Structured Settlements: Maximizing Settlement Dollars in Workers' Compensation Claims

by Jason D. Lazarus, J.D.

What is a Structured Settlement & Why Implement One?

Simply put, a structured settlement is when damages are paid as a periodic stream of payments instead of a lump sum or in addition to a lump sum. Internal Revenue Code Section 130(d) requires structured settlement payments to be funded with either annuities or with United States Treasury Securities. Structured settlement payments, principal and income, are excludable from gross income pursuant to Internal Revenue Code Section 104(a)(2). In order for structured settlement payments to be tax-free, a personal physical injury must exist. Candidate cases include Personal Injury, Medical Malpractice, Products Liability, Wrongful Death and Workers' Compensation Claims. Workers' Compensation cases are particularly well suited for structured settlements because the claimant, if the claim has been accepted by the employer/carrier, is already receiving his benefits in the form of periodic payments.

There are two primary funding vehicles for a structured settlement of a Workers' Compensation claim. The first is for dates of accident prior to August 5, 1997 and is called Reinsurance. A Reinsurance agreement is executed whereby the life insurance company assumes the carrier's liability to make the future payments to the claimant. Specific language is included in the Joint Petition to ensure the tax-free status of the payments. The second is for dates of accident after August 5, 1997 and is called a Section 130 Assigned Annuity. A Uniform Qualified Assignment is done which releases the carrier from liability to make the future payments to the claimant. Again, specific language is included in the Joint Petition to ensure the tax-free status of the payments. Both Reinsurance Cases and Section 130 Assigned Cases are funded with annuities from highly rated life insurance companies, but there are significant procedural and paperwork differences between the two.

The following injuries should routinely be evaluated for use of a structured settlement: (1) wrongful death; (2) serious head injuries; (3) spinal cord injuries; (4) serious burns; (5) loss of limbs; (6) multiple fractures; (7) moderate permanent injury; and (8) injuries which require ongoing medical care. Structured Settlements and Periodic Payment Judgments, Hindert, Dehner & Hindert, § 1.03(3) 1-24 (1995). The preceding injuries will almost certainly require some type of income replacement. A structured settlement can provide for these needs with spendthrift and creditor protection.

Statistics have shown that ninety percent of claimants completely dissipate lump sums received for personal injuries within 5 years of receipt of the lump sum. "Structured Settlements for Tort Victims, Settlements and Plea Bargaining," Journal of the American Trial Lawyer's Ass'n 178 (1981); *see also* California Practice Guide: Personal Injury, Flahavan, Rea, Kelly & Tener, Chp. 4 (TRG 1992) (25% to 30% of accident victims completely dissipate their settlement within 2 months of recovery and 90% spend it all within 5 years). A structured settlement provides financial management for money received that is intended to compensate for an injury and provide for future monetary needs due to the injury. A structured settlement is particularly appropriate for claimants, regardless of the nature of their injury, if they: (1) have poor or limited financial management skills; (2) have no immediate need for money; (3) are minor children; (4) are physically or mentally incompetent; or (5) require a secure and guaranteed lifetime source of future income and funds for future medical care. Structured Settlements, § 1.03(3) 1-24.1. For the foregoing claimants, a structured settlement should be considered as a matter of course.

Structured settlements can help protect funds from creditors, relatives, friends and others seeking money when they learn of a large personal injury award. It can relieve the financial pressures of ongoing medical expenses and basic living needs. Moreover, a structured settlement can provide for the future costs of college funds, retirement funds, down payment on a home, or mortgage payment and provide long-term financial security. By utilizing a structure, a claimant can receive more compensation over time than a lump sum settlement; competitive rates of return can be obtained; and a victim can avoid the risk of outliving his or her recovery by transferring the risk to a secure financial institution.

Generally, the employer/carrier controls the structured settlement process. They choose the structured settlement consultant and the life company that writes the annuity policy. However, this does not have to be the norm. Structured Settlement Consultants generally do not charge a fee for their services. A consultant is paid a commission from the life insurance company that the annuity is placed with. Accordingly, there are no extra costs associated with both sides being represented by Structured Settlement Consultants. In this article I will illustrate the potential pitfalls that may be encountered by counsel when they handle a case involving a structured settlement and how to avoid those pitfalls by employing a structured settlement consultant.

Case Study

An example of the pitfalls that can occur with a defense controlled structured settlement is helpful to demonstrate the point. Richard Risk, an

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advocate for plaintiff controlled structured settlements, gave the following two scenarios in a recent article.

Scenario One: The Claimant is Not Represented by a Structured Settlement Consultant

Your Client is a 40-year-old man. He suffered a severe injury on the job that has rendered him a complete quadriplegic. He is currently eligible for Medicaid and wishes to preserve his eligibility. His health history suggests a shortened life expectancy due to pre-existing hypertension and arrhythmia, as well as from the quadriplegia. The employer/carrier agrees to mediate the case and you submit a demand for seven figures. Both sides have had their respective experts prepare life care plans. The employer/carrier is ready to settle the claim. Mediation is scheduled with the intent to resolve the entire matter by monetary settlement.

You come to the mediation without your own structured settlement consultant. At the mediation the employer/carrier offers a structured settlement. The employer/carrier has their structured settlement consultant at the mediation. The employer/carrier's structured settlement consultant's job is to create sizable cost savings for his clients. After several offers and counter offers, eventually you are told the supposed cost of the annuity and the proposed life company. You have no idea whether the representations regarding the structure are true or not.

Your client finally accepts an offer of future payments with an alleged cost of one million dollars. Your client is to receive $3,998 monthly for the rest of his life, beginning one month after settlement. He is guaranteed $1,638,768 for the next 25 years. Your client is ecstatic. You and your client sign the mediation agreement, which the carrier's structured settlement consultant helped to draft. The cost of the annuity was left out and the name of the proposed annuity issuer is also left out.

At this point, what is called post settlement underwriting begins. Your client has medical conditions that potentially can shorten his life expectancy. Life insurance companies that write structured settlement annuities provide substandard age ratings (i.e., rated ages). A rated age means that the life insurance company expects the annuitant to live the life expectancy of the rated age due to some medical condition that does not have to be related to the underlying claim. A rated age can either be used to decrease the cost of a life annuity for the employer/carrier or be used to increase your client's benefits. A rated age can be a good thing if used to benefit the claimant. In our sample case, the carrier's consultant shops all of the different life insurance companies for the best rated age after basing the cost of your client's income stream upon his true age of 40. The carrier's consultant quoted you one million as the cost, when the true cost was $843,398 once a rated age of 60 was obtained.

Next, the employer/carrier's consultant shopped another company that offered a "daily rate" based on the daily changing financial market conditions, which reduced the cost to $790,040. Daily rates sometimes are better than the standard rates and can be used to save the employer/carrier money or increase the claimant's benefits. Plus the consultant has a commission sharing agreement with the carrier that requires him to rebate typically half of his 4% commission. In this example, that equates to $15,800. The final cost to insurer equaled $774,240.00. Your client lost $225,760.00.

Here are some questions you might want to ask yourself and what your client might ask you after Scenario One takes place. How did I base my fee? Did I base it on the purported cost of the income stream?[1] What your client might ask: The carrier never told us how much they were spending on my structured settlement. Now I find out it was much less than what you estimated. Don't you owe me a refund on your attorney fee?

Who was on my side during the mediation? I had an expert for each aspect of the case, why didn't I have one for settlement? What your client might ask: They didn't spend what they promised for my benefits, did they? How did you let this happen? Do you mean we could have had our own structured settlement consultant, working for us at no extra expense, instead of being forced to use their consultant? Didn't he have a conflict of interest? Was he rebating part of his commission to the casualty insurance company? We had our own expert for everything else. Why didn't we have our own expert for the biggest financial transaction of my life?

Who was looking out for my client's post settlement issues such as loss of Medicaid or estate tax problems? What your client might ask: Do you mean I could still be receiving Medicaid benefits, even though I received a settlement, if we had just known about a Special Needs Trust? I didn't know I would be losing Medicaid when I accepted the cash settlement and the stream of income. I could have had both!

Scenario 2: The Claimant is Represented by His Own Structured Settlement Consultant

Now assume the same set of facts as in Scenario One. You inform the other side that your client planned on engaging his own structured settlement consultant. You tell them that your structured settlement consultant will design the package and inform them which life insurance company your client selects. You, your client and your structured settlement consultant meet before the mediation and explore the options. The relationship you have with your structured settlement consultant allows you to tell him things in confidence that you would not share with the employer/carrier's consultant. Your structured settlement consultant provides you with a one page economic summary of the life care plan and a sample annuity structured settlement package to meet the needs of the client. You know the exact cost of the products needed to fund your client's future care. Finally, your consultant obtained rated ages prior to the mediation to accurately run the numbers. In the end, you are thoroughly prepared for the structured settlement and so is your client.

At the mediation, using the highest rated age, your consultant determined that one million dollars would purchase lifetime monthly benefits, with a 25-year guarantee and 2.5% annually compounded increases, and that the initial monthly payment would be $4,740. Compare this with the $3,998.00 per month quoted by the carrier's consultant using the standard age. Your consultant counseled your client during the mediation on the benefits of structures and gave them ideas as to different financial plans they could implement with a structure.

Once settlement was reached, your consultant made sure the mediation summary reflected only that the employer/carrier would be spending one million dollars for future benefits. This gives your consultant flexibility to obtain the best deal for your client by comparing rated ages and daily rates with the different life insurance companies after the mediation. The exact payment stream can be defined later in the settlement agreement. Your consultant also helps you to set up a Special Needs Trust to preserve Medicaid eligibility for your client.

The next day, your consultant shopped among the life companies that assigned the highest rated ages and asked them for "daily rate" quotes. Your expert found a company that would provide an initial monthly benefit of $5,061.00 ($1,603.00 more than the carrier's offer in Scenario One). Over the guaranteed period, this is an increase of $435,516.00 from the offer in Scenario One. If your client lives to age 78, there would be an increase of $730,600 from the offer in Scenario One.

You and your consultant earned your client benefits that would have cost $1,067,538 using standard rates. Your structured settlement consultant made you aware of the discounts available to the insurer and allowed your client to take advantage of the price breaks. Compared with the cost to the employer/carrier of $774, 239.00 in Scenario One, your consultant has increased the present value worth of the benefits by $293,299.00. In addition, you now have the peace of mind knowing that that you had a skilled settlement professional who maximized every settlement dollar and is accountable to you and your client.

Most importantly, your client has not been left to deal with his or her complex financial situation alone. You have provided a valuable service to your client and added value to the case by engaging a consultant who tailored a total settlement package to meet your client's needs. Your client has a sense of security knowing they had expert assistance on their side during the settlement.

Conclusion

To be certain that you and your client are protected from the pitfalls Scenario One presents, employ your own structured settlement consultant to represent only your interests. Inform the other side that you intend to employ your own structured settlement consultant. Advise them that your consultant will design the plan and choose the life insurance company who will write the annuity policy. Allow the adversary to bring their own structured settlement consultant to the negotiating table, but insist that your consultant will control all the details. The two consultants can share the work and the commission, to create the best possible outcome for your client.

Structured settlements are extremely complex financial transactions raising many tax, estate planning, economic, and negotiation issues. Make sure you and your client has access, like the employer/carrier, to a structured settlement consultant who can provide advice on this complex issue and provide protection against some of the aforementioned negotiating practices involving structured settlements.

Endnote

[1] According to the Florida Supreme Court, contingency fees should be based on the present value of a structured settlement and true cost being the best representation of present value. *See Generally* Florida Bar v. Gentry, 475 So. 2d 678 (Fla. 1985) ("By not reducing the fee on the structured settlement to present value, the Respondent's fee was excessive. . . .").

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