Ethical and Legal Malpractice Considerations in Structuring Settlements

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I. Introduction
At the inception of structured settlements as an alternative means of resolving disputes, many plaintiffs' attorneys viewed them with considerable skepticism and refused to negotiate cases on any basis other than the traditional cash settlement. This skepticism expanded exponentially with the financial collapse of Executive Life of New York and Executive Life of California, two companies who had aggressively marketed structured settlements in personal injury cases. These collapses left plaintiff-annuitants with reduced recoveries and precipitated both criticism and litigation against plaintiff attorneys. This caused many plaintiff attorneys to forego structuring settlements due to their lack of knowledge of tax laws, a perception that insurance companies were using structures to mis-lead plaintiffs and their attorneys, and the fear that the annuity funds may not be secure.

The purpose of this paper is to explore the duty of plaintiff attorneys to inform clients of structured settlement offers, to explain the nuances and ramifications of such offers; to compare the advantages and disadvantages of structures versus cash, and to advise their clients of the desirability of structuring their settlement proceeds.

The issue of the duty of the plaintiff's attorneys has become more relevant recently as a result of the Grillo case in Texas, infra @ 2 and the Lyons case in New York, infra @ 5. The industry discussion of these cases and the increasing concern about annuitants selling their structured settlement proceeds has also led to the introduction of both federal and state legislation which, if passed, would require attorneys to offer the option of a structured settlement to the client, in writing in certain cases.

The following is a brief overview of the factors that must be considered by plaintiff attorneys in confronting the numerous pitfalls that can arise in structuring settlements. The short answer and the best possible advice is for a plaintiff attorney, in every case involving a structure, to seek the assistance of a structured settlement expert who specializes in designing structures for plaintiffs. In the event of a defective settlement that fails to protect the rights and recovery of the plaintiff, the plaintiff's attorney may be guilty of legal malpractice for failure to use a plaintiff's structured settlement specialist. The plaintiff should never rely solely on the defendant's structured settlement specialist. This is particularly true since the services of the structured settlement specialist are cost-free to the plaintiff. The specialist who places the structure with the annuity company is paid a fee based on the purchase price of the annuity. It is customary when both parties have specialist to split the fee between them. It is essential that the plaintiff's specialist be protected on the fee by reciting in the paperwork at mediation or by a side agreement in writing the division of the brokerage fee.

II. The Grillo Case Raises the Bar
In 2000, Josephine Grillo and her 19-year-old daughter, Christina, sued a Houston law firm alleging legal malpractice arising out of representation of the Grillos in a medical negligence case in 1990. The original case accused the defendant hospital of undue delay in performing a caesarian section which left Christina brain damaged and in a persistent vegetative state. Significantly, Christina, at birth was not expected to live long enough to be released from the hospital and her mother began making funeral plans. When Christina survived, her mother sued the hospital for the expense of caring for her. The medical negligence case settled in 1990 for $2.5 million and the hospital was released. At the time, this was thought to be a sufficient sum of money to cover future costs of caring for Christina for the remainder of her anticipated very short life expectancy. However, Christina survived and by the mid-1990s, it appeared that she might outlive her mother.

As it became apparent that the original settlement would not be sufficient to cover Christina's costs of living, Josephine sued her former lawyers who had negotiated and recommended the settlement with the hospital and the court-appointed guardian ad litem who had approved it. The allegations of negligence included failure of the lawyers to determine the best method of structuring the settlement funds; placing the funds in a Section 142 Trust which was not tax-free to Christina; causing constructive receipt of the funds; failing to inform the plaintiffs of the tax-free benefits of a structured settlement with a qualified assignment; and failing to use a “rated age” assessment to maximize benefits under a structure. The legal malpractice claims were settled with payment to the plaintiffs by the ad litem of $2.5 million and payment by the law firm of $1.6 million. This was a case in which the attorneys were misled by the medical
prognosis and did not believe that there was need for a long-term structure due to Christina's short life expectancy. Ironically, the doctor's mistake in prognosis would have been passed on to the annuity company in a rated structure calling for guaranteed payments for Christina's life.¹

III. Definition
Structured settlements, reduced to their lowest common denominator, are merely settlements in which payments are made in more than one installment. In a more sophisticated vein, a structured settlement, as most commonly utilized in resolution of personal injury and wrongful death claims, is one in which a defendant's liability insurance carrier pays funds, either directly or through an assignee, to a life insurance company for the purchase of an annuity which will then produce a stream of income through periodic payments to the plaintiff under predetermined time frames. They may range from an elementary plan consisting of an initial payment followed by annual payments for a term certain to a sophisticated program consisting of an initial lump-sum payment, monthly payments continuing throughout the plaintiff's life. The long term plans may also include an escalation clause, increasing benefits by 3% compounded annually to neutralize inflation, decennial lump-sum payments; endowments for the education of the plaintiff's children, a reversionary medical trust, and term insurance to cover the cost of burial, or to provide for the care of the plaintiff should his or her spouse or parents (in the case of a minor) predecease him or her.

IV. History and Development of Structured Settlements

Seminal tax law
1. Section 104(a)(2) of the Internal Revenue Code of 1954 provides as follows: In general, except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or sickness.

2. Revenue Ruling 79-220 held in 1979 that the exclusion from gross income provided by section 104(a)(2) of the Code applies to afford tax-free status to the full amount of periodic payments received by a plaintiff in settlement of a damage suit so long as certain other requirements, which will be discussed hereafter, are met. The precise holding of the Internal Revenue Service in 79-220 reads as follows:

The exclusion from gross income provided by ¹ 104(a)(2) of the Code applies to the full amount of the monthly payments received by A in settlement of a damage suit because A had a right to receive only the monthly payments, it did not have the actual constructive receipt, or the economic benefit of the lump sum amount that was invested to yield that monthly payment. If A should die before the end of 20 years, the payments made to A's estate under the settlement agreement are also excludable from income under ¹ 104.

3. Section 130 of the Internal Revenue Code of 1986 has two primary effects upon structured settlements: First, the Act amended ¹ 104's description of damages recoverable and excludable from gross income by adding the words "whether a lump sum or as periodic payments," thus giving legislative and executive approval of the tax benefits of structured settlements; and second, the new legislation added ¹ 130 of the Internal Revenue Code which provides a means of achieving more security for an injured claimant's funds through the use of a qualified assignment. This section was amended in 1986 by adding the parenthesis (in a case involving physical "injury or sickness") requirement. In 1988, ¹ 130 was again amended by deleting the requirement previously found at I.R.C. ¹ 130 (c)(2)(c), to wit: "(e) The recipient of such payments has no rights against the assignee greater than those of a general creditor."

¹For an in-depth discussion of the multiple considerations to be taken into account in maximizing a structured settlement for the plaintiff, see the full article entitled "Persuasion in Settlement Negotiations" available at http://www.howardnations.com.
4. Skepticism in the plaintiff’s bar

Plaintiffs’ attorneys perceived abuses by the insurance industry in early structured settlements which led to considerable skepticism among members of the plaintiffs’ bar. Three major elements caused considerable skepticism and refusal to consider utilization of structured settlements by many plaintiffs’ attorneys. These are: (a) publicity emanating from apparent abuses by the insurance industry in settling catastrophic injury cases for considerably less than their true settlement value through the illusion of large settlement dollars produced in a structured settlement; (b) the industry's refusal to disclose to the plaintiff's attorney the insurance carrier's cost of the structured settlement package under the guise of constructive receipt; and (c) numerous warnings by academicians and plaintiff bar publications based upon (a) and (b) as to the dangers inherent for the plaintiff in accepting an insurance company offer of a structured settlement. Analysis provides insight as to why the skepticism and refusal persists among plaintiffs’ lawyers.

5. Refusal to disclose costs

Lending credibility to the concept that the structured settlement is strictly an insurance industry method of settling cases for considerably less than their actual value is the practice of refusing to disclose to the plaintiff's attorney the defendant's cost of the settlement package. The purported reason for such refusal is that the plaintiff's knowledge of the cost constitutes constructive receipt of the funds which will result in the plaintiff losing the tax-free benefits. This fallacious reasoning is an insult to knowledgeable plaintiffs attorneys and the skepticism of the plaintiffs' bar is well founded in that: (1) the Internal Revenue Service has indicated that the plaintiff's knowledge of the cost of the settlement package clearly does not constitute constructive receipt of the funds; (2) constructive receipt is not the problem of the insurance carrier but rather the problem of the plaintiff and protecting the plaintiff's tax-free status is in the province of the plaintiff's attorney, not the insurance carrier; (3) the plaintiff's attorney cannot intelligently evaluate the settlement offer in its true perspective of potential jury verdict without knowing the amount of money being expended by the defendant's carrier; and (4) the cost of the package is one of the major elements to be considered by the plaintiff's attorney in setting a fee for services.

6. Mistrust of the Insurance Industry

Many plaintiff's attorneys refused to structure settlements, even when the costs of the annuity was revealed by the insurance company because they suspected internal insurance industry deals, particularly between members of an insurance group, which hid the true cost of the settlement package. Others felt that they were simply being lied to by the insurance companies as to the true cost of the package. The latter group had its suspicions confirmed in the recent case of Lyons v. Medical Malpractice Insurance Association, 730 N.Y.S. 2d, 345 (N.Y.A.D. 2 Dept., 2001) in which MMIA represented to the plaintiff that the present value of the settlement was $940,180. When the plaintiff, a minor child, subsequently learned that the true present value of the settlement was $410,000, less than half of the professed amount, the plaintiff sued MMIA for fraud, negligent misrepresentation and intentional misrepresentation. After Summary Judgment was granted for MMIA, plaintiff appealed.

On appeal, MMIA admitted that the true present value of the child's settlement was $410,000 rather than the $940,180 of which they had advised plaintiff. However, MMIA sought to justify their deceptive settlement practice on the basis that the plaintiff was not entitled to rely on their misrepresentation as to the true value of the settlement because plaintiff had both an independent duty and an equal opportunity to determine the true present value of the settlement package for himself. Summary Judgment was reversed and the case was remanded.

MMIA confirmed long held suspicions of the plaintiffs' bar that certain insurance companies use structured settlement quotes as an opportunity to deceive uninformed plaintiffs and their attorneys. However, the greater message for the plaintiffs' bar is that the plaintiff's attorney was also sued for legal malpractice for failure to utilize the free services of a plaintiff's structured settlement specialist who would have determined the true cost of the settlement and kept the plaintiff from being deceived by the insurance company. The plaintiff's attorney settled the legal malpractice case for an undisclosed sum. Always use a structured settlement consultant.

V. Advantages to the Plaintiff in Structuring Settlements

Despite the traps inherent in structured settlements, the reasons favoring their acceptance by the plaintiffs' bar outweigh the negative aspects. Analysis of tax advantages, flexibility, professional management of funds, preservation of client funds, and the ability to close the gap between the plaintiff and defendant in an
otherwise "unsettleable" case affirm the viability of the structure as a settlement tool.

**Tax advantages**

Obviously the advantage which is the sine qua non of the success of the structured settlement program is the tax-free benefit to the plaintiff inherent in the use of the structured settlement. A $1 million net cash settlement to a plaintiff which is placed in a certificate of deposit at 6 percent interest generates $60,000 the first year in taxable interest income. This income will be burdened with a considerable tax obligation to the government, leaving the plaintiff a reduced net recovery.

An analogous annuity placed in a properly structured settlement pursuant to 104(a)(2) of the Internal Revenue Code of 1954 which generates $5,000 per month of tax-free benefits will represent a $60,000 net tax-free receipt of funds by the plaintiff.

There are obvious advantages to the $1 million lump sum cash settlement that are not inherent in the structured settlement. For example, at the end of the term, the corpus of the million dollars is still available for the plaintiff whereas the annuity is exhausted over the term of the contract in the payments to the plaintiff. However, the plaintiff may negotiate large lump sum payments at the conclusion of a long-term structure.

**Professional management of the fund**

A second advantage to the plaintiff in the structured settlement is that the plaintiff bears neither the cost nor the risk of managing the annuity funds. The life insurance carrier pays the fee to the financial analyst who arranges the investment plan so as to timely fund the plaintiff's annuity payments. The plaintiff will receive his or her monthly benefit payments without regard to economic niceties such as the prevailing condition of the investment market, interest rates, or inflation. The unsophisticated plaintiff achieves financial peace of mind and can plan his or her life around the certainty of the income provided in the structure.

**Tailoring to the client's needs**

A significant advantage of the structured settlement to the plaintiff, particularly in a catastrophic injury case, is the ability to tailor the structure precisely to the needs of the claimant. In meeting future medical needs, the structure may be tailored so that all medical needs or rehabilitative advancements that materialize will be funded. Numerous types of contingency funds, college endowments, perpetual nursing home care, emergency contingency funds, and lump sum benefits may be built into a structure package in such a way that a carefully devised plan will literally meet all of the future needs of the plaintiff, even those that are undeterminable at the time of settlement.

**Preservation of plaintiff's funds**

The average plaintiff is unable to handle large sums of money in such a way as to protect his or her own interests and provide for his or her future needs. In 1980, the *American Bar Association Journal* published a psychological study concerning persons who had received lump sum payments of various types in excess of $100,000, including recipients of personal injury verdicts. The study revealed that after five years, 90 percent of the test group had nothing left of their windfall income. This included the personal injury settlement recipients who no longer had the money but still had the disabilities. The inherent problem is that cash personal injury settlements, based upon future wage loss and future medical expenses, will often be squandered by the recipient, who will be unable to meet his or her medical or economic needs and will become wards of the state and the charity hospitals, thus, receiving far less medical care than needed. The structured settlement has the advantage to the claimant who will have large financial needs in the future, of preserving the funds and assuring that they will be available as needed. It is, however, essential that the plaintiff fully understand that no changes may be made in the method of annuity payments once the annuity is funded. It is also necessary that the attorney have, as part of the papers in the case, a statement of express understanding by the client of this and other significant factors.

**Coverage for unanticipated medical advances**

Another significant aspect of the structured settlement with respect to future medical needs should be considered, i.e., the tremendous pace of advances in medical science. The progress that will take place in rehabilitation during the lifetime of several of today's catastrophic injury patients is beyond imagination. For example, consider a 17-year-old paraplegic today who is confined to a wheelchair for life. This plaintiff has a 55-year life expectancy that extends his or her life into the year 2057. Given the option of a cash settlement, it would be difficult to project and collect the lump sum that would meet all of this plaintiff's medical needs over the next 55 years. However, in a structured settlement, it is possible to negotiate for
sufficient funds to cover all of the future medical needs of the plaintiff through the funding method of a single premium deferred annuity, a semiannual or annual annuity payment to fund a medical contingency fund or, less desirably from the plaintiff's viewpoint, a medical reversionary trust. One method is a medical contingency fund that will provide all medical benefits as needed. No one can definitively project today what the next 55 years will bring with respect to medical developments in the rehabilitation of paraplegics. It is possible that in the year 2010, medical bionics will be developed to the point where paraplegics who can afford the care may be able to walk again. Through a properly structured settlement providing for all future medical needs of the plaintiff, the 17-year-old paraplegic today would have the funds available to cover the cost of rehabilitation at whatever point in time in the future medical science improves on his or her tragic condition. Such assurances could not be had through the payment of a lump sum because: (1) a medical witness cannot reasonably project the cost of unforeseen medical advances; and (2) regardless of the amount paid, there is no assurance that the plaintiff would not be subject to dissipation of his or her funds long before his or her needs have been met.

Let the United States Treasury Department contribute to the settlement

One additional advantage to the structured settlement is that the format may provide the final impetus to bring together a plaintiff and a defendant in settlement who have exhausted all possible negotiations under a lump sum cash settlement and are still far apart in their respective demands and offers.

Assume that the plaintiff's attorney determines that a $1 million settlement is the lowest figure to meet his or her client's needs and settle the lawsuit. The insurance company determines that its maximum exposure is $1 million, that it has a chance at comparative negligence on the plaintiff, and that $750,000 is its final offer to settle the case. When the facts include large future needs of the plaintiff, the tax-free aspects of the structured settlement may be utilized to close the $250,000 gap between the parties.

With the $750,000 available from the defendant, the plaintiff's attorney, through his or her own annuity specialist, may shop for an annuity package which will, after an initial cash outlay to cover the client's present needs and attorney's fees, utilize the balance of the settlement funds to structure a program to meet the client's future needs.

This will result in a tax-free payout to the plaintiff far in excess of the million-dollar lump sum, which is being demanded. Considering the nature of the injury, the client's future medical and financial needs, the ability of the client to manage funds, and the ability of the plaintiff's lawyer to favorably structure the settlement, the plaintiff should eventually end up with a better settlement, with more true benefits, and with more actual needs met than he or she would have achieved with the million-dollar cash settlement. This, of course, depends upon the facts of the particular case, but it is submitted that the structured settlement is a worthy alternative to consider, particularly in cases of potential comparative negligence or comparative causation on the part of the plaintiff or in cases of questionable liability with large damages. In this type of case, where the defendant's cash offer is far smaller than the plaintiff's future needs and there is a possibility of a jury finding of no liability or a large reduction in plaintiff's recovery through comparative negligence or comparative causation, the structured settlement may be the most auspicious route for the plaintiff to follow. The Treasury Department has agreed that settlements of this type are tax free when properly structured, so consider letting the rare generosity of the Treasury Department serve to close the gap between the plaintiff and the defendant while enhancing the plaintiff's benefit package.

Thus, it is submitted that despite the well-founded skepticism that is prevalent in the plaintiffs' bar with respect to structured settlements, there are far more redeeming values to the structure which commend themselves to the serious consideration of the diligent plaintiff's attorney.

VI. Negotiating the Structured Settlement

Proper frame of reference

1. Defense: Meeting the plaintiff's needs

The major argument used by the insurance industry in negotiating structured settlements is that it is designing a program that will specifically meet all of the claimant's needs, and, if those needs are met, it is a good settlement for the plaintiff. The only acceptable response by the plaintiff's attorney to this tactic is to consistently adhere to the frame of reference that the structured settlement is not measured against the needs of the plaintiff, but is measured against the verdict potential of the case.

Assume a seriously injured plaintiff with projected future medical needs of $500,000. The plaintiff's attorney, after consideration of all aspects of the case, determines that there is a verdict potential of
$3,000,000. The insurance carrier, which can purchase an annuity policy for $100,000 to meet all of the plaintiff's future needs, offers to settle the case for $750,000; $250,000 up front and a $500,000 structure for future medical needs. The insurance industry's position is that it has met all of the client's needs and, therefore, has met its obligation. There is no need for the plaintiff's attorney to know that the carrier's cost is only $350,000.

2. **Plaintiff: actual costs versus verdict potential**

The plaintiff's attorney does not measure the $750,000 structured offer against the needs of the plaintiff in determining if this is an adequate settlement. The proper frame of reference for measuring the carrier's offer is the $350,000 cost measured against the $3,000,000 verdict potential at the courthouse. Thus, before undertaking the negotiation of a structured settlement, the plaintiff's attorney should first evaluate the case fully as if the settlement were being made on a cash basis, then compare the structured settlement, with its tax-free benefits, to determine which is more advantageous to your client. There is no need to offer the liability insurance carrier a substantial savings on a structured settlement because the only additional burden it would assume, if a qualified assignment is used, is payment of additional attorneys' fees to defense counsel for preparing the structured settlement papers.

**Understanding the "rating up" system**

When negotiating a structured settlement it is essential that the attorney understand the method used by the annuity company in establishing the premium cost of an annuity. When an annuity company is to issue an annuity that will provide payments for the lifetime of the annuitant rather than for a set number of years, the company will thoroughly review the individual's medical history and present condition in order to evaluate actual life expectancy. Assume that the plaintiff is a 22-year-old male, comatose patient who sustained a severe head injury and multiple internal injuries to such an extent that he is a IV on the Glasgow Coma Scale. According to the United States Life Tables, this patient has a life expectancy of 55 years. However, due to the life-threatening nature of the injury, the annuity company, which is being called upon to make monthly payments for the remainder of plaintiff's life, has the problem of estimating how long the critically injured plaintiff will actually live. Assume that after a careful review of the medical records the annuity company determines that the plaintiff has approximately 10 years to live. He will be "rated up" to age 72, which would then give him a theoretical life expectancy of 10.2 years. In other words, he would now be treated the same for insurance purposes as a 72-year-old applicant for an annuity.

This "rating up" process provides a tremendous opportunity for the plaintiff's attorney to shop for the most competitive annuity prices among the stalwarts in the annuity industry. Since the annuity prices are based, to a large extent, upon the prediction of the annuity company's medical experts as to the actual life expectancy of the plaintiff, this estimate as to life expectancy can vary tremendously and there will be a corresponding substantial disparity in annuity rates to purchase exactly the same benefits. Significantly, the higher the rated up age, the lower the cost of the annuity.

The plaintiff's attorney should attempt to determine from the insurance carrier the "rated up" age of the plaintiff that is being used as a basis for the structure offered by the defendant. Regardless of whether the carrier will disclose the "rated up" age, the plaintiff's structured settlement specialist may call several annuity companies and shop the annuity market for the best price for the benefits sought. This can result in increased benefits to the plaintiff.

For example, assume that the plaintiff's attorney determines that the cost of the structure is $500,000. The plaintiff's structured settlement specialist then shops the annuity and obtains exactly the same benefits for $430,000 from another qualified life insurance carrier. The $70,000 differential, based upon different "rating up" estimates, can then be used either as part of a lump-sum increase up front or can be utilized to purchase $70,000 in additional structured benefits. This is one of the major reasons why the plaintiff's attorney should affirmatively seek to structure settlements rather than passively waiting for the insurance industry to bring structured settlements to the plaintiffs for their review.

**Negotiable features of the structured settlement**

Every structured settlement should consider the following:

1. An up-front, lump-sum payment to cover medical expenses already incurred, lost wages, pain and suffering, immediate capital expenditures, i.e., special equipment for handicapped plaintiffs;
2. Benefits to start timely and to continue for the life of the annuitant and beyond if the plaintiff leaves dependents. If the funds can be invested in the annuity for two to three years before the monthly benefits begin, the more long-term return on investment can be achieved since annuities are front-end loaded. For example, an annuity for a three-year-old child which will not begin payments until the child’s eighteenth birthday can grow to incredible sums due to the length of early investment without return;

3. A minimum number of payments to protect dependents or to insure that at least a certain amount is paid out. The term of art for this is "x years certain". An annuity on the life of the annuitant should be for "x years certain and life" in order to guarantee a minimum return and avoid malpractice;

4. Benefits to increase by a certain percentage on an established and regular basis to counter the effect of inflation. This is generally a three percent increase per annum;

5. Contingent funds to provide for the education of the children, burial expenses, and future unexpected occurrences;

6. Periodic payments (balloon payments) as a hedge against inflation may be considered; and

7. A guaranteed minimum return, i.e., in the event of the death of the claimant, the payments continue to claimant's designated beneficiaries for the full term of the settlement rather than reverting to the liability insurance carrier as a cash refund reversionary interest.

The last is one of the most important features that one must insist upon. If the liability insurer retains the reversionary interest in the policy it may realize a substantial refund in the event of the plaintiff's untimely death. If this occurs, the defendant will be in the position of having paid only a fraction of the lump-sum settlement value of this case. Naturally, this is a very attractive feature to the insurance industry, especially in cases of catastrophic damages when the plaintiff's life may well be far shorter than indicated on the actuarial tables upon which the settlement was based. The whole point of the structure from the plaintiff's side is to provide a plan by which the victim will be recompensed. Certainly, the survivors should be provided for, and this is best accomplished by the guaranteed minimum return through continuation of periodic payments in the event of the claimant's premature death.

Negotiable provisions of the settlement are those that must be tailored to fit the particular needs of the plaintiff. Items such as the amount of the initial payment, the dates of periodic payments, the amount of each payment, and other special requirements should be negotiated. For instance, if future surgery is required, an estimate of its cost and provisions for a lump-sum payment might be included in the settlement terms. Costs of special equipment, clothing, remodeling the home to accommodate the victim's handicaps, and any therapy expenses are also items for negotiation. The list of possibilities is limited only by the needs of the client and the imagination of the attorney. Since many of these are future needs, the attorney should seek expert structured settlement advice, utilize a life care planner, seek information from the physician, surgeon, therapist, and other health care professionals about any future medical needs and their projected costs. The careful plaintiff's attorney will consider all of his or her client's needs and negotiate the details of the settlement to provide for them.

Shoe on the wrong foot
In order to obtain maximum benefit from a structured settlement, the plaintiff's attorney should not leave to the insurance carrier the design of the structure. Defense initiative in proposing structured settlements has the effect of putting the shoe on the wrong foot in that defense counsel or the insurance representative undertakes to design the settlement program to meet the plaintiff's needs. This should be the province of the plaintiff's attorney, working with his or her own structured settlement specialist.

Determining the plaintiff's needs
1. Review with experts

Only after a carefully detailed review with the claimant and/or his or her family members, treating physicians, and an economist can an intelligent determination be made as to the precise future needs of the claimant which must be met by the structured settlement. All future needs of the claimant, financially and medically, must be analyzed in order to determine the type of structure and the method of funding which would best meet those needs. This is a procedure that requires considerable consultation with the claimant and his or her family members and the health care providers in a catastrophic injury case. It will also require the use of a life care planner working with an economist to project the stream of income that will be necessary in
the future to meet those needs. To leave to the
insurance company the determination as to how to
structure a settlement to meet the plaintiff's needs is a
default on the part of the plaintiff's attorney and may
lead to allegations of malpractice if the insurance
company's representatives are wrong in the projection
and funding of the client's future needs.

2. Framing the structure
Plaintiffs' attorneys should be actively engaged in
affirmatively analyzing the structuring of a settlement
and should do so with the assistance of a professional
structured settlement specialist. It is not sufficient to
leave it to the insurance carrier to submit a structured
settlement to the plaintiff to either be accepted or
rejected by the plaintiff's attorney. The author's
method for negotiating a structure is for the plaintiff's
attorney to submit to the insurance carrier, prior to
negotiating dollars, a framework of the plaintiff's
proposed structure. These include: (1) initial cash
outlay; (2) negotiable provisions; and (3) non-
negotiable provisions.

Affirmative use of the structured settlement

1. How to organize the proposal
The first step for the plaintiff's attorney is to meet
with the life care planner and the treating physician
and obtain a written narrative as to the following: (1)
nature and extent of disability; (2) actual life
expectancy of the claimant in light of the catastrophic
injury; (3) projected future medical needs, e.g.,
surgery, supervisory nursing care, and so forth; and
(4) an estimate as to the cost of each item of future
medical care.

After obtaining a medical projection as to future needs,
the attorney should consult with an economist in order
to project the costs of those future needs over the
anticipated life expectancy of the claimant and also
project the stream of income necessary to meet those
needs and the present dollar value required to produce
the stream of income. The economist will also
formulate an opinion that will provide a basis for
testimony at the time of trial as to the projected future
damage to the plaintiff's wage earning capacity.

Next, the plaintiff's attorney should draft the
framework of the structure which would set out the
minimum requirements the plaintiff will consider as
part of a structured settlement. Note that the
framework does not include the sums of money
necessary to meet each of these needs. If the plaintiff
and defense attorneys can agree on the framework,
i.e., the specific provisions the plaintiff will require in
a structured settlement, then the amount of money
required to fund each provision may be negotiated. It
is far easier to negotiate amounts once the provisions
have been agreed upon between the parties than to try
to compare a plaintiff's structure and a defendant's
structure containing entirely different provisions.

Once these provisions have been determined by the
plaintiff's attorney, he or she should advise the defense
counsel or insurance company representative as to this
framework so that both sides will be formulating
proposals based upon the same goal, i.e., tailoring the
structure with provisions which meet all of the past,
present, and future needs of the plaintiff. Ideally, the
plaintiff's attorney should suggest a dependable
structured specialist who is capable of maximizing the
benefits available for the plaintiff and request that
defense counsel's structured settlement expert work
with that structured specialist to purchase the annuity.
Such cooperation would greatly expedite an agreed
settlement. The fee is generally split between the
experts.

2. Proposal letter
For an example of the manner in which a structured
settlement demand should be included in a settlement
demand letter see attachments to the full article entitled
"Persuasion in Settlement Negotiations" available at

3. Agreeing on the framework
If counsel and their respective structured settlement
specialists are working within the same framework in
attempting to formulate a structure acceptable to all
parties, it is simpler to compare the provisions of the
respective structures and to resolve disputes between
them.

There is one additional major advantage to both sides
operating within the same framework. Generally, the
structured settlement is not a courthouse steps vehicle
for settlement. It often takes several weeks to
evaluate and negotiate a structured settlement. However, if there is agreement as to the specific
provisions being negotiated and the only matter in
dispute is the amount of money to fund the provisions,
this is a matter that may be negotiated at the
courthouse steps.
VII. The Non-negotiable Provision: A Guaranteed Minimum Return

The one feature in all structured settlements that the plaintiff's attorney must negotiate, both for the protection of the client and for the attorney's avoidance of a legal malpractice claim, is the guaranteed minimum payment. This may be accomplished by a life annuity with a period certain, whereby annuity payments continue for a designated guaranteed period, even after the annuitant's/claimant's death.

Guaranteed annuity payments for a certain period are particularly useful when the plaintiff is the family breadwinner. In this case, the structured settlement should be guaranteed at least until the youngest child is expected to leave home or complete college. This will insure the family's financial security regardless of the health of the claimant.

A guaranteed minimum payout avoids a windfall to the insurance carrier in the event of the plaintiff's early death. The insurance bar has suggested throughout the years that the use of the structured settlement grew out of the need to avoid large windfalls to the plaintiff who, after receiving a jury verdict or lump-sum settlement compensating for future losses, died soon thereafter. Early structures contained a reversionary interest to the liability insurance company on the death of the plaintiff prior to the full payout. The plaintiff's attorney must avoid the reversionary interest and replace it with the guaranteed minimum return.

Guaranteed minimum recovery (term certain)

In order to avoid malpractice and accomplish a guaranteed minimum recovery, the periodic payments must be guaranteed for a minimum number of years, payable to either the plaintiff's designated beneficiary or the estate of the plaintiff, in the event that the plaintiff dies within the term certain. Again, by failing to include such a minimum recovery, the plaintiff's attorney can expect a windfall to the insurer that would not be available through a verdict or lump-sum settlement. This is malpractice that must be avoided.

The plaintiff's non-ownership of the annuity

Some attorneys balk at the idea of the defendant, or the defendant's carrier, or an assignee owning the annuity policy. They fear the loss of control that such an arrangement represents. This arrangement is necessary, however, to preserve the favored tax status which the structure provides.

VIII. Preserving the Tax Advantages: Avoidance of Constructive Receipt

Avoidance of Constructive Receipt

No incidence of ownership in the plaintiff

In order for the damages that are received for a personal injury or wrongful death to be excludable from gross income under section 104(a)(2) of The Internal Revenue Code of 1954, there are certain criteria with which the plaintiff must comply. The safest route for insuring the tax benefit is through the use of annuity funded periodic payment plans wherein the annuity policy is issued in the name of the plaintiff as the annuitant. The ownership of the policy is placed in the name of a person agreed upon by the parties to the settlement, generally an assigned holding company under a qualified assignment. The purpose of setting up the annuity in this fashion is that an annuitant (plaintiff) who is not the owner of the policy cannot change the beneficiary or reassign the policy to anyone else. Thus, under our prevailing tax laws, the periodic payments are not taxable as income to the plaintiff who is not the owner of the policy, not in constructive receipt, and has no control over the right to invest and control the funds.

Guidelines for constructive receipt

Constructive receipt under the Internal Revenue Code of 1954 is defined under Section 1.451-2(a) pursuant to the following guidelines:

1. The injured party should never have the right to receive the present discount value;
2. The annuitant should have no control over the investment of the funds;
3. The annuitant should not be able to increase or decrease the monthly payments;
4. The negotiations and settlement agreement should not offer the plaintiff a lump sum as an alternative to the periodic payment settlement.

Advise client of inflexibility

It is essential that the plaintiff's attorney make it clearly understood to the claimant that in accepting a structured settlement, he or she is giving up the right to the control over his or her funds and that there are severe limitations on the type of changes which can be made in the structure in the future. This is necessary in order to avoid constructive receipt and protect tax advantages. The flexibility in a structured settlement
comes prior to the structure being memorialized in writing. Once the structure is completed, the flexibility no longer exists.

**Insurance industry's position regarding constructive receipt**

As previously discussed, the insurance industry uses the "fear of constructive receipt" as a basis for refusing to disclose the actual cost to the liability insurance carrier of the structured settlement package on the theory that if the plaintiff knows the cost of the package, he or she will be in constructive receipt of the funds and will, therefore, waive the non-taxable benefits on the periodic payments. This is totally without foundation in the Internal Revenue Code, in case law, or anywhere else that this author has been able to find other than in the insistence of the insurance industry.

The foregoing test from 1.451-2(a) of the Internal Revenue Code of 1954 is the test of constructive receipt utilized by the Internal Revenue Service. The only conceivable portion of the guidelines that could support the position of the insurance industry is subsection 5 to the effect that the negotiations and settlement agreements should not offer a lump sum as an alternative to the periodic payment settlement.

**IRS uses the best evidence rule**

The Internal Revenue Service utilizes the best evidence rule in assessing the tax liability of settlement funds. The court records and settlement papers are the basis for determining if the plaintiff has constructive receipt. Granted, if the court papers and settlement agreement indicate that the plaintiff has the option of accepting a lump-sum benefit as an alternative to the periodic payment settlement, then the Internal Revenue Service may choose to impose constructive receipt on the funds and deny tax advantages to the plaintiff. However, this is considerably different than the plaintiff's attorney or structured settlement specialist being advised as to the cost of the entire package as part of settlement negotiations.

**Treasury Regulation § 1.451-2(A)**

The position of the insurance industry simply does not comport with the Treasury Regulation 1.451-2(a) and several Revenue Rulings that stand for the proposition that "knowledge is not determinative in deciding a question of constructive receipt, but that qualified availability is decisive."

**Private Letter Ruling 8333035**

More precisely, in Private Letter Ruling 8333035 on May 16, 1983, the Internal Revenue Service made the following ruling:

Disclosure by defendant of the existence, cost or present value of annuity will not cause plaintiff to be in constructive receipt of the present value of the amount invested in the annuity.

Thus, the insurance industry's position that it is refusing to disclose the full cost of the settlement package to the plaintiff for the plaintiff's own benefit in order to avoid placing the plaintiff in constructive receipt of the funds is without foundation in the Internal Revenue Code or in Revenue Rulings and continues to be the major source of skepticism and prejudice by plaintiffs' attorneys against utilization of structured settlements.

**IX. Consult a Plaintiff's Structured Settlement Expert**

Use an annuity expert to evaluate the provisions of the structured settlement. The true value and relative merit of the alternatives can be misleading. Before negotiating such a settlement, an attorney should discuss with a structured settlement specialist the nuances of structured settlements. There are companies that provide professional assistance in designing the structured settlement and also present and explain its benefits to the claimant, complete the annuity applications and releases, and service the annuity contract. Many structured settlement specialists limit their representation to the insurance industry and for many years the life insurance industry ostracized specialist who worked for plaintiffs. While this type of insurance industry self-protection still exist, there are a substantial number of highly qualified experts who work with plaintiff's attorneys in structuring settlements. It is essential that we protect their fees in settlements by making the splitting of the brokerage fee a term of the settlement agreement.

There is a new method of structuring on the horizon which will soon allow plaintiff attorneys and structured settlement specialists to take the control of structures away from the insurance industry and stop the insidious practice of defense brokers getting half or all of the brokerage fee for no work.

We are very close to getting the necessary rulings which will allow settlement proceeds to be paid into a fund out of which the plaintiff's broker can directly
purchase the annuity without fear of constructive receipt or other adverse tax consequences. When this is finalized, the defense brokers who have monopolized the structured settlement market and ostracized plaintiff's broker will suffer a considerable loss of power in the industry and may find themselves working only in cases where the plaintiff is unrepresented by counsel and thus subject to being misled.

**Services of the expert**
Have the expert review figures to determine true benefits; present worth and cost of the total settlement; contact other insurance companies to compare costs for the same benefits; set a guaranteed monthly payment to provide lifetime care and support at an income level which will allow the person to retain or exceed his status prior to injury as the minimum goal and consider education funds for minor dependents as additional annuities. Work with the specialist and familiarize yourself with the vital portions of structures such as qualified assignments. An attorney specializing in this area of personal injury practice can be extremely helpful with preparation of the necessary documents.

**Expert’s fee**
A broker's commission is paid for placing the annuity premium with the life insurance company. For this commission, service work is to be performed by the agent, such as verifying lost checks, or change of addresses of beneficiaries. Servicing of the structured settlement annuity is a very good point to present since, if the defendant places the annuity with a defendant-oriented broker, it will not be anxious or available to help your client resolve future problems, which often arise with respect to future payment of benefits. This is another incentive to try to get defense counsel to work with the structured settlement specialist of your choice. After all, historically, the defendant has been asking the plaintiff to work with an insurance-oriented broker. It is essential that the plaintiff's attorney have his or her own structured settlement specialist to protect the rights of the plaintiff and to help insure against mistakes by the attorney. Since the expert services are free, it is naive not to utilize them.

**X. Shopping the Annuity**
Since the price of an annuity varies on a short-term basis, it is imperative to obtain current prices on a daily basis through an expert to maximize benefits from the most secure company. Shopping the annuity is particularly important in rated risk cases.

**XI. Checklist for Avoiding Malpractice**
The plaintiff's attorney who accepts a serious personal injury case needs to be informed about structuring the plaintiff's settlement and must be equipped from the outset for that possibility. In the event that a settlement can be effected, the attorney must choose between a lump-sum amount or a structured payout. The decision of whether to structure or not to structure must be made on an informed consideration of the client's case and a thorough understanding of the structured settlement alternative. Should structuring be chosen as the best route to take, remember the 12 signposts of successful structuring.

1. Always use the free services of a highly skilled plaintiff's structured settlement specialist who will help design the precise structure to fit the needs of your clients, aggressively shop the annuity and bond markets for the best funding with the most secure company, determine the precise present value of the settlement package, protect against constructive receipt, review the settlement documents and perform a plethora of other valuable services, all without cost to the plaintiff. How often can we get an expert that is truly worth a very substantial fee but whom we pay nothing?

2. Always fully document every demand, offer, refusal and counteroffer and the explanation which was given to the client as to the cash or structured alternatives of the settlement proposal.

3. Always negotiate a guaranteed minimum return (GMR) for the client. This is achieved through a term certain annuity, e.g., 40 year certain and life. This also avoids a reversionary interest in the purchasing party.

4. Determine the client's present total indebtedness, present needs and future needs (life care planners). In determining future needs, be certain that you are dealing with an accurate life expectancy for your client considering their physical condition rather than merely using standard life tables.

5. Determine the exact projected cost of each present and future need (economist).

6. Choose the appropriate funding mechanism to maximize a secure payout while meeting the specific present and future needs of the client. In doing so, consider and compare all of the relevant funding mechanisms, e.g., annuities, bonds, etc.
7. Protect the record from constructive receipt, keeping in mind that the Internal Revenue Service uses the best evidence rule, i.e., the papers and record in the case. In the event of fraud or the suspicion of fraud the Service will go beyond the settlement papers and the transcript of the hearing for court appeal. While avoiding constructive receipt, never settle a case without knowing the precise cost of the entire settlement package to the defendant.

8. Place the structure with the most secure company that offers the most competitive return on the investment of the settlement funds.

9. Calculate attorney's fees based on the defendant's total cost of the settlement package. In order to do so it is necessary for the attorney and the ad litem to know the precise cost of the entire settlement package to the defendant.

10. Include the possibility of a structured settlement in the employment contract. One of the earliest legal malpractice cases arising out of structured settlements occurred because the attorney got a lump sum fee and the client get a long term payout of monthly payments.

11. In the case of a catastrophically injured annuitant, highly substantial increases in the annuity payout can be achieved by vigorously shopping the rated age of the annuitant. Rated age is educated guesswork by the medical consultants with the insurance companies as to how long the annuitant will live. These educated guesses can vary by decades, thereby increasing the potential payout as well as the guaranteed return for the annuitant.

12. Carefully document the client's understanding of the terms, risks, and peculiarities of the settlement. This is best accomplished by videotaping the session in which you explain all of the nuances of structured settlements to the client.

XII. Conclusion: The Safe Haven
The cautious Plaintiff's attorney can no longer ignore structured settlements by simply adopting an attitude of "Give me the cash." The inevitable time has arrived when attorneys are being sued for failure to offer the client the option of a structured settlement. It is now necessary to consider a structure and explain the nuances of the structured settlement versus a cash settlement to a client in a plethora of personal injury and wrongful death cases. The safe haven for Plaintiff's attorneys who feel the increased pressure to consider and explain structured settlements to their clients is the plaintiff's structured settlement specialist. Their services are free to the Plaintiff and there is no good reason not to use them. Aside from all of the expertise which a qualified broker can bring to the design of the best possible structure for your client, another reason to utilize a plaintiff's broker is that the failure to do so may constitute legal malpractice. Seek the safe haven; maximize your client's recovery and sleep better at night.