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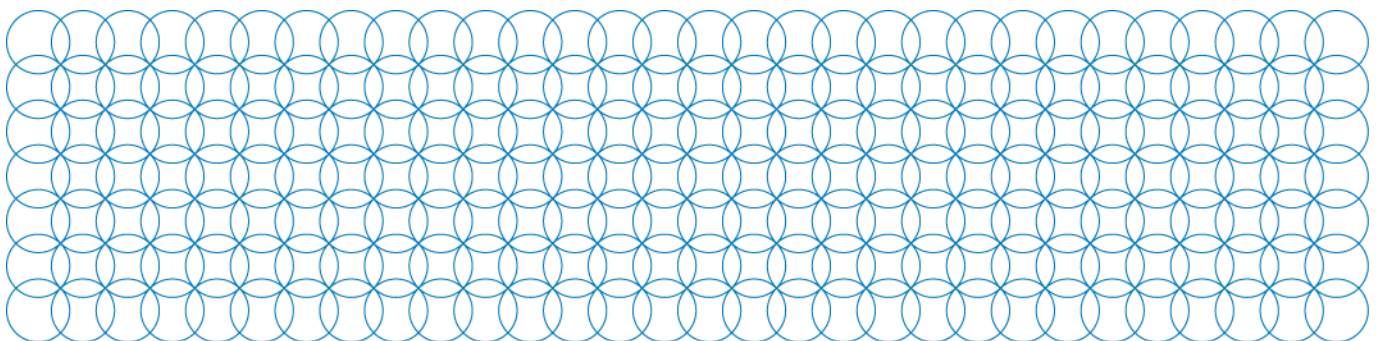
Damages Act 1996: The Discount Rate

Review of the Legal Framework

Consultation Paper CP 3/2013

This consultation begins on 12 February 2013

This consultation ends on 7 May 2013





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Damages Act 1996: The Discount Rate

Review of the Legal Framework

A joint consultation produced by the Ministry of Justice, the Scottish Government and the Department of Justice, Northern Ireland. It is available on the Ministry of Justice website at www.justice.gov.uk

About this consultation

To:	All those with an interest in personal injury claims
Duration:	From 12/02/2013 to 07/05/2013
Enquiries (including requests for the paper in an alternative format) to:	Damages Discount Rate Consultation Ministry of Justice Post point 6.21 102 Petty France London SW1H 9AJ Tel: 020 3334 6964 Email: damagesdiscountrate@justice.gsi.gov.uk
Enquiries relating specifically to Scotland to:	Justice Directorate St Andrews House Regent Road Edinburgh EH1 3DG Tel: 0131 244 6931 Email: damages@scotland.gsi.gov.uk
Enquiries relating specifically to Northern Ireland	Civil Justice Policy and Legislation Access to Justice Directorate Massey House Stormont Estate Belfast BT4 3SX Tel: 028 90169541 E-mail: atojconsultation@dojni.x.gsi.gov.uk
How to respond:	Damages Discount Rate Consultation Ministry of Justice Post Point 6.21 102 Petty France London SW1H 9AJ Tel: 020 3334 6964 Email: damagesdiscountrate@justice.gsi.gov.uk Online: https://consult.justice.gov.uk/ Please note that all formal responses will be shared by the Ministry of Justice with the Scottish Government's Justice Directorate and the Department of Justice in Northern Ireland.
Response paper:	A response to this consultation exercise is due to be published by 29/07/2013 at: http://www.justice.gov.uk , http://www.scotland.gov.uk and http://www.dojni.gov.uk

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Executive summary

Awards of damages are intended to compensate claimants for the losses they have suffered as a result of wrongful actions. This principle of full compensation – neither more, nor less – is a cornerstone of the law of damages. It is, however, not a precise concept. In this paper we are concerned with one of the factors influencing the extent to which the award will provide full compensation: the discount rate.

Lump sum awards of damages for future pecuniary loss, such as loss of earnings, cost of medical treatment and cost of care in personal injury cases, have to be adjusted to take account of the income that they might produce before they are spent. This adjustment, which can significantly affect the size of the award, is made by applying a discount rate.

The discount rate that the courts have to take into account is currently under review but stands at 2.5% in real terms. The rate is set under section 1 of the Damages Act 1996 in accordance with the guidelines established by the House of Lords in *Wells v Wells* by the Lord Chancellor in England and Wales, Scottish Ministers in Scotland and the Department of Justice in Northern Ireland. The rate was last changed in 2002 in Scotland and 2001 in the remainder of the United Kingdom.

The discount rate anticipates returns that will be earned. The returns will vary according to the types of investments that are being considered. The calculation of lump sum payments of damages for future pecuniary loss has therefore to involve an element of prediction about returns from investments. These predictions will to a greater or lesser extent almost certainly be inaccurate. Assumptions have also to be made as to the types of investments that it is appropriate to take into account for these purposes. The question is what degree of risk is a personal injury victim to be expected to take.

At present the discount rate is set by reference to the expected rates of return on certain types of safe investments. However, there is evidence that recipients of these lump sums do not invest in the cautious way that is envisaged by the guidelines. Instead, the initial evidence indicates, they seem to invest in mixed portfolios, including higher risk investments. This may be the result of a number of factors, but it might suggest that the current legal parameters for setting the rate may produce a rate that is too low. This would result in over-compensation for claimants and extra cost for defendants and those who fund them. These unnecessary costs could unfairly increase the burden on taxpayers and consumers as ultimately they have to fund the payments by state bodies and private insurers. Conversely, if the rate is too high, it is the victims of wrongful personal injury who will suffer.

The inherent uncertainty as to whether a lump sum award will fully compensate the injured person's losses, which is at least partly attributable to the application of a discount rate, can, however, be avoided because

compensation can be taken wholly or partly in the form of periodical payments to meet the losses as they arise. These payments clearly have to be funded and come with their own advantages and disadvantages but they do avoid problems attributable to the application of a discount rate.

The purpose of this consultation is to examine two main issues.

First, whether the legal parameters governing the way in which the discount rate is currently calculated produce a rate that is as 'right' as it ought reasonably to be so that the person injured is fully compensated but not over-compensated or under-compensated. The options are to retain the present law or to change the law so that the rate can be set by reference to higher risk investments, which would produce a higher discount rate and would be expected to produce lower lump sum awards than under the present law. We do not express any preference as to what the legal parameters should be.

Secondly, given the potential problems with the long term adequacy of lump sum awards, the paper examines whether there is a case for encouraging the use of periodical payments. Answering this question will require an understanding of the reasons that claimants do or do not chose periodical payments at present and the consequences of any potential change. If there is no case for change the outcome will be to leave the law unchanged. If, on the other hand, there does appear to be a case for change, the appropriate changes will have to be defined and their consequences considered. We do not have a provisional preference between these outcomes.

This second issue will be primarily examined in the context of the law of England and Wales and Northern Ireland only. For Scotland, consideration of this issue is limited to the extent that a periodical payment order may be made but only with the consent of the parties involved.

We invite views on both these issues and related matters and invite replies to a number of questions about them. We also invite views on the impact of possible changes to the law as a result of this consultation, both economically and as to how the changes might impact on the persons with protected characteristics under the Equality Act 2010 and the Northern Ireland Act 1998 respectively.

We welcome views generally or in relation to specific parts of the United Kingdom only.

Introduction

This paper sets out for consultation questions relating to the legal parameters governing the setting of the discount rate under section 1 of the Damages Act 1996 by the Lord Chancellor and his counterparts in Scotland and Northern Ireland in their respective jurisdictions. The consultation is aimed at people and organisations with an interest in personal injury claims and damages in the UK.

A Welsh language summary is available at www.justice.gov.uk.

An impact assessment has been prepared and is available with this consultation paper.

Copies of the paper are being sent to the organisations named in Annex 1. Responses are welcomed from anyone with an interest in or views on the subject covered by the paper.

Acknowledgement

In relation to the consideration of periodical payments within this paper we have drawn extensively on the recent study of periodical payment orders by the International Underwriting Association Casualty Treaty Group (IUA study)¹ and the work done by the General Insurance Research Organisation (GIRO) 2011 Working Party in its report *Periodical Payment Orders Revisited*.²

Structure of Paper

Part 1 of the paper introduces the issues under consideration. We deal with those relating to the setting of the discount rate in Part 2 and those relating to periodical payments in Part 3. In Part 4 we consider the impact of the possible changes that could be made as a result of this consultation, including in relation to the public sector equality duties. In Part 5 we list the questions asked. Annex 1 names the organisations to which this paper has been sent.

Definitions

References to defendants should, where appropriate, be read as including reference to persons funding the payment of awards of damages, typically insurers.

¹ http://www.iaa.co.uk/IUA_Test/Documents/Circulars_2010/Circulars_2011/Periodical_Payment_Orders__PPO__Study.aspx

² <http://www.actuaries.org.uk/system/files/documents/pdf/plenary-4-paper.pdf>

The following terms and abbreviations are defined in the paragraphs indicated:

“ASHE” please see paragraph 77

“August Consultation Paper” please see paragraph 11

“GIRO Report” please see page 5

“ILGS” please see paragraph 18

“IUA Study” please see page 5

“NHSLA” please see paragraph 77

“Ogden Tables” please see paragraph 2

“Wells v Wells” please see paragraph 27.

The proposals

PART 1 – INTRODUCTION

Introduction

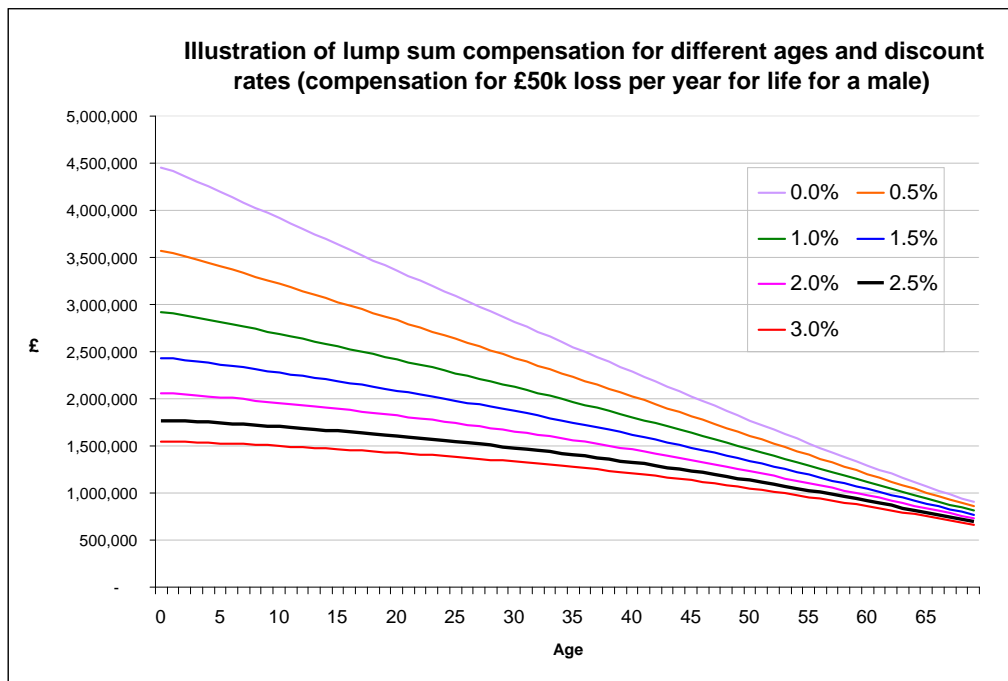
1. The payment of damages by one person to another for a wrongfully inflicted personal injury is intended to provide the victim with full compensation, neither more nor less. If the award includes a lump sum for future pecuniary loss (for example, loss of earnings or the cost of future medical and care expenses) allowance should be made in its calculation for the possibility that the recipient will invest the money until it is needed. This adjustment is made by applying a discount rate, which is, in effect, an estimate of the return on that investment. The ‘discount’ may be positive or negative depending on the anticipated rates of return for the relevant period.
2. The application of the discount rate can have a very significant effect on the size of some awards. The scale of the impact of the discount rate in a particular case will be affected by a number of factors. By way of illustration, the following chart indicates how the size of the lump sum will be affected by the age of claimant³ at the time of the injury, his or her life expectancy and different discount rates. The chart is illustrative only and is based on the figures in one of the Ogden Tables.⁴ It assumes that compensation of £50k per year is awarded (in real terms) for a male claimant for life. If this compensation were to be taken as a lump sum, a claimant aged 10 at the time of the injury would be awarded £1.7m if the

³ In Scotland, a claimant is known as a pursuer and in Northern Ireland, a claimant is known as a plaintiff.

⁴ These are the tables used by parties to litigation to take into account actuarial factors in computing the quantum of damages. The first edition appeared in 1984; the latest (seventh) edition was published on 10 October 2011. The latest (seventh) edition was published on 10 October 2011. The tables are prepared by the Government Actuary’s Department with a multi-disciplinary group of actuaries (including the Government Actuary), lawyers, accountants and insurers, chaired by Robin de Wilde, QC. The tables provide an aid for those assessing the lump sum appropriate as compensation for a continuing future pecuniary loss or consequential expense, such as care costs, in personal injury and fatal accident cases. The tables provide factors known as multipliers which are used to assess the present capital values of future annual losses or expenses. Different multipliers are provided for each full half per cent point of the discount rate. The multipliers are based on projected future mortality rates from the 2004-based national population projections for the United Kingdom. As well as providing tables of multipliers, the publication provides explanatory notes as to how the tables should be used. For further information please see http://www.gad.gov.uk/services/Other%20Services/Compensation_for_injury_and_death.html

discount rate were 2.5% compared to £3.2m if the discount rate were 0.5%; and a claimant aged 60 at the time of the injury would be awarded £0.9m under a discount rate of 2.5% and £1.2m under a discount rate of 0.5%.

Chart 1: Illustration of lump sum compensation payments for life time compensation of £50,000 per year (in real terms) for a male for different discount rates and ages (based on table 1 of the Ogden tables)



3. Changes in the discount rate may therefore have significant effects but will affect different cases in different ways. The greatest impact is likely to be in cases of people severely injured when young, but with a long life expectancy.
4. As the law aims to provide full compensation for the loss suffered and the courts will generally use the general discount rate prescribed under section 1 of the Damages Act 1996 to make the necessary adjustment, it is very important to ensure that the basis on which that discount rate is set is as 'right' as it can be. If it is not, the amount of under-compensation or over-compensation could involve many hundreds of millions of pounds annually.
5. The main criticism of the present law regarding the setting of the discount rate seems to be that the types of investments used as a basis for setting the discount rate are too cautious. Their rates of return are therefore too low. A less risk averse set of investments would, it is argued, be a more realistic reflection of the way that claimants actually invest and a better basis on which to set the discount rate.

6. As the main payers of compensation in personal injury cases involving significant amounts of future pecuniary loss are public sector health service bodies and the private sector insurers of individual defendants,⁵ the cost of the additional burden of a rate that is too low would fall ultimately, albeit indirectly, on the taxpayer and the consumer. On the other hand, if the rate is too high, the burden would fall on the victims of the wrongful act, who include some of the most vulnerable members of society, who would be under-compensated, thereby possibly increasing their reliance on the state and, therefore increasing costs to the taxpayer.
7. We have not reached any preliminary conclusions as to what the outcome of this examination should be. But it is clear that irrespective of the outcome, any problems with the discount rate can be avoided if the compensation for future pecuniary loss is paid by way of a series of payments in the future to meet anticipated needs as they are expected to arise. Periodical payments of this kind do not need to be adjusted by a discount rate. We would like to examine whether there is a case for encouraging the use of periodical payments.

Scope and aim of this consultation paper

8. This paper therefore examines and seeks views on two main issues relating to awards of damages for personal injuries. First, whether the legal parameters governing the way in which the discount rate applied to lump sum awards of damages for future loss in personal injury cases is currently calculated under section 1 of the Damages Act 1996 produces a rate that is as 'right' as it ought reasonably to be. The paper is not concerned with damages for past loss or with the calculation of fines or penalties.
9. Secondly, given the potential problems with the long term adequacy of lump sum awards, whether there is a case for encouraging the use of periodical payments. This second issue will be examined primarily in the context of the law of England and Wales and Northern Ireland only, because under the law of Scotland, the courts may only make an order for periodical payments with the consent of the parties involved.⁶ Nonetheless, as the Scottish Government is currently consulting on issues relating to personal injury⁷ it would welcome views from consultees on whether there would be merit in reviewing the existing approach to periodical payments in Scotland.
10. This paper is not examining the principle (sometimes referred to as the 100% rule) that the object of an award of damages is to provide, as far as money can do so, full compensation (no more, no less) for the losses

⁵ In Scotland, a defendant is known as a defender.

⁶ Damages Act 1996, s 2.

⁷ A copy of that paper can be viewed at www.scotland.gov.uk/Publications/2012/12/5980.

caused by the injury in question. Nor is this paper concerned with how, the application of the discount rate apart, the amount of an award of damages is actually calculated. The Ogden Tables are a well established part of that process and we have assumed that they will continue to be so irrespective of how the discount rate is set.⁸

11. This paper is not concerned with the issues addressed in the UK-wide consultation paper on how the discount rate should be set issued by the Ministry of Justice, the Scottish Government and the Department of Justice on 1 August 2012 ('the August Consultation Paper').⁹
12. The August Consultation Paper and the review of which it forms part is solely concerned with how the discount rate should be set under the present law. The present consultation addresses the question of whether the law should be changed. The two exercises are entirely separate.

Background

Damages in personal injury cases

13. The legal remedy for wrongfully inflicted personal injury is usually an award of damages. The award will be in settlement of all the losses flowing from the injury, whether they be past, present or future, certain or contingent. Examples of damages for future loss or expense include compensation for loss of earnings, care costs, case management costs and medical expenses. These future losses and expenses may in some cases run for many years into the future.
14. The award may take the form of a lump sum, periodical payments or a combination of both. A lump sum award should be exhausted at the end of the period for which it is given. Periodical payments should run for the period that the anticipated loss or expense in question is expected to occur or until the death of the claimant, if that is earlier.
15. The overall aim is that the award as a whole, whether lump sum or periodical payments or a combination of both, will neither under-compensate nor over-compensate the claimant. Achieving full compensation may sound a precise formulation but the assessment of damages can never be an exact science, particularly in matching future loss, where predictions have inevitably to be based on assumptions as to what may happen in the future. These predictions may turn out to be inaccurate.

⁸ We note that Lord Justice Thorpe in the Court of Appeals decision on *Wells v Wells* suggested that consideration might be given to adopting a form of assessment of future returns used in ancillary relief cases in the Family Division of the High Court known as the Duxberry Method. However, this suggestion does not appear to have gained much support.

⁹ Damages Act 1996: The Discount Rate *How should it be set?*

16. Moreover, as rates of return on investments and the size and duration of awards vary the most appropriate discount rate for an individual case would strictly be unique to it. Such a rate would be set taking into account the specific circumstances of the victim. However, this would probably require detailed – and quite probably expensive – expert evidence and argument specific to the case in question, which would delay the settlement of cases. A generally applicable rate avoids this. The precision of the application of the principle of full compensation is therefore inevitably going to be approximate rather than exact – and the assessment of whether any particular rate is the ‘right’ rate and whether the award under-compensates or over-compensates needs to be interpreted in this light.
17. Identifying and applying the discount rate in relation to an individual case is in theory a complicated exercise, but, in practice, the use of a prescribed rate and the Ogden Tables has the effect of automatically applying a discount rate because different figures are given in the Ogden Tables for different rates of return.

History of the personal injury discount rate

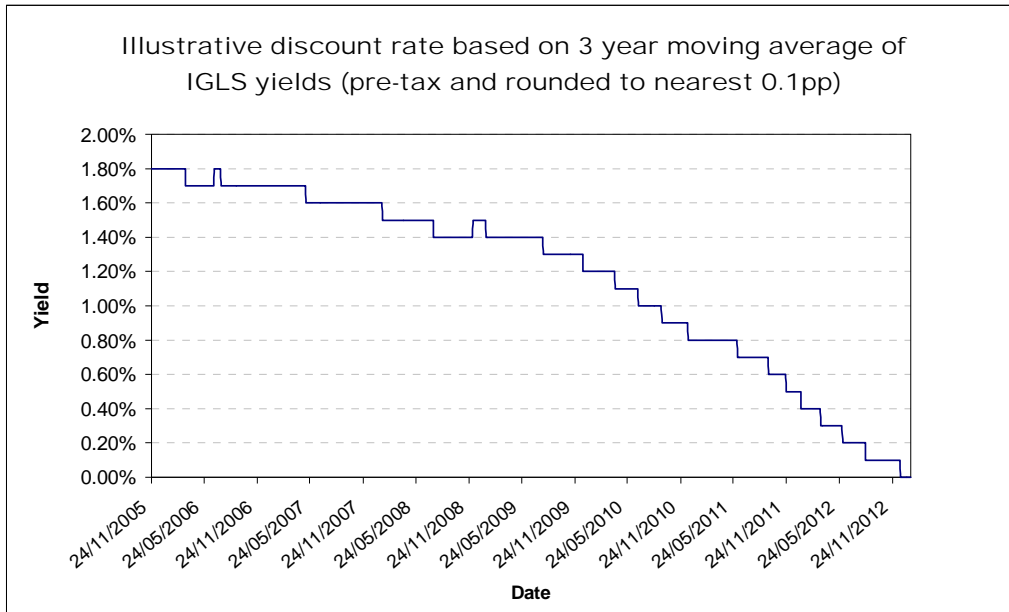
18. Up to the late 1990s, the courts applied a discount rate of 4.5% net of tax (6% gross) based on the return from a mixed portfolio of investments.¹⁰ Then, in 1998 the House of Lords in the case of *Wells v Wells*¹¹ set the discount rate to be applied by the courts at 3% by reference to a three year average rate of return on Index-Linked Gilts (ILGS).¹² This rate remained in force in England and Wales and Northern Ireland until 2001 and, in Scotland, until 2002, when the then Lord Chancellor, in relation to England and Wales and Northern Ireland, and the Scottish Ministers, in relation to Scotland, respectively prescribed a rate of 2.5% under section 1 of the Damages Act 1996. This rate is a real rate. This means it represents a rate of return over and above inflation. It remains in force today and is thought to be applied to the vast majority of cases. In view of

¹⁰ The thinking behind this approach, which would probably not be considered sound in modern financial economic theory or investment practice, was that if the claimant were to put the damages awarded into gilts or another form of investment generating fixed interest, the high rate of interest the claimant would obtain in inflationary times should be in advance of inflation, hopefully by about 4.5%: if the claimant invested in equities, while the dividends might not exceed 4.5%, the capital growth should keep up with inflation. The fixed interest on the one would be matched by the total return on the other, leaving a real rate of return in each case in the region of 4.5%.

¹¹ References to the decision of the House of Lords in *Wells v Wells* are to the judgments of the conjoined appeals of *Page v. Sheerness Steel Company Limited; Wells (Suing by Her Daughter and Next Friend Susan Smith) v. Wells; Thomas (Suing by His Mother and Next Friend Susan Thomas) v. Brighton Health Authority* [1999] AC 345.

¹² This rate was also relevant in Scotland and Northern Ireland, even though *Wells v Wells* was an English case.

the decline in the yields of ILGS illustrated by the chart below, the rate is now being reviewed.



Impact Assessments

19. We have considered the impact of the changes that might be made as a result of this consultation both generally and in relation to the respective public sector equality duties. An impact assessment accompanies this consultation paper.

General issues

General principles

20. To help guide the choice between the various options it may be helpful to set out the general principles that in the abstract we think an appropriate discount rate should satisfy.
21. The general principles we propose are:
- a. **Accuracy:** the rate should provide as accurate as possible a reflection of the return on investment the hypothetical claimant¹³ should reasonably be expected to make to ensure so far as possible that the claimant is not under-compensated or over-compensated by virtue of the opportunity to invest the monies received until they are intended to be spent in accordance with the terms of the award.

¹³ We refer to the hypothetical claimant because the discount rate is set in the abstract on the basis that the lump sum will be invested without reference to any particular case.

- b. **Transparency and simplicity:** calculation of the rate should be easy to understand and easy to perform. For the users of the system, the application of the rate is at present part and parcel of using the Ogden Tables.
 - c. **Stability:** for simplicity and certainty frequent changes in the rate should if possible be avoided.
22. There may be trade-offs between these three objectives, but we would welcome views on whether these are the correct general principles by which the appropriateness of proposed solutions should be assessed. Although all three principles are important, it seems to us that accuracy is the most important because of its direct relation to the principle of full compensation.

Question 1: do you agree that the general principles of accuracy; transparency and simplicity and stability should be used to assess the appropriateness of proposed solutions? If not, please give reasons.

Question 2: do you agree that accuracy is the most important of these three general principles? If not, please give reasons.

Risk

23. We assume that claimants who take a capitalised lump sum will invest this money. Investing is never free of risks, but, generally, in a well-constructed efficient investment portfolio, it will be the case that higher expected returns mean taking greater risks and vice versa. However, not all higher risks will bring higher rewards. Investors may, for example, not be compensated by higher expected returns if the risks do not apply to all market participants. For example, the risk of failing to meet an individual's cashflow needs may be important to the investors in question but they would not expect higher investment returns for taking on that risk.
24. In relation to periodical payments the court in England and Wales and Northern Ireland cannot make an order for periodical payments unless it is satisfied that the continuity of payment is reasonably secure. The degree of risk attached to periodical payments is therefore relatively limited. Nonetheless, there are, for example, risks that the indexation adopted may prove to be inadequate for the precise costs incurred or because the claimant's condition turns out to be worse than expected (although this risk applies to lump sum awards as well).

Other issues

25. In this paper we have focussed on the matters that we consider to be the most important in relation to the setting of the discount rate and the possible encouragement of the use of periodical payments. If there are matters that we have not discussed but which you consider important in relation to these subjects we would welcome your views.

Question 3: are there any other issues relating to the setting of the discount rate and the possible encouragement of the use of periodical payments that you would wish to draw to our attention? Please give reasons.

PART 2 – THE DISCOUNT RATE ISSUES

26. In this Part we examine what the legal parameters should be for the setting of the discount rate to make it as “right” as it can be within the principle of full compensation (also known as the 100% rule). We also briefly discuss the methodology to be adopted within those parameters.

Setting the discount rate – the hypothetical investor

27. In setting a discount rate to apply to all cases an assumption has to be made about the investments that claimants are expected to make with the lump sum received for the future pecuniary loss caused by the injury. This assumed investment is to be made by a hypothetical claimant in receipt of a hypothetical award for future loss.
28. The current legal parameters relating to the setting of the discount rate are defined by section 1 of the Damages Act 1996 and the decision of the House of Lords in the 1998 case of *Wells v Wells*. In that case the House of Lords set the discount rate to be applied by the courts at 3% largely by reference to a three year average rate of return on ILGS. The House of Lords adopted this approach because it decided that claimants in personal injury cases were not in the same position as ordinary investors and what was prudent for ordinary investors, who could ride out difficult times, was not necessarily prudent for personal injury claimants, particularly ones suffering from serious long term illness or disability. Such claimants, the House of Lords thought, needed an investment which would be certain to bring the money they needed when they required it without shortfall. These investors could not leave the ability to pay for essential services to the risk of fluctuations of the investment market. The rate of return obtainable from their investments would therefore be determined by their limited appetite for risk.
29. Under the present law it is therefore assumed that the hypothetical claimant envisaged in the setting of the discount rate is in a special sub-category of prudent investor, having a lower risk appetite than the simply prudent ordinary individual investor. The types of investment to be used in measuring the discount rate have therefore to be correspondingly low risk – and, of these investments, the House of Lords considered ILGS to be the most accurate way of measuring the relevant rate of return. The effect of applying a rate of return set on this basis is that the risk of shortfalls should be minimised or avoided but awards of damages would probably be larger than they would have been had a higher risk appetite on the part of the hypothetical claimant investor been assumed.
30. This decision of the House of Lords reversed the decision of the Court of Appeal in the same case.¹⁴ The Court of Appeal had concluded that for the purpose of setting the discount rate the claimant was in no different position from the ordinary investor and that treating the claimant as being

¹⁴ [1997] 1 WLR 652.

in some different category would be to place him or her unwarrantably in a privileged position. The Court of Appeal thought that the role of the court was to hold the balance evenly between both sides, so that the claimant got an award as nearly as possible to full compensation but the defendant benefited from the presumption that the claimant would adopt a prudent investment policy. In considering what would be a prudent investment policy the Court of Appeal accepted that equities were more risk-prone than ILGS but did not consider that ILGS were risk free. In the opinion of the Court of Appeal the flexibility of equities as an investment was attractive as against the relative rigidity of ILGS if the estimate of the claimant's future losses and needs turned out to be inaccurate. The Court of Appeal considered that prudent investment required the choice of a basket of investments.¹⁵

Assumptions about claimants

31. The discount rate is set on the basis of investments that it is considered the hypothetical claimant ought to make. Actual claimants are free to spend their awards as they wish. Although actual investment decisions do not dictate the investments to be used in setting the discount rate, the present law may be criticised on the ground that the assumptions about the hypothetical claimant made in *Wells v Wells* are too far removed from reality to be a valid basis for identifying the investments that a hypothetical claimant is reasonably to be expected to make. If the criticisms of the present law are correct the present system is not an efficient way – or perhaps even a fair way – to deliver the principle of full compensation. It may also be an excessively expensive one.
32. Although there is no definitive study of the evidence, there do appear to be some indications that claimants do not invest in the way envisaged by the House of Lords. A number of interested parties have told the Ministry of Justice that in practice many personal injury victims are unlikely to invest solely in ILGS and hold them to maturity. Instead, they suggested that although investors tend to vary in their appetite for market risks mixed portfolios, with an emphasis on income generation rather than capital growth, might be typical for personal injury victims. They gave examples of claimants' investment portfolios that were predominantly based on safe equities and fixed income investments, such as government gilts and corporate bonds, with the use of some alternative investments, including gold, property, hedge funds and cash. These portfolios included both sterling and foreign currency denominated assets. The range of investments in these portfolios is therefore wider than the range of investments permitted to be considered in the setting of the discount rate under the present law.

¹⁵ The Court of Appeal had itself overturned the three separate decisions of the High Court in the cases that were joined together for the appeal. In these cases the High Court had departed from the traditional approach taken by the courts and applied a discount rate based on ILGS.

33. In considering information about investments, allowance may need to be made for the possibility that current investment patterns may not reflect individuals' real preferred risk appetites. This may be for a number of reasons including:
- If claimants are under compensated as a result of an unduly high discount rate they may be forced to invest in a riskier basket of assets in order to generate the returns they require to meet their expenses as they arise.
 - Investment opportunities under ILGS are not available to meet their desired consumption profile.¹⁶
 - The claimant's immediate needs may have reduced the amount of the award available for investment to a greater extent than the claimant would have ideally desired: for example, during negotiations the claimant may have increased the proportion of the overall award taken as a lump sum rather than as periodical payments so as to obtain the capital required to extend or adapt his or her home to make it suitable for occupation.

Thus, investment behaviour at any time may be driven by circumstances and may not actually represent the optimum choice available or desirable in other – perhaps more ideal – circumstances. Some caution should therefore be exercised when deducing from current practice what the hypothetical claimant ought to be expected to do with the lump sum.

The spending of the award

34. Notwithstanding the application of a discount rate claimants are free to spend their lump sum award in whatever way they wish. The defendant is not allowed to dictate the behaviour of the claimant following the injury.

The interests of defendants

35. The identity of the defendant and the extent of the defendant's means to pay cannot define or affect the amount of compensation payable. The effect on the defendant of the setting of the discount rate is therefore irrelevant to the choice of the rate save in so far as the claimant should not be over-compensated.

Criticisms of the present law – investments assumptions

36. In essence, whilst defendants and their funders are in theory protected by the principle of full compensation, the main criticism of the present legal parameters is that they fail to provide a sufficiently realistic estimate of the future rates of return that will be earned by the claimant on the lump sum. In support of this argument it is alleged that there is no evidence that the

¹⁶ See the August Consultation paper paras 65–67.

- funding provided by lump sum awards made to claimants runs out too soon. If this is true, it suggests that the awards are at least adequate.
37. We have not reached any conclusion on the arguments but if claimants do not invest only in ILGS; if independent financial advisers would not generally advise a claimant to do so; or if the range of ILGS investments is not always adequate to provide the kind of risk free investment envisaged by the House of Lords then there is at the least an argument that the discount rate should be calculated on different investment assumptions.
38. If the present assumptions are not realistic, it could be argued that the defendants and their funders are being treated unfairly because the assumptions will be inconsistent with the principle of full compensation which, however imprecise it may be, has to operate in and be assessed against results in the real world. In this respect we note the comment in one of the leading works on the subject of damages, McGregor on Damages, that: "Full compensation for victims of personal injury is a principle which should be rigorously adhered to, but it is thought the application of the new discount rate leads to overcompensation. Probably not fully compensated in the past, the injured victim, certainly the very severely injured one, is to be overcompensated in the future. For the new thinking ignores the hard fact that claimants, like the Court of Protection for their patient claimants, are not in reality going to invest their awards in ILGS and, as the Court of Appeal in effect recognised in *Warriner v Warriner*, do better with their money elsewhere."¹⁷
39. If these arguments are correct, claimants are being treated as a special category of investor in relation to the setting of the discount rate but are acting as more ordinary investors in reality. This would have the result that relative to the expectations informing the award claimants may be over-compensated. A remedy for this problem, if it exists, would be to base the discount rate on more realistic assessments of the way in which lump sum awards for future loss are invested in practice.
40. If any change is to be made in the approach to the setting of the rate then consideration will have to be given to the types of investments that the hypothetical investor would be assumed to make. It seems likely that in this case, as the Court of Appeal decided in *Wells v Wells*,¹⁸ the hypothetical claimant would be assumed to invest in a mixed portfolio of investments so that any risk attached is spread. The question is then what investments should be included in the portfolio.

¹⁷ McGregor on Damages 18 ed para 35–132 p 1373.

¹⁸ See paragraph 30 above.

Criticisms of the present law – availability of periodical payment orders

41. Another criticism that has been made to us is that the discount rate is set without taking into account the availability of periodical payment orders. The argument is that a claimant can wholly or at least largely avoid the risk of future shortfall in meeting loss or expense by taking an award in the form of periodical payments. Therefore, if a periodical payment order is available, a rational knowledgeable claimant would, disregarding extraneous factors, only choose a capitalised lump sum if he or she thought a better investment return could be obtained than the discount rate. In these circumstances, the argument runs, it might be reasonable to suppose that the hypothetical rational claimant would invest in a way consistent with the investing population as a whole – judging which option gives a better return – rather than adopt the necessarily risk averse behaviour assumed under the present law.
42. In consequence, it is said, the claimant who takes a lump sum settlement is turning his or her back on a risk free way to protect his or her position and, as a result, ought not to be able to benefit from a discount rate that assumes the claimant will only invest in low risk investments. Instead, it is argued, the discount rate should be set on a basis that assumes the claimant will invest in higher risk investments.
43. The main counter-argument is probably that the lump sum and the periodical payment are alternative ways to achieve full compensation and that the availability of the one should not have any effect on the other. It can also be argued that even though the court is to take into account the claimant's preferences, the claimant does not necessarily have a free choice between lump sum and periodical payments. Indeed, in some cases, contrary to what might be expected to be the norm, it may be that the defendant or the funder of the compensation is pressing the claimant to accept a periodical payment order.
44. On the other hand, there may be difficulties in allowing for the existence of periodical payment orders in setting the discount rate. In reality claimants may not always choose rationally and may lose out by taking a lump sum calculated on a higher discount rate, when rationally they should have chosen a periodical payment order. Of course, the rate taking the existence of periodical payment orders into account would not be appropriate for cases where they were not available. This could, in principle, be avoided by the existence of (at least) two discount rates but this would add complexity. Having more than one rate may, however, also create the perception of unfairness between different defendants or different claimants.

Setting the discount rate – the hypothetical personal injury claimant – options

45. The issue is whether the current legal parameters for the setting the discount rate produce a rate that is inherently too low so that awards of lump sum damages for future loss are too high and over-compensate

claimants. We therefore wish to establish whether any change needs to be made in the legal parameters governing the investment preferences of the hypothetical claimant. There appear to be two options. We do not express any preference as to what the legal parameters should be.

A.1 No change

46. The first option in relation to the legal parameters governing the setting of the discount rate is to leave the law as it is and to retain the *Wells v Wells* guidelines. This will mean the continuation of a low risk hypothetical investor as the basis for the setting of the discount rate.

A.2 Change the legal parameters used to set the discount rate

47. The second option is to change the legal parameters so as to depart from *Wells v Wells* guidelines in relation to the assumed investment profile of the hypothetical claimant.

Question 4: do you consider that the legal parameters governing the setting of the discount rate should be changed? Please give reasons.

Question 5: if you consider that the legal parameters governing the setting of the discount rate should be changed, what do you think they should be? Please give reasons and define any terms used.

Question 6: if you consider that the legal parameters governing the setting of the discount rate should be changed, what investments do you think the hypothetical claimant should be deemed to make for the purposes of calculating the rate of return? Please indicate the types and proportions of assets that should be included in the hypothetical claimant's portfolio of investments. Please give reasons.

Question 7: do you consider that the availability of periodical payments should affect the level at which the discount rate is set? Please give reasons and indicate what effect you think it should have.

How many rates should be prescribed?

48. We have assumed so far that there will only be one prescribed discount rate. However, section 1(3) of the Damages Act 1996 allows for different rates to be set for different classes of case. Since 2001 in England and Wales and in Northern Ireland (2002 in Scotland) there has, however, only been one prescribed rate.
49. One prescribed rate promotes greater certainty and avoids the problem of attempting to distinguish between different types of cases, which could lead to satellite litigation and all the wasteful expenditure it entails. However, the greater flexibility of two or more rates might help produce greater overall accuracy in the calculation of awards of damages as a range of rates might create a better match to a greater range of circumstances.

50. Despite the inevitable difficulties that would affect borderline cases, it is therefore for consideration whether it might be preferable to have more than one prescribed rate. The power to set different rates could, for example, be used to specify different discount rates for awards of different periods of time or for different types of expenses.
51. In relation to time periods, it is generally the case that the longer the period of time that the award is to cover the higher the discount rate would be expected to be because investment returns tend to be higher for longer maturities. We note that in Ontario, for example, a different rate applies after 15 years and it may be that it is at or around this period of time that different assumptions should come into play because differences in the discount rate are likely to have a greater effect on awards of longer duration.¹⁹ It may therefore be appropriate to specify different rates in respect of longer and shorter periods. Under the Ontario approach the rate applicable to less than 15 years follows current rates and is changed regularly.²⁰ The longer term rate is set on a different basis reflecting assumptions about longer term yields.²¹
52. In relation to different types of expenses, we note that the Judicial Committee of the Privy Council has said in the case of *Simon v Helmot*²² that if the evidence shows that inflation will affect different heads of loss in different ways and that the differential is capable of being evaluated, the court should not close its mind to using different [discount] rates. The rationale was that to do otherwise would be to fail to provide full compensation. This case related to Guernsey law but the principle could be applied in England and Wales, Scotland and Northern Ireland.

When should the prescribed rate be disapplied?

53. Section 1(2) of the Damages Act 1996 makes clear that the court can take a different rate of return into account if one of the parties shows that this is more appropriate than the prescribed discount rate. In 2001 the then Lord Chancellor referred to this provision as permitting the court to depart from the rate he had prescribed in exceptional circumstances.
54. We are not aware that the court's power to apply different rates has caused any problems and assume that it provides an adequate safeguard for cases where the prescribed rate is not appropriate. At the very least

¹⁹ This approach was adopted following the "Report of the Subcommittee of the Civil Rules Committee on the Discount Rate and Other Matters" in 1998.

²⁰ Rule 53.09(1) of the Rules of Civil Procedure applicable in Ontario requires that the courts use the rate observed on real return bonds for the 12 months ending August of the year preceding the date of calculation, less one percent, rounded to the nearest one quarter percent. The rate was 0% in 2012 and is -0.5% in 2013.

²¹ A general discount rate of 2.5% was adopted following a "Report to the Committee of the Supreme Court of Ontario on Fixing Capitalization Rates in Damage Actions" in 1980. This rate has become the longer term rate.

²² [2012] UKPC 5.

such a power enables justice to be done in cases that have facts far removed from the norm. However, notwithstanding various attempts to persuade it to do so, the court has rarely, if ever, applied a different rate and it is difficult to know when the court would actually exercise its power. The absence of problems may therefore be as much a reflection of lack of use as anything else.

55. One attempt was based on the fall in returns from ILGS. However, the court did not find any exceptional circumstances in the case, with one of the judges analysing the attempt as a criticism of the prescribed rate and another justifying non-interference by reference to the ability of the claimant to invest in higher earning investments than ILGS.²³ Other unsuccessful attempts have been made on the grounds of tax liabilities and earnings inflation.²⁴
56. The court's present restrictive approach is consistent with the logic that the prescribed rate is intended by Parliament to be the rate generally applied, but in view of its lack of use, it is for consideration whether the court should retain the power to set a different rate from that prescribed and if so whether it might be desirable for the court to be more willing to apply a specially determined rate in the future. If such a change were to be encouraged, we should need to consider whether there should be any specific guidelines to assist the court in deciding whether to exercise the discretion.

A single rate, a default rate – questions

Question 8: Should the court have power to depart from the prescribed rate and, if so, should the terms on which it may do so be expressly defined? Please specify the terms and give reasons.

Question 9: Should the power to prescribe different rates be available for:

- a. Different classes of case?
- b. Different periods of time over which damages are paid?
- c. Different heads of damages?
- d. Cases where periodical payment orders are available and where they are not?

and, if so, for which classes, periods or heads would you specify different rates. Please give reasons.

²³ Warriner v Warriner [2002] 1 WLR 1703 CA: Dyson LJ at 1712B and Latham LJ at 1713B.

²⁴ See Warren v Northern General Hospital NHS Trust (No 2) [2000] 1 WLR 1404 CA and Cooke v United Bristol Healthcare NHS Trust [2004] 1 WLR 251 CA.

Calculating the prescribed rate

Calculating future rates of return

57. Settling the overall risk profile of the hypothetical claimant investor defines the investment assets that will form the basis for the setting of the rate, but does not provide any guidance as to how the rate should actually be set. The methodology ultimately adopted for the setting of the rate if the law is changed will affect the rate chosen. This choice may be all the more difficult and complicated in the case of a mixed portfolio than in relation to the narrower range of investments allowed by the present law. If, therefore, it is decided to change the legal parameters for the setting of the discount rate, consideration will have to be given to the same types of methodological issues relating to how the rate should be set that are being considered in relation to the existing legal base in the August Consultation Paper.
58. Questions that will need to be answered include: How is the predicted rate of return to be estimated? What averages should be used? From what data? Over what period of time?
59. These questions can be applied to a whole spectrum of choices which reflect different methodologies and risk appetites, including:
 - Identifying historical returns over appropriate periods from the relevant set of assets.
 - Identifying current returns from the relevant set of assets.
60. Each of these options could be applied to a wide range of different baskets of asset classes, some of which may be denominated in foreign currencies, and could include various combinations of:
 - Gilts (including index-linked gilts)
 - Stocks and shares
 - Corporate bonds
 - Commodities (e.g. gold)
 - Property
 - Cash/Money market
 - Alternative investments such as hedge funds, artworks or luxury items.
61. When the appropriate investments have been identified, it will need to be decided how their respective rates of return are to be calculated for the purposes of setting the discount rate. It may or may not be that there will be authoritative indices from which suitable averages can be worked out.
62. In theory, there are several models and methods which could potentially be used to forecast future investment rates of return. These different

methods essentially offer trade-offs between the principles of accuracy and stability outlined previously.²⁵

63. It can, for example, be argued that averaging past performance to remove volatility is only useful if past average yields are a good guide to future performance. Some of the interested parties to whom we spoke²⁶ stressed that current market conditions are significantly different from the recent past and, therefore, the historic performance of investments is not necessarily a good guide to what returns are available for individuals investing now. In this respect, standard financial economics would suggest that current market conditions, whether current yields or current implied yields on investing in the future (i.e. using 'yield curves' or 'forward rates') may be the best predictor of future returns, which is particularly relevant to achieving an accurate discount rate.
64. Using an average of real yields reduces the risk of setting a rate based on extreme market conditions which are not representative of market conditions generally. However, although using current rates of return may provide the most accurate discount rate, the rate may have to be updated frequently to maintain accuracy in light of changing economic conditions. If this is not done, the discount rate may be artificially low or high relative to longer cycles. This could mean that, given the then current conditions at the time the award is made, claimants are over-compensated or under-compensated because economic conditions have changed since the rate was set.
65. On the other hand, long term averages²⁷ could, provide a more stable rate as they provide a guide to past performance.²⁸ The disadvantage of relying on longer term trends, rather than the present is, of course, a potential loss of accuracy, given that there is no guarantee that market conditions at any given time will be close to the long term average.
66. Using an average of real yields over some shorter period is one way to potentially balance the requirements for accuracy and stability, while avoiding reliance on either a potentially inaccurate long term rate or potentially unstable day to day returns.

²⁵ See para 21 above.

²⁶ See para 32 above.

²⁷ 1, 3 or 5 years periods are typically used but consideration might be given to very long periods of, say, 50 years.

²⁸ See, for example, MILLENNIUM BOOK II 101 Years of Investment Returns Elroy Dimson, Paul Marsh and Mike Staunton London Business School 2001 and the Barclays: Equity Gilts Study (www.barcap.com/egs/).

Other factors to be considered in setting the discount rate

67. Other factors that may have to be considered in assessing the return to be earned by the hypothetical claimant in relation to a mixed portfolio include taxation, investment advice and management expenses and, perhaps above all, inflation.
68. In relation to the treatment of tax in respect of the discount rate the House of Lords in *Wells v Wells* commented that the discount rate should take into account standard rate tax and that higher or unusual rates of tax could be the subject of an appropriate adjustment in individual cases.²⁹ It is for consideration whether this is still an appropriate conclusion.
69. Similarly, it will need to be decided if any allowance should be made to compensate claimants for future investment expenses related to managing their asset portfolio. The kind of costs that we have in mind relate to the setting up and management of investment portfolios. The more complicated the choice of investments within the portfolio used to calculate the discount rate, the greater the investment costs would be likely to be for a claimant replicating that approach in practice.
70. Inflation is to a large extent taken care of where investments are index-linked but in a mixed portfolio there are likely to be other types of investments and inflation will need to be taken into account in some way. It will therefore need to be decided how to adjust yields on non-index-linked assets for inflation. One method is to look at the long term difference in returns between the asset and index-linked gilts. Another would be to derive a long term inflation assumption from current or historic market information. Care would have to be taken to ensure this was consistent with the calculation of the returns on the asset under consideration.
71. There is also a question of whether the discount rate (or rates) set should take different indices used to measure inflation into account³⁰ (possibly setting different discount rates for different heads of claim) or whether the objectives of simplicity and transparency imply that ignoring these differences and setting one rate is preferable, even at the cost of some accuracy. For example, if ASHE 6115 exceeds retail price index inflation and periodical payments are linked to the former, what should happen to any lump sums affected by a discount rate calculated by reference, in whole or part, to the latter?
72. The discount rate is in practice generally applied through the use of the Ogden Tables. If the Ogden Tables are to continue to be used, the prescribed rate will have to be set at a rate for which figures are given in

²⁹ [1991] 1 AC 345, 393E: Lord Hope said that the impact of higher rate tax on particular awards in exceptional cases should be dealt with in the manner described by Lord Oliver of Aylmerton in *Hodgson v Trapp* [1989] 1 AC 807, 835D–E.

³⁰ For example, ASHE 6115, the Retail Price Index and Consumer Price Index.

the Tables. At present the Ogden Tables provide figures at half percentage points, but could, we understand, be relatively readily amended to include quarter percentage points. In either case there is an issue whether the rounding should be strictly mathematical or capable of being influenced by other factors as at present. Rounding is perhaps a useful reminder that setting the discount rate inevitably involves some approximations.

Lump sum payments – method of calculating the rate – options and questions

73. The actual calculation of the rate within agreed parameters raises a range of questions concerning the detail of how the discount rate should be calculated and requires consideration of the techniques to be adopted to produce the 'right' discount rate. We do not make any provisional recommendation as to how the rate should be set, but there seem to be two broad options. We would welcome replies to the following questions.

B.1 No change

74. This option only applies if a methodology consistent with *Wells v Wells* is retained.

B.2 Identify a methodology

75. This option would lead to the adoption of a methodology suitable for setting the discount rate by reference to a hypothetical claimant with a risk appetite higher than that permissible under the current legal parameters governing how the discount rate is set.

Question 10: if you consider that the legal base for setting the rate should be changed, what methodology should be used to set the rate, including:

- a. What quantitative and qualitative data should be used (e.g. historic or forward looking, specific indices)?
- b. What assumptions should be made (e.g. asset mix, weighting of assets)
- c. How should inflation be taken into account?
- d. What allowances should be made for tax, administration or management expenses and investment expenses?

Please give reasons.

PART 3 – THE PERIODICAL PAYMENT ISSUES

Introduction

76. In this Part of the paper we examine whether there is a case for encouraging the use of periodical payments. This part of the paper is primarily relevant to the law of England and Wales and Northern Ireland only³¹ although the Scottish Government would be welcome views on the use of periodical payment orders in the Scottish courts.

Periodical payments – background

77. Traditionally, damages had to be paid in a once and for all lump sum. This approach was modified by the emergence of structured settlements in the 1990s and then changed when section 2 of the Damages Act 1996 allowed the court to award periodical payments with the consent of the parties. This power was initially little used, but the law was then further amended³² for England, Wales and Northern Ireland, with effect from April 2005 so that the court could make periodical payment orders without the consent of the parties. This led to an increase in use in England, Wales and Northern Ireland but the IUA Study indicates that the use of periodical payments only “took off” when the court adopted ASHE 6115 (an earnings related index)³³ rather than the Retail Price Index in 2008.³⁴ The IUA Study estimates that the NHSLA³⁵ alone in 2010/11 was party to 930 periodical payments orders and that the average initial periodical payment was in the region of £70–80,000. These payments were accompanied by lump sum payments in the region of £1.3–£1.5 million.³⁶
78. The IUA Study’s view appears to be corroborated by the following quotation from the NHSLA annual report for 2012³⁷: “Many claimants, especially in maternity incidents, are best served by receiving their damages payments over the period of their life, usually in annual amounts to pay for their continuing needs. We encourage these Periodical Payment Orders for most high value, personal injury claims which are likely to extend over a long period, because they represent the fairest method of payment both for the recipient and for the NHS. The financial provision necessary to cover these large liabilities has been identified by the NHSLA and had increased by more than 26% at the year-end to £3,040m across 1,116 Orders (up by 20%).”

³¹ See paragraph 9.

³² Courts Act 2003, s 100.

³³ Annual Survey of Hours and Earnings.

³⁴ IUA Study p 2.

³⁵ National Health Service Litigation Authority.

³⁶ IUA report Tables 1 and 2 pp 19 and 20.

³⁷ At page 16.

79. The IUA Study states that the numbers of periodical payments funded by insurers (overwhelmingly through the Motor Insurers Bureau) are now not very far behind the NHSLA's. This would suggest that about 200 to 250 periodical payment orders are being made annually.
80. The IUA Study and the GIRO Report indicate that the vast majority of damages awarded by way of periodical payments are in respect of future care and case management costs linked to ASHE 6115 as the recalculation index. The second most common loss to be met by periodical payments is loss of future earnings but this occurs in far fewer cases.
81. Periodical payments orders can take a number of forms. They can be variable: that is the amounts payable can be reassessed in the light of changing circumstance: for example, significant deterioration or improvement of the claimant's condition. Very few of these orders are thought to be made. Stepped orders, where the amount payable from time to time varies in accordance with the order as originally made, are more common. The most common form of periodical payment orders are orders where the payments can simply be index-linked to a variety of indices, including, for example, the Retail Price Index and ASHE 6115.
82. The statutory provisions in the Damages Act 1996 are supplemented in England and Wales by the Civil Procedure Rules and the related Practice Direction and in Northern Ireland by the Rules of the Court of Judicature (Northern Ireland) 1980.³⁸

Periodical payments – factors influencing use

83. Typically, claimants are thought to be in a more secure position with a lifetime periodical payment award than a lump sum. Periodical payments reduce or remove the need to argue about life expectancy in litigation as they transfer the risk of longer than expected life from the claimant to the defendant, whilst providing a benefit to the defendant in the event of early mortality. They are also expected to provide a close match between the award of damages and the actual expenditure needed to meet the anticipated expenses and losses when they are actually occur. This should remove much of the risk associated with the application of the discount rate to lump sum payments.

³⁸ Rule 41.7 of the CPR and, in Northern Ireland, rule 14(1), Order 37 of the 1980 Rules. The court must have regard to all the circumstances of the case and must consider which form of award would best meet the claimant's needs, having regard to the factors set out in the Practice Direction 41B and in Northern Ireland the factors set out in rule 14(2) in Order 37 of the 1980 Rules. These factors include the preferences of the claimant and defendant and the reasons for them and the requirement that the continuity of payment must be reasonably secure. See also Damages Act 1996 s 2(3) and (4).

84. Periodical payment orders should therefore create stability and certainty of income for claimants as they transfer the investment risk of producing the required amount of money at the required time (and the related investment advice costs) from claimants to defendants. The claimant does not have to manage his or her investments to try to match the assumed rate of return applied in the calculation of the lump sum. On the other hand, the defendant will have the cash-flow advantage of making periodical payments instead of a lump sum payment and the opportunity to try to outperform the indices to which the periodical payments may be linked.³⁹
85. The periodical payments are also received tax free by the claimant, which removes another uncertainty from the calculation of the amount of money needed.
86. However, as the continued predominance of lump sum awards would appear to indicate, claimants may well prefer that lump sum payments form the whole or part of an award. Some claimants need to lay out considerable capital sums in the purchase of property or equipment and these payments may be difficult to accommodate within anything other than an award that at the least includes a lump sum. This requirement seems likely to continue particularly in the case of seriously injured claimants, albeit the discount rate will have no application in relation to immediate expenditure.
87. Claimants' preferences may also depend on general factors such as the prevailing economic climate and the rate of increase of earnings. They may also be affected by very personal matters, such as a desire to take control of the money, to make a clean break from the defendant or to provide a lump sum inheritance for their families or others in the event of early death. For defendants, other factors holding back their use of periodical payments include whether general insurers can find a cost effective solution to enable them to pass on their liability and achieve finality.
88. Defendants may be thought to have the most to gain from sticking with lump sum awards whilst the discount rate is thought by some to be relatively high, but it is interesting that among the leading users of periodical payment orders are the NHSLA and the Motor Insurers Bureau. There are, however, costs as well as benefits associated with postponing the payment of damages by way of future periodical payments rather than present lump sums. Defendants could be affected by the administrative and balance sheet effects of financing periodical payment orders rather than lump sum awards: for example, they have to meet the cost of administering the payments (whether they do so directly or outsource the work); they may also have to make provision for the future liabilities in their accounts or incur the cost of insuring the liabilities in question. We

³⁹ Typically for care costs ASHE 6115.

are not able, at this stage, to reach a simple answer to the question of whether periodical payments cost more or less than lump sum awards.

89. Another important factor for claimants and defendants is whether the security of the future payments is sufficiently secure. This may depend on the availability in the market of appropriate financial investment products, such as annuities, to enable the payer to set up the mechanisms to make the payments when they fall due. A defendant might, for example, be able to buy an annuity from a life insurer covered by the Financial Services Compensation Scheme. This would provide the necessary level of security but we understand that this approach is not possible for future care and case management costs because there are no annuities available linked to the appropriate recalculation index, ASHE 6115.⁴⁰
90. The appetite for periodical payments may also be affected by a number of other issues. The IUA Study mentions several including familiarity, a change in the discount rate, the general financial climate, the rate of pay inflation, the implementation of reforms to the civil justice system, the introduction of ASHE linked annuities, and solutions to reinsurance issues. The range of these matters suggests the underlying complexity and interconnectivity of factors that affect decisions about the form of an award of damages.⁴¹

Periodical payments – options and questions

91. In England, Wales and Northern Ireland periodical payments are used in a reasonably significant proportion of cases. We are unsure why they are not used more widely. We would welcome views on why this is the case and whether it would be appropriate to try to increase their use.
92. The following questions relating to the use of periodical payments are relevant primarily to England and Wales and Northern Ireland although views would be welcomed on the use of periodical payments in Scottish courts.

Question 11: do you consider that the present level of usage of periodical payments is appropriate and that no change is necessary? Please give reasons.

Question 12: if not, please indicate the measures that you think should be taken to increase their use. Please give reasons.

Question 13: do you consider that claimants and defendants are sufficiently informed about the availability of periodical payments and how they operate? Please give reasons.

⁴⁰ IUA report para 3.2.14.

⁴¹ IUA Study p 2.

Question 14: why are periodical payment orders not used in a larger proportion of cases? Are there, for example, types of cases where periodical payment orders are not appropriate? Or are there particular costs, obstacles, risks or circumstances which limit the use of periodical payment orders?

Question 15: where periodical payments are used in conjunction with a lump sum, what determines the balance between the lump sum and the periodical payment elements of the overall award of damages?

Question 16 [Scotland only]: do you consider that there would be merit in reviewing the existing approach to periodical payments in Scotland? If so, please give reasons.

PART 4 – IMPACT ASSESSMENTS

93. In this Part of the paper we introduce the impact assessment that we have prepared and consider issues relating to the public sector equality duties. In relation to both we seek further information as to the impact of any changes that might be made as a result of this consultation.
94. Changes to the way the discount rate is set and awards of damages are made up as between lump sums and periodical payments could have significant effects. We have, however, at this stage only limited information and have not been able to quantify the costs or benefits of the options considered. General information about the quantum of damages paid and the number of cases in which awards are made does not assist in understanding the impact of the discount rate because many cases will not include any element of future loss.
95. Additionally, although it is clear that (all other things being equal) if the discount rate is increased the size of capitalised lump sums will reduce and vice versa the size of the effect is far from clear. Also it will not be clear whether the discount rate is likely to increase, decrease or remain the same until the wider questions considered in this consultation have been decided.
96. In particular, we have only limited information about the effect of the present discount rate on the size of awards of damages and as to the likely effect of a change in the rate on the size of awards in the future. The same is true as to the extent to which awards made under the present law turn out to be inadequate. The IUA Study and the GIRO Report give an insight into the use of periodical payments but we would still like a much better understanding of when periodical payments are used and the reasons why they are not used. We are also unclear of the effect of periodical payments on the overall long term total cost of awards.
97. Claims of damages for future loss caused by personal injury are almost always initially calculated by using the Ogden Tables, which take into account actuarial factors in computing the appropriate quantum of damages for particular claimants. However, we understand in practice that this initial quantification of the claim is generally the subject of negotiation and by the time a settlement is reached it is often difficult to make a direct link between the individual component figures produced by the use of the Ogden Tables and the overall figure settled on by the parties.
98. The direct link between the discount rate and the size of the final award may be further weakened by the make up of the award. The IUA Study indicates that in practice where periodical payments are made initial capital expenditure is sometimes met by 'borrowing' from other heads of loss.⁴² We do not know if this is a serious problem but having to do this

⁴² IUA Study 5.5.3a.

suggests that the underlying structure of the award does not match the requirements of the claimant used to calculate the award, which further obscures the effect of the discount rate.

99. We would therefore welcome further information about the impact of the discount rate and the possible impacts of the changes that we have discussed so that the impact assessments can be developed.
100. We may be able to obtain some of the desired further information on this topic from the research into the personal injury discount rate currently being carried out on behalf of the Ministry of Justice (albeit the research is based on a small sample). This may possibly be supplemented by looking at other types of similar investors, such as pensioners as a proxy. This may be appropriate as pensioners have similar investment requirements (guaranteed returns over some period without the option of returning to work if investments fail). However, we are also intending and expecting this consultation to be a source of more information.

Impact assessment

101. An impact assessment has been prepared to accompany this consultation. The impact assessment assesses two principal options:
 - Change the parameters used to set the discount rate to reflect a mixed portfolio of financial assets rather than ILGS alone; and
 - Encourage greater use of periodical payment orders.
102. The impact assessment takes the current discount rate of 2.5% as the base case to which the outcomes of the options can be compared. Should this rate be changed as part of the review of which the August Consultation Paper forms part, the new rate would form the baseline. Similarly, if the outcome of that consultation is the adoption of a mixed portfolio of assets within the parameters set by the present law, the change in parameters would reflect that different starting point. Reference is made to ILGS alone because that is the basis on which the present rate was set.
103. In the absence of adequate information, the impact assessment concludes that the costs and benefits of the proposals under consideration are not currently quantifiable. As we have mentioned we are using this consultation to obtain more information.
104. At this stage therefore all the impact assessment can conclude is that a change in the legal parameters for the setting of the discount rate may lead to a discount rate that is greater or lower than the current rate of 2.5% (real terms) depending on the investments that are actually chosen as the basis for the determining of the relevant rate of return. In relation to increasing the use of periodical payments, it is assumed that, for a given discount rate, periodical payments and lump sum payments represent the same overall award for compensation. Increasing the use of periodical payments may therefore be viewed as transferring investment and

mortality risks from claimants to defendants. As such, the costs and benefits of periodical payments to claimants and defendants would depend in part at least on their willingness and ability to invest lump sums and whether, on average, they would generate a return greater than the discount rate.

105. These are very general conclusions and we would therefore welcome views on the impact assessment and the effect of the changes under consideration.

Question 17: Do you agree with the impact assessment that accompanies this consultation paper? If not, please give reasons.

Question 18: Do you have any information regarding: the effect of the current discount rate on the size of awards of damages and as to the likely effect of a change in the rate on the size of awards in the future; on whether awards made under the present law turn out to be inadequate; on the reasons why periodical payments are used; the effect of periodical payments on the overall long term total cost of awards; or on any other issues relevant to the assessment of the impact of the proposals under consideration? If so, please could you provide details.

Regulation

106. In implementing any changes to the law we will need to consider whether they amount to regulation of business or voluntary sector organisations. Regulation for these purposes is “[a] rule or guidance with which failure to comply would result in the regulated entity or person coming into conflict with the law or being ineligible for continued funding, grants or other applied for schemes. This can be summarised as all measures with central force imposed by central government and other schemes operated by central government.”⁴³ Whilst the discount rate can clearly have a significant effect on businesses, particularly in the insurance industry, we do not consider that the setting of the prescribed rate, which is in law only a factor to which the court must have regard in determining the size of a lump sum award for future pecuniary loss in personal injury cases,⁴⁴ or the possible encouragement of periodical payments can be described as regulation in this sense.

Question 19: do you consider that a change in the approach to setting the discount rate or any encouragement of the use of periodical payments would affect the behaviour of businesses or voluntary sector organisations? If so, please give reasons.

⁴³ One-In, One-Out (OIOO) Methodology July 2011 para 13.

⁴⁴ Damages Act 1996, s1.

Small Firms

107. We do not expect that changing the parameters within which the discount rate can be set or encouraging the use of periodical payments as opposed to lump sum awards (in whole or in part) will have any different effect on small businesses than on any one else. We will, however, be making enquiries of small firms to seek their views and would welcome any views on this issue in response to this consultation paper.

Question 20: do you consider that a change in the approach to setting the discount rate or any encouragement of the use of periodical payments would have any direct affect on small or micro-businesses? Please give reasons.

Question 21: do you consider that a change in the approach to setting the discount rate or any encouragement of the use of periodical payments must apply to small and micro-businesses as it applies to others? If not, please give reasons.

Equality Issues

108. Section 149 of the Equality Act 2010, the Public Sector Equality Duty (PSED), provides that:

“A public authority, must in the exercise of its functions, have due regard to the need to-

- (a) eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under this [the 2010] Act;
- (b) advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it;
- (c) foster good relations between persons who share a relevant protected characteristic and those who do not share it.”

109. We accordingly need to consider whether and, if so, how any of the changes under consideration might impact on people with protected characteristics: (disability, race, sex, gender reassignment, age, marriage and civil partnership, religion and belief, pregnancy and maternity, and sexual orientation).

110. In relation to Northern Ireland, under section 75 of the Northern Ireland Act 1998, the Department of Justice is required to have due regard to the need to promote equality of opportunity between persons of different religious belief, political opinion, racial group, age, marital status or sexual orientation; between men and women generally; between persons with a disability and without; and between persons with dependents and without. The Department is also required to have regard to the desirability of promoting good relations between persons of different religious belief, political opinion or racial group.

111. There is no comprehensive database regarding either the payments made under the present law or the persons paying or receiving them. We hope to be able to form a clearer assessment of the likely impacts from the response to this consultation and from other sources, including the research the department commissioned to provide more evidence on which to assess the effect of a change in the discount rate.⁴⁵
112. In the context of personal injury claims, factors such as age and sex may also, for example, have a bearing on the duration of awards. Whilst it remains unknown what the impacts of these factors might be, it could be that some groups might be differently affected by the choice of basis for setting the discount rate or rates or the choice of periodical payments rather than a lump sum than others.
113. Our initial assessment is that personal injury claimants may be more likely to have a disability (for example, as a result of an accident that is the subject of their claim) when compared to the population as a whole. It seems likely therefore that a higher proportion of persons with a disability than people generally might be adversely affected by changes to the discount rate as a result of the adoption of higher risk assumptions regarding investments. Defendants would be likely to benefit and claimants to lose out correspondingly if the discount rate were to be higher in future compared to the rate that would have been set under the current law. If the rate decreased relative to the level at which it would have been set under the present law, the opposite would be true.⁴⁶
114. However, it is not clear whether particular groups of claimants with protected characteristics will be affected differentially by the changes to the discount rate (for example, whether male claimants will benefit differentially more than female claimants). This is because while the same investments are available to all claimants, irrespective of their characteristics, we do not know the protected characteristics by the time profile of payments (for instance whether males are more likely to receive longer injury payments than females, and how much these might be). Certain groups may be more likely to occupy different segments of this time profile distribution and thus be impacted differentially by the proposals.
115. Periodical payments should in principle provide life long full compensation for claimants. They appear to be predominantly used in serious brain and spinal injury cases with long term large awards of damages. If there is a case to do so, increasing their use in appropriate cases might provide the basis for positive equality impacts but not if they are used in inappropriate cases.

⁴⁵ See paragraph 100.

⁴⁶ An equality screening completed by the Department of Justice, Northern Ireland in relation to its statutory duties under section 75 of the 1998 Act is available on the Department's website.

116. We cannot predict at this stage what the outcome will be. In theory, the outcome could be that the discount rate remains at the current level, in which case there would be no change to existing equality impacts. If the rate changes or the use of periodical payments is encouraged, we think it unlikely that there will be no equality impacts, but will be looking at the consultation responses and information from other sources to consider further the equalities impacts. The scale and nature of these equality impacts will be determined by changes made and the characteristics of the claimants receiving damages awards as well as the characteristics of the defendants paying damages, in the instances where defendants are individuals.

117. To help us consider the equality impacts of the issues under consideration we would also welcome evidence of any ways in which the current discount rate affects people with these different protected characteristics.

Question 22: do you agree with the initial assessment of the equalities impacts of the possible changes under discussion in this consultation paper? If not, please give reasons.

Question 23: if you consider that the changes under consideration in this consultation paper in relation to the discount rate or the use of periodical payments will affect people with different protected equality characteristics please give reasons and provide evidence of any ways in which this will occur?

PART 5 – QUESTIONNAIRE

We would welcome responses to the following questions set out in this consultation paper either generally or specifically in relation to one or more of the jurisdictions in the United Kingdom. In providing your responses to these questions, it would be helpful if you could include any analysis or evidence you have to support your responses, drawing on experience of other sectors or countries as appropriate.

General Issues

Question 1: do you agree that the general principles of accuracy; transparency and simplicity and stability should be used to assess the appropriateness of proposed solutions? If not, please give reasons.

Question 2: do you agree that accuracy is the most important of these three general principles? If not, please give reasons.

Question 3: are there any other issues relating to the setting of the discount rate and the possible encouragement of the use of periodical payments that you would wish to draw to our attention? Please give reasons.

Discount Rate

Question 4: do you consider that the legal parameters governing the setting of the discount rate should be changed? Please give reasons.

Question 5: if you consider that the legal parameters governing the setting of the discount rate should be changed, what do you think they should be? Please give reasons and define any terms used.

Question 6: if you consider that the legal parameters governing the setting of the discount rate should be changed, what investments do you think the hypothetical claimant should be deemed to make for the purposes of calculating the rate of return? Please indicate the types and proportions of assets that should be included in the hypothetical claimant's portfolio of investments. Please give reasons.

Question 7: do you consider that the availability of periodical payments should affect the level at which the discount rate is set? Please give reasons and indicate what effect you think it should have.

Question 8: Should the court have power to depart from the prescribed rate and, if so, should the terms on which it may do so be expressly defined? Please specify the terms and give reasons.

Question 9: Should the power to prescribe different rates be available for:

- a. Different classes of case?
- b. Different periods of time over which damages are paid?
- c. Different heads of damages?

- d. Cases where periodical payment orders are available and where they are not?

and, if so, for which classes, periods or heads would you specify different rates. Please give reasons.

Question 10: if you consider that the legal base for setting the rate should be changed, what methodology should be used to set the rate, including:

- a. What quantitative and qualitative data should be used (e.g. historic or forward looking, specific indices)?
- b. What assumptions should be made (e.g. asset mix, weighting of assets)
- c. How should inflation be taken into account?
- d. What allowances should be made for tax, administration or management expenses and investment expenses?

Please give reasons.

Periodical Payments

Question 11: do you consider that the present level of usage of periodical payments is appropriate and that no change is necessary? Please give reasons.

Question 12: if not, please indicate the measures that you think should be taken to increase their use. Please give reasons.

Question 13: do you consider that claimants and defendants are sufficiently informed about the availability of periodical payments and how they operate? Please give reasons.

Question 14: why are periodical payment orders not used in a larger proportion of cases? Are there, for example, types of cases where periodical payment orders are not appropriate? Or are there particular costs, obstacles, risks or circumstances which limit the use of periodical payment orders?

Question 15: where periodical payments are used in conjunction with a lump sum, what determines the balance between the lump sum and the periodical payment elements of the overall award of damages?

Question 16 [Scotland only]: do you consider that there would be merit in reviewing the existing approach to periodical payments in Scotland? If so, please give reasons.

Impact assessment

Question 17: Do you agree with the impact assessment that accompanies this consultation paper? If not, please give reasons.

Question 18: Do you have any information regarding:

- the effect of the current discount rate on the size of awards of damages and as to the likely effect of a change in the rate on the size of awards in the future;
- on whether awards made under the present law turn out to be inadequate; on the reasons why periodical payments are used;
- the effect of periodical payments on the overall long term total cost of awards;
- or on any other issues relevant to the assessment of the impact of the proposals under consideration?

If so, please provide details.

Question 19: do you consider that a change in the approach to setting the discount rate or any encouragement of the use of periodical payments would affect the behaviour of businesses or voluntary sector organisations? If so, please give reasons.

Small Firms

Question 20: do you consider that a change in the approach to setting the discount rate or any encouragement of the use of periodical payments would have any direct affect on small or micro-businesses? Please give reasons.

Question 21: do you consider that a change in the approach to setting the discount rate or any encouragement of the use of periodical payments must apply to small and micro-businesses as it applies to others? If not, please give reasons.

Equalities impacts

Question 22: do you agree with the initial assessment of the equalities impacts of the possible changes under discussion in this consultation paper? If not, please give reasons.

Question 23: if you consider that the changes under consideration in this consultation paper in relation to the discount rate or the use of periodical payments will affect people with different protected equality characteristics please give reasons and provide evidence of any ways in which this will occur?

Thank you for participating in this consultation exercise.

About you

Please use this section to tell us about yourself

Full name	
Job title	
Capacity in which you are responding to this consultation exercise (select all which apply)	Legal representative: <input type="checkbox"/> claimant/plaintiff/pursuer <input type="checkbox"/> defendant/defender <input type="checkbox"/> Insurer <input type="checkbox"/> Judiciary <input type="checkbox"/> Financial institution <input type="checkbox"/> Academic <input type="checkbox"/> Public sector body <input type="checkbox"/> Business <input type="checkbox"/> Equality group <input type="checkbox"/> Member of public <input type="checkbox"/> Other [please state]
Date	
Company name/organisation (if applicable):	
Address	
Postcode	
If you would like us to acknowledge receipt of your response, please tick this box	<input type="checkbox"/>
Address to which the acknowledgement should be sent, if different from above	

If you are a representative of a group, please tell us the name of the group and give a summary of the people or organisations that you represent.

Contact details/How to respond

Please send your response by 7 May 2013 to:

**Damages discount rate consultation
Ministry of Justice
Criminal Law and Legal Policy Team
Area 6.21
102 Petty France
London SW1H 9AJ**

Tel: 020 3334 6964

Fax: 020 3334 4035

Email: damagesdiscountrate@justice.gsi.gov.uk

Online: www.justice.gov.uk

Extra copies

Further paper copies of this consultation can be obtained from this address and it is also available on-line at <http://www.justice.gov.uk/index.htm>.

Alternative format versions of this publication can be requested from the above address.

Publication of response

A paper summarising the responses to this consultation will be published in three months' time. The response paper will be available on-line at <http://www.justice.gov.uk/index.htm>.

Representative groups

Representative groups are asked to give a summary of the people and organisations they represent when they respond.

Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004).

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as

confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Ministry.

The Ministry will process your personal data in accordance with the DPA and in the majority of circumstances, this will mean that your personal data will not be disclosed to third parties.

Consultation principles

The principles that Government departments and other public bodies should adopt for engaging stakeholders when developing policy and legislation are set out in the consultation principles.

<http://www.cabinetoffice.gov.uk/sites/default/files/resources/Consultation-Principles.pdf>

Annex 1 – Named Consultees

Main professional bodies

Bar Council
General Council of the Bar of Northern Ireland
Institute of Legal Executives
The Actuarial Profession
The Faculty of Advocates
The Law Society
The Law Society of Northern Ireland
The Law Society of Scotland

Main representative groups

Association of British Insurers (ABI)
Association of Personal Injury Lawyers (APIL)
Association of Run-Off Companies
Civil Justice Council
Convention of Scottish Local Authorities (CoSLA)
Federation of Small Businesses
Federation of Small Businesses Northern Ireland
The Forum of Complex Injury Solicitors (FOCIS)
The Forum of Insurance Lawyers (FOIL)
The Forum of Scottish Claims Managers
Her Majesty's Council of Circuit Judges
Her Majesty's Council of County Court Judges (Northern Ireland)
High Court Judges Northern Ireland
Judges of the Court of Session
Medical Protection Society
Medical Defence Union
Medical and Dental Defence Union of Scotland
Motor Accident Solicitors Society (MASS)
Motor Insurers' Bureau
Office of the Lord Chief Justice of Northern Ireland

Sheriffs Association

Equality groups

Age Concern Cymru

Age Scotland

Age Northern Ireland

Age UK England

Black and Ethnic Minority Infrastructure Scotland

Capability Scotland

Carers Northern Ireland

Children First Scotland

Children in Northern Ireland

Children's Law Centre Northern Ireland

Children's Society

Churches Together in Britain and Ireland

Council of Ethnic Minority Voluntary Sector Organisations

Disability Action Northern Ireland

Engender

Equality Commission for Northern Ireland

Equality Network

Families and Friends of Lesbian and Gays

Fawcett Society

Gender Identity Research and Education Society (GIRES)

Glasgow Women's Library

Headway

Inclusion Scotland

Independent Living in Scotland

Institute for Race Relations

Interfaith Network for the UK

LGBT Youth Scotland

Muslim Council

Northern Ireland Council for Ethnic Minorities

Northern Ireland Gay Rights Association

Northern Ireland Human Rights Commission

Network of Sikh Organisations in the UK

Papworth Trust
Race Equality Foundation
RADAR
Rene Cassin
Scottish Disability Equality Forum
Scottish Human Rights Commission
Scottish Inter-Faith Council
Scottish Refugee Council
Scottish Transgender Alliance
Scottish Women's Convention
Stonewall Scotland
The Gender Trust
The Hindu Council UK
UK Disabled People's Council
Womens Aid
Women's Forum Northern Ireland

In accordance with standard practice, copies are also being sent to:

- the Clerk of the Scottish Parliament's Justice Committee, to the Scottish Parliament's Information Centre and to all Scottish MEPs;
- the Clerk of the Northern Ireland Justice Committee and the Speaker of the Northern Ireland Assembly.

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