



The Scottish Parliament  
Pàrlamaid na h-Alba

SPICe

The Information Centre  
An t-Ionad Fiosrachaidh

SPICe Briefing

Pàipear-ullachaidh SPICe

# Damages (Investment Returns and Periodical Payments) (Scotland) Bill

Abigail Bremner

The Damages Bill aims to reform the way compensation for personal injury is calculated and paid. It contains provisions about the personal injury discount rate and periodical payments of compensation.

PERSONAL INJURY

LAW

19 September 2018  
SB 18-59

# Contents

<b>About this briefing</b>	<b>3</b>
<b>About the Bill - relevant dates and documents</b>	<b>4</b>
<b>How personal injury claims work</b>	<b>5</b>
Terminology	5
The legal framework for personal injury cases	7
Establishing liability	7
Calculating compensation	8
The 100% compensation principle	9
How personal injury claims are processed	9
The role of the insurance industry	10
Which courts handle personal injury claims	10
The role of the personal injury discount rate	11
The rationale behind the discount rate	11
Calculating the discount rate	12
Controversy surrounding the recent change to the discount rate	13
The role of periodical payment orders	13
<b>What the Bill does</b>	<b>15</b>
What consultation has been carried out on the Bill's proposals?	15
Proposals for setting the discount rate	16
The role of the UK Government actuary	17
How the discount rate would be set	18
How the discount rate would be reviewed	19
Setting different rates for different circumstances	20
Proposals for Periodical Payment Orders	21
When periodical payments are considered to be reasonably secure	21
The courts' power to reconsider compensation awards	22
Protecting payments	23
<b>Bibliography</b>	<b>24</b>

# About this briefing

This briefing looks at the proposals in the Damages Bill, as well as providing contextual information about the system for making personal injury claims.

The Damages Bill proposes to

- **Reform the way the discount rate is calculated**

The discount rate is an adjustment made to a lump sum award for future financial loss in personal injury cases. It accounts for the notional rate of return if the money were invested. It is intended to ensure that the injured person neither benefits nor suffers as a result of receiving the money before the losses it compensates for have occurred.

Previous court judgments state that the discount rate should be calculated on the basis that injured people are not required to take investment risks with their compensation. It is currently set by Scottish Ministers, with reference to returns on index-linked [gilts](#) - a form of UK Government bond.

The Bill would reform the law to require the discount rate to be set by the UK Government Actuary, using a methodology set out in legislation. This would consider a **hypothetical investor** with a mixed investment portfolio. The rate would be reviewed regularly.

- **Allow the courts to require periodical payments of compensation**

The law currently enables people who have been injured to receive compensation via regular periodical payments, rather than as a lump sum. This can remove some of the uncertainties associated with calculating a one-off, lump sum award.

At present, the court can only make a compensation award involving periodical payments where the parties involved in the case agree.

Provisions in the Bill would require the court to consider periodical payments in every case involving future financial loss. The court would be able to impose periodical payment, but only where ongoing payment is considered **reasonably secure**.

The Bill would also enable a compensation award to be reconsidered by the courts in the event of a specified change to the pursuer's condition.

# About the Bill - relevant dates and documents

The Damages (Investment Returns and Periodical Payments) (Scotland) Bill is a Scottish Government bill. It was introduced in the Scottish Parliament by Michael Matheson MSP on 14 June 2018.

The [Scottish Parliament website](#) provides information relevant to parliamentary scrutiny of the Bill. Relevant documents include:

- the [Bill \(as introduced\)](#) <sup>1</sup> ;
- [Explanatory Notes](#) <sup>2</sup> ;
- a [Policy Memorandum](#) <sup>3</sup> ; and
- a [Financial Memorandum](#) <sup>4</sup> .

According to the Policy Memorandum, the purpose of the Bill is to:

- set a method for calculating the personal injury discount rate which is "clear, certain, fair, regular, transparent and credible" (paragraph 4); and
- give the courts power to require compensation for future economic loss to be paid in periodical instalments.

The Economy, Jobs and Fair Work Committee has been designated the lead committee for parliamentary scrutiny of the Bill at Stage 1. The Committee has issued a [call for views](#) on the Bill, which closed on 7 September 2018.

# How personal injury claims work

A person can claim compensation if they are injured through the wrongful behaviour of another person or organisation. The role of compensation is to put the person - to the extent that a financial award can - as close to the position they were in before they were injured as possible.

This section of the briefing looks at:

- [terminology](#);
- [the legal framework for personal injury claims](#);
- [how personal injury claims are processed](#);
- [the role of the insurance industry](#);
- [which courts handle personal injury claims](#);
- [the role of the personal injury discount rate](#); and
- [the role of periodical payment orders](#).

## Terminology

The Bill deals with a specialist area of law. The issues raised require an understanding of some technical and legal terms. Frequently used terms are defined below.

**Advocate** - an advocate is a lawyer with expertise in making legal arguments. When a case is heard in the Court of Session, a solicitor must use an advocate or solicitor-advocate to present it. There are a small number of other professionals who can present specific types of case.

**At first instance** - this describes when a court hears a case for the first time. The court may have to consider issues of fact (for example, whether the pursuer was employed by the defender) as well as issues of law. A court may also hear a case on appeal from a lower court.

**Binding** - the decision of a higher court is binding on lower courts. This means that the judges in the lower courts have to follow the decision when dealing with similar cases.

**Bonds** - financial instruments constituting debt. Bonds will offer interest to compensate for loss of the use of the money lent. The better the credit rating of the organisation offering the bond, the lower the interest rate is likely to be. Bonds can usually be sold on at the prevailing market rate.

**Claims management company** - businesses which handle legal claims from individuals, usually on the basis of charging a percentage of the compensation awarded if the case is won. Claims management companies can only negotiate on behalf of their clients. They cannot represent them in court. Thus, if court action is needed, the case will be passed to a solicitor (perhaps for the payment of a referral fee).

**Damages** - the legal term for compensation awarded by a court.

**Defender** - the party defending court action. The party bringing court action is the pursuer. The English legal term in this situation is the defendant.

**Equities** - stocks and shares. These give the buyer a share of the ownership of the company, but are perhaps more usefully seen as a stake in the future performance of the company. The owner of equities would usually expect a regular dividend based on the performance of the company. They can also sell their shares at the prevailing market rate.

**Gilts** - the informal name for UK Government bonds. When the UK Government sells bonds, it agrees to pay a set return every six months until maturity. On maturity, the initial investment is also repaid. Index-linked gilts link both the bi-annual return and the repayment to inflation (via the Retail Price Index). Index-linked gilts have traditionally been considered a very safe form of investment to provide a future income stream. Currently, demand outstrips supply, meaning that they can be over-priced. This impacts on their usefulness as a way of protecting future income.

**Inner House** - the section of the Court of Session which hears cases on appeal. The Outer House hears cases at first instance.

**Multiplicand** - the sum representing a pursuer's annual loss when calculating a compensation award for future economic loss. This is multiplied by the appropriate multiplier to calculate a future award.

**Multiplier** - the figure by which annual loss (the multiplicand) is multiplied by to calculate an award for future economic loss. It takes into account life expectancy, the period the award covers and the discount rate. The multiplier can be found using the Ogden Tables.

**Ogden Tables** - these are statistical tables used to calculate an appropriate lump sum in personal injury cases. They provide various "multipliers" which can be used to turn an annual loss into an appropriate future award.

**Outer House** - the section of the Court of Session which hears cases at first instance. The Inner House of the Court of Session hears cases on appeal.

**Patrimonial loss** - economic loss, such as loss of earnings, as opposed to loss associated with pain and suffering.

**Pro bono** - the phrase used to describe when a lawyer provides their services for free.

**Pursuer** - the party bringing court action. The party defending court action is known as the defender. The term "claimant" is used in low value cases. Claimant is also the term used in English court procedure.

**Senior courts** - the phrase refers to the Court of Session in a Scottish context and may also be used to include the UK Supreme Court.

**Solatium** - the part of a compensation award that deals with pain and suffering, including loss of enjoyment of life.

**Solicitor-advocate** - a solicitor-advocate is a solicitor who has undergone additional training in making legal arguments. They are able to present cases in the Court of Session.

## The legal framework for personal injury cases

Personal injury claims are a branch of the law of delict. The law requires that, where a person or body has acted wrongfully, they are liable to compensate anyone who suffers loss as a direct result.

This part of the briefing looks at:

- [establishing liability](#);
- [calculating compensation](#); and
- [the 100% compensation principle](#).

### Establishing liability

Most personal injury claims involve an allegation that the defender has acted negligently. It is possible for a claim to be based on other grounds though, such as strict liability.

Strict liability covers situations where someone (such as the manufacturer of a consumer product) may become liable to pay compensation without any investigation into whether they acted wrongfully.

For a personal injury claim based on negligence to be successful, the pursuer must be able to prove three elements. These are:

- that the defender owed the pursuer a "duty of care";
- that there has been a breach of this duty (negligence); and
- that the breach caused the harm complained of (causation).

Very broadly, a **duty of care** can be said to exist where it is reasonably foreseeable that one party's actions or omissions are likely to cause harm to another party. However, in recent times, courts have become more cautious about finding that a duty of care exists. Before doing so, they will consider whether imposing a duty is fair, just and reasonable.

In practice, there is room for significant factual and legal argument about whether liability exists in a specific situation.

## Calculating compensation

Once liability has been established, it will be necessary to work out what level of compensation is appropriate. When calculating an award of compensation, the courts will consider various categories of loss. These can, broadly, be divided into:

- **Solatium** - awarded for the pain and suffering caused by the injury. The award can include, for example, sums to compensate for developing a psychological condition and for no longer being able to enjoy a favourite hobby.
- **Patrimonial loss** - these are the economic losses flowing from the injury, such as the costs of care and equipment and the loss of earnings.

The level of compensation will depend on a number of factors, for example:

- how serious the injury was;
- whether the pursuer has recovered from the injury, or whether it will have an ongoing effect; and
- the personal circumstances of the pursuer, such as the nature of the work they do and the amount they earn.

Again, there is room for significant argument over what an appropriate level of compensation might be.



## The 100% compensation principle

It is a legal principle that a successful pursuer should receive 100% compensation - no more, and no less. This has led to a number of assumptions being made when calculating awards.

For instance, pursuers' incomes are calculated net of tax and National Insurance contributions which they would have had to pay. When calculating compensation related to early death, it is assumed that the pursuer would have spent 25% of the income they might have earned on essential living costs.

However, despite what may be implied by the 100% compensation principle, the calculation of compensation is far from an exact science. Broad assumptions are made in relation to life expectancy and future economic conditions. There may be great uncertainty about the future impact of a pursuer's injuries, and there is no true financial substitute for pain and suffering.

The House of Lords, in the case of *Hodgson v Trapp* ([1988] UKHL 9), described the job as requiring:

“ ... not the services of an actuary or an accountant but those of a prophet.”

## How personal injury claims are processed

Around a tenth of the court cases raised in Scotland's civil courts relate to personal injuries. However, the vast majority of personal injury cases do not end up in court. Instead, they are settled via negotiation between the parties.

### **There is a whole industry based around making personal injury claims**

Pursuers will usually be represented in negotiations by a solicitor or a [claims management company](#). Claims management companies cannot represent their clients in court. If court action is necessary, they will refer the case to a solicitor. It is argued that some companies try to avoid court action by taking on only straight-forward cases.

Trade unions also play an important role in supporting personal injury actions for members. Most trade unions will cover the costs of legal action for members who have suffered an injury in relation to their work. Some cover all types of personal injury.

### **Both the Court of Session and sheriff courts have developed specific procedures to deal with personal injury cases**

This is in recognition of the fact that, although they form a significant proportion of court business, personal injury cases rarely raise important legal issues. The purpose of personal injury court procedure is therefore to get cases through the system and to encourage the parties to settle with minimal court involvement where possible.

This type of court procedure is sometimes termed "case-flow management". Senior Scottish judge, Lord Gill, defined this form of procedure as follows<sup>5</sup> (Chapter 5, paragraph 9):

“ The core feature of such a model is that the case is conducted by reference to a standard timetable with limited scope for variation and sanctions for non-compliance. Judicial supervision of the case is limited to policing the timetable and dealing with any specific application to the court, by way of motion. A model of this type is used to deal efficiently with a large volume of routine cases, to eliminate unnecessary delay, to minimise the cost to the parties and to make the most efficient use of the court's time. ”

## **The role of the insurance industry**

Most defenders are represented by insurance companies. This is because, in most cases, defenders will have insurance to underwrite the risk of causing someone a personal injury.

Car drivers and employers are required by law to have insurance against certain risks. Other forms of insurance - such as public liability insurance - are also common.

Nevertheless, it is possible that a defender may not have insurance to cover the injury in question. In these cases, a defender would usually be expected to engage a solicitor to represent them. However, some might choose to represent themselves.

### **Lack of insurance cover is a tactical issue in personal injury cases**

Scots law cannot be used to require people to pay money they do not have. Thus, if a person or body does not have insurance cover, it may not be worth taking court action against them.

Where a defender does not have insurance cover, the pursuer will have to consider the risk that compensation will not be recovered, even if they win their court case. This risk is reduced if the defender has assets - such as land or buildings, business stock or money - which can be seized to enforce a court award.

### **Public sector bodies may not be insured to cover the risk of personal injury claims from members of the public**

Some public sector bodies may take out insurance to cover the risk of personal injury claims. However, others "self-insure". This usually involves pooling resources with similar bodies for this purpose. Claims which are not covered by insurance are met from public funds.

Even those with insurance may have policies with high monetary thresholds for paying out (the policy "excess"). This may mean that many claims are not covered.

## **Which courts handle personal injury claims**

People with personal injury claims usually have a choice of which court to raise their claim in.

### **Sheriff court**

Sheriff courts are Scotland's local courts. Any personal injury claim can be raised in the sheriff courts. A pursuer would usually do so because their claim had a relatively low monetary value, or because they valued using a local court over benefiting from a specialised personal injury court procedure.

### **All Scotland Sheriff Personal Injury Court**

Scotland also has a specialist personal injury court which sits in Edinburgh (although it can deal with claims from any part of the country). Cases are dealt with by sheriffs who specialise in personal injury work. There are also specialist court procedures which aim to deal with claims efficiently.

People who were injured in an accident relating to their work, with a claim worth more than £1,000, can use the All Scotland Sheriff Personal Injury Court. Pursuers' whose accidents were not work-related must have a claim worth more than £5,000.

### **Court of Session**

The Court of Session is Scotland's most senior civil court (although it is possible to appeal to the UK Supreme Court). The [Outer House](#) of the Court of Session can hear personal injury cases [at first instance](#).

The Outer House also has specialist procedures to deal with personal injury claims. The claim must be worth at least £100,000.

## **The role of the personal injury discount rate**

The personal injury discount rate helps to standardise the calculation of compensation for economic loss which occurs in the future. This reduces the potential for disputes in this area, which fits with the general policy of keeping court involvement in personal injury claims to the minimum necessary.

This part of the briefing looks at:

- [the rationale behind the discount rate](#);
- [calculating the discount rate](#); and
- [controversy surrounding the recent change to the discount rate](#).

### **The rationale behind the discount rate**

Under the [100% compensation principle](#), a successful pursuer should receive 100% compensation, no more and no less. When compensation for future economic loss is awarded as a lump sum, it is argued that the pursuer receives an advantage by essentially being paid today for something that will happen in the future.

The pursuer can invest the money and so receive an additional return on the payment. This would result in over-compensation.

In order to address this, an adjustment is made to the initial lump sum, representing the notional rate of return if the money were invested. **This is the personal injury discount rate.**

The discount rate only applies to compensation for future economic loss (often referred to as "future patrimonial loss"). This covers things like compensation for future care costs and lost earnings.

Compensation for losses which have occurred before the claim has been settled are paid without a discount for their investment potential. Instead, the pursuer will receive interest on the payment to represent the loss of the use of the money over the period covered.

## Calculating the discount rate

The Damages Act 1996 gave Scottish Ministers (and the Lord Chancellor in England and Wales) the power to set a discount rate. This rate could be used by the courts as the default rate, removing the need for court time to be spent on legal arguments over the merits of different rates.

The courts retain the power to use a different rate where this is "more appropriate in the case in question" (Damages Act 1996, section 1(2)). However, this power has not been used in practice.

Scottish Ministers first used their power to prescribe a discount rate in 2002, when they set it at 2.5%. The rate was set on the basis of the principles outlined in the House of Lords case **Wells v Wells** ([1998] UKHL 27). These are:

- that index-linked gilts are an appropriate form of investment for successful pursuers; and
- that the court should set the discount rate based on the average yield from index-linked gilts over the past three years.

Under the methodology used in *Wells*, a further deduction should be made to the discount rate to account for the tax a pursuer would have to pay on the money generated by their investment.

Several other relevant points emerged from the *Wells* judgment.

- **Successful pursuers could not be considered as ordinary investors**

This is because they needed to use the compensation award to generate an ongoing income stream. They could not necessarily wait for a market to improve before drawing down income. Therefore, they could not be expected to take the risk involved in investing in shares. While these may perform better in the longer term, they were subject to significant volatility.

- **The courts should not concern themselves with what pursuers might actually do with their award**

Pursuers were free to take more or less risk with their award if they wanted to. The court's job was to decide what type of investment it was reasonable, in a hypothetical sense, to expect pursuers to make.

- **Periodical payments reduce the risk faced by pursuers**

Several of the judges noted that some pursers would be better served by having periodical payments rather than a lump sum award. With a periodical payment, the defender pays the agreed amount of compensation to the pursuer every year and therefore takes on various risks, such as life expectancy. This would remove the need for adjustment via the discount rate.

## **Controversy surrounding the recent change to the discount rate**

Scottish Ministers (and the Lord Chancellor) set the discount rate for a second time in March 2017. Using the rational set out in [Wells v Wells](#), they came to a rate of **minus 0.75**. This, of course, means that the sum the court awards is increased (rather than decreased) through the application of the discount rate.

### **The rate change caused controversy because of its impact on defenders**

The insurance industry argued that paying significantly larger compensation awards would have an impact on insurance premiums.

Public sector bodies such as the NHS would also be paying significantly more in compensation. The UK Government has set aside £1.2 billion per year to meet the additional costs to the public sector <sup>6</sup> (page 13).

### **The discount rate is calculated on a compound basis**

This means that the impact of rate changes is large. To use an example from the UK and Scottish Governments' 2017 consultation on the discount rate <sup>6</sup> (page 12):

An 18-year-old claimant who suffers a catastrophic injury in a road traffic accident is rendered quadriplegic. She requires 18 hours of daytime care, a night sleeper, some one-off equipment costs and increased care needs in later life. The annual care costs of such a claimant could typically exceed £100k. At 2.5% the total award of a claimant of this type of claim would receive a lump sum of maybe £5m to £6m. At a minus 0.75% discount rate this award could be around £9m, meaning perhaps a 60% increase in the lump sum.

## **The role of periodical payment orders**

Compensation for personal injury can be paid in periodical instalments rather than a lump sum. Periodical payments can mitigate the uncertainties involved in lump sum calculations.

**Lump sum compensation payments are only a best guess at what a pursuer's future needs might be**

For example, the courts use actuarial tables to calculate life expectancy for the purpose of compensation awards. It is very unlikely that the pursuer will live for the exact amount of time predicted.

If they live longer, then they risk running out of money to cover their care and living costs. It is likely that public services will have to pick up the burden.

If they die earlier, their estate will receive any money left over. This may be to the advantage of their relatives. However, it is to the disadvantage of those paying tax or insurance premiums, who are likely to be the ultimate funders of most compensation awards.

Periodical payments will usually last for the life of the pursuer, removing the guesswork and the risk of running out of money.

Periodical payments also remove other risks. There is no need for a discount rate, or for the pursuer to consider an investment strategy, as the money will be paid when it is due. It is usual practice for payments to be inflation-proofed, with payments linked to an index such as the Retail Price Index.

### **Scottish courts can currently only make an award requiring periodical payment if both parties agree**

The periodical payment can cover all or part of the award.

Periodical payments are rare in Scotland. It is not entirely clear why. They are most relevant in high value cases where pursuers have suffered serious, ongoing injury.

However, it would appear that there is a general preference among pursuers for lump sum payments. There was also some suggestion in responses to the UK and Scottish Government's 2017 consultation on the discount rate that insurers were not always prepared to offer periodical payments <sup>7</sup> (page 12).

The courts in England and Wales are able to impose periodical payments for the future economic loss element of a personal injury claim, without the consent of the parties.

### **The main risk with a periodical payment is that the defender will not be able to pay at some point in the future**

Thus, the courts in England can only make an order if payment is "reasonably secure" (Damages Act 1996, section 2(3)). Payments from many public bodies and payments from institutions covered by the [Financial Services Compensation Fund](#) are considered to be reasonably secure.

# What the Bill does

The Bill would legislate for a new method for setting the personal injury discount rate. It would also allow the courts to require compensation for future economic loss to be paid in periodical instalments.

The Bill would:

- make the UK Government actuary responsible for setting the discount rate, following a methodology set out in the Bill;
- require the discount rate to be reviewed every three years, with provision for additional reviews at the request of Scottish Ministers;
- allow the UK Government actuary to assume that successful pursuers have a set, mixed portfolio of investments, the precise balance of which could be adjusted via secondary legislation; and
- allow courts to impose periodical payment orders for future economic loss where payment by the defender is reasonably secure.

According to paragraph 4 of the Policy Memorandum:

“ The overall policy of Part 1 of the Bill in reforming the law on the setting of the personal injury discount rate is to make provision for a method and process which is clear, certain, fair, regular, transparent and credible.”

This part of the briefing looks at:

- [what consultation has been carried out on the Bill's proposals?](#)
- [proposals for setting the discount rate](#); and
- [proposals for Periodical Payment Orders](#).

## What consultation has been carried out on the Bill's proposals?

The UK and Scottish Governments have consulted extensively on options for reforming this area of the law since 2012. In relation to the discount rate, there has been little consensus among stakeholders as to the best way forward.

The Ministry of Justice (usually with the Scottish Government) has produced the following consultation documents and responses:

- [Damages Act 1996: The Discount Rate - how it should be set?](#) (2012) <sup>8</sup>
- [Damages Act 1996: The Discount Rate - how it should be set? Summary of responses](#) (2017) <sup>9</sup>
- [Damages Act 1996: The Discount Rate - review of the legal framework](#) (2013) <sup>10</sup>

- [Damages Act 1996: The Discount Rate - review of the legal framework - summary of responses \(2017\)](#) <sup>11</sup>
- [The Personal Injury Discount Rate: how it should be set in the future \(2017\)](#) <sup>6</sup>
- [The Personal Injury Discount Rate: how it should be set in the future - summary of responses \(2017\)](#) <sup>12</sup>

The Ministry of Justice also commissioned an expert report looking at issues around the discount rate - [The Discount Rate - a report for the Ministry of Justice \(2015\)](#) <sup>13</sup> .

The Scottish Government has, separately, consulted on proposals for periodical payment orders.

It consulted on the law of damages generally, including periodical payment orders, in 2012 - see:

- [Civil Law of Damages: Issues in Personal Injury - A Consultation Paper](#) <sup>14</sup> ; and
- [Civil Law of Damages: Issues in Personal Injury - Analysis of Written Consultation Responses \(2013\)](#) <sup>15</sup>

It also consulted on draft legislation in 2017 - [Draft proposals to enable a court to impose a Periodical Payments Order in respect of personal injuries](#) <sup>16</sup> .

## Proposals for setting the discount rate

The Bill would provide for a detailed methodology for calculating the discount rate. It would do this by adding further sections into the Damages Act 1996. The new methodology would replace the guidance to be found in the [Wells judgment](#).

The key features of the proposed methodology are:

- that the rate would be set by the UK Government actuary;
- the calculation would be based on a notional portfolio of investments, with a number of other assumptions; and
- that the rate would be reviewed at least every three years.

The courts would retain the discretion to use a different discount rate. This could happen where a party to court action shows that a different rate would be "more appropriate in the circumstances of the case" (section 1(B1)(2)b) of the Bill).

It would be possible for Scottish Ministers to set more than one discount rate. However, the Bill is drafted in a manner which assumes, for the time being, that one rate will be set, considering returns over a 30 year period.

This part of the briefing looks at:

- [the role of the UK Government actuary](#);



- [how the discount rate would be set](#);
- [how the discount rate would be reviewed](#); and
- [setting different rates for different circumstances](#).

## **The role of the UK Government actuary**

The UK Government actuary will be responsible for setting the discount rate, following the methodology laid out in the Bill.

The UK Government actuary heads the [Government Actuary's Department](#) (GAD). GAD provides advice to public and private sector clients about the management of risk. Its main areas of work are in relation to pensions, investment, insurance and quality assurance.

GAD funds its services by charging a fee to those who seek its advice.

### **The majority of consultees thought either the Lord Chancellor, with advice from an independent panel, or an independent panel should set the discount rate**

In its 2017 consultation <sup>12</sup>, the Ministry of Justice asked consultees who should set the discount rate. The majority preferred either the Lord Chancellor/Scottish Ministers with advice from an independent panel, or an independent panel (see page 33).

Broadly, the main reason given for supporting a role for the Lord Chancellor/Scottish Ministers was that there should be political accountability for the decision. The main reasons for favouring an expert panel were to maintain independence and avoid conflicts of interest.

### **The Scottish Government's approach is to set out a detailed methodology for calculating the discount rate in legislation**

Arguably, using the UK Government actuary achieves neither political accountability nor independence. Instead, the Scottish Government has adopted a different policy approach.

Its intention is to set out a detailed methodology for calculating the discount rate in legislation, providing political accountability. Thereafter, it argues that the actual setting of the rate is a technical exercise.

Paragraphs 40 and 41 of the Policy Memorandum state:

“ The policy approach has been to regard the determining of the rate as an actuarial exercise in which there should be no need to exercise political judgement. The proposal is, therefore, to shift the mechanics of determining the rate to a suitably qualified and credible professional. The Government Actuary was selected because of their particular expertise and standing. The legislation will provide, in an accountable way, the framework in which the rate should be set and thereafter the mechanics of determining the rate will sit with an appropriate professional. The Scottish Government thinks this strikes the appropriate balance. ”

## How the discount rate would be set

The Bill provides a detailed methodology for calculating the discount rate. This is based on returns from a **hypothetical investor** investing a **notional investment portfolio** over 30 years. Deductions would be made to the rate of return to take into account inflation, taxation, the cost of investment advice and to reduce the risk of under-compensation.

### The hypothetical investor is defined in the Bill

Paragraph 17 of the Schedule to the Bill sets the following requirements. The hypothetical investor would:

- have no financial resources to meet their expected expenses other than their compensation award;
- invest their compensation award in line with professional financial advice;
- make withdrawals from the investment fund;
- invest in such a manner as to meet the losses and expenses that the compensation is intended to cover so that the money will be exhausted at the end of the period the award covers.

### The notional investment portfolio moves away from the no risk approach recommended in the [Wells judgment](#)

The Scottish Government states that the notional investment portfolio represents a "cautious" investment approach. It believes that this would meet the needs of an individual in the position of the hypothetical investor (Policy Memorandum paragraph 68).

Paragraph 12 of the Schedule to the Bill sets a notional investment portfolio made up of the following assets:

Asset class	Percentage of portfolio
Cash or equivalents	10%
Non-index linked gilts	15%
Index-linked gilts	10%
UK company shares	7.5%
Overseas company shares	12. %
High-yield bonds (bonds with a higher risk of default, and consequent higher interest rate)	5%
Investment-grade bonds (bonds with a lower risk of default, and consequent lower interest rate)	30%
Property (land, buildings or moveable property)	5%
Other assets	5%

Scottish Ministers can adjust the make-up of the notional investment portfolio via regulation (affirmative procedure).

### Further adjustments to the discount rate

The Bill provides for the discount rate to be further reduced to take into account other contingencies. These are:

- the impact of inflation (based on the Retail Price Index);
- 0.5% to represent reductions as a result of taxation and the cost of investment advice; and
- a further 0.5% to protect against under-compensation due to investment volatility.

In relation to under-compensation, the Policy Memorandum (paragraph 71) notes:

“ Damages are not surplus funds which can be speculatively invested. Any losses are likely to be material to a pursuer's ability to meet their needs. For all these reasons, the Scottish Government considers that a further adjustment is needed to reduce the likelihood of under-compensation. [...] The further adjustment is in recognition of the fact that any investment, however carefully advised and invested may fail to meet their needs.”

## **How the discount rate would be reviewed**

The Bill would require the discount rate to be reviewed at least every three years, with provision for additional reviews at the instigation of Scottish Ministers.

### **The current discount rate has not been reviewed regularly**

Under the current regime, the discount rate was first set in Scotland in 2002 and only revised once, 15 years later. Arguably, the gap between reviews was at least partly responsible for the big adjustment to the rate and the consequential impact on defenders.

### **Consultees favoured more regular reviews**

The vast majority of respondents to the Ministry of Justice's 2017 consultation <sup>12</sup> favoured regular reviews of the discount rate to a schedule set in legislation (see page 27). It was argued that this would increase certainty and avoid previous problems caused by large gaps between rate reviews.

### **However, there was concern that an imminent review may impact on litigation behaviour**

Some respondents noted that the knowledge that a rate review was imminent may influence the timing of personal injury claims. There was a concern that pursuers may expedite or delay making a claim depending on whether they thought the results of the review would work in their favour. This would have an impact on court resources and the resources of defenders trying to negotiate settlements.

This potential practice was colloquially referred to as "gaming" the system.

Consultees were also asked how often reviews should be held (see pages 28 to 30). The results were inconclusive. However, a majority of those answering the question preferred reviews every one to three years or every three to five years.

Respondents who favoured frequent reviews argued that this would increase predictability, reduce the likelihood of big changes to the rate and minimise the potential impact on litigation behaviour.

However, some argued that basing reviews on changes in investment returns, rather than fixed periods, was more appropriate. This, it was thought, would minimise the impact on litigation behaviour further.

There was some support for an approach (in line with the Scottish Government's policy position) that a combination of fixed reviews and additional reviews was most appropriate. This, it was argued, would increase flexibility.

## **Setting different rates for different circumstances**

The [hypothetical investor](#) in the Bill is assumed to be investing over a 30 year period. Taking a long term view provides capacity for investment returns to recover from the inherent volatility of the markets.

### **The most vulnerable pursuers are likely to be those who receive compensation awards covering long time periods**

Those who have suffered catastrophic injuries or have been injured early in their lives can be argued to represent the most vulnerable pursuers. They are likely to receive the biggest compensation awards. They are also more likely to be entirely reliant on their compensation payments to meet their future needs.

Pursuers of this sort are likely to be looking at substantial compensation awards, covering a 20 to 60 year period.

### **Pursuers receiving awards covering shorter periods are less able to protect against market volatility**

However, some pursuers will be looking at awards which cover much shorter periods. For example, those who are injured later in their lives may be looking at compensation for a five year period. This provides significantly less flexibility to deal with volatility in relation to the value of investments.

### **Consultees preferred a single rate on grounds of simplicity**

The majority of those responding to the Ministry of Justice's 2017 consultation preferred a single discount rate (see page 22). It was argued that this approach was simple and would reduce the likelihood of further disputes requiring litigation.

Of those supporting more than one rate, most thought that different rates should be applied to awards of different durations.

### **Scottish Government approach**

The Bill gives Scottish Ministers the power to use regulations to require more than one discount rate. However, the policy intention appears, for the time being, to have one rate, based on investment returns over a thirty year period.

## Proposals for Periodical Payment Orders

Periodical payments of compensation can reduce the uncertainties inherent in making a lump sum award. Currently in Scotland, a court can only order periodical payments if both parties to the case agree.

### **The Bill would change the law to require the courts to consider whether to order periodical payment of compensation in each case involving future economic loss**

The courts would be able to make a periodical payment order without the consent of the parties involved. However, the courts could only make an order where ongoing payment by the defender was **reasonably secure**.

Future payments would usually be adjusted to take into account changes in the Retail Price Index. However, the court would retain discretion to adjust future payments on a different basis, or to not allow for adjustment at all.

The Bill would also enable a compensation award to be reconsidered by the courts in the event of a specified change to the pursuer's condition.

### **A Scottish Government consultation in 2012 found support for changing the law**

Broadly, the Bill mirrors the approach already in place for England and Wales. In the Scottish Government's 2012 consultation <sup>14</sup>, there was significant support for the law on periodical payments in Scotland to be brought into line with that in England (see pages 59 to 60).

This section of the briefing looks at:

- [when periodical payments are considered to be reasonably secure](#);
- [the courts' power to reconsider compensation awards](#); and
- [protecting payments](#).

## **When periodical payments are considered to be reasonably secure**

Under the Bill's provisions, payments from government bodies and financial institutions backed by the Financial Services Compensation Scheme would be considered reasonably secure.

The Bill makes provision for payments to be considered to be reasonably secure in three situations:

1. **where a government minister issues a guarantee** that payment will be made in relation to a public body under their control (see section 6 of the Damages Act 1996). Guarantees can be issued by UK and Scottish Government ministers and ministers in the Northern Ireland Executive.
2. **where the financial institution in question is covered by the Financial Services Compensation Scheme (FSCS)**. All businesses which offer regulated financial

services - including insurers - are covered by this scheme. In the case of insurance claims, it guarantees that all liabilities will be met.

3. **where bodies or office holders are part of the Scottish Administration or UK Government.** There is provision for Scottish Ministers to add health service and non-governmental bodies to this list. The Scottish Government has confirmed that it intends to bring forward regulations covering health service bodies <sup>17</sup>.

## **The courts' power to reconsider compensation awards**

The Bill would provide the courts with additional flexibility to deal with future changes to a pursuer's medical condition. Ongoing payments could be varied to take account of a specified change.

### **There can be significant uncertainty as to the likely ongoing effects of a pursuer's injury or condition**

For example, the full impact of a head injury may not be discernible until many years after the injury occurred. Some mental health conditions resolve themselves over time or with treatment, but others do not.

A lump sum payment offers a once and for all chance to settle the matter. It is not possible to go back to court if things should turn out significantly worse (or better) than expected. Instead, the courts try to factor considerations of future risk into the award.

When a risk actually manifests itself, under- or over-compensation can occur.

### **The Bill would provide for the amount of a periodical payment to be varied to take account of specified changes in the pursuer's condition**

The Bill's provisions would cover both court-ordered periodical payments and payments agreed between the parties through negotiation. This means there would be no need to go to court just to gain the power to vary payments. This is in line with the principle of keeping court involvement in personal injury cases to the minimum possible.

It wouldn't be open to the parties to request a variation just because there had been an unexpected change in circumstances. Instead, the original order or agreement would have to have identified the possibility of a variation due to a specified change occurring.

The Bill would provide the courts with wide ranging powers to alter the amount or type of payment, to suspend payments, or to convert the award to a lump sum where:

- the possibility of variation due to an identified change appeared in the original order or agreement;
- a specified change in the pursuer's physical or mental condition actually occurred; and
- as a result, the award would result in "significant" over- or under-compensation.

Orders or agreements would also be able to specify a timescale in which a change has to occur.

The Bill also provides that a court would not normally allow more than one variation in relation to a specified condition, or a variation to occur which was requested outwith the agreed timescale. However, provision is made to allow these things to happen in exceptional circumstances.

## **Protecting payments**

It is possible that the right to receive periodical payments could be transferred to someone who is not the pursuer. The Bill provides protection against this happening to the part of the payment which covers ongoing care costs.

### **Assignment of payments requires court agreement**

It is possible to transfer rights contained in an agreement from one person or body to another. The legal term for this in Scotland is assignment.

It would therefore be possible for the recipient of a periodical payment to assign the right to receive the payment to someone else. They may be paid for doing this, or there may be other considerations at stake.

The Bill provides that an assignment of the part of the payment dealing with ongoing care costs would not be valid unless it has been agreed by the court. It would, however, remain possible to assign other parts of the payment, for example, relating to loss of future earnings.

### **Assignment in bankruptcy**

When someone is declared bankrupt, ownership of their non-essential assets automatically passes to their trustee. The trustee is the person appointed to manage their property with the purpose of gathering as much money as possible to repay creditors.

Assets which take the form of contractual (or other) rights are automatically assigned to the trustee.

The Bill provides that, in bankruptcy, periodical payments must be treated as income. This means that they do not automatically transfer to the trustee. The debtor cannot be required to make a contribution to the bankruptcy from the part of the periodical payment intended to meet future care costs.

The Protected Trust Deed is an informal form of bankruptcy. The Bill provides similar protection for periodical payments when the recipient enters a trust deed.

# Bibliography

- 1 Damages (Investment Returns and Periodical Payments) (Scotland) Bill [as introduced]. SP Bill 35 (Session 5). (2018). Retrieved from [http://www.parliament.scot/Damages%20\(Investment%20Returns%20and%20Periodical%20Payments\)%20\(Scotland\)%20Bill/SPBill35S052018.pdf](http://www.parliament.scot/Damages%20(Investment%20Returns%20and%20Periodical%20Payments)%20(Scotland)%20Bill/SPBill35S052018.pdf) [accessed 2 August 2013]
- 2 Damages (Investment Returns and Periodical Payments) (Scotland) Bill - Explanatory Notes. SP Bill 35-EN (Session 5). (2018). Retrieved from [http://www.parliament.scot/Damages%20\(Investment%20Returns%20and%20Periodical%20Payments\)%20\(Scotland\)%20Bill/SPBill35ENS052018.pdf](http://www.parliament.scot/Damages%20(Investment%20Returns%20and%20Periodical%20Payments)%20(Scotland)%20Bill/SPBill35ENS052018.pdf) [accessed 2 August 2018]
- 3 Damages (Investment Returns and Periodical Payments) (Scotland) Bill. SP Bill 35-PM (Session 5). (2018). Retrieved from [http://www.parliament.scot/Damages%20\(Investment%20Returns%20and%20Periodical%20Payments\)%20\(Scotland\)%20Bill/SPBill35PMS052018.pdf](http://www.parliament.scot/Damages%20(Investment%20Returns%20and%20Periodical%20Payments)%20(Scotland)%20Bill/SPBill35PMS052018.pdf) [accessed 2 August 2018]
- 4 Damages (Investment Returns and Periodical Payments) (Scotland) Bill. SP Bill 35-FM (Session 5). (2018). Retrieved from [http://www.parliament.scot/Damages%20\(Investment%20Returns%20and%20Periodical%20Payments\)%20\(Scotland\)%20Bill/SPBill35FMS052018.pdf](http://www.parliament.scot/Damages%20(Investment%20Returns%20and%20Periodical%20Payments)%20(Scotland)%20Bill/SPBill35FMS052018.pdf) [accessed 2 August 2018]
- 5 Scottish Civil Courts Review. (2009). Report of the Scottish Civil Courts Review. Retrieved from <http://www.scotcourts.gov.uk/about-the-scottish-court-service/the-scottish-civil-courts-reform> [accessed 15 August 2018]
- 6 Ministry of Justice and Scottish Government. (2017). The Personal Injury Discount Rate: how it should be set in the future. Retrieved from [https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/supporting\\_documents/discountrateconsultationpaper.pdf](https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/supporting_documents/discountrateconsultationpaper.pdf) [accessed 16 August 2018]
- 7 Ministry of Justice. (2017). The Personal Injury Discount Rate: how it should be set - summary of responses. Retrieved from <https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/results/discount-rate-response-consultation-web.pdf> [accessed 16 August 2018]
- 8 Ministry of Justice, Department of Justice for Northern Ireland and Scottish Government. (2012). Damages Act 1996: The Discount Rate - how should it be set?. Retrieved from [https://consult.justice.gov.uk/digital-communications/discount-rate/supporting\\_documents/discountratedamagesact1996consultation.pdf](https://consult.justice.gov.uk/digital-communications/discount-rate/supporting_documents/discountratedamagesact1996consultation.pdf) [accessed 16 August 2018]
- 9 Ministry of Justice. (2017). Damages Act 1996: The Discount Rate - how should it be set? Summary of Responses. Retrieved from <https://consult.justice.gov.uk/digital-communications/discount-rate/results/damages-act-1996-the-discount-rate-how-should-it-be-set.pdf> [accessed 16 August 2018]
- 10 Ministry of Justice, Department of Justice for Northern Ireland and Scottish Government. (2013). Damages Act 1996: The Discount Rate - review of the legal framework. Retrieved from [Ministry of Justice, Department of Justice for Northern Ireland and Scottish Government](#) [accessed 16 August 2018]



- 11 Ministry of Justice. (2017). Damages Act 1996: The Discount Rate - review of the legal framework - summary of responses. Retrieved from <https://consult.justice.gov.uk/digital-communications/damages-act-1996-the-discount-rate-review-of-the/results/response-to-discount-rate-consultation.pdf> [accessed 16 August 2018]
- 12 Ministry of Justice. (2017). The Personal Injury Discount Rate: how it should be set in the future - summary of responses. Retrieved from <https://consult.justice.gov.uk/digital-communications/personal-injury-discount-rate/results/discount-rate-response-consultation-web.pdf> [accessed 16 August 2018]
- 13 Cox, P., Cropper, R., Gunn, I., & Pollock, J. (2015). The Discount Rate - a report for the Ministry of Justice. Retrieved from <https://consult.justice.gov.uk/digital-communications/discount-rate/results/discount-rate-report.pdf> [accessed 16 August 2018]
- 14 Scottish Government. (2012). Civil Law of Damages: Issues in Personal Injury - A Consultation Paper. Retrieved from <https://www.gov.scot/Publications/2012/12/5980> [accessed 23 August 2018]
- 15 Scottish Government. (2013). Civil Law of Damages: Issues in Personal Injury - Analysis of Written Consultation Responses. Retrieved from <https://www.gov.scot/Publications/2013/08/6983> [accessed 23 August 2018]
- 16 Scottish Government. (2017). Draft provisions to enable courts to impose a Periodical Payments Order in respect of damages for personal injury. Retrieved from <https://www.gov.scot/Resource/0052/00522973.pdf> [accessed 23 August 2018]
- 17 Scottish Government. (2018). Personal correspondence between A Bremner and Scottish Government.

Scottish Parliament Information Centre (SPICe) Briefings are compiled for the benefit of the Members of the Parliament and their personal staff. Authors are available to discuss the contents of these papers with MSPs and their staff who should contact Abigail Bremner on telephone number 85361 or [abigail.bremner@parliament.scot](mailto:abigail.bremner@parliament.scot).

Members of the public or external organisations may comment on this briefing by emailing us at [SPICe@parliament.scot](mailto:SPICe@parliament.scot). However, researchers are unable to enter into personal discussion in relation to SPICe Briefing Papers. If you have any general questions about the work of the Parliament you can email the Parliament's Public Information Service at [sp.info@parliament.scot](mailto:sp.info@parliament.scot). Every effort is made to ensure that the information contained in SPICe briefings is correct at the time of publication. Readers should be aware however that briefings are not necessarily updated or otherwise amended to reflect subsequent changes.

