

“Mediation and Settlement”

Steven C. Laird
www.texlawyers.com

ATLA
December, 2002

Steven C. Laird
LAW OFFICES OF
STEVEN C. LAIRD, P.C.
2400 Scott Avenue
Ft. Worth, Texas 76103
Telephone:(817) 531-3000
Facsimile: (817) 535-3046

Table of Contents

MEDIATION AND SETTLEMENT

I.	INTRODUCTION	1
II.	MEDIATION	1
	Think Outside the Box	2
	Timing is Everything	3
	Areas to Consider When Going to Mediation	4
III.	SETTLEMENT	7
	Factors Affecting Settlement of Case	7
	Use of Focus Groups	8
	Settlement Brochure	8
IV.	TAX CODE – on Personal Injury Awards	8
	What is and is not taxed?	9
V.	SPECIAL NEEDS TRUSTS/SUPPLEMENTAL CARE TRUSTS	9
	Specialized Language that Must be Included	9
VI.	STRUCTURED SETTLEMENTS	10
	What to Look for in Selecting an Annuity Company	10
	3 Step Process for Structured Settlement	10
	Pit-falls to Avoid in Drafting of Structured Settlement Documents	10
	Structuring Attorney’s Fees	11
VII.	ANNUITIES	11
VIII.	SECTION 468B, QUALIFIED SETTLEMENT FUND	11
	Statute	11
	Other Information on QSFs	13
IX.	SELF DEALING BY INSURANCE COMPANIES	13
	Words of Caution in Structuring Settlements	15
X.	CONCLUSION	16

Mediation and Settlement
ATLA Weekend With the Stars
December, 2002

Steven C. Laird
Law Offices of Steven C. Laird, P.C.
2400 Scott Avenue
Fort Worth, Texas 76103
1-800-448-2889
www.texlawyers.com

II. I. INTRODUCTION

The vast number of trial attorneys are too eager to enter into settlement negotiations. They show their cards too quickly to adjusters and defense counsel. Often attorneys simply misjudge timing for legitimate settlement discussions. This paper attempts to offer a few friendly suggestions to consider when negotiating.

As most of you are aware, the majority of cases settle prior to trial, whether by working out an arrangement between the parties, or with the help of a mediator.

Whether settlement and mediation are helpful has been argued both ways. Some have argued that the trend towards settlement and mediation is eroding the trial system¹ by eliminating public scrutiny, pressuring litigants to settle and isolating the justice system from the public.² Others view the trend towards alternative dispute resolution as a positive step in the judicial process as it encourages litigants to settle cases for fair amounts of money without spending exorbitant sums of money on litigation, while allowing for earlier resolution without the wait and uncertainty of a trial and verdict.³

III. II. MEDIATION

Some states⁴ have clearly established laws concerning non-binding mediation. The Uniform Mediation Act⁵ has been drafted and approved by the National Conference of Commissioners on Uniform State Laws at its annual conference in August, 2001. It was approved by the American Bar Association on

¹ Hope Viner Samborn, *The Vanishing Trial*, ABA Journal (October, 2002): 24-27.

² *Id.* at 26.

³ *Id.* at 27.

⁴ Texas, Florida and California have clearly established laws or traditions concerning mediations as stated in the drafted Uniform Mediation Act at page 11. A complete copy (totaling 56 pages) of the drafted Uniform Mediation Act can be obtained at www.nccusl.org (site visited 11-01-02).

⁵ A complete copy (a total of 56 pages) of the drafted Uniform Mediation Act can be obtained at www.nccusl.org (site visited 11-01-02)

February 4, 2002. States either have reviewed and adopted a version of this Act, or are expected to eventually review and adopt a version of the Uniform Mediation Act.

The primary purpose of the Uniform Mediation Act is to simplify the law regarding mediation and to allow uniformity between the states.⁶ It is the anticipation of the drafters of the Act that the hundreds of different privilege statutes currently on the books regarding mediation in the 50 states could be repealed if the Uniform Mediation Act is adopted.⁷ The individual state's privileges would be replaced with the privileges under the Uniform Mediation Act if it is adopted.

Some states⁸ have statutes that allow parties in certain instances to file motions to request mediation.

Think Outside the Box

The reality is that all of us fall into the same trap of doing the expected and using the same old routine.

A case appears to have merit, so therefore you accept the case. You receive some preliminary information which confirms your suspicion (and hope). Depending upon the potential of the case, including a review of both liability and damages, you do one of the following:

- a. Write a notice letter to the potential defendant(s) and receive a reply from the liability carrier;
- b. Prepare a demand package/letter to the insurance adjuster;
- c. Negotiate with the adjuster; and
- d. Eventually settle the claim or file a lawsuit.

This approach may be adequate for a smaller damage case, but it leaves much to be desired if the case you are pursuing has any significant potential (yes, I know that the term "significant potential" is a relative term.)

So what do we normally do if the case has significant potential? We probably consider doing the following:

- a. Put the liability carrier on notice and start negotiating with a demand letter (Remember, the vast, vast majority of the time you will have a low level adjuster with extremely limited authority responding to demand letters);
- b. Eventually, whatever "negotiations" take place will probably lead to the filing of a lawsuit; or
- c. You simply proceed to file a lawsuit after appropriate investigation, and plan on eventually negotiating with the defense attorney. (This frequently involves bringing up settlement discussions or mediation by the Plaintiff's attorney, sooner than later, and usually at an inappropriate time.)

So what should we consider doing in a case with potentially significant damages? Obviously, liability is an equally important factor, but this part of the discussion focuses on significant damages cases.

Dealing with an adjuster early on is usually of little or no benefit in these types of cases. Remember, the carrier has to "justify" paying out large sums of money. This is rarely justified any time soon after the

⁶ *Id.* at 54.

⁷ *Id.*

⁸ Texas, Bus. & Com. Code, Section 17.5051 (Vernon's Code Ann. 2002)

carrier has been placed on notice of the claim or lawsuit. Certainly, there are exceptions, such as those cases in which there is limited insurance that is obviously inadequate to pay the full measure of potential damages.

Additionally, you are likely to be dealing with a low level adjuster who will have significant difficulty obtaining additional authority which will “justify” these significant damages.

Although none of us want to file a lawsuit unless it is truly necessary, frequently cases with significant damages require nothing less. If you know that a lawsuit is likely to be necessary, it raises a question as to whether there is likely to be any benefit “negotiating” with an adjuster or a defense attorney before or soon after the lawsuit is filed. In fact, attempting to negotiate or even mentioning settlement or mediation may send the wrong message, even if it is done inadvertently.

Insurance carriers love consistency and certainty. They do not like inconsistency and uncertainty. A Plaintiff lawyer who shuns settlement negotiations, quite frankly, is inconsistent with what the majority of carriers see and experience. Don’t be in too big a hurry to enter into negotiations. This means you have to be in a position of knowing the strengths and weaknesses of the case prior to negotiations, and ultimately be willing to try the case if necessary. Yes, this sounds very basic, but how many cases have been knowingly settled for less than their settlement value (not trial value)?

The point of the above suggestions is simply to not act (or be) too eager to enter into negotiations too early.

X. Timing is Everything

Believe it or not, the timing of mediation is frequently overlooked or under-emphasized by the Plaintiff’s lawyer. There are times when many factors come into play regarding the potential settlement of a case.

For example, the client may be desperate to get the case resolved for financial or other reasons. There may be extremely detrimental information/discovery yet unknown to the Defense which requires the case to be settled. (Of course, there are situations where it’s the Defense which does not want detrimental information/discovery revealed, and they are the ones pushing for settlement. Or the Defendants may want to avoid the negative publicity which may likely accompany ongoing litigation.) The dynamics of the case may be such that a particular set of circumstances require any and all attempts to settle a case. (A favorable adjuster may be on the verge of leaving the insurance carrier, as an example.) And, some lawyers have been known to determine that a case is ready for mediation primarily on the basis of the lawyer’s cash flow needs. That doesn’t mean that the lawyer is always going to put his/her needs above the client’s needs, but it can result in the lawyer making a bad decision regarding the timing for mediation.

Insurance carriers and defense attorneys love to be in a position where there is little doubt that the Plaintiff or the Plaintiff’s lawyer, or both, are known to be eager to settle the case. What a built in advantage this automatically gives the defense! So how would the defense know that the Plaintiff or the lawyer are eager to settle?

Let's think about what we do as Plaintiff's lawyers. How often do we write demand letters before filing a lawsuit for a claim which we feel has significant damage potential? Insurance carriers have to justify paying a significant amount of money on a case. This justification is primarily to withstand any future audit, as well as to provide substantiating information to a superior who has higher claims authority. Generally speaking, it is the exception to the rule for a significant damage case to be settled with a demand letter but without a lawsuit.

Areas to Consider When Going to Mediation:

- Strength of the Mediator
- Reputation of Opposing Counsel
- Are the key decision makers for Defendant going to be there?
- Does the Defendant have to give consent to settle?
- Is it a wasting policy?
- Is the Defendant self-insured?
- Are there excess carriers?
- Does the Defendant have personal counsel?
- What settlement negotiations have been done up to this point?
- Is it a court ordered mediation?
- Did the parties mutually select the mediator?
- What are the policy limits?
- What is the financial solvency/condition of the insurer?
- What is the financial solvency/condition of the Defendant?
- Does the Defendant/insurance company have any incentive to get this off their books this year?
- Are there settlement credits that will apply to other Defendants?
- Is the Defendant publicly traded? Are there any mergers or acquisitions pending?

If you have decided or agreed with opposing counsel upon a time for mediation, there are a few additional things to consider before the mediation actually takes place. For example, you may want to consider writing a letter to opposing counsel (and enclosing a duplicate original signed by you) which strongly suggests personal counsel be retained for an individual defendant. This may be necessitated because of the potential of an excess verdict, or damages being claimed not covered by the policy, e.g. exemplary damages. This may not result in personal counsel being present at mediation, but it will be a document in the carrier's file, and will hopefully have prompted some discussion between the defense attorney and his/her actual client, the defendant. The best of all worlds is that it results in the defense attorney writing a demand letter to the carrier on behalf of the defendant and/or personal counsel being present at mediation. Don't get your hopes up, though.

How important is the actual mediator? The reality is that the carrier has probably allowed a certain amount of authority to be paid on your case. The question is whether the mediation (and the mediator) actually gets to that amount. No, all mediators are not created equally. If the carrier wants to settle the case at mediation (or at least offer the full amount of its authority), does it really matter who the mediator is? More often than not, it is more important to an insurance carrier who the mediator is than it should be to the plaintiff's attorney.

Remember, it really doesn't matter that much where the mediation begins. What really matters is where the parties are toward the end of the mediation, especially at its conclusion.

Most of us may get written permission from the client for specific authority on the initial offer of settlement made before mediation. Once mediation begins, however, we tend to do almost everything verbally beyond that point until something is put in writing if the case settles. A friendly suggestion is to have something written regarding each offer of settlement authorized by your client (and signed by the client), along with something written regarding each offer of settlement extended by the defendant. This has a built-in advantage of protecting the attorney should any question arise later. It is a little inconvenient, but it also has the effect of truly getting the client involved in the mediation process. It is also suggested that you allow the mediator to let the defendant and the adjuster know that your client is literally signing off on every offer of settlement. This way the other side will know that it is not just the lawyer calling the shots, and that the plaintiff is willing to proceed to trial.

Since defense attorneys and carriers seem to be using initial mediations more and more frequently simply as a free discovery tool, give some thought to your presentation. Are you really going to impress and convince the opposition with a full-blown "dog and pony show" when all you may be accomplishing is giving a free road map for future discovery to the other side? Granted, there may be times when a full presentation is necessary; however, the other side is expecting you to show all of your cards. Once again, this comment is intended to at least get you to think about the big picture instead of blindly following your instinct to "blow the other side away" at mediation.

Some cases may be much more appropriate for no presentation, whether there is a general session with the opposition or whether the mediation begins with individual caucuses. If there is a general session there is no better way to send the message that you are dealing from a position of strength than to walk in with a blank legal pad and simply tell the mediator and the opposition that you feel certain that they have carefully reviewed all of the information and discovery in the case, and you would be happy to answer any questions they have. Period. End of presentation. About 45 seconds. That's all. This will probably have the effect of totally flustering the other side. Once again, this would be unexpected, therefore, uncertainty for the opposition begins to exist. If you decide to employ this approach, do not let the mediator sway you or convince you that you need to give a full presentation. The mediator should be given confidential background information before the beginning of the mediation. Stand your ground. You can always allow a general session later in the day to make a limited presentation, if the dynamics call for this.

Consider not allowing a general session. You may wish to tell the mediator that neither you nor your client are willing to have a general session, and that the mediation simply needs to begin with individual caucuses. Once again, this may fluster the other side by "denying" them their opportunity to present their defensive arguments directly to your client. Stand your ground, even if the defense "demands" a general session if this is the approach you decide upon.

There may be cases in which a defendant "coincidentally" files a dispositive motion shortly before the mediation in order for it to be pending at the time that the mediation is taking place. This is sometimes a tactic to create uncertainty for the plaintiff. Remember that the plaintiff is not prohibited from filing a dispositive motion in a case if such a motion is justified, whether it relates to a no evidence summary

judgment motion (depending upon your jurisdiction) or the qualifications of an expert or the reliability of his/her opinions. Consider the timing that your motion should be filed.

Be aware if the defense starts to “bracket” the plaintiff. This means that the defense starts to negotiate in a way to get both parties to move identical or similar amounts with each move, ultimately culminating in reaching an amount desired by the defense. If this becomes apparent, you can simply stop the bracketing by not following the same pattern or incremental movements.

Consider proposing that the plaintiff will drop to a particular amount if the defendant will offer a particular amount. If the defendant refuses, then you have done nothing more than make a proposal, not an offer of settlement. Just make sure that the particular amount for the plaintiff in this approach is not too low.

If you and your client feel comfortable, and if the circumstances allow it, consider giving a “bottom dollar” or “final offer of settlement” to the other side at the conclusion of the mediation. A word of caution, however, is in order. If you do this, be prepared to maintain your credibility by sticking to your guns. The biggest mistake you can make is to give a “bottom dollar,” have the case not settle, and then continue to negotiate at a later time from that “bottom dollar.” What message do you think that sends to your opposition? They will probably remember your weakness on the next case, as well.

Only you will know if you can trust your mediator. Some mediators rely on a significant amount of repeat business from particular defense firms and/or insurance carriers. Try to find out in advance if your mediator routinely mediates for defense counsel and/or the carrier.

- IV. No one can put in a paper all of the particular advantages and/or disadvantages of settling with just one defendant in a particular multi-party case. Each situation has to be judged on its own merits and the potential applicable law of your particular jurisdiction, e.g. settlement credits, etc.

One other thing to take into consideration is the solvency of the liability insurance carrier, and possibly the defendant. This is becoming more and more of an issue in settlement negotiations. It is not uncommon to see carriers refusing to negotiate fairly based in part on their own financial problems, especially if they are perilously close to either rehabilitation or receivership.

Lastly, consider allowing the mediator to take to the defendant (although it may be shown to the adjuster) a signed settlement authorization from the Plaintiff indicating that the causes of action will be dismissed in consideration of “x” number of dollars, plus taxable costs of court. If the Plaintiff is anticipating structuring any part of the settlement, indicate that the Defendant will be given instructions on how any part of the settlement is to be made payable. This allows part of the settlement to be paid directly to a structured settlement carrier or a 468B qualified settlement fund if any part of the settlement is to be structured by a structured settlement carrier of the Plaintiff’s choice. In other words, you don’t want to be forced to use a structured settlement carrier that the insurance liability carrier “requires.” Think about it – there is a reason why the liability carrier may be adamant that any structured settlement is to be done by one of their wholly owned subsidiaries, or by a company on the liability carrier’s “approved” list. This is discussed more fully later in the paper.

V. III. SETTLEMENT

A settlement that is fair and adequate should mean that the case settles for an amount equal to that which a jury would award if the case had been tried, with a discount given for the saved litigation expenses, uncertainty and delay.⁹ This discount may be very significant or minimal, depending upon the facts and applicable law.

Factors Affecting Settlement of Case:

- Amount in controversy
- Amount of any liens
- If the party has to give consent
- How much discovery has been completed
- How plaintiff and/or defendant will present at trial
- Strength of witnesses, and experts
- Venue of case
- Experience and reputation of attorneys involved
- When trial date is
- Facts of individual case

When a case is settled, the plaintiff's attorney needs to obtain written authorization from their client regarding the settlement, and whether there is going to be any structured settlement.

Use of focus groups:

Preferably, focus groups and/or mock trials should be completed prior to settlement negotiations and mediation. Focus groups and/or mock trials are often helpful in large damages cases to help the plaintiff's attorney and his/her client see the weaknesses of their case, as well as the range of likely damages a jury would award. It is surprising how often a properly facilitated focus group picks the correct range that a later trial verdict encompasses. If you have good results from your focus groups, don't hesitate to share with the other side the simple fact that you have had focus group research performed. This does not necessarily mean sharing the specific results. A good way to use this information is to state in writing or in mediation that you are certain that the defendant has also done focus groups, and that you are confident that they have obtained the same results that you have, assuming that their focus group studies were done objectively and correctly.

Settlement Brochure:

A written and/or videotaped settlement brochure may be effective in presenting the strongest elements of your case. You may want to include the strongest documentary evidence obtained in discovery and through investigation of your case in your brochure. A video brochure is especially helpful in allowing the adjuster to see and hear how persuasive and what a good impression your witnesses will make, especially independent witnesses or treating healthcare providers. In addition, you can utilize the defendant's own witnesses and experts who make a bad impression and edit the brochure to highlight these witnesses' weaknesses, inconsistencies and poor credibility factors. A settlement brochure will assist the plaintiff's attorney in trial preparation should the case not settle, as you have to focus on the entire case and look at the strengths and weaknesses in preparation of the brochure.

⁹ Fred Misko, *The Videotape Settlement Brochure*, www.misko.com (site visited October 23, 2002)

IV. TAX CODE – on Personal Injury Awards

I.R.C., Section 104(a)(2) (West 2002) relates to Compensation for Injuries or Sickness. The I.R.C. rule states in Sections 104(a)(1)(2) & (3) (West 2002) in pertinent part:

(a) 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 –

- (1) amounts received under workmen’s compensation acts as compensation for physical injuries or sickness;
- (2) **the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness;**
- (3) amounts received through accident or health insurance (or through an arrangement having the effect of accident or health insurance) for personal injuries or sickness (other than amounts received by an employee, to the extent such amounts (A) are attributable to contributions by the employer which were not includible in the gross income of the employee or (B) are paid by the employer).
(emphasis added)

What is and is not taxed? Generally, payments for physical injuries are not taxed and payments for punitive damages are taxed. Your client should be given the opportunity to consult with a CPA or tax attorney of their choice prior to settlement of a case and after a verdict to fully explore tax consequences of a verdict or settlement.

V. SPECIAL NEEDS TRUSTS/SUPPLEMENTAL CARE TRUSTS

Special needs trusts allow severely disabled persons to have a trust and remain on governmental entitlement benefits, i.e. Medicaid. Check with your state to determine if your statutes allow the creation of a special needs trust.

Special needs trusts are authorized by 42 U.S.C.A. Section 1396p (d)(4)(A) (2002) and allow for a disabled person under the age of sixty-five (65) to have a trust established by the disabled person’s parent, grandparent, legal guardian or a court IF the State will receive all amounts remaining in the trust upon the death of the disabled person up to an amount equal to the total medical assistance paid by the State plan on behalf of the individual.

EXAMPLE: If your disabled client was on Medicaid and had a special needs trust set up, and had \$250,000.00 worth of medical expenses that the State’s Medicaid program paid, then on the death of your disabled client, the estate of the disabled client must repay the State \$250,000.00 for the medical expenses previously paid under Medicaid. Thereby, the special needs trust delays the payment to the state of the Medicaid expenditures until the death of the disabled person.

Specialized Language that Must be Included:

Specialized language must be included in any structured settlement if a special needs trust is being utilized. Be sure to check your state's requirements.

* Please note that if your client is purchasing an annuity, the expected life expectancy remaining for your client, must equal or exceed the stated life of the annuity. A penalty will be assessed to your client based upon the transfer of assets that is considered to have occurred at the time the annuity was purchased, minus any principal paid to the client prior to the filing date for Medicaid benefits. Therefore, an annuity purchased for a person with a poor life expectancy (i.e. a very old client) may not be in the client's best interest as the projected pay-out may be less than the client's life expectancy.

VI. STRUCTURED SETTLEMENTS

In Black's Law Dictionary (6th Ed. 1990) structured settlements are defined as:

“Type of damages settlement whereby Defendant agrees to make periodic payments to injured Plaintiff over his or her life. Commonly such settlement consists of an initial lump-sum payment with future periodic payments funded with an annuity.”

Probably the biggest reason Plaintiffs choose structured settlements are that there are tax benefits to a structure that are not available with a lump-sum payment. So long as there is no actual or constructive receipt by the Plaintiff of the periodic payments, the Plaintiff (or their estate) can claim that the payments are excluded from gross income under the I.R.C. Section 104(a)(2) (West 2002) and Revenue Ruling 79-220.

In a structured settlement the interest earned for the life time payout are currently tax-free. Many plaintiffs choose structured settlements because it forces the plaintiff to obtain the money over a period of time, where there is less likelihood of the plaintiff going on a spending spree and dissipating their award.

What to Look for in Selecting an Annuity Company:

When selecting an annuity company, factors you may want to look at include:

- a. price of the annuity
- b. cash refund option at the death of the measuring life
- c. high rated age

Structured settlements may be useful in cases involving death, guardianship cases, reduced or lost retirement benefits, catastrophic injuries, inadequate policy limits or where there is questionable liability.

You can devise structured settlements that pour over into special needs trusts.

3 Step Process for Structured Settlement:

1. The parties to the settlement agreement agree that the Defendant will pay Plaintiff periodic payments as part of the negotiated settlement.
2. The Defendant transfers the obligation to make the periodic payments to a third party Assignee by means of a qualified assignment.

3. The Assignee purchases and owns a qualified funding asset (annuity) to fund the stream of future periodic payments.

Pit-falls to Avoid in the Drafting of Structured Settlement Documents:

1. It should not be stated that the plaintiff is purchasing the annuity. The defendant, its liability carrier or its assignee is purchasing the annuity.
2. The cost of the annuity is not consideration being paid to the plaintiff (releasor) and should not be mentioned as such in the structured settlement documents.
3. Punitive damages should not be part of the document. Allocate that the amount being paid is for compensatory damages only.
4. Watch out for conflicting language in the terms of the structured settlement and the Settlement Agreement and Release.

XI. Structuring Attorney's Fees

An attorney can structure earned fees by a structured settlement and purchasing an annuity for the attorney's fees. In doing this, the income is taxed as the periodic payments are received, and not on the entire lump sum at one time. This may be helpful to the attorney to spread the income over several years and to defer (not avoid) the income taxes for a later time, especially if the attorney suspects he or she may eventually be in a lower tax bracket.

VII. ANNUITIES

Defense attorneys often designate individuals with annuity backgrounds as defense experts (usually seen are economists, life care planners, statisticians, and/or life expectancy experts) in order to try to slant the jury to award less money for the plaintiff's long term needs. Obviously, this defense tactic is just another way the defense carrier is trying to save themselves from paying a larger award. The defense annuity expert will tell the jury that the plaintiff's needs could be met by an annuity with a lower present value than the plaintiff is seeking. Be prepared to counter these attempts during any settlement discussions or mediations.

VIII. Section 468B QUALIFIED SETTLEMENT FUND:

Section 468B of the Internal Revenue Code of 1986 and the underlying Treasury Regulations are the laws governing the qualified settlement fund ("QSF").

26 U.S.C.A. Section 468b (West 2002) provides:

- (a) In general.--For purposes of section 461(h), economic performance shall be deemed to occur as qualified payments are made by the taxpayer to a designated settlement fund.
- (b) Taxation of designated settlement fund.--
 - (1) In general.--There is imposed on the gross income of any designated settlement fund for any taxable year a tax at a rate equal to the maximum rate in effect for such taxable year under section 1(e).
 - (2) Certain expenses allowed.--For purposes of paragraph (1), gross income for any taxable year shall be reduced by the amount of any administrative costs (including State and local taxes) and other incidental expenses of the designated settlement fund (including

legal, accounting, and actuarial expenses)--

(A) which are incurred in connection with the operation of the fund, and

(B) which would be deductible under this chapter for purposes of determining the taxable income of a corporation.

No other deduction shall be allowed to the fund.

(3) Transfers to the fund.--In the case of any qualified payment made to the fund--

(A) the amount of such payment shall not be treated as income of the designated settlement fund,

(B) the basis of the fund in any property which constitutes a qualified payment shall be equal to the fair market value of such property at the time of payment, and

(C) the fund shall be treated as the owner of the property in the fund (and any earnings thereon).

(4) Tax in lieu of other taxation.--The tax imposed by paragraph (1) shall be in lieu of any other taxation under this subtitle of income from assets in the designated settlement fund.

(5) Coordination with subtitle F.--For purposes of subtitle F--

(A) a designated settlement fund shall be treated as a corporation, and

(B) any tax imposed by this subsection shall be treated as a tax imposed by section 11.

(c) Deductions not allowed for transfer of insurance amounts.--No deduction shall be allowable for any qualified payment by the taxpayer of any amounts received from the settlement of any insurance claim to the extent such amounts are excluded from the gross income of the taxpayer.

(d) Definitions.--For purposes of this section--

(1) Qualified payment.--The term "qualified payment" means any money or property which is transferred to any designated settlement fund pursuant to a court order, other than--

(A) any amount which may be transferred from the fund to the taxpayer (or any related person), or

(B) the transfer of any stock or indebtedness of the taxpayer (or any related person).

(2) Designated settlement fund.--The term "designated settlement fund" means any fund--

(A) which is established pursuant to a court order and which extinguishes completely the taxpayer's tort liability with respect to claims described in subparagraph (D),

(B) with respect to which no amounts may be transferred other than in the form of qualified payments,

(C) which is administered by persons a majority of whom are independent of the taxpayer,

(D) which is established for the principal purpose of resolving and satisfying present and future claims against the taxpayer (or any related person or formerly related person) arising out of personal injury, death, or property damage,

(E) under the terms of which the taxpayer (or any related person) may not hold any beneficial interest in the income or corpus of the fund, and

(F) with respect to which an election is made under this section by the taxpayer.

An election under this section shall be made at such time and in such manner as the Secretary shall by regulation prescribe. Such an election, once made, may be revoked only with the consent of the Secretary.

(3) Related person.--The term "related person" means a person related to the taxpayer

within the meaning of section 267(b).

(e) Nonapplicability of section.--This section (other than subsection (g)) shall not apply with respect to any liability of the taxpayer arising under any workers' compensation Act or any contested liability of the taxpayer within the meaning of section 461(f).

(f) Other funds.--Except as provided in regulations, any payment in respect of a liability described in subsection (d)(2)(D) (and not described in subsection (e)) to a trust fund or escrow fund which is not a designated settlement fund shall not be treated as constituting economic performance.

(g) Clarification of taxation of certain funds.--Nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax. The Secretary shall prescribe regulations providing for the taxation of any such account or fund whether as a grantor trust or otherwise.

Other Information on QSFs:

These QSFs are utilized when deciding where to put the settlement money and the defendant is ready to pay. An escrow account or fund is set up and the defendant is then released from liability. The plaintiff is not considered to be in "constructive receipt" of the settlement funds. Under section 130, a physical injury tort claim is the only cause of action where damage payments may be assigned. A fund administrator, on behalf of the qualified settlement fund, settles claims against the defendant and the defendant pays the agreed upon settlement amount into the fund, which then extinguishes any alleged liability of the defendant. When the settlement funds are paid out to plaintiffs, lien holders, the attorneys, or to a third party assignee, the fund then closes, and the administrator files a final tax return. Usually the qualified settlement fund exists for only a short duration.

IX. SELF DEALING BY INSURANCE COMPANIES:

In some cases you will see the defendant insurance company try to broker the settlement and then try to use only their affiliated annuity company or "approved" companies for funding any structured part of the settlement. What this potentially does is to allow the insurance company to recoup some of the settlement money through their affiliated company or "approved" company. It may be a type of shell game. They may make your client believe they are offering a certain amount to settle the case, and then the defendant's insurance company says you have to use one of their affiliated annuity companies or "approved list" companies. Why do the insurance companies do this? In almost all cases, it is to save money, and those savings may actually represent money out of your client's pocket. The defendant's carrier may get a considerable present discount using future periodic payments. "Present value" from the defense is often based on an estimated number from their annuity broker, and may be subject to manipulations according to what assumptions are used. Be aware that sometimes the "approved" companies and brokers give monies back to the insurance carriers for using them, and other times the defendant's carrier may be sending your money in fees back to themselves in a subsidiary that does structured settlements.

A recent Supreme Court case from Connecticut, *Macomber v. Travelers Property and Cas. Corp.*, 804 A.2d 180 (CT., 2002) addresses the self dealing and rebating issues. In *Macomber*, Travelers Casualty provided a structured settlement annuity to the Plaintiffs in which Travelers Casualty used insurance brokers that had an affiliation or other special relationship with them whereby Travelers Casualty got 25-75% of the commission back. The Connecticut court found that the payment plan that the plaintiffs had agreed to was "induced by a representation as to its cost, and that the cost was not accurately

reported to the plaintiffs in good faith.” *Id.* at 187. The court stated, “The key to the plaintiff’s argument, is that, once Travelers Casualty made a representation as to how much the annuity would cost for it to purchase, Travelers Casualty had a duty to disclose any rebates or other schemes that would reduce the final cost of the annuity to Travelers Casualty.” *Id.* at 191.

Make sure that the financial ratings of the insurance company used is strong, and have your broker check several different insurance companies’ proposals to insure that your client is receiving the most competitive rates available on the market. Often times the defense’s approved companies have an unfavorable rated age for the plaintiff when compared with other companies. This is especially true if lifetime benefits are wanted. Using a Plaintiff’s structured settlement broker will help (but not guarantee) that the appropriate medical information is highlighted or emphasized when sent to a structured settlement insurance company for purposes of obtaining a quote (based on a rated age).

Further, the defendant will release themselves and the selected structure from all future liability, including liability for them picking a flawed structured settlement vehicle. This is another reason why you want to make sure that the structured settlement carrier has a high rating.

Some insurance companies that have appeared in the past to have requirements to use their own structured settlement brokers and/or affiliated life insurance companies include: Travelers; AIG; St. Paul; CNA; and Hartford. In these situations, you have some choices:

- a. Allow the defendant’s insurance company to pick the structured settlement company. (In some cases, the defendant’s structured settlement companies may have the best rates available with well rated annuity companies that you would want your clients to use, but you need to independently confirm this with a plaintiff’s broker who is also checking for structured settlements.)
- b. Have a co-broker for the plaintiffs work with the defendant’s insurance company. Be aware, however, that often times the plaintiff’s co broker is going to share fees with the defendant’s broker/insurance company. This means that the liability carrier may actually end up receiving part of your client’s settlement money, since the commission for a structured settlement is ultimately going to come out of your client’s portion.
- c. **Have a 468b qualified settlement fund established by filing motions with the court, and then having the settlement money held in escrow until the court determines the proper distribution.** (This option will probably cost somewhere in the neighborhood of \$4000.00, but could be well worth it for your client when the insurance company is dragging their feet or trying to strong arm your client into working ONLY with their brokers/approved list companies.)
- d. Try the case and not use the defendant’s structured settlement company.
- e. Consider looking at Treasury Bond settlements as a real option.
- f. Also, consider requesting the broker (yes, even the Plaintiff’s structured settlement broker) to reduce the normal 4% commission to 2% or 3%. They are able to obtain quotes based upon a 2% or 3% commission, and this should especially be considered if it is a mega-settlement.

Words of Caution in Structuring Settlements:

A prudent plaintiff’s attorney will have the input of structured settlement specialists and probate/trust attorneys, as these areas of law are often outside the common knowledge of most plaintiff’s attorneys. The rules and regulations surrounding tax issues can change and the client

should be advised to consult with a certified public accountant/tax attorney to answer any questions they might have concerning tax implications of their settlement proceeds prior to the plaintiff selecting their best option. Independent tax advice should be sought from a tax professional by your client, as well.

Additionally, if you are representing a husband and wife in a tort action, advise each of them in writing to seek the advice and counsel of a family law attorney regarding any type of marital/family law issues regarding the recovery.

Structured Settlements are normally for a certain number of years guaranteed, meaning that the annuity income stream will continue for that guaranteed number of years, even if the plaintiff dies during that time period. A potential problem may develop if the plaintiff dies and the IRS places a valuation on the remainder of the income stream. In this case, the IRS may well require the immediate payment of the present value of the income stream. What happens if the plaintiff's estate does not have enough cash to pay the claim levied by the IRS? These are the types of questions that you don't want to have to be addressing. The IRS has even been known to place a levy on the house occupied by the surviving family members, notwithstanding the fact that there are monthly payments still coming in. The IRS usually doesn't want to be paid on a monthly basis. A way to avoid this is to request a "Commutation Clause" in the annuity. The Commutation Clause can be for any percentage of the remaining periodic payments. For example, a 50% Commutation Clause means that should the plaintiff die within the guaranteed payment period, 50% of the remaining payments will be immediately converted to cash. This is usually sufficient to provide any necessary cash required from an estate tax perspective. Once again, it is another aspect of a structured settlement to consider.

X. CONCLUSION: A well known and respected trial attorney, Ira Leesfield, is credited with the following statement which is known to be oh-so-true in the Plaintiff lawyer's practice, "TRIALS MAKE THE BLOOD FLOW, BUT SETTLEMENTS MAKE THE CASH FLOW!"

No statement or information in this paper is intended to state or give any tax advice or opinions.