

**EXPLANATORY MEMORANDUM TO THE
DAMAGES (VARIATION OF PERIODICAL PAYMENTS) ORDER 2005**

2005 No.841

1. This explanatory memorandum has been prepared by the Department for Constitutional Affairs and is laid before Parliament by Command of Her Majesty.

2. Description

2.1. The Order sets out the circumstances in which a court order or an agreement between the parties, providing for the payment of damages for future loss and care costs in respect of personal injury in the form of periodical payments, may be varied; and sets out various procedural requirements, including a requirement that a party must obtain the court's permission to apply for the order or agreement to be varied, unless the court orders otherwise.

3. Matters of special interest to Joint Committee on Statutory Instruments

3.1 None.

4. Legislative background

4.1 Section 2 of the Damages Act 1996 gave courts in England, Wales and Northern Ireland the power to order that damages for future pecuniary loss in respect of personal injury are to be paid wholly or partly in the form of periodical payments rather than a lump sum, provided that the parties consent. The power did not extend to making such an order should the parties not both consent, or to varying the order subsequently.

4.2 Section 100 of the Courts Act 2003 (together with section 101, which makes provision for enhanced protection for periodical payments) amends the 1996 Act to extend the power. It replaces section 2 of the 1996 Act with a new section 2 (enabling the court to order that damages for future pecuniary loss in respect of personal injury should take the form wholly or partly of periodical payments); a new section 2A (enabling provision to be made by Civil Procedure Rules, or in Northern Ireland by rules of court, requiring the court to take specified matters into account when considering the exercise of that power); and with a new section 2B, which provides that the Lord Chancellor may by Order

- enable a court which has made an order for periodical payments to vary the order in specified circumstances; and
- enable a court in specified circumstances to vary the terms on which a claim or action for damages is settled by agreement between the parties, if the agreement provides for periodical payments and expressly permits a party to apply to court for variation in those circumstances.

4.3 This is the first use of this power. During passage of the Courts Act, Ministers indicated their intention to limit the terms of the first Order to the circumstances set out in paragraph 2 of the Order (HL Deb 27 March 2003 vol 646 c1006; SC Deb (D)

8 July 2003 c184). These are where there is proved or admitted to be a chance that at some definite or indefinite time in the future the claimant will

- (a) as a result of the act or omission which gave rise to the cause of action, develop some serious disease or suffer some serious deterioration, or
- (b) enjoy some significant improvement in his physical or mental condition, where that condition had been adversely affected as a result of that act or omission.

4.4 These provisions are similar to those which apply to awards of provisional damages under Section 32A of the Supreme Courts Act 1981.

5. Extent

5.1 This instrument applies to England, Wales and Northern Ireland.

6. ECHR

6.1 David Lammy, Parliamentary Secretary at the Department for Constitutional Affairs has made the following statement regarding Human Rights:

“In my view the provisions of the Damages (Variation of Periodical Payments) Order 2005 are compatible with the Convention rights”

7. Policy background

7.1 In March 2002 the Lord Chancellor published a consultation paper “Damages for future loss: Giving the courts the power to order periodical payments for future loss and care costs in personal injury cases”, which sought views on the use of periodical payments in personal injury cases. The proposals contained in the consultation paper were taken forward in sections 100 and 101 of the Courts Act 2003. The post-consultation report can be accessed at <http://www.dca.gov.uk/consult/general/periodpayresp.htm>.

7.2 A clear majority of responses agreed that the courts should have the power to order periodical payments without the parties’ consent. The majority also supported some form of variation of periodical payment orders. The Order reflects the results of that consultation, and also debate during passage of the Courts Bill. The ability to vary payments in certain circumstances is necessary to realise fully the potential benefits of periodical payments.

8. Impact

8.1 A Regulatory Impact Assessment is attached to this memorandum.

8.2 The impact on the public sector will be mainly focused on the NHS in its role as defendant in clinical negligence cases. The Regulatory Impact Assessment indicates that the overall financial impact of the proposals for variation should not be significant.

9. Contact details

- 9.1 Janet Howe at the Department for Constitutional Affairs Tel: 0207 210 1221 or email janet.howe@dca.gsi.gov.uk can answer any queries regarding the instrument.

Regulatory Impact Assessment

Purpose and intended effect of measure

Objective

1. This impact assessment considers the impact of exercising the Lord Chancellor's power, under new section 2B of The Damages Act 1996 (inserted by Section 100 of the Courts Act 2003), to make an Order enabling courts to vary periodical payment orders and agreements in specified circumstances.

2. The draft Damages (Variation of Periodical Payments) Order 2004 provides that an application for variation will be allowed only where it can be foreseen at the time of the original agreement or court order that there is a chance that at some time in the future the claimant will develop a serious disease, suffer serious deterioration, or enjoy significant improvement in his or her medical condition, and where it is explicitly provided for in that order or agreement. It is intended that all applications to vary payments will be subject to the permission of the court, unless the court orders otherwise.

Devolution

3. The Order will apply to England, Wales and Northern Ireland.

The background

4. In March 2002, the Lord Chancellor published a consultation paper "Damages for future loss: Giving the courts the power to order periodical payments for future loss and care costs in personal injury cases", which sought views on the use of periodical payments in personal injury cases. The paper sought data on the potential impact of variation, but did not yield sufficient information to develop a full analysis. The Regulatory Impact Assessment published on introduction of the Courts Bill therefore focused on the power to order periodical payments and the Government undertook to develop a second Regulatory Impact Assessment specifically to assess the costs and benefits of the Order for variation which it proposed. Further formal consultation on this took place from April to June 2004. In addition, informal discussions have taken place with key stakeholders in an effort to obtain as much information as possible.

5. At present, where periodical payments are agreed, part of the settlement usually takes the form of a lump sum known as a "contingency fund". The purpose of the "fund" can be to provide for future needs, the extent of which cannot be calculated at the time of the original settlement (e.g. the likelihood of developing a serious disease as a consequence of the original injury). Because the amount of the award has to be calculated at the time of settlement, such funds almost inevitably over or under estimate the costs of uncertain future needs. In addition, the award often compensates for the chance that a future need may arise, rather than the need itself. If, for example, there is a 20% chance of a significant medical deterioration occurring and it never occurs, the defendant or insurer would have made a payment unnecessarily. If the deterioration does occur, the claimant will be seriously under-compensated because they will only have received 20% of the compensation required to meet their needs.

6. Therefore, in cases where there are real difficulties in assessing the likelihood of a claimant developing a particular medical condition or overcoming a particular medical disability at the time the periodical payments order is made, an order which will allow future flexibility in specific circumstances can provide the best solution.

7. The current system of provisional damages already provides some flexibility in respect of lump sum awards, although most lump sums are ordered or agreed to on a “once and for all” basis. Section 32A of the Supreme Courts Act 1981 provides that provisional damages can be awarded “for personal injuries in which there is proved or admitted to be a chance that at some definite or indefinite time in the future, the person will, as a result of the act or omission which gave rise to the cause of action, develop some serious disease or suffer some serious deterioration in his physical or mental condition”. The provisional damages will be assessed on the basis that the claimant will not develop the disease or suffer the deterioration, but if this does occur the claimant can then return to court to seek further damages.

8. The proposed scope of variable periodical payments is no more than is provided for by this system of provisional damages, except that it will allow for significant medical improvement as well as deterioration. It will also allow defendants to apply – at present only claimants can do so.

Risk assessment

9. In principle, periodical payments made as the needs arise provide a more appropriate means of compensating claimants than lump sums. However, if there is no scope for variation the full benefits of periodical payments will not be realised. Where it is impossible to assess the extent or likelihood of a claimant developing a certain medical condition at the time of trial or settlement, the deficiencies of the current system would continue. Insurers would still have to make substantial contingency payments for events which might never occur and claimants would continue to be over or under compensated. Allowing variation in the limited circumstances provided for in the draft Order is intended to address this risk.

Scaling the Issue

10. The possibility of variation will only apply to damages which are to be paid by way of periodical payments, and then will only be appropriate in a limited number of cases.

11. In most cases involving periodical payments, a non-variable award will be appropriate. We have been told that many foreseeable changes have in the past been built into an annuity in a flexible way to reflect anticipated changes in the claimant's needs. However, some respondents to consultation pointed out that the annuity market has retracted significantly over the past twelve months and took the view that that flexibility no longer exists. We hope that as periodical payments become more common the market for annuities will improve and that incentives to develop new products should increase.

12. The number of cases in which variation *will* be appropriate is likely to be similar to those in which provisional damages are used now, which we understand to be few. Figures provided by the Compensation Recovery Unit show that of a total of 1,955,296 personal injury settlements recorded between 2000 and 2003, only 459 were provisional damage settlements. This is less than 0.03% of the total settlements recorded. Figures obtained from the Court of Protection show that only six out of approximately 800 damages awards approved since June 2002 were settled on a provisional damages basis. Other responses also indicated that in their experience the number of provisional damages awards was very low or non-existent.

13. Even where variable orders are made, we do not expect that there will be many applications to vary payments made under those orders. The circumstances in which variation

will be allowed are limited and, as is the case with provisional damages now, the original court order or agreement will have to specify the nature of deterioration or improvement for which parties can apply for variation. Our view is that the proportion of parties returning to court seeking to vary payments is likely to be similar to those applying for further damages in provisional damages cases. We have been unable to obtain precise estimates of how many claimants seek further damages in such cases but, anecdotally, we understand that it is only a small number of those receiving provisional damages awards (which as noted above is a minute proportion of overall settlements).

14. The experience of the Criminal Injuries Compensation Scheme also suggests that awards which theoretically can be revisited rarely are in practice. Damages awarded by the Criminal Injuries Compensation Authority (CICA) are usually regarded as final. However, a case can be re-opened where there has been such a material change in the victim's medical condition that injustice would occur if the original assessment of compensation were allowed to stand, or where the victim has since died of the injury. The grounds for re-opening a case are therefore similar to those in which it is intended that parties will be able to apply to vary periodical payments made under a variable order or agreement. CICA have reported that over the past 5 years there have been a total of 386,253 cases, of which only 811 have been medically reopened. This amounts to less than 0.2% of those cases. Respondents to consultation generally agreed that the likely number of applications for variation would be small, although some suggested that comparisons between provisional damages and variable payments were not valid and that a greater number of cases were likely to include provision for variation.

2. Options

Option 1 - Do not exercise the Lord Chancellor's power – i.e. periodical payments without the power to vary. Following public consultation and Parliamentary debate during the course of the Courts Bill, it was decided that this option should not be pursued.

Option 2 – Allow courts to vary the level of periodical payments in the circumstances set out in the draft Order.

3. Sectors Affected

15. The following groups have been identified with an interest in the Order:

claimants;
defendants and their insurers – mainly general insurers and Medical Defence Organisations (MDOs);
the NHS;
the taxpayer.

4. Benefits

16. No environmental benefits have been identified.

17. The following social and economic benefits of the proposed Order for variation have been identified:

Claimants

18. The proposal will provide additional flexibility to reflect claimants' future needs. If a claimant's care needs increase at a future date, the current system of a contingency fund is unlikely to be sufficient to fund those needs due to the basis on which such funds are

calculated. However, under the proposed order, where the specified change in the claimant's condition does occur, any consequential increase in the claimant's needs can be reflected in increased payments on variation. This will help ensure claimants are not under-compensated.

Defendants/Insurers and the NHS

19. As the proposal will allow variation both as a result of an improvement and deterioration in the claimant's condition, and will allow the defendant to apply, it will put claimants and defendants on a level playing field so far as is possible; although it was argued that that position will be affected by the absence of a mechanism to ensure that the defendant is informed about any changes in the claimant's condition which might allow the defendant to apply for a variation to decrease payment.

20. There will be savings for defendants and insurers where they no longer have to make up-front contingency payments.

21. Most applications for variation are likely to be made by claimants but, where payments are decreased there will be savings to defendants. This will be a direct saving to the NHS. Where the defendant is insured however, this saving is likely to be a benefit to the life insurer who is providing the annuity, rather than the indemnity insurer.

Taxpayers and Others

22. There may be savings to the taxpayer if variation makes it less likely that claimants will require state benefits and additional care as a result of deterioration in their condition.

5. Costs

23. The following costs of the proposed Order allowing variation have been identified:

Defendants/Insurers and the NHS

24. The cost implications of the proposed Order estimated in the responses to consultation varied from minimal to more substantial.

25. The Association of British Insurers (ABI) indicated that it does not hold statistically significant information (about provisional damages claims that have been re-opened) from which to extrapolate market-wide estimates of the impact of variable periodical payments. Therefore to suggest a figure at this stage would be conjecture only. Its view was that as the scope for variation was the same as for provisional damages, one would expect - based on the history of provisional damages claims and all other things being equal - few variable awards to be made, and even fewer to be the subject of subsequent applications to vary. ABI could foresee litigation about the circumstances in which variation might apply, which would add to the costs for insurers. It therefore suggested that it would be important to monitor closely the use and take up of variable awards.

26. Although the proposal will not involve any new liability for damages, there will be cost where payments are increased on variation, although the amount will depend on how much may be saved by not making a contingency payment in the first place. There will also be the legal and court costs involved in the application for variation. These will fall mainly on defendants, assuming claimants make most applications and are generally successful.

27. The National Health Service Litigation Authority estimated that, on the basis of a number of assumptions, it was possible that its overall liability might increase by a half per cent, resulting in extra costs of £2.5million per annum. The Medical Protection Society and the Medical Defence Union suggested that the uncertainty caused by the possibility of future variation might increase the costs of indemnifying claims for defendants, and the MPS estimated that if it has five claims per annum settled with variable periodical payments, and

half of these result in an application to vary, then (subject to certain other assumptions) the additional cost would be 13.4% of subscriptions earned in 2003. However, the MPS indicated that it has no experience of court-ordered provisional damage awards, and the MDU indicated that it settled only three claims on the basis of provisional damages in the three years to May 2002. We therefore believe that this may be an overestimate of the likely use of variation. Some costs will be offset by the fact that defendants and insurers will no longer have to make up-front contingency payments, and to a lesser extent by payments decreased on variation.

28. When a variable order is made, insurers and MDOs will not be able to close their books. They will be required to hold assets to cover uncertain future liabilities. This will have an impact on their balance sheets and may increase administrative costs. However, insurers and MDOs already reserve for further damages claims in provisional damages cases so they should be able to do the same in cases involving variable periodical payments.

Taxpayers and others

29. There may be some cost implications for taxpayers in cases where the NHS has to make increased payments on variation, although these should be offset by not having to make contingency payments, and to a lesser extent any downward variation of payments will lead to some savings.

6. Equity and fairness

30. Allowing variation in the limited circumstances outlined above provides the fairest system of compensation for both claimants and defendants. The additional flexibility to meet claimants' future needs that it offers is an important element in realising the full benefit of periodical payments. The proposals will ensure that if a specified improvement or deterioration in the claimant's condition does occur, the claimant will receive increased payments to meet any increase in need; but that defendants and their insurers will not have to make payments for contingencies which never occur or for care which is no longer needed.

7. Compliance

31. The issue of compliance does not arise here as it does with a classic regulatory proposal. The underlying impact of tort liability is unaffected. It will be for the court to decide whether variation is suitable in a particular case.

8. Consultation with Small Business

32. We have consulted the Small Business Service in preparation of this RIA. Where small businesses take out insurance (for example motor insurance or employer's liability) they will be affected, along with others, in so far as these proposals may lead to changes in insurance premiums.

9. Costs for a typical business

33. Business would only be affected in so far as the proposal for variation led to any changes in insurance premiums. As noted above, it has not been possible to obtain quantification of these effects. The costs to insurers are likely to be offset by not having to make contingency payments and to a lesser extent by downward variation of periodical payments. However, a number of respondents took the view that savings would be limited, and as any applications will involve legal costs some increase in premiums would appear likely. However, in the overall scheme of things this should not be significant.

10. Competition assessment

34. The competition filter undertaken as part of the Competition Assessment suggests that there is unlikely to be a negative impact on competition if the courts can vary the level of periodical payments in specified circumstances.

11. Monitoring and Review

35. We intend to monitor the use of variable periodical payments on an ongoing basis by recording all court orders made containing provision for variation and any subsequent applications for variation, and will consider the need for and timing of review based on the information received.

12. Consultation

36. There has been full public consultation with a range of stakeholders, including insurers, the legal profession and medical defence organisations, and consultation within Government on the proposals leading to this RIA. There has also been consultation and informal discussions with key stakeholders to obtain information on the potential costs and benefits of these proposals. The issues have also been fully debated in Parliament during passage of the Courts Act 2003.

Declaration

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed.....Falconer of Thoroton, C.....

Date.....16/09/04.....

The Right Honourable The Lord Falconer of Thoroton

Secretary of State for Constitutional Affairs and Lord Chancellor
Department for Constitutional Affairs