

DISCUSSING FINANCIAL OPTIONS AT SETTLEMENT: ETHICAL OBLIGATIONS AND LIABILITY

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You have fought long and hard to secure a financial recovery for your client's personal injury. Now, the case has settled and the money you have secured will be provided to the client to take care of all of his or her future needs. What are the client's financial settlement options? Who will advise the client of the laws that impact his or her financial options? If the client selects certain financial options, who will explain the risks associated with that option?

Using an analogy, you do not want to be like the clean and jerk weightlifting competitor. In the clean and jerk, the weight lifter expends a lot of effort getting the weight from the floor over his head, but then drops it quickly. A lawyer can't afford to do the same thing with a personal injury settlement—expend all of the effort getting the recovery then dropping the money in the client's lap without advisement of their financial options. The remainder of this article examines a lawyer's duties when it comes to counseling clients regarding their financial options at settlement and the malpractice liability the personal injury lawyer may face for failing to counsel clients.

A Duty to Advise?

For the personal injury practitioner the most treacherous time, from a malpractice standpoint, is when a personal injury case settles. This section of the article explores what the personal injury lawyer's ethical duties are regarding advisement of financial options at settlement. The critical initial question is does a lawyer have any obligation to advise clients regarding the financial options they have at the time of settlement? Is the lawyer providing financial advice or legal advice? Does a lawyer have an ethical obligation to advise the client regarding impact of a settlement on public benefits and techniques to protect eligibility as well as protection from the Medicaid Estate Recovery Lien? Below I examine the ethical rules, statutes and case law to answer these questions.

There are four ABA Model Rules of Professional Conduct that are relevant to the personal injury lawyer's advisement obligations. Rule 1.4(b) provides: "A lawyer shall explain a matter to the extent reasonably necessary to *permit* the client to make *informed decisions*. ..." Rule 1.3 states: "A lawyer shall act with reasonable diligence and promptness in representing a client." The commentary warns: "A client's interests can be *adversely affected* by the *passage of time*." Rule 1.2(a) admonishes that: "A lawyer shall abide by the client's decisions concerning the objectives of representation ... and shall consult with the client as to the means by which they are to be pursued." Finally, Rule 2.1 indicates: "In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, *economic*, social and political factors, that may be relevant to the client's situation."

In addition, there are two main statutory provisions that provide a personal injury victim with different settlement options. The first statutory provision that is important is §104(a)(2) of the Internal Revenue Code

which excludes from gross income personal physical injury recoveries. "(G)ross 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 injuries or sickness." Section 104(a)(2) gives the personal injury victim two financial options at the time of settlement.

The first option is to take all of the settlement proceeds in a single lump sum. If this option is selected, the lump sum is not taxable, but once invested, the gains become taxable and the settlement proceeds will impact his or her ability to receive public assistance. A lump sum settlement does not provide any spendthrift protection and leaves the settlement proceeds at risk for creditor claims, judgments and wasting. The personal injury victim has the burden of managing the money to provide for their future needs be it wage loss or future medical. The second option is receiving "periodic payments". called a structured settlement, instead of a single lump sum payment. A structured settlement's investment gains are never taxed, it offers spendthrift protection and the money is protected against creditor claims as well as judgments. A structured settlement recipient can avoid disqualification from public assistance when a structure is used in conjunction with the appropriate trust.

The second statute that addresses a personal injury victim's options is 42 U.S.C. §1396p(d)(4) which authorizes trusts whose assets are not counted as an available resource for public assistance eligibility. This type of trust is commonly referred to as a Special Needs Trust (SNT) or Supplement Needs Trust. In many cases, an SNT is created even if the plaintiff is not currently on public assistance but there is an anticipation that he or she may need public assistance in the future.

In summary, the law gives personal injury victims two settlement options and the decision of which option to accept can have a tremendous impact on their financial future. The law also provides for an opportunity to protect public assistance eligibility through the use of an SNT. If the trial lawyer does not discuss these options with the client given they are part of the law, who will? The Model Rules require matters to be explained to the extent that the client can make an informed decision and the lawyer act diligently so that the passage of time does not adversely impact the client. If a lawyer fails to counsel clients regarding their financial options at settlement, it results in the client losing the opportunity to exercise options available under the *law*.

Personal injury victims can't make an informed decision if they are not aware of all their legal options. Passage of time without explanation about financial settlement options gives the client no chance to utilize favorable tax laws and mechanisms to preserve public assistance leading to a potential adverse impact. A lawyer may discuss financial options with a client without giving financial advice, and the model rules allude to discussing economic factors in the scope of representation. A complete failure to advise clients of their financial options under the law can lead to violation of some of the aforementioned model rules and exposes the lawyer to a malpractice claim such as in *Grillo*.

Legal Malpractice Liability?

The *Grillo* case was a 2001 Texas settlement of a legal malpractice claim. The underlying case was a medical malpractice claim for a birth injury. Christine Grillo was

born with cerebral palsy and was receiving Medicaid benefits at the time her personal injury lawyers settled her case. The medical malpractice case was settled on a lump sum basis for \$2.5 million. As a result of the lump sum settlement, the child lost Medicaid coverage and once the settlement was invested, taxes had to be paid on the gains. After the settlement, a legal malpractice claim was brought against the plaintiff attorney. The main allegation was that the:

"Plaintiff attorney failed to employ or consult 'competent ... experts in *taxation, trusts and/or structured annuities ... to secure competent direction and guidance on how to best maximize the value of the minor plaintiff's settlement.*"

If you fail to advise the client of their options, what is your defense to this argument? The legal malpractice case was settled for \$1.6 million against the plaintiff's attorney. There was also a \$2.5 million settlement in a separate suit against the guardian ad litem.

If a lawyer fails to discuss the financial options a client has at settlement and then the client sues for legal malpractice, there are demonstrable damages (loss). The loss of protection of settlement proceeds from creditors, judgments, family and friends.¹ The loss of cost-free financial management for the client that probably needs it most since 25 to 30 percent of personal injury victims dissipate their settlement within two months of recovery and 90 percent spend it all within five years.² Without knowledge of the tax law, the client can lose the power of a significant tax exemption offered for structured settlement recipients. He or she can lose out on the opportunity for a safe investment with competitive rates of return. Finally and potentially the most damaging, the client can lose public assistance eligibility.

Reading the *Grillo* decision together with the Model Rules, a lawyer must counsel clients regarding their financial options to avoid causing a potential loss to the client. *Grillo's* message to plaintiff lawyers is to employ or consult competent experts in taxation, trusts and structured settlements *prior to settlement*. The problem is that plaintiff counsel typically has a very short time period within which to counsel the client in between settlement and disbursement of the funds. The biggest mistake a trial lawyer can make is triggering constructive receipt by placing the settlement proceeds in his or her trust account.

Constructive receipt is a tax doctrine that says even though a taxpayer might not have actual possession of money, they have constructively received the money if it has been set aside, credited to an account or otherwise is available without limitation to the taxpayer. Money held in a plaintiff attorney's trust account that belongs to the personal injury victim are constructively received for tax purposes. This concept is important because once triggered, the plaintiff *forever* loses the ability to structure his or her settlement and possibly could lose public benefits.

One solution to the settlement time crunch is to use a qualified settlement fund (QSF). A QSF is a trust that can be created pursuant to Treasury Regulation 1.468B-1 to receive personal injury settlement proceeds.³ A court with jurisdiction over the matter must issue an order creating the trust and the trust must meet the definition

of a trust under state law.⁴ Once created, it allows for an immediate cash settlement with the defendant and removes the defendant from the process. The QSF acts as a holding tank for the settlement proceeds and gives plaintiff counsel time to employ experts while preserving the ability to structure the settlement as well as create an SNT without violating the tax doctrine of constructive receipt. A financial plan can be developed and the client's needs addressed.

Conclusion

A personal injury practitioner must discuss with clients their financial options at settlement or hire an expert to do so. Structured settlements and Special Needs Trusts are done for people from all walks of life, different ages and backgrounds. There is no threshold settlement amount before this obligation is triggered, and there are no clients, no matter what age, sex or level of sophistication, that should not be given their financial options available under the law.

The problem is that if clients are not given their financial options at settlement, they could suffer quantifiable damages that can be proven in a legal malpractice case later on. There are many experts that can be hired to make sure clients are properly advised of all their options at settlement. To avoid future liability, the personal injury lawyer should hire such experts to protect their clients and themselves. If clients refuse counseling or refuse methods to protect the settlement, have them sign a waiver that they have been advised of their options and understand what they are giving up. If you give clients all of their options and have them sign a waiver if they accept a lump sum, you have done everything possible to protect your clients and yourself.

¹ Florida Statute §222.14 provides protection for annuities against legal process. It provides "[t]he cash surrender values of life insurance policies issued upon the lives of citizens or residents of the state and the proceeds of annuity contracts issued to citizens or residents of the state, upon whatever form, shall not in any case be liable to attachment, garnishment or legal process in favor of any creditor of the person who is the beneficiary of such annuity contract, unless the insurance policy or annuity contract was effected for the benefit of such creditor."

² Anecdotally, as I was writing this article I received a call from a personal injury victim I worked with whose net was \$520,000. He took approximately \$170,000 in cash and structured \$350,000. He said he spent all of his upfront money and wanted to get at the structure to pay child support.

³ There are three requirements for creation of a QSF:

- (1) It is *established pursuant to an order of ... a court law ...;*
- (2) It is *established to resolve or satisfy one or more contested or uncontested claims ... and that has given rise to at least one claim asserting liability;*
 - (i) Under CERCLA;
 - (ii) Arising out of a tort, breach of contract, or violation of law; or
 - (iii) Designated by the Commissioner in a revenue ruling or revenue procedure; and
- (3) The fund, account, or trust is a trust under applicable state law. ...

⁴ The mechanical steps involved in utilizing a QSF are as follows:

1. Settle with defendant for cash and execute a cash release which includes the agreement that defendant will pay the settlement proceeds into the QSF.
2. Petition the court for creation of Qualified Settlement Fund and obtain order creating QSF.
3. Defendant writes a check for the net proceeds to the plaintiff to the Qualified Settlement Fund.
4. Funds remain in Qualified Settlement Fund, without violating constructive receipt doctrine, until:
 - a. Allocation decisions are made
 - b. Liens are satisfied
 - c. Special Needs Trust is created
 - d. Amount to be structured and the plan is decided upon.
5. QSF automatically terminates when all funds have been disbursed.



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