



DAMAGES ACT 1996: THE DISCOUNT RATE - REVIEW OF THE LEGAL FRAMEWORK CONSULTATION

RESPONSE BY THE CIVIL JUSTICE COUNCIL

The Civil Justice Council (CJC) welcomes the opportunity to respond to the Damages Act 1996 consultation paper¹. There is no doubt that an effective mechanism is needed to enable the discount rate to be reviewed regularly. Such a mechanism needs to be designed carefully both to ensure that the discount rate is properly calibrated, while not giving rise to any unnecessary cost or delay while parties postpone resolving proceedings pending any anticipated change.

Before turning to the specific points, the CJC makes the following general observations.

General Observations

The CJC has a general concern regarding the reform proposals, as they and the assumptions on which they are based, appear to lack sufficient, if any, evidence-base. There is little to no hard evidence underpinning many of the points made in the consultation, a fact acknowledged at paragraph 103 of the Consultation. Before any change is made to the discount rate, clear evidence is needed of the numbers of claims that are settled with a lump sum payment and those that are settled with a periodical payment order (PPO), as well as into how claimants receiving large sums of damages decide to spend and invest their awards.

¹ Consultation Paper CP12/2012

The CJC is also concerned that the consultation does not give sufficient weight to the need to take account of the effect that an individual claimant's circumstances might have on their decision, on proper legal and financial advice, to pursue either a lump sum or periodical payment.

The CJC is convinced that periodical payments are an effective means of securing an appropriate level of compensation over a claimant's lifetime. Anecdotally, it appears however that there may still be some resistance on the part of both claimant lawyers and compensators to pursue the use of periodical payment awards.

The CJC suggests that such evidence will bear out the point, and that, in respect of claimants it may arise through a combination of the following reasons, both real and perceived:

- (i) A general decline in confidence in the wider financial system may affect the level of trust of claimants in ongoing payments of any kind;
- (ii) The risk of funder insolvency;
- (iii) The effect of *Roberts v Johnstone* [1989] QB 878 and the implications for those wishing to recover the costs of adapted accommodation;
- (iv) A possible selection bias among claimants, with those whose with a short expected lifespan preferring a lump sum, while those whose diagnosis is less certain, or who have a longer lifespan, preferring the certainty of an ongoing annual payment;
- (v) A sense among claimants that a defendant who makes an annual payment (rather than a lump sum) is somehow 'holding back'. Similarly, claimants may not wish to have a continuing relationship with the insurance company, or other compensator that they associate with their accident;
- (vi) Inadequate training or awareness of the nature of periodical payments and the circumstances in which they might be considered beneficial among some claimant (and defendant) lawyers, and in particular among those firms that do not specialise in personal injury law;
- (vii) The possibility that some claimant lawyers do not have real expertise in providing their clients with financial advice or simply prefer to advise them to opt for a lump sum award as they are more familiar with them.

The CJC is equally concerned that there may be a number of factors that reduce the willingness of compensators (other than the NHS and the MIB) to consider the use of periodical payments awards, such as:

- (i) A perception that they are difficult to put in place and/or could turn out to be more burdensome than lump sum payments;
- (ii) Insurers or other secure compensators, for example, might prefer the finality of a lump sum payment;
- (iii) In order to meet their liabilities under periodical payment orders, regulated insurers are required to put an amount to one side as reserve capital, to keep that reserve up-to-date and to demonstrate to their regulator that they have reserved for their liabilities on a prudent basis;
- (iv) There is also an annual cost associated with maintaining the PPO and recalculating the payments;
- (v) Moreover there are implications regarding the relationship between insurer and their reinsurers.

Given all these variables, some insurers might prefer to make a one-off lump sum payment, so that the ongoing liability is no longer on their books.

The CJC suggests that further research into both claimant and defendant attitudes towards periodical payments needs to be carried out. In particular research should be carried out in the approach taken by solicitors, and the role and importance of independent financial advisers, in this area. The latter appears to be particularly important given the long-term nature of periodical payments.

The CJC's response to the specific issues raised in the consultation is as follows:

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.

The CJC agrees with the general principles. It notes however that there is no reference to fairness. While it might be said that fairness is implicit to the specified general principles, its relevance ought to be made explicit. Fairness is clearly an essential factor in assessing the appropriateness of any solution. The CJC would therefore favour it being added as a further express general principle.

In so far as stability is concerned, while this is clearly important it should not be used to stifle the need to ensure that the rate is revised as regularly as necessary.

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

The CJC agrees that accuracy is the most important of the three general principles, closely followed by transparency and simplicity. Accuracy is the primary means through which both claimants and defendants can have confidence that no more and no less than the proper level of compensation is being provided.

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.

The CJC understands that there may be reasons – real and perceived – for which claimants and defendants are reluctant to use periodical payments, for the reasons set out in the introductory text above.

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.

The CJC does not consider that it would be appropriate to change the legal parameters governing the discount rate in the absence of a clear evidential basis justifying such a reform. *Wells v Wells* [1999] 1 AC 345, and the statement of 100% compensation for claimants, remains essential to the proper reparation for the injured person.

While the assumptions set out in the consultation paper – particularly those relating to claimant behaviour – are not necessarily wrong, they are largely anecdotal, and considerably more certainty is required before fundamental changes can properly be made. Given the likely polarity of opinion between claimant and defendant lawyers and insurers, the likely impact on claimants and the risk of under-compensation and

its subsequent burden on the taxpayer and defendants and particularly on those who are required to make payment i.e., insurers and their clients and the risk of over-compensation to the eventual burden on the premium payers and therefore again the tax payer, any reform however minimal is likely to be controversial and should therefore be based on clear and convincing evidence.

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.

The CJC does not believe that any assumptions can be made about the investments made by a hypothetical claimant.

Research should be carried out in order to assess the factors considered by different claimants and, perhaps, classes of claimants, in arriving at investment decisions. Any generalisation, or introduction of, or instance, a risk matrix such as those used by financial advisers to consider with their clients the nature and type of investments they may choose in the ordinary course of events, must be based on evidence of what actually happens in practice.

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.

The CJC does not consider that the availability of periodical payments should affect the level at which the discount rate is set. The principle on which compensation is given – to render the claimant whole – is the same whether compensation is provided via lump sum or periodical payment. The discount rate should be set so as to ensure that such compensation is provided.

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.

This power already exists: Damages Act 1996 s1(2). The CJC can see no reason why it should not be retained.

The CJC suggests that the judiciary may be reluctant to depart from the set discount rate for two reasons: first, as Parliament has provided that the rate should be set in the ordinary course of events by the Lord Chancellor; secondly, because the power can only be exercised by the judiciary where there is compelling evidence that the set rate is unjustified in any given case. As both parties are likely to need actuarial evidence to demonstrate such a compelling case exists, there are likely to be significant cost and case management implications. Consequently, the CJC believes that guidance on when the judiciary can depart from the set discount rate would be beneficial. That guidance might specify that it would generally require some exceptional feature to justify departure from the set rate, such as the claimant's acute care needs against uncertain longevity, or the amount of a given award, e.g. under £1 million, say, with limited investment potential.

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.

The power already exists: Damages Act 1996, s1(3). The CJC can see no justification for it not being retained. Any more elaborate structure may render the process of setting rates too complex, inaccurate and potentially unfair. The removal of the power may undermine accuracy and fairness.

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.

N/A

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.

The CJC, for the reasons set out above, suggests that levels of uptake is anecdotal and needs to be investigated further.

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

N/A

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.

The CJC is concerned that this is the case, albeit further evidence is required. To the extent that there is insufficient information available the Ministry could work with The Law Society, Bar Council, insurers, MIB and the NHLSA, to ensure that they are properly aware of the potential use of periodical payments. An independent guide to periodical payments could be developed by the Ministry and/or The Law Society.

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?

The CJC refers to its general comments.

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?

The CJC refers to its general comments.

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.

N/A

Impact assessment

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

See answer to question 23.

**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.

N/A

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.

It is likely that any change may have an impact businesses or voluntary sector organisations. The CJC is not in a position to set out what they may be. Evidence should be obtained from such businesses as to the likely effect of any specific proposed changes.

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 effect on small or micro-businesses? Please give reasons.

It is likely that any change may have an impact on small or micro-businesses. The CJC is not in a position to set out what they may be. Evidence should be obtained from such businesses as to the likely effect of any specific proposed changes.

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.

See answer to question 20.

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.

See answer to question 23.

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?

The CJC is concerned that not enough consideration has been given to the potential effect that any changes to the discount rate may have on individuals with a disability as the result of an injury.

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