscript{14} income stream for so long as he lives which (at least under present legislation) will not be taken account of with regard to means tested income and housing benefits\textsuperscript{15}. Even if we are talking about a relatively modest annual income – say of £15,000 per annum loss of earnings – the claimant may be rather attracted by the idea of a secure annual income, RPI linked, tax-free with no responsibility for fund management with at least some power to provide for continuation of some payments for the benefit of dependants\textsuperscript{16}.

**Dealing with uncertainties**

One issue that has interested commentators is the impact of periodical payments on the discounts that Courts apply to multiplier/multiplicand/lump sum awards to reflect contingencies such as the discount for contingencies on loss of earnings. Some commentators\textsuperscript{17} think that in practice Courts will discount less. I see no logical reason why it should make any difference: it depends what discounts there would have been in the first place and whilst the discount might be applied to the period during which the periodical payments order will run (at least for loss of earnings) it could equally, perhaps more conveniently, be applied to the multiplicand.

\textsuperscript{14} Section 329AA of the *[Income and Corporation Taxes Act 1998](https://www.legislation.gov.uk/ukpga/1998/27/section/329AA)* (as amended by section 100 of the *[Courts Act 2000](https://www.legislation.gov.uk/ukpga/2000/27)*) provides that periodical payments received in respect of damages for personal injury are exempt from income tax, in contrast to the income derived from the investment of a lump sum. The tax exemption applies whether the payments are self-funded or made under an annuity purchased for the claimant. This protection remains if (say after initial self-funding) the funding method changes – see section 329AA(3). The sub-section provides “The periodical payments….may, if the agreement so provides, consist of payments under one or more annuities purchased or provided for, or for the benefit of A by the person by whom the payments would otherwise fall to be made”.


\textsuperscript{16} See Rule 41.8(2). However, Peter Andrews QC writing in the recent edition of Kemp suggests that an annual loss of £30,000 would be the lowest level at which one might contemplate such an order.

\textsuperscript{17} Such as Brian Langstaff QC in an excellent paper delivered to the PIBA Annual Conference.
Contingencies and commutation

Two other practical considerations should be mentioned.

First, if there is to be a periodical payments order it will almost always be the case that there will also be a lump sum “contingency” fund to guard against the unforeseen or simply to provide a substantial capital resource. The money should usually come from sources such as past and future loss of earnings, general damages and (if the providers agree) past care.

Second, there is the possibility of commuting some part of the periodical payments to provide such a fund. This is, in my view, fraught with difficulties. Whether done with the approval of the Court at the time of the original settlement or at some later stage, it seems inevitable that it would be necessary to have some evidence respect of life expectancy because any actuarial calculation will depend upon it. And that is exactly one of the things the new regime sought to avoid.

Remember also that periodical payments can also be ordered on an interim basis. This will prove a useful way of providing for a properly organised and fully funded care regime to be set up before trial.

The need for proper financial advice

In summary, I repeat that a claimants’ legal adviser will need a very good reason, probably backed by expert financial advice, for not having commended such a provision to his client in clear terms. And the solicitor or barrister must be careful to get such financial advice since they are neither permitted nor (usually) qualified to give such advice themselves.

The Defendant’s perspective: decline of the Annuities market

in April 2005
Defendants - whether they be insurers, the NHS or the Government – would seem to face unavoidable additional cost\(^{18}\) where there is an actual or possible order for periodical payments. That is plain from the recent examples of the cost of annuities in the present market.

Those who are able to self-fund will probably see some financial – or at least budgetary – advantages\(^{19}\). But self-funding has its own problems either with the interrelation between insurer and reinsurer or because – as is the case with more than one big insurer – their actuaries are not yet comfortable with the budgetary and fiscal implications.

There are also major difficulties in understanding how a defendant can properly and effectively provide or budget for the prospective increase or decrease on variation. There are similar and related difficulties in reserving against long term exposure particularly in respect of what will, in most cases, be prospective increases in the event that the claimant deteriorates some years later. In any case, defendants, particularly insurers, like claimants, prefer certainty and finality. They like to see the state of their books at the end of each accounting period and have no enthusiasm for long term, sometimes opaque, financial obligations.

There will certainly be changes in the present, depressed, state of the annuities market. I have no means of knowing whether this business will eventually be regarded as profitable. Until earlier this year there were two UK insurers in the market but, until recently, they were prepared only to provide annuities for their own cases and subject to certain premium limit. There are now the Canada Life products and AIG. Other players are also mentioned\(^{20}\) as prospective providers. But there is a long way to go before we have anything the buoyant market that was anticipated when this all began.

**The attitude of the Courts**

\(^{18}\) Although, as we have seen, when the legislation was conceived, the general understanding, including that of insurers, was that the periodical payments regime would be “cost neutral”

\(^{19}\) Insurers may think that they have much to learn from the experience of the NHS and at least one of the major insurers is intending to self-fund. Of course, the NHS does not have the same FSA constraints.
Experience of the attitude of the Courts is limited and it differs.

Denzil Lush, for example, Master of the Court of Protection, gave a paper to the London Common Law and Commercial Bar Association in April in which he made it clear that, whilst it was still very early in the new regime, he was generally relaxed about whether or not cases settled on a lump sum or periodical payments basis so long as he was confident that the parties had had sensible advice. He recognized there might be what he characterized as “sound reasons” for settling on a lump sum basis. These would include reasons that were “not simply financial but extend across a much broader range of considerations – medical, social and personal –and are more holistic insofar as they treat the Claimant as a member of a family rather than an isolated entity”.

Other Judges seem to have taken a stronger line. In Godbald v Mahmood21, Mitting J ordered the Defendants to pay £50,000 per annum, RPI linked, rising to £61,000 per annum, in October 2009, for the rest of the Claimant’s life to cover his care costs, notwithstanding that neither party had indicated a preference for such a method of settlement.

Funding questions also arise. In Walton v Calderdale NHS Trust [2005] EWHC 1053 Silber J found that the Claimant required RPI linked periodical payments from age 19. He also held that it was for the Defendant to adduce cogent evidence as to how it was able to fund those care costs on an alternative basis – and it had failed to do so in the instant case. In the case of YM v Gloucestershire Royal Hospitals NHS Trust, which was due to be heard on October 4th 2005 and was at one stage thought likely to be the first case testing the RPI plus argument a settlement with a Foundation Hospital ran into difficulty when it became clear that it did not satisfy the requirements of security.22

**The key provisions**

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20 Barkshire Hathaway, Prudential etc
22 Clearly, urgent Ministerial action is needed to resolve this difficulty affecting not only
Section 2(8)

Section 100 of the Courts Act 2003 substituted for Section 2 of the Damages Act 1996 the following provisions:

(8) An order for periodical payments shall be treated as providing for the amount of payments to vary by reference to the Retail Price Index (within the meaning of Section 83(2) of the Income and Corporation Taxes Act 1988) at such times, and in such manner as may be determined by or in accordance with Civil Procedure Rules.

(9) But an order for periodical payments may include provision -

(a) disapplying subsection (8), or

(b) modifying the effect of subsection (8).

Section 2B Variation of orders and settlements

Sub-section (1) provides that

The Lord Chancellor may by order enable a court which has made an order for periodical payments to vary the order in specified circumstances (otherwise than in accordance with section 2(5)(d))

23 The provisions of Section 2(1) to 2(7) are not directly addressed in this article. Nevertheless, the provisions for security and continuity of payment raise a number of issues of their own a useful analysis of which will be contained in (new) Chapter 23 of the substantially revised edition of Kemp and Kemp due for publication later this/earlier next year.
Sub-section (2) makes a parallel provision in respect of agreements providing for periodical payments.

**The main Rules, Practice Directions and Statutory Instruments**

The new provisions are in CPR 41.1 to 41.10. CPR 41.8(1) provides as follows:

(1) *Where the Court awards damages in the form of periodical payments, the order must specify* -

(a) *the annual amount awarded, how each payment is to be made during the year and at what intervals;*

(b) *the amount awarded for future -*

   (i) *loss of earnings and other income;*

   (ii) *care and medical costs and other recurring or capital costs;*

(c) *that the claimant’s annual future pecuniary losses, as assessed by the court, are to be paid for the duration of the claimant’s life, or such other period as the Court orders; and*

(d) *that the amount of the payments shall vary annually by reference to the Retail Prices Index, unless the Court orders otherwise under Section 2(9) of the 1996 Act.*

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24 They were not altered as a result of the discussions leading to the final draft of the amendment to Part 36 which provides that the consequences of Part 36 offers with or without provision for periodical payments is a matter for the discretion of the Court. There are other amendments to the rules and regulations yet required, particularly directed at defining structured settlements as a sub-group of periodical payments.
(3) Where an amount awarded under paragraph (1)(b) is to increase or decrease on a certain date, the order must also specify -

(a) the date on which the increase or decrease will take effect, and

(b) the amount of the increase or decrease at current value.

The factors to which the Court shall have regard under Rule 41.7 “include” -

“(1) The scale of the annual payments taking into account any deduction for contributory negligence.

(2) The form of award preferred by the claimant including -

(a) the reason for the claimant’s preference; and

(b) the nature of any financial advice received by the claimant when considering the form of award; and

(c) the form of award preferred by the defendant including the reasons for the defendant’s preference.

The Practice Direction (PD 41B) identifies “examples of circumstances which might lead the Court to order an increase or decrease under Rule 41.8(3)” as including

(1) the claimant’s condition will change leading to an increase or reduction in his or her need to incur care, medical or other recurring or capital costs;

(2) gratuitous carers will no longer continue to provide care;

(3) the claimant’s educational circumstances will change;
(4) the claimant would have received a promotional increase in pay;

(5) the claimant will cease earning

With regard to variation, all that is said in the Practice Direction is that the “Damages (Variation of Periodical Payments) Order 2004 sets out provisions which enable the court in certain circumstances to provide in an order for periodical payments that it may be varied”.

Article 2 provides that

If there is proved or admitted to be a chance that at some definite or indefinite time in the future the claimant will -

(a) as a result of the act or omission which gave rise to the cause of action, develop some serious disease or suffer some serious deterioration, or

(b) enjoy some significant improvement, in his physical or mental condition, where that condition had been adversely affected as a result of that act or omission,

the court may, on the application of a party, with the agreement of all the parties, or of its own initiative, provide in an order for periodical payments that it may be varied.

and Article 5 provides:

Where the court makes a variable order -

(a) the damages must be assessed or agreed on the assumption that the disease, deterioration or improvement will not occur;
(b) the order must specify the disease or type of deterioration or improvement;

(c) the order may specify a period within which an application for it to be varied may be made;

(d) the order may specify more than one disease or type of deterioration or improvement and may, in respect of each, specify a different period within which an application for it to be varied may be made;

(e) the order must provide that a party must obtain the court's permission to apply for it to be varied, unless the court otherwise orders.

Articles 6 to 9 deal with extending the time within which one may make an application to vary (Article 6), the limit of one upon the applications that may be made in respect of a specified disease or type of improvement (Article 7), the obligation to retain case files (Article 8) and with variable agreements (Article 9).

As the Explanatory Notes make clear, the circumstances in which variation is permissible are restricted to those “where there is a chance that the claimant will develop some serious disease or suffer some serious deterioration, or enjoy some significant improvement, in his physical or mental condition, and the court has ordered, or the parties have agreed, that the order or agreement is to be capable of variation”\textsuperscript{25}.

**Practical considerations: amendments to CPR Part 41**

Part 41.6 requires the court to consider and indicate to the parties as soon as practicable (usually the first CMC, one might expect) whether periodical payments or a lump sum is likely to be the more appropriate method of settlement or order. Rule 41.5 enables the parties to give their reasoning in their statements of case. The sensible practitioner will gain the

\textsuperscript{25} This quotation comes from the Explanatory Note itself.
initiative by having (and providing) well considered reasons at the earliest possible stage. This suggests that it would be sensible to get proper financial advice early and having clients that understand and are able to give clear instructions as to their preference and the reasons therefor.

It will be unrealistic to do so in a case where liability is seriously in issue or where it has not yet been possible to identify the nature and extent of any recurring losses in the future.

Note also that PD 41.7(2) (b) requires consideration of “the nature of any financial advice received by the claimant”. This also serves to emphasise the importance of getting good, expert, financial advice early, so long as it is clear that it is an appropriate case for such an order.

Rule 41.5 allows the court to order the parties to give reasons or to provide better particulars. We should expect this power to be exercised vigorously. However, the courts have, by virtue of section 4(7), a wide discretion to take all circumstances into account to ascertain, in particular, the form of award that best suits the claimant’s needs. Note, in particular, that Practice Direction 1B provides that the factors to be considered include the scale of the annual payments after taking into account any deduction for contributory negligence. The impact of such a finding on the attractions of a periodical payment order is considered later in this paper.

Part 36: fertile ground for arguments

26 PD 41.7(2) (b) requires consideration of the “nature of any financial advice received by the Claimant”.

27 Whereas in deciding on the level of award (in particular, as to whether the claimant may not in fact be able to afford his own residential arrangement rather than a cheaper but no more reasonable institutional arrangement) the court must, according to the Court of Appeal’s rejection of the “50% argument” in *Sowden v Lodge* EWCA Civ 1370, disregard the impact of contributory negligence. Whether these two different approaches can sensibly be reconciled is open to argument. Whether the 50% point might yet be revived on a better case (for its advocates) than *Sowden/Crookdake* is more difficult.
The Civil Procedure (Amendment No 3) Rules 2004\textsuperscript{28} makes amendments to Part 36 which are intended to ensure that the costs consequences of offers to settle and payments into court can accommodate the new regime.

There was a great deal of debate about the content of the new rule at the end of which (depending on one’s point of view) the Rule Committee either filed the issue under “Too Difficult” or took the sensible, pragmatic solution of allowing a broad discretion so that the court has as much flexibility as possible, unfettered by over-prescriptive rules or guidelines.

Hence the rule that costs consequences follow if the Claimant fails to obtain a judgment which is “more advantageous than the Part 36 offer made under Rule 36.2A\textsuperscript{29} or if judgment against a Defendant is more advantageous to the Claimant than what was offered. But “more advantageous” is not defined or explained\textsuperscript{30}.

Practitioners should note that (new) Rule 36.2A(5) requires any offer to state

- the amount of any lump sum element
- what part of the offer relates to periodical payments
- the amount and duration of such periodical payments
- the amount of any payments for any substantial capital purchases (and when they are to be made)
- the basis for variation (that is, how/by reference to which index)
- the security of the funding

and the offer may also state

- what part of the offer relates to future pecuniary loss in the form of a lump sum
- what amounts (if any) relate to other damages by way of a lump sum

\textsuperscript{28} Which came into force on 1\textsuperscript{st} April 2005
\textsuperscript{29} Rule 36.20(1)(a)
\textsuperscript{30} See also cases like \textit{Williams v Devon CC} [2003] EWCA Civ 365
and Rule 41.8 provides that

- A Claimant may only accept the offer as a whole rather than in part
- The lump sum element must actually be paid in if a Defendant’s offer is to have costs consequences
- Time for acceptance is calculated from the date of the offer rather than the payment into Court

**Periodical Payments and Indexation**

*The issue*

Can/should the Courts provide that the periodical payments will vary at a different (usually, more generous) rate than RPI? This is an issue due to be resolved in a hearing currently listed for the High Court in October 2005 and which has been the subject of debate between (among others) the present author, Rowland Hogg and Robin de Wilde QC.

**Background**

As was decisively settled by the Court of Appeal in *Cooke v United Bristol Healthcare* [2003] EWCA Civ 1370, the effect of Section 1(1) of the *Damages Act 1996* together with the Lord Chancellor’s Order under that Subsection and other longstanding authority is that on a lump sum award future loss must be calculated by reference to a discount rate of 2.5% after allowing for RPI and the impact of tax.

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31 The analysis of the competing indices has been undertaken by Mr Hall.
35 And probably also after allowing for the actual costs of fund management - see an article by William Norris QC and Doug Hall in JPIL September 2004.
In reaching that conclusion, the Court of Appeal took as the “central thesis” of the claimant’s accountancy expert, Rowland Hogg, his argument that the effect of assessing future losses by reference to an RPI related discount rate would lead to significant under-compensation because “care costs (and indeed wages also, though not to the same extent) have historically increased at a significantly steeper rate than is represented by RPI”.

It is important to remember that although the Court read the evidence that Mr Hogg would have given at trial about the sort of index that might most appropriately be used for care costs it also recognised that none of that evidence had been tested and would be likely to have been challenged at any trial.

It would seem uncontroversial to say that, at least as regards the discount rate applicable to lump sum calculations, there is no scope for further argument.

**Effect of sub-sections 2(8), (9): Mr Hogg’s argument**

Nevertheless, in JPIL in September 2004, Mr Hogg argued that, in respect of periodical payments, sections 2(8) and (9) can and should be interpreted as allowing the Court to fix an index higher than RPI at least for future costs of care. On the basis that “the cost of care has been rising significantly faster than general inflation as measured by the RPI (and that this) is likely to continue in future”, he contends that periodical payments for care indexed to the RPI will “become increasingly inadequate to provide the level of care decided by the Court with nothing the claimant can do about it”. He adds that “it would be reasonable to assume increases in line with average earnings or 2% pa above the RPI” and suggests that it would be

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36 See paragraph 21 of the Direction of Laws LJ.
37 Mr Hogg’s proposal was that the best index to use was the NHS Pay Costs Index (PCI).
38 At paragraph 22 of the Judgment of Laws LJ.
39 There are frequently rumours suggesting that the Lord Chancellor may be considering changing the discount rate – say, to 1.5% or 2% (which would certainly have an impact on the relative attractiveness of a periodical payments order as against a lump sum). Enquiries of DECAF are met with the same reply: “The Lord Chancellor always has the discount rate under review”. So there you are.
“practical” and “a realistic estimate” for the Court “to order that periodical payments for care should vary either by reference to the average earnings index or to the RPI plus 2%”40.

The evidential foundation for the argument is much the same as that which he put forward in *Cooke*. Essentially, the argument is that since care costs are largely driven by the earnings of those who do the caring, the best basis upon which to calculate future increases in care costs would be by reference to a wages index rather than the RPI. Although Mr Hogg acknowledges that there is “no generally recognised index of carers’ earnings”, he observes that “in 2003 a survey of BNA charges for carers covering a period of 20 years showed average increases of 3% pa above RPI”41. He also notes that in the “period of 27 years from 1975 to 2002 pay costs in the NHS increased on average at 2.3% pa above RPI”.

**Mr Hogg’s proposal: RPI plus 2%**

Because conventional annuities cannot be indexed to an average earnings (or other) index42 and, further, because of the difficulty of indexation to the average earnings index even for a general insurer, an NHS or a Government Department, Mr Hogg proposes indexation to the RPI plus a fixed percentage - his proposal being RPI plus 2%.

He outlines a number of bases for arguing that one should adopt an indexation at RPI plus 2%. These range from data assumed to be specific to the care costs, such as a 2003 BNA survey on the costs of carers and data from the Department of Health website on NHS pay costs over the past 27 years, to general data across the whole economy as measured by the New Earnings Survey (NES) and the Average Earnings Index (AEI).

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40 Mr Hogg’s commitment to the cause of calculating future loss by reference to a different, more generous and, he would argue, more accurate, approach and/or indices is apparent in Appendix A to the new (5th) edition of the Ogden Tables produced by the committee of which he is a member. Appendix B sets out the views of the ABI and NHSLA.

41 He adds that that is without taking account of “increased costs resulting from regulations and legislation” in recent years.

42 Because of the close-matching requirements, the impact of which I discuss later in the article.
Mr Hogg acknowledges that the AEI will not precisely reflect increases in the cost of care but sees it as providing a “realistic guide” and, it appears, primarily on this historic differential between the AEI and the RPI, arrives at the proposed indexation of RPI plus 2%.

A danger of over-simplification

Mr Hogg commends the adoption of the historic differential between the AEI and the RPI on the grounds of simplicity but, in doing so, and perhaps inevitably, over-simplifies the numerous evidential issues to be addressed before any conclusion can be drawn on the selection of an appropriate uplift to RPI to be applied to allow for future increases in care costs. The issues include:

a) What reliable evidence is available as to the actual trend in care costs in the past?

b) What differential has been established between the trend in care costs and RPI in the past and over what period should the historic trend be considered?

c) What are the underlying reasons for this differential?

d) Is it reasonable to assume that this differential will continue and for how long?

The trend in care costs in the past

Indices such as the NES or the Average Earnings Index may be relied upon as establishing general trends in labour costs in the economy as a whole, given that they can be assumed to be based on statistically sound sample sizes and have been compiled on a consistent basis over the years by a Government agency, the Office for National Statistics.

However, no reliable index has yet been identified on which reliance could be placed to establish a basis for an expected future differential between general inflation as measured by the RPI and the costs of care. For example, any measure of wage inflation across the whole of an industry or organization such as the NHS\(^43\) is inevitably very - probably too - broad given

\(^{43}\) The NHS Pay Cost Index (PCI).
that it includes personnel not involved in care as well as a range of grades, including managerial and senior grades, which would not be relevant. Further, the PCI, which Mr Hogg argued in Cooke was the most appropriate index to use for care costs\textsuperscript{44}, includes the earnings of many professional grades which appear to have grown at a faster rate than the earnings of those providing the care.

Certainly, the basis of the BNA survey cited by Mr Hogg would need to be examined carefully before concluding that it is any more reliable as an index to adopt as evidence of future increases in care costs. It does not appear that, so far, it has been subjected to such close, external scrutiny.

\textit{The historical differential between care costs and RPI}

In his article, Mr Hogg cites long-term trends in the NHS and from the BNA survey. However, the longer the term considered, the more likely that the trends have been influenced by factors which are no longer relevant, or at least will not apply in the future.

More recent trends will have the benefit of reflecting factors that are more likely to be sustained into the future. As an example, the following is a comparison of the trends in recent NHS pay reviews for nursing staff compared to the RPI:

<table>
<thead>
<tr>
<th>Year ended</th>
<th>Pay Review NHS Nursing Staff</th>
<th>RPI</th>
<th>Differential</th>
</tr>
</thead>
<tbody>
<tr>
<td>31-Mar-01</td>
<td>3.4%</td>
<td>2.3%</td>
<td>1.1%</td>
</tr>
<tr>
<td>31-Mar-02</td>
<td>3.7%</td>
<td>1.3%</td>
<td>2.4%</td>
</tr>
<tr>
<td>31-Mar-03</td>
<td>3.6%</td>
<td>3.1%</td>
<td>0.5%</td>
</tr>
<tr>
<td>31-Mar-04</td>
<td>3.2%</td>
<td>2.6%</td>
<td>0.6%</td>
</tr>
<tr>
<td>4 year Average</td>
<td>3.5%</td>
<td>2.3%</td>
<td>1.2%</td>
</tr>
</tbody>
</table>

\textsuperscript{44} Interestingly, Mr Hogg makes no reference to this index in his recent article
Whilst this exercise happens to show a lower differential between a category of healthcare labour costs and the RPI in recent years, and might certainly be one basis for doubting Mr Hogg’s proposed uplift of 2%, it is no more than an example of the wide range of data that would need to be examined carefully before any real conclusion could be drawn over any likely differential between care costs and RPI in the future.

**Underlying reasons for the differential**

In order to form a view on whether the future will see an escalation of care costs in excess of RPI, it would be necessary to understand the reasons for any such differential in the past and to establish whether these will continue in the future and to what extent. Demand and supply factors may influence short term trends, for example. But a detailed analysis has yet to be undertaken.

*Will there be a continuing differential of care costs increases over RPI? AEI or PCI as an alternative index to the RPI + 2%*

A key question is whether past experience of care costs (and past data generally) are sound bases for predicting what will happen in the future.

Whilst the generalised data cited by Mr Hogg suggests a differential between care costs and the RPI of 2%, which is assumed to continue into the future, it is almost certain that detailed expert evidence on this question will demonstrate a range of conflicting views.

As was emphasized in *Cooke*, the courts have not yet conducted any detailed analysis of such expert evidence. Even if Mr Hogg’s initial analysis appears compelling in establishing that there is a real differential between care cost inflation and the RPI, it is, thus far, only a superficial exercise. Further, there is no consistently reliable index that has been identified as a preferred alternative.
It is certainly correct that, in this country, earnings since the Second World War have increased at a greater rate than RPI presumably as a consequence of increased economic prosperity. Whether such continued prosperity and increases can be assumed for the future is speculative.

Apart from the difficulties with using an index such as the PCI that I have already addressed, an analysis of carers’ actual earnings over the years show a number of apparent disparities. For example, the rates used for most of the basic care with which a disabled person is provided are significantly lower than those of average earnings. Moreover, there are cases in which it can be shown that the increases in hourly rates that the care experts have used have not matched the progress of percentage increases in national average earnings.

Much the same observations are apposite in relation to the proposal by Dr Victoria Wass\(^{45}\) in various papers that AEI is the more appropriate index.

Essentially, the real advantage of RPI is that it has historically been recognised as the best measure of average inflation. That is why it has always been used by the courts as the index for all heads of future loss. In that approach there is, inevitably, an element of “swings and roundabouts”. If you decide that, for example, future loss in relation to wages may be more accurately assessed by reference to a wages index or care costs by reference to the PCI, you might also have to allow for the fact that, as against that “swing”, there is the “roundabout” of losses in relation to other heads where costs may actually fall in the future. An obvious example would be computers and communications equipment and specialist equipment like wheelchairs and prostheses. Other losses that have probably risen at a slower rate than RPI would include transport expenses. Nevertheless, the swings and roundabouts arguments is not quite so strong if care is the single major component of the claim and is dealt with by a periodical payments order tied to RPI. The lump sum, comprising some other capitalized future losses and other heads may not be sufficiently large a “swing” to counteract the care “roundabout”. But there are still arguments both ways.

\(^{45}\) Of the Cardiff Business School
Interpretation of the Statutory Provisions, Explanatory Note and Other Related Material.

One must consider how far the Parliamentary and other material support a departure from an RPI approach. The judicial guidance currently indicates only that “the provision in the Act on indexation of payments…(is)… merely intended to reflect the current position in respect of indexation”.

Section 2(8) itself identifies the RPI as, in effect, the pre-eminent index, subject to whatever may be said in the CPR. Section 2(9) gives no hint as to when an order disapplying subsection (8) should be made.

The Explanatory Notes (at paragraph 354) say this:

To ensure that the real value of periodical payments is preserved over the whole period for which they are payable, new section 2 provides that periodical payments orders will be treated as linking the payments to the Retail Prices Index (RPI). The timing and manner of adjustments to take account of inflation will be determined by, or in accordance with, Civil Procedure Rules. It is expected that, as now, periodical payments will be linked to RPI in the great majority of cases. However subsection (9) preserves the court’s power to make different provision where circumstances make it appropriate.

No real clues are given elsewhere as to when it might be appropriate to depart from an RPI link. The current draft of CPR 41.8(1)(g) effectively restates the RPI as the pre-eminent rule. The Practice Direction does not illuminate the issue further: the “examples of circumstances” which might lead to an increase or decrease in a periodical payments order are concerned with those made under CPR 41.8(3) where the amount of the periodical payment is to increase or

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46 Assuming that it is not appropriate to do so in relation to care, the only example that anyone has been able to offer is where a Claimant was intending to live overseas so a different index (an RPI for that country, as it were) might be more appropriate.
decrease on a certain date and in certain circumstances. The first draft of the guidance on the DCA website suggested that there might be departure from the RPI link only in “exceptional” cases. That language apparently caused controversy and anxiety: accordingly, the second draft speaks more cautiously – or timidly – of it happening only where “appropriate”.

The Damages (Variation of Periodical Payments) Order 2005 adds nothing of significance.

The Parliamentary Debate

The link between RPI and the variation of periodical payments arose in debate in the House of Lords in May 2003. On 12th May, Lord Goodhart dealt with Amendments Nos 148 and 149. He specifically raised the “new issue” arising under Amendment No 149 explaining that the problem had been “brought to (his) attention by Mr David Kemp QC”. He identified in terms47 that “the costs of care and treatment have risen faster than Retail Prices Index and are likely to do so. Therefore it is not enough to order periodical payments of an amount sufficient to provide care treatment today and simply index link them. Sadly, in a few years’ time, even though index linked, those payments are likely to be inadequate to secure what are then regarded as the appropriate current standards of care and treatment”.

Lord Hunt of Wirral48 drew the House’s attention not only to the (then) ongoing debate in Cooke but to the “drastic effect of such an increase in future loss payments not only for the insurance industry but also for the National Health Service”.

The Government’s position was stated by Baroness Scotland. Turning to the group of amendments, she referred to what she had said in Committee as follows:

“... We agree that it is important that the real value of periodical payments is preserved over the whole period for which they are payable. I express concern that,

47  12th May 2003: Column 57
48  Senior Partner in Beachcroft Wansbroughs who acted for two of the Respondents in the Cooke appeals.
although it is common practice to link payments to the Retail Prices Index - and it is likely that this will continue to be the case - it would not be appropriate to prescribe this as a blanket index to which all payments must be linked. Amendment No 148 addresses these concerns and preserves the Court’s flexibility to link periodical payments to other indices where appropriate. We do not consider that the amendment is necessary as the need to allow for inflation is an inherent part of assessing the quantum of damages, which is already within the Court’s discretion. The calculation of lump sums allows for inflation, as do structured settlements ... given the importance of inflation-proofing damages against future loss, we agree that there could be - I repeat could be - some merit in removing any doubt that the Court has power to index-link periodical payments ... there are several issues which we will need to consider - for example, when and how adjustments for inflation should be calculated and the most suitable definition of the Retail Prices Index ... Although I am making a clear commitment to look at the matter, I should tell the House that I can by no means guarantee that we will be able to make any movement on the issue. However I think it is right that we should have a vigorous look to see whether anything may be possible. Amendment No 149 provides that a Court may order that periodical payments for additional care and treatment costs are increased in line with care costs inflation, but should not exceed it ... the uplifted payments would seek to reflect the true costs of compensation. It is an important point of principle that the negligent party should pay for the costs of his or her negligence. There is no reason why the taxpayer should have to meet those costs. The operation of such a scheme would be complex and would itself create additional costs. Of course we are aware of concerns that there are no suitable investments that would allow life insurers, who are subject to close matching regulations, to offer annuities that would match care and earnings-based indices exactly.

However, it would currently be possible for insurers to provide annuities linked to the retail prices index plus a certain percentage. So it would be open to the court, if it thought that was the most appropriate way to quantify certain future losses, to order that they be linked to the retail prices index plus a percentage as a proxy for some other index. We should also keep in mind that not all periodical payments will be
backed by insurance products and that the same regulatory considerations will not apply where payments are funded by other means.

As I explained, the court already has the power to order payments linked to whatever index it considers suitable. A provision allowing it to order payments linked to care costs inflation is therefore unnecessary. It is important that the courts are able to take a flexible approach, so that where the circumstances of the case make it appropriate—if a defendant is unable to meet the terms of the proposed order because funding could not be adequately secured—he or she can inform the court and a different order can be made.”

On 19th May, dealing with Amendment No 23, which introduced what is now Section 2(8), Baroness Scotland outlined a position in line with the Explanatory Notes.

“…Amendment No 23 provides that periodical payments orders shall be treated as providing for the amount of payments to vary by reference to the retail prices index. We expect that, as now, periodical payments will be linked to the retail prices index in the great majority of cases. However, subsection (9) preserves the court’s existing power to make different provision where the court considers it appropriate in the circumstances.

I emphasise that the amendment is merely intended to reflect the current position in respect of indexation. The Bill addresses how payments of personal injury compensation are to be made. It does not seek to deal with how such claims are to be valued. As I said, we expect that the retail prices index will continue to be the norm and that the court will only depart from it where the particular circumstances of the case make it appropriate. That position is parallel with that of the discount rate, which effectively incorporates the retail price index in calculating the future loss element of lump sums. I am mindful of the reasons given by …the Lord Chancellor … when setting the discount rate….In his reasons, the Lord Chancellor emphasized the need for certainty for all parties while noting that it would remain open for the courts, under Section 1(2) to adopt a different rate in a particular case if there were
exceptional circumstances which justified their doing so. That view has been supported by the Court of Appeal. We would expect the courts to adopt the same approach in the analogous case of periodical payments when considering whether to exercise their discretion under subsection (9).”

She concluded by inviting Lord Hunt not to press his own amendment (No 2449) in the light of that explanation. He welcomed her observations and agreed not to do so.

**Discussion: what is likely to be the attitude of the courts?**

It may be thought unwise for me to offer a view when a Court of Appeal ruling might be with us within a year if we have a High Court decision before Christmas. But that is what I have to do.

Assuming that one accepts that it is likely that future care costs will increase at a faster rate than RPI, even though it may not be clear by how much, will sections 2(8) and (9) be interpreted so as to allow the use of an alternative index or mechanism such as that advocated by Mr Hogg? I think it unlikely, not least because of the very considerable economic consequences of doing so. It is worth remembering that, had Mr Hogg’s figures prevailed in *Cooke*, the assessment of future care according to his own figures would have been £4.6m as against a figure assessed on a conventional basis of £2.3m.

Hence it is strongly arguable that the choice of appropriate index is one that really ought to have been - and should in the future be - made by Parliament because the commercial and social consequences of moving away from RPI as the preferred index are so considerable. Not only would there be a huge impact on Government resources, but the effect on the insurance industry (and thus indirectly upon society generally) would also be great – and all

49 Which would have inserted (after “may”) the words “in exceptional circumstances or by agreement between the parties”.

50 See Carnwath LJ at paragraph 56 of *Cooke*
of this in the context of an original expectation that this would be cost neutral for Defendants51.

Further, as soon as one moves away from RPI as the preferred index with regard to a periodical payments order, there would be no logical reason for continuing to adopt RPI as the basis for the discount rate in lump sum awards52. And there would be no reason to limit this approach to claims for care. In theory, one could then equally justify a move away from the use of an RPI multiplier in almost cases of future loss. Claims for loss of earnings in particular would seem a potentially suitable candidate for an earnings related index. But this would represent a very considerable departure from existing practice and one that would have broad economic consequences that the Courts are not well placed to evaluate53. Additionally, as we have seen, there is a dearth of suitable annuity products and there are very real difficulties in identifying a satisfactory alternative index. There are also problems with the impact of the close matching regulations which I look at separately below.

For all those reasons, I expect the Courts will decide that RPI should be the ordinary index of choice until Parliament deems otherwise. That is consistent with the judicial guidance that I have already quoted and paragraph 45 of which records also that “… the provisions of the courts Act were merely intended to reflect the current position in respect of indexation. During passage of the Act, Ministers indicated that it was expected that, as now, periodical payments would be linked to RPI in the great majority of cases…”

What that leaves open to debate is the practical significance of Section 2(9). It is all very well for Baroness Scotland and the Explanatory Notes to the provision to say that “periodical payments will be linked to RPI in the great majority of cases”. Which cases are likely to be regarded as exceptional in some way? There is after all, absolutely nothing in the least

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51 See footnote 4 above  
52 Which, one might think, is what Baroness Scotland meant when she said that the choice of RPI as the norm for periodical payments was a “parallel” position to the choice of the discount rate for a lump sum calculation. In his article, Mr Hogg professes to finding this remark “difficult to understand”.  
53 As to which, see Heil v Rankin [2001] P.I.Q.R Q3
exceptional about cases that include future care costs - even where that cost is very considerable. But one can think of examples where RPI would not be appropriate a foreign claimant would be one, or an English Claimant likely to move overseas and live in, say, Italy where another (non UK) index might seem obviously more appropriate. To that extent, Section 2(9) is not a dead letter. Whether it is the basis upon which one can develop the law so creatively as to allow any number of competing indices to be used in relation to different heads of loss is a different matter.

**Limits of protection: security of payments**

Periodical payments may be funded by the purchase of an annuity to benefit from tax freedom. But for an annuity to benefit from enhanced protection it must satisfy the criteria set out in section 5 of the *Damages Act 1996*, yet the term “structured settlement annuity”, whilst defined in that statute, is not used in ICTA so that an annuity can qualify as tax-free whilst not enjoying enhanced protection. There is no direct link between the two statutes.

In practice, that could mean that periodical payments might be agreed between the parties in a manner which did not involve the purchase of an annuity and did benefit from tax freedom but did not meet the criteria for enhanced protection. In such a case, the future periodical payments would be in jeopardy if the defendant or his insurer became insolvent and so such arrangements are very unlikely to appeal to claimants unless the self-funding defendant is a government department within the terms of section 6 of the *Damages Act*.54

The whole question of security is a crucial one and often it will only be the financial expert who is able to answer it55. As we have already seen in relation to Foundation Hospitals, what seems clear today may become confused tomorrow56.

54  Which deals with “Guarantees for public sector settlements”
55  Too big an issue for this paper! Annexe A to the current draft guidance provides a useful
Remember that section 2(3) of the 1996 Act precludes the court from making any order for periodical payments unless it is satisfied that the continuity of payments under the order is reasonably secure. Section 2(4) provides that the continuity of payment can be considered reasonably secure if (a) it is protected by a ministerial guaranteed under section 6 of the 1996 Act (b) it is protected under section 213 of the Financial Services and Markets Act 2000 or (c) the source of the payment is a government or health service body.

**Impact of the close-matching regulations**

**General**

Life Offices issue annuities because they are long-term life insurance policies. The Financial Services Authority (FSA) regulates the long-term business funds of Life Offices. In simple terms, for the future payments under an annuity to be index-linked, the Life Office must be able to purchase suitable matching assets to cover that liability.

A permissible index-linked annuity is an RPI annuity because of the availability of Index-Linked Government Stocks (ILGS) to match them. Unfortunately, until recently, such stocks were only available under 2035 in which case, at that stage, unless fresh stocks were issued, the FSA would be unlikely to agree that there was an alternative, suitable, matching asset and if the insurance policy were to remain index-linked, it would have to be held on a mismatching basis. Under present FSA policy, that might be permitted but only at the expense of tying up significantly greater reserves. The FSA has, apparently, indicated informally that there is no “class of business” regulatory prohibition in respect of a general insurer who wishes to take on self-funded periodical payments. There are, however, possible reserving analysis as does the guidance itself.

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56 YM v Gloucestershire Royal Hospital - see above  
57 This discussion is based upon an analysis of the relevant provisions by Mr Cropper
implications and there is no clear answer to the question of whether – and, if so, to what extent – general insurers will be required to “asset match” in respect of self-funded periodical payment liabilities.

To accommodate this difficulty, Life Offices who have provided RPI-Linked Structured Settlement annuities incorporated a Limited Price Index clause into their policies, the effect of which is that if no suitable matching assets were available post 2035, then the Life Office will match RPI up to the limit of a fixed percentage/escalation thereafter. Typically this is within a range of 1 to 7% depending on the provider and the age/health of the claimant.

It is to be hoped that this problem has been alleviated by the recent\(^{58}\) issue of further stock to 2055 albeit there is limited supply of this new bond which is already reported to be over-subscribed and the rate of return upon which is reported to be only 1.25% (after RPI but before tax). The further problem, obviously, is that even 2055 may be too near as a final date: many Claimants litigating at the moment have expectations of life well beyond that date

There also remains a concern that the impossibility of guaranteeing RPI payments post 2035/2055 may undermine the requirement of “reasonable security” which is a pre-requisite of making the order\(^ {59}\).

\textit{A similar solution not available for other indices}

The difficulty with a link to an alternative index such as AEI or PCI is that there are no suitable close-matching assets which can be held against them. This is why the only structured settlement index-linked annuities were RPI based unless the defendant was a government department outside the regulation of the FSA.

\textbf{Protection, 2035/2055 clauses and links other than RPI}

\textsuperscript{58} September 2005
\textsuperscript{59} See section 2(4) of the \textit{Damages Act 1996} as amended
The Courts Act 2003 will amend the ICTA and the Damages Act. As we have seen the ICTA provides (at section 329 AA (3)) that periodical payments may be funded by the purchase of one or more annuities. And the Damages Act now gives enhanced protection to all periodical payments orders and agreements as if they were annuity policy documents. In practical terms this means that so long as the defendant or his insurer is adequately secure, the claimant will benefit from enhanced protection.

However, this brings us back to the 2035/2055 problem. The court can make a periodical payments order against a defendant backed by a FSA regulated UK insurer. Assume that it orders an RPI link: but if the claimant is likely to live beyond 2035/2055, the defendant can only (as the regulations stand) buy a structured settlement annuity from a Life Office which will have a 2035/2055 clause for reasons we have seen. It may therefore have to self-fund some or all of the order.

This creates a further problem. If a General Insurer self-funds periodical payments then the liability is taken by the short-term business fund as opposed to the Life Office which deals with the long term business fund. The rules that restrict index-linking and the close-matching requirements do not, at present, apply to the short term business fund. Hence a General Insurer could take on a fully RPI-linked periodical payments order without having a 2035/2055 clause. Nevertheless, concern has been expressed about the ambit of FSCS protection for periodical payments, especially if self-funded and assumed by a general insurer in respect of a claim in respect of a non-compulsory liability.

What if the court wished (for example) to impose an AEI link? It appears that a General Insurer would not be precluded from providing such a benefit. But a Life Office would. That may seem an obvious and unsatisfactory inconsistency since, one assumes, the FSA prohibits

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60 There is no guarantee that this situation will not change. Whether it does or not depends on the future attitude of the FSA and that in turn may be affected by the volume of business in this market.

61 It is, however, also argued that any periodical payment by an authorized insurer is protected.

62 Though one should distinguish between contracts of business entered into by Life Offices and a court order which would have to be met by the General Office under an indemnity.
the issue of AEI-linked annuities for good reason, that reason (presumably) being that the perceived risk is too great without the security of suitably matching assets. Can it be that a court might be prepared to order a periodical payment on a basis the effect of which would oblige a General Insurer to enter into a contract that the FSA would not allow? It hardly seems likely.

It is in this context and for those reasons that Mr Hogg is able to advance his “RPI plus 2%” solution as legitimate within current regulations.63

**Other implications of moving away from the RPI link**

The foregoing is intended only as an introduction to and summary of some of the concerns that are currently expressed even before the new regime is introduced. Certainly, a dearth of annuity providers in this market is already a major problem. The difficulties are especially acute as soon as one looks to move away from an RPI based product. And, for reasons already explained, I doubt that the arguments in favour of so doing will make much progress in the courts. I think that it is extremely unlikely that courts would be enthusiastic about imposing an AEI-linked liability on a General Insurer that the FSA would preclude, especially if the current arbitrage between the long and short terms business funds were to be closed, as must be a possibility.

There are also concerns about how claims that may be subject to reinsurance will be adjusted and about the impact upon the relationship of general insurer with the re-insurer64. There may well be competing interests between them as to whether a claim should be settled by lump

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63 Quoting Baroness Scotland’s assurance (cited in full above) during the debate that “it would currently be possible for insurers to provide annuities linked to the retail prices index plus a certain percentage. So it would be open to the court …. to order that [periodical payments] be linked to the retail prices index plus a percentage as a proxy for some other index”.

64 There are also likely to be problems with liability insurance limits if, under an existing policy, the sum of the payments exceeds the limit of insurance
sum or by periodical payments. In the latter case, the continuing indexation of retentions will affect recovery particularly where there may be years or even decades before the re-insurer has paid all or a substantial part of the claim. Is it likely that the re-insurer will agree to commute its liability or will the purchase of an annuity by the re-insured be seen as the best way in which the re-insurer’s involvement is resolved at an early stage? Will the re-insurer carry the future burden after the insurer’s limit is reached? Will they be around - and solvent - so long as the claimant lives? The answer is that nobody yet knows. What is, however, likely, is that the difficulty of resolving the conflicting interests of insurers and re-insurers (a fortiori where there are more than one of either) is going to make the process of settling the major claims very much more complicated than it was for a lump sum claim, especially in multi-party actions.

Varving or stepped orders

These will have to be considered in every case where there is likely to be a change – it will usually be an increase – in a recurring loss at some future point.

Here we are concerned with a “non-variable” order but one that may step up or down at a future time – such as when the infant Claimant ceases to be in full time education or moves from (say) a care regime that is largely provided by his family to one that is commercially provided. This will not be dealt with by a variable order which depends upon foreseeable changes in the claimant’s physical condition but by a stepped order which will provide for a different scale of payments at different times.

How can one accommodate the fact that it may not be possible to identify with accuracy or confidence when that change may be likely to take place? Can one simply identify the step and the event upon which it depends but not the date?

65 Likely to be their strong preference if an indexed retention does work in their favour.
66 The implications of which are beyond the scope of this article
The answer is no. Part 41.8(3) provides that where an amount awarded under Part 41.8(1)(b) “is to increase on a certain date” (emphasis added), the order “must also specify

(a) the date on which the increase or decrease will take effect; and
(b) the amount of the increase or decrease at current value”

Hence there is the same artificiality as under the old lump system which requires the Court to make an assumption as to when the change is likely to happen. And although, in theory, the artificiality of making an assumption about life expectancy is avoided, it may not be avoided absolutely. That is because it is by no means unusual for the approach of the parties or Court to be to say that half the period of loss should be taken at £x and half at £y. But such a broad brush approach does pre-suppose that you know the whole of which you are to take half which may well depend on the Claimant’s expectation of life A better method, therefore, will be to assume the date – so many years hence – when the change will take place and make that the specified date for the purposes of the order.

**Variable Orders**

**The power**

The power to make an order for variable periodical payments applies only in respect of proceedings issued on or after 1st April 2005. And variable orders are not the same as providing (by agreement or order) that amounts to be paid may step up or down in certain events. A variable order will permit consideration of the appropriate payment on the occurrence of an uncertain event.

The issue for consideration is what will be the effect and impact of Section 2B of the Damages Act which provides that the Lord Chancellor

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67 According to Anthony Jeeves of the DCA in the announcement quoted above.
may by order enable a Court which has made an order for periodical payments to vary the order in specified circumstances (otherwise than in accordance with Section 2(5)(d)68.

Paragraph 357 of the Explanatory Notes states that

the first order will enable variation of periodical payments orders only where there is a significant medical deterioration or improvement in the claimant’s condition which can be foreseen at the time of the original order and where the Court provides for the possibility of variation in that order.

Will they be made in only exceptional cases?

That is the expectation of many: indeed, the DCA guidance suggests that it “is likely that the use of variable orders will be very limited”.

However, I would distinguish between ensuring that there is such a provision in the original order or term of settlement and the making of an application as such. I do agree that successful applications to vary are likely to be few and far between. On the other hand, I believe that the wise practitioner on either side will wish to try and include such a provision in the original order……just in case.

In practice

It is clear from the Damages (Variation of Periodical Payments) Order 2005 that there can be no application to vary unless the original order or agreement provided at the time that it might later be varied (Article 2) and specified the “disease or type of deterioration or improvement” contemplated (Article 5).

68 The DCA Regulatory Impact Assessment November 2002 stated that it was “intended that the scope, if any, for variation should be limited and the process strictly controlled”.)
Given the terms of PD41.8, prospective changes in (for example) the extent of the claimant’s care regime should be identified when the Court makes its original order in the form of periodical payments\(^{69}\). It means that practitioners will have to be extremely careful to be sure that they have chosen a form of words that will allow a later application to be made. One must remember also that Article 5 makes clear that “where a Court makes a variable order the damages must, in the first instance, be assessed or agreed both on the assumption that the disease, deterioration or improvement will not occur”, the disease or type of deterioration or improvement must be specified and the period within which the application should be made may be specified\(^{70}\).

Because Article 2 talks in terms of “physical or mental condition”, and because Article 5 draws a distinction between “disease” and “type of deterioration or improvement”, one may expect this provision to be given a broad interpretation. For example, the claimant’s capacity to care for himself would be an important and identifiable aspect of his “condition” and a change in its nature would be likely to have major financial consequences for the claimant. That could easily be accommodated under the terms of Articles 2 and 5. One can see no sensible basis upon which it could be contended that the mere fact that (for example) a care regime had become more expensive could justify an application to vary under this provision. On the other hand, the actual change in the nature and extent of the care regime would be useful evidence upon which to base an application in the sort of circumstances outlined earlier. It remains to be seen whether – and, if so, in what way - a Court may be persuaded to allow for the prospective risk of the claimant needing more or less care in the future when making the original order.

Can (and should) the parties guard against the risk that the claimant might, in the future, need one, not two, or two, not one, carers to look after him? My view is that that is exactly the kind of serious eventuality against which both parties should attempt to guard. Equally, one can be sure that Courts will not allow the parties entirely free rein to accommodate all prospective

\(^{69}\) See CPR 41.8(3) and PD41B, para 2.2.
\(^{70}\) See Article 5.
changes given that Article 2 speaks in terms of “serious deterioration” or “significant improvement” in a claimant’s condition.

As yet, there is very little clarity\(^{71}\) as to how applications to vary will work in practice, particularly from the defendant’s perspective. Will a defendant be obliged to monitor the claimant’s progress by occasional surveillance? Will a claimant be obliged to provide the defendant with annual invoices to show (for example) that he has not improved to the point that he needs one paid carer not two? Is a claimant under an obligation to notify the other side of improvement or deterioration (or that he has moved abroad or even died)? If so, when and in what circumstances does this arise unless an application has been issued? It is, I suggest, an area of great uncertainty where clear guidance is urgently needed.

**Responsibility for variable orders: security for any change in the future**

Where the insurer or defendant purchases an annuity to meet the obligation to meet the claimant’s periodical payments the liability to make those payments due under the court order is discharged and passes to the life office. However, if the original order is variable, the life office will not have assumed liability in respect of any future increase or decrease. That liability will remain with the defendant. Hence Article 3 emphasises that when the court is considering whether to make a variable periodical payments order against an uninsured private defendant, that defendant’s present and prospective financial resources will have to be taken into consideration. To meet the security provisions, the uninsured defendant will have to purchase an annuity but the liability for the future remains with the defendant and there is no statutory protection available. In a case where this is a real concern, the court will have to look at other ways of providing for that eventuality.

**Conclusions: what will probably happen?**

These are very early days. We can really only speculate on what real judicial enthusiasm there will be for the new provisions. The likely attitude of the parties is also uncertain. In the short
term, however, I expect that many claimants will still prefer a lump sum\textsuperscript{72} and that a non self-funding defendant will almost always do likewise. What will happen with the annuities market is impossible to predict. At the moment, the state of the market means that it will always be significantly more expensive to settle a claim where a periodical payments order is respectably arguable than one where a lump sum calculation is the only one in issue.

\textsuperscript{71} Nor anything adequate in the Rules or Practice Directions

\textsuperscript{72} Though I repeat that those who advise them must be exceptionally careful to draw all the pros and cons to their clients’ attention. It will be imperative for the advisers (legal and financial) to have considered the financial implications of any form of order and to be familiar, for example, with the impact of any award on the State provision of services and on the possible benefits of a structure or personal injury trust etc.