

Current Issues in Structured Settlements

Richard B. Risk, JD, CSSC

Introduction

- Current issues will impact on how everyone does business
- Awareness is an important aspect of bringing change
- Each settlement planner has an opportunity to make an impact
- Hopefully, changes will be for the good

Topics of Discussion

- Status of the Structured Settlement Industry
- Legislation and Regulation
- Rulings
- Litigation
- Standards

Status of the Industry

- Overall decline in outlook of insurance industry
- Exits from structured settlement annuity marketplace (Canada Life, AEGON, CNA)
- Increased efforts for profiteering by liability insurers and related life companies
- Life companies enter factoring marketplace
- Emergence of alternative products
- Unprecedented era of litigation over structures
- Court rulings on factoring cases apply “best interest” test

Legislation & Regulation

- Tort reform: Federal and State
- Regulations to implement new IRC § 5891
- HIPAA Regulations
- Regulations to implement DOJ Act

Legislation & Regulation

Tort reform: Federal and State

- “Help Efficient, Accessible, Low-cost, Timely Healthcare (HEALTH) Act of 2003” ultimately defeated in Senate
 - Forces periodic payment of damages “at request of any party”
 - NSSTA lobbied to remove reference to Uniform Periodic Payment of Judgments model act as standard for selecting annuity issuer, rather than attempting to codify updated “bright line”
- Tort reform legislation appearing in multiple states
 - Driven by insurance industry and self-insured business
 - Little benefit for consumer
 - Many contain forced periodic payments of judgments

Legislation & Regulation

Regulations to implement new IRC § 5891:

- Issued February 19, 2003 as temporary regulations
- New Title 157 “Excise Tax on Structured Settlement Factoring Transactions,” 26 CFR § 157.5891-1, et seq.
- Set forth the manner and method of paying excise tax
- Do not address method of determining proper amount, which may be addressed in future revisions
- No surprises; follow statute

Legislation & Regulation

HIPAA Regulations:

- Standards for Privacy of Individually Identifiable Health Information, 45 CFR Parts 160 and 164
- Issued under Health Insurance Portability & Accounting Act of 1996 (HIPAA)
- Effective April 14, 2003
- May give relief to injury victim plaintiffs whose medical records are routinely given to defense brokers

TIP

Become familiar with HIPAA regulations, as they can be applied to the defense's indiscriminate distribution of medical records without permission.

Legislation & Regulation

Regulations to implement DOJ Act:

- 21st Century Department of Justice Appropriations Authorization Act, effective November 5, 2002
- Section 11015, “use of Annuity Brokers in Structured Settlements”
- DOJ Torts Branch created Declaration to be signed by any broker who wants to be on list
 - Requires defense practice as qualification criterion
 - Does not regulate Torts Branch in its selections
 - Allows continuation of cronyism practice
 - Continues to ignore procurement laws

TIP

Consider filing GAO bid protest, which does not require that you be represented by an attorney.

Must be filed by an “interested party ... an actual or prospective bidder or offeror with a direct economic interest in the procurement.”

Guide available on Internet. Search for GAO-03-539SP

See 4 CFR § 21.0(a)

Rulings

- Request to Treasury and IRS for formal guidance on 468B for single claimants
- Rev. Rul. 2003-115, 10/28/03, confirming 9/11 VCF structures tax-free
- Taxable damages and taxation of atty fees
- Treasury Decision 9046

Request to Treasury and IRS

Skadden Arps Slate Meagher & Flom, LLP, engaged by SSP to request formal guidance on qualified assignments from single-claimant 468B; submitted June 19, 2003

- Recommended revision to Rev. Proc. 93-34
- Argued intent of Congress underlying 1988 revision to IRC § 130
- Argued intent of IRS in issuing Rev. Proc. 93-34
- Single-claimant argument, if applied, would cause every QSF to incur economic benefit

Two of three signers (Goldberg and Gideon) had been assistant secretary of the Treasury for Tax Policy and general counsel of the IRS. Goldberg also was IRS commissioner. Third signer (Brewster) also from IRS

Request to Treasury and IRS

Letter signed by Steve Boger of Allstate, as NSSTA president, opposing issuance of guidance; July 24, 2003

- Mischaracterization of marketplace financial health “flat wrong”
- Rev. Proc. 93-34 was not intended (by NSSTA) to address single claimant QSF
- NSSTA “felt so strongly” about “mischaracterization” of marketplace and Rev. Proc. 93-34’s purpose “that we have chosen to focus our comments on these two fundamental points.”
- “Please do not construe our silence on the other points to indicate agreement; we simply have not spoken to these points.”

TIP

Translation:

There are no valid arguments against a qualified assignment from a single-claimant QSF

NSSTA Letter to Membership

“Finally, we discussed NSSTA’s longstanding position that the power of the structured settlement lies in a free and unfettered negotiation process as embodied in the settlement conference. NSSTA’s well-established view is that if either party of a settlement negotiation were placed at a disadvantage by legislation or regulation, fewer structured settlements would result.”

Steve Boger letter to NSSTA membership, October 2, 2003, on meeting earlier that week with Treasury and IRS

NSSTA Letter to Membership

“In closing, let me reiterate that in pursuing these discussions with Treasury, NSSTA is working to preserve the free and vigorous settlement negotiation process that has worked so well over the past 20 years and has built the success of the business in which we all participate. NSSTA is seeking to ensure that neither side in the negotiation is placed at a disadvantage by regulatory fiat. These are principles that all NSSTA members should share and toward which we all should continue to work.”

Steve Boger letter to NSSTA membership, October 2, 2003, on meeting earlier that week with Treasury and IRS

McColloch Presentation to NSSTA

- Does not address arguments presented by Skadden Arps or by Risk, especially Rev Rul 79-220 and legislative history of Periodic Payment Settlement Tax Act of 1982
- Primary theories ignore absurdity of single-claimant argument
- Alternate theories, “substance-over-form” and “step transaction,” are weak, designed to create more doubt
- Presentation was designed to justify Allstate’s position of not accepting qualified assignment from QSF created for single claimant

McColloch Presentation to NSSTA

The following excerpt from McCulloch's presentation to the January 2004 regional NSSTA meeting in Los Angeles appears to be in direct conflict with efforts by Allstate's Steve Boger, through his letter and personal meeting on behalf of NSSTA, to convince Treasury and the IRS that guidance should not be issued:

“With the posture of Treasury at question and the issue unresolved, we choose to wait for clarity from Treasury”

Rulings

Rev. Rul. 2003-115, 10/28/03, confirming 9/11 VCF structures tax-free:

- Any payments pursuant to an Award Determination Agreement from September 11th Victim Compensation Fund excluded
- Contains two references that violate public policy
 - No recognition of rights under IRC § 5891
 - May not be granted security interest
- Determined through conversation with IRS author that text was simply a recitation of facts presented by DOJ and not relevant
- Determined through communication with Office of Special Master that these restrictions will not be imposed
- Election to structure must be made before issuance of “substantially complete” letter, when size of award is revealed
- May create QSF in probate court as alternative

Rulings

Taxable damages and taxation of attorney fees:

- U.S. Circuit Courts of Appeal continue to issue rulings that set tax liability on damages according to residence
- Rulings indicate that this may not be so much a split among the circuits as it is application of state property law
- If damages are taxable to claimant (i.e., non-physical injury or punitive), attorney fee may be taxed to claimant and not deductible when paid to the attorney
- Alternative Minimum Tax may apply, causing claimant to owe more in taxes that left over after paying attorney fees

Rulings

Treasury Decision 9046, March 3, 2003:

- Requires disclosure of “potentially abuse tax transactions”
- Worded broadly enough to be assumed to apply to confidential structured settlements
- Safe harbor language had been recommended
- Revision in December 2003 clarified so as not to apply to structured settlements

Litigation

- *Macomber v. Travelers (Conn.)*
- *Stafford v. Allstate (Texas)*
- *Coppedge v. State Farm (Texas)*
- *McMickle v. Pension et al. (Texas)*
- *Pacheco et al. v. Clark et al. (N. Mex.)*
- *Bentzen v. SFA (Tenn.)*
- *Liberty v. Barnett et al. Interpleader (Mo.)*
- *Struc Sett Svcs v. PLICO et al. (Okla.)*

Macomber v. Travelers

- On remand from Connecticut Supreme Court:
804 A.2d 180 (Conn. 2002)
- New Britain (Conn.) Dist. Superior Ct.,
CV-99-0496761-S Complex Litigation Docket
- Motion for class certification filed June 6, 2003
- Objection filed by defendants June 27, 2003
- Reply filed July 8, 2003
- Hearing held

Macomber v. Travelers

- Threshold requirements for class certification:
 - 1. Class is so numerous that joinder of all members is impracticable
 - 2. There are questions of law or fact common to the class
 - 3. The claims or defenses of the representative parties are typical of the claims or defenses of the class
 - 4. The representative parties will fairly and adequately protect the interests of the class.

Stafford v. Allstate

- Jefferson Co. (Tex.), 172nd Dist., E-166795
- Class certification hearing held in early 2004
- Allegations:
 - Violation of Texas Deceptive Trade and Practices-Consumer Protection Act and violation of Texas Insurance Code
 - Violations of Texas Free Enterprise and Antitrust Act of 1983
 - Civil conspiracy
 - Unjust enrichment
 - Conversion

Coppedge v. State Farm

- Travis Co. (Tex.), 53rd Dist., GN-200735
- Causes almost identical to Stafford case
- Dismissed on motion for summary judgment on “satisfaction and accord” theory that fraud was covered in release
- Judge admitted lack of understanding
- Appeal pending

McMickle v. Pension et al.

- Tarrant Co. (Tex.), 17 198061 03
- Defendants:
 - The Pension Company
 - Pension Financial, Inc.
 - Michael Herald (defense broker)
 - Medical Protective Finance Corporation
 - Medical Protective Insurance Services, Inc.
 - Smith, Rose, Finley, Harp & Price, P.C. (law firm)
- Illegal rebating agreement alleged
- Misrepresentation to annuity issuer as broker
- Conversion of brokerage fee

Pacheco et al. v. Clark et al.

- Santa Fe Co. (N. Mex.) D0101-CV-2002-00855
- CNA breached settlement agreement reached at mediation “by unilaterally requiring that plaintiff use CNA to structure the settlement”
- Finding plaintiff:
 - Has right to choose annuity company
 - Has right to choose broker
 - Suffered a loss of monthly payments
 - Incurred attorney fees and costs
 - Broker should be paid expert witness fee

Bentzen v. SFA

- U.S. Dist. Ct. (M. Tenn.), Civ. No. 3-02-1200
- Alleged fraud and misrepresentation in luring Plaintiff to Tennessee under false pretenses regarding employment opportunities

Liberty v. Barnett et al. (Interpleader)

- U.S. Dist. Ct. (E. Mo.), 1:04CV00001TCM
- Physical injury case on husband's accident settled in 1988 included periodic payments, 20 C&L, lumps
- Subsequent factors:
 - Divorce
 - Beneficiary designations
 - Sale of payments to J.G. Wentworth
 - Death of husband
- Liberty asking court to determine proper payee(s)
- Counterclaims against Liberty:
 - Payments should be until second death; or (in the alternative)
 - Annuity value overstated by \$30,000+ at time of settlement

Struct Sett Svcs v. PLICO et al.

- Comanche Co. (Okla.) Dist. Ct., CJ-2004-201
- Defendants:
 - Physicians Liability Ins. Co. of Oklahoma (PLICO)
 - C.L. Frates & Co. (administrator for PLICO)
 - The Mangelsdorf Companies
- Causes of action:
 - Tortious interference with contract
 - Conspiracy

TIP

The statute of limitations on fraud does not begin to run until the fraud is discovered. Cases settled many years ago potentially hold causes of action for settling parties if fraud can be demonstrated.

Standards

Annotated Model Qualified Assignment Agreement, Rev. Draft 01/09/04:

- Will not be a “uniform” document
- Acknowledges IRC § 5891
- Incorrectly characterizes IRC § 104(a)(1)
- Excludes non-annuity qualified funding assets
- Incorrectly suggests VCF structures may not sell, etc.
- Clarifies “failure to satisfy § 130(c)” paragraph
- Acknowledges complexity of perfecting security interest, but provides toothless bankruptcy statement
- “Red flag” according to NSSTA antitrust guidelines

TIP

“Personal physical injury or physical sickness” language does not apply to workers’ compensation payments. An adjudicated disability for a mental breakdown qualifies for the exclusion from gross income, even if there is no physical injury or physical sickness.

TIP

It is important to be particularly careful at trade association meetings. These meetings, which by definition are gatherings of competitors, can raise serious antitrust problems. Because representatives of competitors attend these meetings frequently, they get to know each other well, and there is the risk that the normal social interchanges will spill over into dangerous areas. Moreover, for reasons already expressed, the standard-setting activities of trade associations can raise antitrust problems. [Emphasis added.]

“A Model Antitrust Compliance Manual,” from Hogan & Hartson L.L.P. , distributed to NSSTA membership July 30, 1999

What This Means

- The structured settlement industry is a dynamic one, to say the least
- Legislation, rule-making, case law, litigation, product innovations and changes in practice all affect standards
- Some progress is being made through litigation to clean up the illicit practices (other attempts fail)
- It is impossible to effectively serve your clients unless you make a concerted effort to stay current