The SETTLEMENT STRATEGIST
HALPERN GROUP

## The Dominant Thought

By
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## THE LIVING SETTLEMENT BROCHURE

Economist John Kenneth Galbraith first coined the phrase "conventional wisdom" to describe the commonly accepted assumptions that live long past the point where the conditions upon which they were based have changed. It's an ironic phrase, because nothing could be more *un*-wise than blindly accepting and acting on a popular assumption without analyzing whether it is still (or was ever) valid.

Litigation practice is littered with conventional wisdom, and nowhere is folly more insidious than in negotiation strategy. I, for one, am forever reassessing rules, traditions, and accepted practices, and frequently find that "conventional wisdom is obscuring a valuable tactic. That is how I stumbled upon the "living settlement brochure."

The conventional wisdom in this instance involves the supposed undesirability of having the plaintiff attend a settlement conference or mediation. There's good logic behind that caveat: the defense wants the plaintiff present to dazzle, confuse, intimidate, or persuade. The plaintiff is the ultimate decision-maker, and giving the defense an opportunity to directly influence the plaintiffs thinking is dangerous, to say the least. Your client may he exposed to persuasive sales pitches for inappropriate structured settlements or casual references to the defense counsel's victory record, or threats of long and expensive appeals. Meanwhile, of course, there is no equivalent (in personal or emotional terms) decision-maker on the defense

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# IT'S OFFICIAL - A SAFE STRUCTURED SETTLEMENT

### Halpern Group's Fail-Safe Structured Settlement Gets IRS Okay

Plaintiffs attorneys who have been wary of annuity-based structured settlements for their injured clients now have a virtually risk-free alternative bearing the stamp of approval from the Internal Revenue Service. (If the U.S. doesn't become insolvent you can drop "virtually." )

In a private letter ruling, the IRS has given its approval to The Halpern Group's **U.S. Treasury Bond Structured Settlement Trust**. It is the only structured settlement plan on the market in which both the "qualified funding asset and the "qualified assignee are completely backed by the full faith and credit of the United States government. [See related article on page 2.] The IRS's green light for the trust makes possible, for the first time, a structured settlement that "cannot fail," according to the product's inventor, Richard G. Halpern.

The ruling specifically approves the use of a trust as the assignment vehicle for a structured settlement, declaring that "an assignment of liability to [the trust as] assignee will be treated as a qualified assignment under section 130(c)." This refers to Section 130 of the Internal Revenue Code, the law which enhanced the structured settlement option for litigants. The Section permits the liable party to assign the

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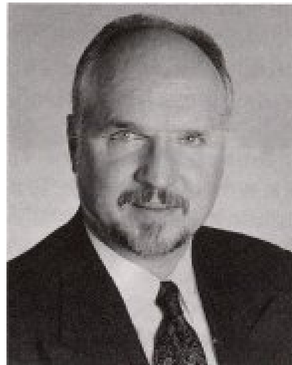
# HALPERN DESIGNS NY LIFE'S T-BOND STRUCTURED SETTLEMENT PRODUCT

"We wanted to develop a structured settlement product that addressed the special needs of injured plaintiffs. And we concluded that Rich Halpern was the obvious choice to design it."

The speaker is Joe Shannon, corporate vice president for New York Life, as he explains how the insurance company came to Halpern Group President Richard G. Halpern to design its U.S. Treasury Bond Structured Settlement.


New York Life V.P Joe Shannon

"Injured plaintiffs have to be concerned about the ultimate safety of their funds. We asked Rich to design a product that would be in total compliance with IRS regulations, and that would give plaintiffs confidence that the money would be there when they needed it. " He developed our T-Bond Structured Settlement, giving us a product with all of that, plus acceptability for use by the defense community. We couldn't be more pleased."

Halpern echoes the sentiment. "It was gratifying to see what I consider to be the highest quality life insurance company in the structured settlement industry showing genuine concern for injured plaintiffs. This is a company that had the courage to seek the assistance of someone who is known as a plaintiffs advocate because it felt I could help it meet victims' crucial need for financial security. I was excited to have the opportunity.

Shannon adds, "The defendants don't like to be pulled back into cases when annuity settlements fail any more than plaintiffs do. This product satisfies the needs of both sides."

# WHAT COUNSEL MUST KNOW ABOUT THE U.S. TREASURY BOND STRUCTURED SETTLEMENT TRUST AND WHY

The vital starting point is this:

Structured settlements do not have to use annuities issued by insurance companies. Internal Revenue Code Section 130 (the section covering tax-exempt structured settlements) provides that a *"Qualified Funding Asset* [Translation: the device that funds the periodic payments of a structured settlement for an injured victim] may be any annuity or contract issued by... an insurance company... **OR, any obligation of the United States.** That is, U.S. Treasury Bonds.

The advantage of relying on T-Bonds rather than commercial annuities is evident: annuity carriers can default, and do, leaving injured victims who are dependent on annuity income in dire straits. U.S. Treasury Bonds are absolutely secure, unless you believe that the U.S. Treasury is going to collapse.

The U.S. Treasury Bond Structured Settlement Trust is created through these steps:

1. The plaintiff provides the defendant with a release or another form of cessation of action in exchange for cash paid upon settlement and the promise of future periodic payments. (This is exactly the procedure used with an annuity structured settlement.)
2. The defendant then *assigns* (with the plaintiff's assent) its liability to make the future periodic payments, the assignment going to a dedicated trust created for this purpose. The trust (like the assignment corporation used in annuity structured settlements) serves as the *"qualified assignee"* required by the aforementioned Section 130, and receives the cash from the defendant.
3. The Trust is administered by a national bank, acting as Trustee.
4. After paying fees and expenses, the bank uses the cash to purchase United States Treasury Bonds in amounts sufficient to cover all periodic and lump sum payments.
5. The bank as Trustee further provides financial security for the plaintiff in the form of a security interest in the bonds being held by the Trust. [This is documented in the assignment agreement, as well as the trust.]

The IRS' acknowledgement that the use of a dedicated trust with a bank trustee complies with the Code tax requirements on structured settlements is significant. It means that there is universal agreement that plaintiff's attorneys can advise their injured plaintiff clients that their critical objectives in a structured settlement can be achieved without any of the risk associated with the more common annuity-based structured settlements:

- **There is no risk of financial failure** - all future payments are back by U.S. Treasury Bonds with the full faith and credit of the U.S. Government as the guarantor.
- **There is no risk of future insurance company insolvency,** as no insurance company is involved.
- **There is no risk of failure of the Trustee,** because the Trustee is a national bank. If the bank becomes insolvent, the Federal Deposit Insurance Corporation (FDIC) is the successor Trustee until a successor trustee is chosen.
- **There is no risk of loss of either the money to fund the structured settlement, or the bonds themselves to create the benefit stream,** as all Trust assets are held outside of other operations of the bank and are not subject to the bank's creditors in any type of default.
- **There is no risk of interruption of the income stream,** because the United States Government-backed U.S. Treasury Bonds generate the income that supports the payments from the Trust, unlike an annuity settlement, which derives its income from insurance company investments.

### Practice Implications for Counsel

Unfortunately, plaintiff's counsel's job has become more demanding. With the official sanction of the U.S. Treasury Bond Structured Settlement Trust, it appears that plaintiff's counsel has an affirmative duty under the Rules of Professional Conduct of most states to at least make the plaintiff aware that this risk-free alternative to conventional settlements exists.

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# NEW TAX PROVISIONS: PLAINTIFF'S COUNSEL BEWARE!

***By Steven Siegel***

On August 20, 1996, President Clinton signed a new Tax Bill which has a major impact on **personal injury cases.** The Bill makes two major changes in cur means that there is universal agreement rent law, as follows:

1. Punitive damages will now be taxable in all personal injury cases, regardless of whether the damages are awarded as the result of *physical* or *non-physical personal injury*.
2. **Any** damages received for *non-physical personal injuries* will no longer be excluded from taxation. *Emotional distress* is specifically considered a non-physical injury or sickness. Accordingly, where the origin of a claim arises from a non-physical injury, such as in cases involving wrongful discharge, job or age discrimination, defamation, insurance bad faith, civil rights violations, business-related torts, etc., the damages recovered will no longer be free of federal income tax.

The new law applies to all payments made after August 20, 1996, even if the payments are made in accordance with an earlier settlement. However, the new tax law does not apply to amounts received under a written binding agreement, court decree, or mediation award in effect on (or issued on or before) September 13, 1995.

The new tax law places serious burdens on plaintiff's attorneys. Clients in cases involving *non-physical injury* must now be advised that awards will result in **taxable income**. Failure to do so could give rise to malpractice claims.

In addition, careful attention will have to be paid to the precise wording of pleadings. For example, in a *sexual harassment* case, there may have been acts of unauthorized physical touching. This could lead to a battery claim which would be viewed as a physical injury. The legislative history of the new Tax Bill does attempt to limit plaintiff claims by stating that the term *emotional distress* includes physical symptoms such as insomnia, headaches, and stomach disorders, which may result from emotional distress. Even though these physical manifestations are injuries, if the origin of the claim in these cases is a *non-physical act* giving rise to the emotional distress, the recovery will be considered taxable.

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## New Tax Provisions

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Similarly, both pleadings and settlement agreements will have to be carefully drafted to make certain that allocations toward punitive damages are eliminated or minimized, with allocations to compensatory damages increased accordingly.

### Fees

Another problem for the plaintiffs attorney may arise in connection with his or her legal fee. The entire award payable to the plaintiff in these *non-physical injury* cases will constitute taxable income. Is the attorney fee a deductible expense? Even if the answer is yes, the deduction is subject to various tax law limitations, including the loss of deductions equal to two per cent of the plaintiffs adjusted gross income, and the possible reduction of the plaintiffs personal exemptions.

For example, assume a gross recovery of $300,000 with an attorney's fee of $100,000. The $300,000 is gross income, but the maximum deduction for the legal fee is $94,000 ($300,000 X 2% = $6,000; $100,000 less $6,000 = $94,000). The tax on the $204,000 of taxable income is approximately $61,000 for an unmarried person, leaving the plaintiff with a net recovery of $139,000 ($300,000 gross recovery less $100,000 attorney's fee less $61,000 tax bill). This does not even take into account the possible impact of state income taxes, if any.

The problem is even worse if the IRS can argue that the attorney fee is non-deductible. This would be the case if the plaintiff's claim arose in a personal setting, not connected to employment, business or the production of income. In such a case, it is conceivable that the attorney's fees would not be deductible, so that the full $300,000 would then be subject to federal income tax of approximately $95,000, leaving the plaintiff with $105,000, net of fees and federal taxes.

One of the mysteries surrounding the new tax law is how the IRS will distinguish an *emotional injury* from a *physical injury*. How much of a physical harm will be necessary to cross the line? What about cases where the claim is for the fear of injury arising from a physical procedure such as a breast implant, where no injury has yet to appear, and the entire claim focuses on the *emotional* harm arising from that fear? The legislative history offers no guidance on this point, but in an environment of hostility to plaintiff claims in general, is this now a "foot in the door" for the IRS to argue that settlements and verdicts in these cases give rise to taxable income? Only time, litigation and further IRS pronouncements will answer these questions.

### Structured Settlements

It is not permissible to use an assigned structured settlement in a case involving a *non-physical personal injury*. As a result of the new tax law, it may not be advisable to use any type of structured settlement in any cases involving non-physical personal injuries, emotional distress, and punitive damages. With taxation now required, the IRS is more likely than ever to rely on constructive receipt and economic benefit theories, and argue that the present value of the entire structured settlement is taxable income in the year the case is settled. This would require the taxpayer to pay, up front, an amount of taxes which may well exceed the amount of cash received from a structured settlement in the same year.

Again, plaintiff's lawyers are cautioned that allowing their clients to accept a structure in such a case could be grounds for a malpractice claim against the lawyer, should the potential tax expense for the client not be properly explained. In these cases, a far preferable alternative would be to accept a cash settlement, place the funds into a reliable management trust, and pay whatever taxes are due, leaving the balance managed in accordance with the terms of the trust.

It is important to note as well what the new tax law does **not** do. That is where an action has its origin in a *physical injury* or *physical sickness*, then **all damages** (other than punitive), even for *emotional distress*, will be treated as payments received on account of physical injury or physical sickness, whether or not the recipient of the damages is the injured party. These damages remain excludable from gross income. For example, damages (other than punitive) received by survivors on account of a claim of wrongful death arising from a physical injury will remain excludable from taxable income as under present law. In addition, damages (other than punitive) received by an individual on account of a claim for loss of consortium due to the physical injury or physical sickness of one's spouse are excludable from gross income.

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## What Counsel Must Know About the U.S. T-Bond Trust

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**Rule 1.4(b) of the ABA Model Rules** provides that *"A lawyer shall explain a matter to the extent reasonably necessary to permit a client to make informed decisions regarding the representation."*

It is hard to imagine that the existence of a safer alternative to a settlement proposal with far-reaching effects on the future of the plaintiff would not be regarded as a "necessary" component of a plaintiffs informed consent.

There is also growing consensus that attorneys not possessing a basic level of understanding about structured settlement options may not be providing "competent representation under the rules. **Rule 1.1,** *Competence*, states: *"...Competent representation requires the legal knowledge, skill, thoroughn ess, and preparation reasonably necessary for the representation."*

It would seem unreasonable for an attorney not to have the requisite knowledge to alert a plaintiff to a structured settlement option that avoids significant risk.

The objection raised by some attorneys that the subject matter of structured settlements crosses into non-legal territory, in effect "letting them off the hook," is belied by the language of Rule 2.1, *Advisor: ". . . 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 a client's situation."*

Again, there should be no question of the "relevance of an IRS-approved structured settlement option to a client's "situation."

The point here is not to raise fears of legal malpractice or disciplinary action, but rather to demonstrate that **good** practice in injured plaintiff representation now requires counsel to have a working knowledge of this structured settlement option, and to make the client aware of it in appropriate cases.

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## The Dominant Thought

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side likely to be present at the proceedings. It appears that, by bringing in the plaintiff~ you have put your side at a strategic disadvantage.

That's the convention wisdom, and I have been a subscriber to it in good standing. What it obscures is this: there is a sub-group of plaintiffs who have special qualities. They are appealing and likable, and they can communicate with devastating emotional effect the experience of living every day with a disability or grievous injury. Their credibility is total, and no plaintiff's counsel no matter how articulate, skilled or respected, can approach with a second-hand account what these individuals can convey about their plight.., the pain of getting into braces every morning; the agony of using a bathroom (and the embarrassment of being unable to close the door); the daily emptiness of rolling over to see an empty bed where a catastrophically injured spouse once lay; or the sorrow of watching a brain-damaged loved one try to cope with a shattered life.

Coming from your mouth, the same story would be regarded by the defense as hyperbole, a calculated exaggeration designed to put your case in the best possible light. The plaintiff engenders no such skepticism. A plaintiff who can communicate his or her plight in an appealing and convincing manner functions much like a settlement brochure, only alive and thus far more powerful. The defense will know that the jury will be seeing and experiencing the same wrenching exposition from the plaintiff that is being shown to him as a preview. He will know that no amount of courtroom technique will overmatch true human tragedy, honestly expressed. You will have created an ideal environment for a favorable settlement.

There's another conventional wisdom hurdle to clear, however: Why expose your best trial weapon prematurely? This one has a simple answer. Your job is to get a fair and just settlement *without* exposing your client to the risk of trial if at all possible. Using your client before trial can advance that objective.

But beware: this isn't for every plaintiff. The unappealing plaintiff- bitter or scowling, profane, physically or facially unattractive, slovenly, with substance abuse or other life style problems, who talks too much, or monotonously, or who is difficult to understand -- plaintiffs with these or other troublesome qualities were made to be subject to the conventional wisdom. Their presence can only backfire.

The attractive plaintiff, however can be your living settlement brochure. Keep that thought well in mind, so you know when to discard conventional wisdom as unwise, and follow unconventional wisdom to a powerful negotiation strategy.

## It's Official - A Safe Structured Settlement

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liability to a third party (or legal entity) - the "qualified assignee" - who will then be fully responsible for making fixed periodic payments to the injured plaintiff. Until now, the only "qualified assignee with explicit IRS approval has been the corporate entities usually created by insurance companies to purchase annuities for plaintiffs.

"The combination of U.S. Treasury Bonds as the qualified funding asset and a trust created for the purpose of serving as the qualified assignee eliminates all the risk usually associated with traditional annuity-based structured settlements," explains Halpern. "Annuities can fail, as they did with Executive Life and others; U S Treasury Bonds are backed by the government, so the safety of the funding asset is assured. Assignment corporations can fail and have, shifting ownership of the annuities back to the plaintiffs along with potentially ruinous tax consequences. 1 he trust we devised can't fail, and preserves the tax-exempt status of the assets."

Although other Treasury Bond-based structured settlements are on the market only the Halpern version uses a dedicated trust as the qualified assignee with a national bank (NationsBank) serving as the trustee. Because the bank is fully backed by the FDIC, there is no chance that corporate insolvency could derail the trust.

"It is so critical for injured plaintiffs to have a safe structured settlement option," says Halpern. "Lump sum settlements are dissipated by the family 90% of the time leaving injured plaintiffs in dire financial straits. This IRS ruling is truly a godsend because it means a plaintiff can receive a tax-exempt structured settlement to provide periodic payments to meet medical and other needs with absolute certainty, with no fear of external circumstances stopping or reducing the funds. It makes structured settlements safe again."