Periodical Payments after *Thompstone*

Revision

1. A lump sum award for future loss is bound to be inaccurate. It is impossible for the court to predict future events with accuracy. The uncertainty includes prospects for the claimant's injury, the claimant's earning capacity, the level of the claimant's needs, the cost of meeting the claimant's needs, and life expectancy.

2. It is tempting to conclude that, because a lump sum award is likely to be inaccurate, this means that it is likely to be wrong. This raises a wider question about the purpose of tort compensation, but the answer given by the common law is that the purpose of compensation for future pecuniary losses is that the claimant should recover as near to full compensation as possible, subject to the rules of mitigation and remoteness, to put the claimant as nearly as possible in the same position as he would have been in if he had not sustained the wrong.

3. The discounting of an award for future loss to take account of chances and contingencies lies at the heart of personal injury damages assessment, and for future loss it takes a place of the all-or-nothing balance of probabilities test. This and is one technique by which the court tries to make a lump sum award as accurate as possible. When the House of Lords approved the use of actuarial evidence in *Wells v Wells*[1], it was for the purpose of enabling the court to make a lump sum award that would come as closely as possible to full and accurate compensation for pecuniary loss. Lord Steyn famously observed in *Wells* that it is a flaw in the lump sum system that the court requires the judge to resort to guesswork about the future, and a relatively straightforward solution would be to give the court power to make an award to periodical payments.

4. Provisional damages awards mitigate the first of these uncertainties by allowing a second application for damages where a risk of future deterioration is identified at the time of assessment. Structural settlements enabled the parties to negotiate for annual payments, but by reference to the notional lump sum award rather than by reference to the claimant's needs ("top down" rather than "bottom up"). Periodical payments awards try to go further in mitigating the uncertainty, but are concerned mainly with the last of these uncertainties, life expectancy. A periodical payments order does not, under the current rules, give the court flexibility to adjust the claimant's compensation year by year to reflect all of the claimants changing needs and expenses resulting from the injury, so the system has not in fact removed the need for the court to resort to guesswork about the future except in relation to life expectancy, and a foreseeable risk of deterioration. In addition a periodical payments order transfers the risk and responsibility of future fund management from the claimant to the defendant and, by providing for recurring payments to replace recurring income and expenses, the order comes closer than a lump sum to providing compensation comparable to what the claimant has lost.

5. The court was given power to award periodical payments by consent under section 2 of the Damages Act 1996, but there was no power of variation and the requirement of consent meant that the provision was of little practical use, since insurers will generally try to avoid a long-term periodical payments liability if they can.

6. The power was substantially amended by section 100 of the Courts Act 2003, enabling the courts to impose a periodical payments order without the consent of both parties, subject to a test financial solvency, and the statutory regime is now contained in the amended s. 2 of the 1996 Act. A power to provide for future variation was elaborated by the Damages (Variation of Periodical Payments) Ordered 2005. The scope for future variation is very limited. If you ask a matrimonial lawyer about periodical payments, you will find that a key characteristic of a periodical payments order in the family jurisdiction is unrestricted future flexibility in the hands of the court in order to take account of future changes in the needs and resources of both the

[1] Wells v Wells [1999] 1 AC 345

payer and the recipient. In personal-injury, the power of variation depends on the court finding a chance of future deterioration or improvement, in terms closely modelled on the conditions for a provisional damages award but providing for improvement to result in a variation of the award by a reduction, as well as for deterioration to result in an increase.

7. While the court has a power to make a periodical payments order, under s. 2(1)(b) it has a duty to consider whether to make such an order in any case where it awards damages for future pecuniary loss in respect of personal injury. There are rules of court set out in CPR Part 41 rules 41.4 to 41.10 and in Part 41 Practice Direction B. The claimant's legal representatives must therefore be ready to answer questions about the suitability of a periodical payments order in every case, and the key test under CPR 41.7 is the form of award which best meets the claimant's needs, but also the scale of the annual payments, the preferences of each of the parties, and any financial advice received by the claimant.

8. Inflation has become a major issue with periodical payments orders. With a lump sum award, future inflation can be ignored, because the rate of growth that is attributed to the invested lump sum award when making the actuarial calculations under the Ogden Tables is the real rate of return after allowance for growth/income that does no more than keep pace with inflation. The specified rate of return of 2.5% takes account of the opportunity open to the claimant of avoiding the risk of future inflation eroding the value of the lump sum by investing in Index Linked Government Stock. The lump sum process is itself riddled with uncertainties about the future, and the Court of Appeal in *Cooke v United Bristol Healthcare*[2] has resolutely refused to entertain the argument that a different discount rate should be used for a head of loss (in that case, future care) where the evidence suggests that future inflation is likely to be greater than RPI.

9. A claimant who is awarded a lump sum has the freedom to invest in ILGS for safety or to seek a higher rate of return at a higher risk. The claimant who is awarded a periodical payments order has a fixed future income which is intended to meet his ascertained needs, and must be protected against future inflation in the cost of meeting those needs, otherwise the primary objective of periodical payments, securely meeting the needs of the claimant, will not be met. Sub-sections 2(8) and (9) say that an order for periodical payments shall be treated as providing for the amount of payments to vary by reference to RPI, but may include a provision disapplying or modifying the effect of this rule.

10. One of the key questions about the periodical payments regime has been the courts' approach to the power under section 2(9) to specify a rate of indexation that is different from RPI. There is cogent evidence to show that historically, costs of care have risen by an amount significantly in excess of RPI, so a claimant with long-term care needs whose payments were limited to an RPI adjustment would probably face an ever-increasing shortfall.

11. Payments received under a periodical payments order are exempt from income tax (section 329AA of the Income and Corporation Taxis Act 1988) whereas the income from an invested lump sum is taxable. Payments received under a periodical payments order are disregarded, to the same extent as payments from a personal injury trust, in assessing eligibility for income means tested state benefits, and liability to contribute to the cost of local authority provision of residential care.

Subsequent developments

12. In a prescient talk to the London, and Law and Commercial In bar Association in April 2005, Master Denzil Lush looked at the early experience of the Court of Protection in approving large awards of damages[3]. In the first three months of the new powers, there was an order for periodical payments in only 9 out of 31 final settlements of a large clinical negligence claims, and very few cases other than clinical negligence claims had involved either a structured settlement or a periodical payments order. Financial advisers had often suggested

[2] Cooke v United Bristol Healthcare [2004] 1 WLR 251
[3] The text is reproduced at Kemp & Kemp 41-050

that the claimant would achieve better performance with a prudently invested lump sum, and there was concern that indexation to RPI would not be sufficient. There had been concern that the periodical income would be reduced to an inadequate level if it was necessary also to provide for a contingency fund and/or for the purchase of an expensive house. There was concern about the inability to cope with fluctuating future care needs, and about the impact of contributory negligence (a concern reflected by CPR 41 PDB 1(1)). Master Lush concluded that, in 70% of the higher value cases, claimants were preferring a lump sum award for a variety of financial, medical, social and personal reasons.

13. The rules to not require that the whole of the claimant's future pecuniary loss should be subject to the periodical payments order, and the court may wish to award a lump sum which enables the claimant to meet immediate capital needs such as for housing or to establish a contingency fund, even if a periodical payments order is suitable in respect of future care needs. If the immediate capital needs cannot be met from the awards were general damages and past loss, there can be considerable difficulties in calculating the appropriate reduction in the starting point of future periodical payments. In *Godbold v Mahmood*[4] Mitting J made a periodical payments order in respect of the claimant's future care costs, but not a future loss of earnings.

14. Under section 2(3) the court cannot make a periodical payments order unless payment is reasonably secure. Continuity of payment is deemed to be secure if the source of payment is the government or health service body, and after some initial doubts, arrangements have been made to ensure that foundation hospital trusts come within this regime[5].

15. So far as private insurers are concerned the question is whether the payments are protected under the Financial Services Compensation Scheme, but the market of insurers providing index linked annuities remains limited and the compensation scheme does not cover periodical payments that are self-funded through some insurers or local authorities.

16. The most important development in periodical payments since 2005 has been the decision of the Court of Appeal on indexation in *Tameside v Thompstone*[6]. In four appeals in cases of catastrophic birth injury resulting in a lifetime need for a major and expensive care regime, and the Court if upheld decisions at first instance that wages for the providers of care would increase at a faster rate to RPI so that, in awarding periodical payments for future care needs, the court had rightly exercised The power under s. 2(9) to replace RPI indexation with indexation by reference to the 75th percentile of ASHE occupational group 6115.

17. In reaching this decision, the Court held that periodical payments cases should be approached as completely different from lump sum awards. ASHE is the Annual Survey of Hours and Earnings, which has taken the place of the New Earnings Survey, published by the Office of National Statistics. Group 6115 is for care assistants and home carers who assist residents to dress, undress, wash and bathe, serve meals at tables or in bed, accompany residents on outings and recreational activities and undertake light cleaning and domestic duties as required. This was held to be a suitable improvement on RPI for fixing the future annual cost of meeting the claimant’s care needs. The first task is to establish the real hourly current cost of the claimant's care, from the factual and expert evidence before the court. This rate (£8.50 per hour in Thompstone) could then be fixed as a percentile of the survey results reported in ASHE 6115, and in the future this can be used for indexation of the original figure of £8.50 per hour (75% in Thompstone).

18. In coming to this decision the Court recognized the duty to strive for full pecuniary compensation (the 100% principle), and in practical terms recognized that if claimants were limited to RPI when there were good reasons to believe that the inflation of future care costs would substantially exceed RPI, this would act as a strong disincentive to claimants considering the merits of a periodical payments order, and might cause them to lose the other benefits of security and relief from risk.

[4] Godbold v Mahmood [2005] EWCA 1002, [2006] PIQR Q70
[5] YM v Gloucestershire Hospitals NHS Foundation Trust [2006] EWHC 820 QB, Lloyds Med Rep 309
[6] Tameside & Glossop Acute Services NHS Trust v Thompstone [2008] EWCA Civ 5, [2008] PIQR Q10

19. Three Court also gave some guidance on the use of expert evidence. In a substantial case, the claimant would usually instruct and call an independent financial adviser to report on the form of order which would best meet the claimant's needs. Where the defendant wishes to argue against a periodical payments order, they are strongly discouraged from calling evidence on questions of general preference, although this might be necessary on specific issues such as, for example, its ability to make suitable financial provision consistent with regulatory requirements. "It will only be in a rare case that it will be appropriate for a defendant, such as the NHSLA, to call expert evidence to seek to demonstrate that the form of order preferred by the claimant will not meet his needs."

Practicalities

13. Value: There is no lower limit of value for cases where a periodical payments order may be relevant, except for the limitation that the regime only applies to claims for future pecuniary loss. in practice it is inevitable that periodical payments orders will be most attractive to claimants who have serious long-term care needs so that they cannot afford to take the risk that the fund of damages may run out.

14. Security: NHS claims will continue to be regarded as secure, and will probably continue to be the most important area for periodical payments awards. While commercial insurers will probably continue to be anxious to close claims and to limit their long-term overall exposure, the politicians appear content to saddle the NHS with long-term periodical payments liabilities, in spite of the cost implications of *Thompstone*, as a form of quasi-PFI financing of clinical negligence liabilities. In the private sector, it remains to be seen whether the credit crunch and recent financial turmoil will undermine the compensation scheme and the future security of periodical payment orders.

15. Financial advice: In the first instance the onus is on the advisers of claimants to consider whether a periodical payments order might be in the best interests of the client. The financial considerations will always require expert financial input. Now that indexation can be tailored to the specific need following *Thompstone*, financial advisers have greater freedom when comparing the long-term security of a periodical payments order with the inadequacy of a multiplier for a lump sum award based on an increasingly unrealistic assumption of a 2.5% real rate of return. A vigorous attack on the 2.5% discount rate from a consulting actuary is set out at page x in the Introduction to the 2008/9 13th edition of the PNBA's Facts and Figures and concludes with a plug for PPOs as a way around this unfairness. In any case with a significant future pecuniary loss, the claimant's solicitor may be open to criticism if a report from a financial adviser has not been obtained; and in any case with a significant pecuniary loss, it is hard to conceive of any basis on which the defendant could avoid liability of the costs of obtaining such a report.

16. The effect of *Thompstone*: In cases of continuing care need, the resounding success of the claimants' arguments on indexation has removed the main principled objection to periodical payments orders. There may still be cases in which claimants will choose to take their chance with the freedom and flexibility of a lump sum order, but no claimant can make an informed decision about this without careful legal and financial advice. Claimants generally will surely be much more alert to the downside risk after the recent financial crisis. Gradually the effect of *Thompstone* is likely to be an increase in the popularity of periodical payments orders, not only in the high-value claims of catastrophic birth injury, but in a wider range of low value claims where there is continuing disability, loss of earning capacity and a need for significant care.

17. Pros and cons: it may be helpful to conclude with a summary of the main characteristics of periodical payments orders, considered in terms of the advantages and disadvantages for claimants:

Advantages

(1) Payments will continue for the lifetime of the claimant, which removes the fear that the money may run out.

(2) The claimant does not have the worry and risk of managing the investment of a lump sum award so as to generate necessary income while preserving sufficient capital for the long term. The investment work and the investment risk are transferred to the insurer or the annuity provider.

(3) Following *Thompstone*, the level of payment can be adequately indexed to protect the claimant in cases where inflation is likely to be significantly more than RPI.

(4) Payment is guaranteed by the government or under the compensation scheme. As recent events in the financial markets have vividly demonstrated, there is no guarantee about the capital value or the returns from an invested lump sum.

(5) Periodical payments are free of income tax, whereas the income from an invested lump sum is taxed.

(6) Periodical payments do not affect entitlement to means tested benefits, without the need to establish and operate a personal injury trust.

(7) Compared with structured settlements, there is no need (except for the purpose of giving and receiving informed advice) to bring the claimant face-to-face with a reduction of expectation of life or a comparison with a lump sum award.

(8) The claimant has some limited protection against bankruptcy, since periodical payments the care needs will not fall into his estate.

Disadvantages

(9) The claimant loses the flexibility to decide how to spend his damages, perhaps in ways that do not match the calculation of the claim, example in deciding to buy a nicer house or to invest business.

(10) The claimant loses me freedom to manage the investment of his damages in the hope of achieving better growth better income.

(11) There is no certainty of the amount of the defendant will pay, compared with a lump sum award which gives a clear, final and certain end to the claim.

(12) There will be nothing left over to go into the estate of the claimant from the heads of damage covered by the periodical payments order. However the court does have power to make some provision for payments to continue in favour of dependants, anticipating a Fatal Accidents Act claim.

(13) The guarantee involves a continuing dependency relationship with the (insurer of the) wrongdoer who caused the injury, which may be particularly unattractive if there has been bitter and hostile litigation.

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