

The Dominant Thought

TORT REFORM: TAXATION WITHOUT REPRESENTATION

By
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[With this column, The Halpern Group departs from a policy of not commenting on political issues. We do not do so lightly. For though we are a firm that for reasons of conscience works on the plaintiffs side, we also recognize that multiple concepts and perspectives must be considered in political discourse.]

The Republican "Contract With America" received overwhelming support at the polls. Little did these voters realize that while supposedly supporting measures like welfare reform and tax reduction, they were also endorsing "tort reform that would lead directly to expansion of welfare costs, resulting in income tax increases.

The receptiveness of the American public to the arguments of tort system critics is, on the surface, bizarre. After all, the critics represent the interests of insurance companies, large corporations, neg-

ligent doctors and tortfeasors... hardly a popular crowd. But when one looks at how the opposing arguments have been framed, the public's response is not surprising. Why? Because the tort reformers have tied their position to the immediate self-interest of the average voting-age American, while the defenders of the tort system (already laboring under the handicap of being one of the few groups held in less esteem by the public than insurers, corporations, and doctors) have not. The anti-tort reformers' arguments are valid and their facts are solid. Nonetheless, they are fighting a losing battle.

Tort reform advocates hammer away at one argument: *"The tort system costs you money."* Higher prices. Lost jobs. Bigger insurance premiums. Particularly in today's political and economic climate, this is no contest at all. Perceived self-interest will win every time.

That is why the defenders of the tort system must stop relying only on the sanctity of the jury system, the plight of the injured, and corporate disregard for safety, no matter how noble and true these arguments are. Another argument will carry the day. And it is easy to

understand:

Tort reform will have the direct effect of costing taxpayers money.

The battle over tort reform is not a conflict between the rights of personal injury victims and the goals of unclogging our courts and creating a more efficient economy. It is, instead, an attempt by the liability insurance industry, product manufacturers, and doctors to transfer the costs of their negligent acts from themselves to the taxpayers.

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Tort reform is a disguised entitlement for wealthy corporations, medical professionals, and the liability insurance industry. The obscured fact is that injured parties aren't going to pay either way because ***injured parties have no money.*** It's only a question of whether the plaintiffs long term needs are going to be paid by the defendant corporation, hospital, doctor, or insurance company, as they would under our current system, or whether they'll be covered by welfare, food stamps, and Medicaid - all of which are funded by taxes and increased debt. That's the real tort reform trade-off. The tortfeasors and their insurers pass the bill off to the tax-paying public, whom they duped into supporting tort reform in the first place.

Tort reform proponents distort the irrefutable fact that in today's America, grievous injuries to individuals result in costs to everyone in our society. Public policy can only adjust the relative distribution of those costs. The party that is least able to bear the economic burden of catastrophic injury is almost always the injured victim. A disproportionate number of plaintiffs in major personal injury and

TRUST SPECIALIST JOINS HALPERN GROUP

Dick Moore, a banker with 25 years of experience heading trust departments in major financial institutions, has become the newest Halpern Group vice president. "Dick's addition is the logical next step as we intensify our efforts to make financial protection and flexibility available to injured plaintiffs, and to give plaintiffs attorneys the tools they need to ensure the long term welfare of their clients, said Richard G. Halpern, the company's founder and president. "He's a rare talent, and we were lucky to get him."

A graduate of Yale, Moore first came to Halpern's attention in 1991, when The Halpern Group was developing the U.S. Treasury Bond Structured Settlement Trust. "We were looking for a trustee, and were thrilled to find one with such business sense and creativity," Halpern relates. "The T-Bond Trust would have never been brought to market without Dick's efforts. Now that we have him full-time, our capabilities are greatly expanded."

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CRITICAL QUESTIONS OF DUE DILIGENCE IN ANNUITY-BASED STRUCTURED SETTLEMENTS

[Although annuity-based structured settlements have accounted for more than 95% of all structured settlements, recent developments have resulted in changes that may have profound implications for plaintiff's counsel attempting due diligence in deciding whether to recommend a particular proposal. In this installment of "Direct Examination", we address the critical questions in determining the proper course of action.]

Q: How have plaintiff's counsel evaluated the security of proposed annuities in the past?

A: Before 1990, plaintiff's counsel concerned about the safety of structured settlement annuities would usually consult the Best's rating (Alfred M. Best & Company, Oldwick, NJ) of the annuity issuer in question. Many attorneys would accept only A+ ratings, but the majority of attorneys (as well as courts in infant and incompetent cases) would accept annuities with a Best's rating of A or higher. The late 80's and early 90's saw the use of additional rating services for confirmation of safety, including Standard & Poor's, Moody's, and Duff and Phelps.

Q: Did this constitute due diligence?

A: Certainly. Prior to 1991, nothing Confederation Life, and Mutual Benefit had occurred that would cause a logical person to question the approach. Until the failure of Executive Life, reliance on the ratings services as an indicator of future stability was a method that had proven effective over the years.

Q: Are the financial ratings services a valid basis for determining the future financial stability of annuity issuers ?

A: No, because the recent failures of highly-rated annuity companies have demonstrated that the ratings are not an accurate measure of future stability.

In May of 1989, Best's gave the Executive Life Companies their highest rating of A+. and Standard & Poor's gave them their highest rating of AAA (Best's introduced the A++ as their highest rating sometime in 1992). Yet two years later, in April of 1991, the Companies were seized by their respective state insurance commissioners.

Confederation Life was seized in August of 1994 and yet, as recently as February of 1991, it had received Best's highest rating (A+), the highest rating from Duff and Phelps (AAA), and the highest rating from Standard & Poor's (AAA).

Although not an issuer of structured settlement annuities, Mutual Benefit Life's ratings history is especially significant. A company known for conservatism that did not deal in junk bonds or risky products, Mutual Benefit Life was seized by the commissioner in May of 1991. Just one year earlier, in May of 1990, it had received the highest ratings from Best's (A+) and Standard & Poor's (AAA).

Q: Does this mean that all life insurance companies are in jeopardy?

A: No. Almost certainly, the majority of companies will continue to prosper.

But of equal certainty is the likelihood that some companies will collapse in the near and long term, like Executive Life, Confederate Life, and Mutual Benefit Life. The financial ratings services, however, cannot be relied upon to alert plaintiffs as to which annuity issuers are riskier than the others, as the ratings services themselves have stated.

Q: Is there any reason to believe that the investment practices of insurance companies place them at risks for future failures?

A: Possibly. An article in the September 29, 1995 Wall Street Journal entitled "Life Insurers Moving into Riskier Bonds, Ratings Agency Says," discusses a report released by Moody's Investor's Services on the investment behavior of life insurance companies. It notes that: "Below-investment-grade holdings topped 80% in 1990," which may have laid the groundwork for the largest number of regulatory agency seizures of highly-rated annuity issuers in history the following year. The article went on to say that the pattern has continued:

"The report said while below-investment-grade bonds as a percentage of capital remained flat last year, at about 46%, a few large companies allocated a greater portion of cash flow to such investments, and exposure is expected to rise this year."

This would result, said the Journal, in "potentially weak ratings in the medium to long term," according to a Moody's analyst. In other words, the companies were likely to be less stable in the future, a fact not necessarily predicted by their current ratings.

Q: How does the insurance industry itself view the risks of annuity-based structured settlements?

A: The Confederation Life liquidation is revealing.

As part of the rehabilitation plan, the rehabilitators and insurance commissioners decided to sell all the assets of Confederation Life Insurance and Annuity Company (CLIAC). The purchaser was Aetna Life Insurance and Annuity Company in Hartford (ALIAC). An October 2, 1995 news release issued by the rehabilitator said that:

"This transaction fulfills my pledge to protect policy values and benefits, and to ensure the fair treatment of CLIAC policy holder," said Commissioner Oxendine."

An article published a month earlier in The National Law Journal told another part of the story. Entitled "Winners Caught in a Vise," by Gail Diane Cox, it revealed the following:

"... Georgia's commissioner of insurance went to court this summer with a rehabilitation plan... The plan -- which calls for Aetna Life Insurance and Annuity Company to purchase all of CLIAC's business except the structured settlement contracts -- touched off anger among annuitants who suspected Aetna was cherry picking. Their attorneys, however, said insurance officials persuaded them that the alternative was liquidation... The state regulators -- and so far we are just trusting that they are telling us the truth -- made the case that if we filed objections and caused delay, Aetna would walk."

An item appeared in Aetna's structured settlement newsletter (Cutting Aedge News) on October 3, 1995, one day after the rehabilitator's news release. It was entitled "ALIAC Withdraws from Structured Settlement Business Effective October 13, 1995." The opening paragraph of this communication specifies

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- If you're not on the Halpern Plaintiff's Counsel Alert Network, you missed:
- An explanation of how defense structured settlement brokers' ties to the insurance industry can compromise your client.
- Warning on a proposed bill in the House that would tax punitive damages and damages for non-physical injuries.
- An expose of companies trying to persuade attorneys to prod their clients into selling their structured settlements...a violation of U.S. tax law and professional ethics.
- Don't miss the next Fax Alert - a free service of The Halpern Group to alert the plaintiff's bar on breaking news and developing issues affecting settlement strategy. Just call 1-800-524-1637 with your name and fax number, and join the network today.

Aetna's reason for taking this drastic move. It stated:

"This decision was driven by the significant capital investment required for this line..., and by concerns about the long-tailed liabilities unique to structured settlement annuities."

Thus Aetna, a major force in both the structured settlement and liability insurance industries, took the position that it was withdrawing from the structured settlement industry as an annuity issuer because this particular line of business entailed unacceptable risks. It had concluded that it was not prudent to continue to issue structured settlements directly, nor was it safe to purchase the structured settlement obligations that were held by Confederation Life Insurance and Annuity Company.

In late 1992, Allstate introduced their own structured settlement trust, which is a structured settlement funded with U.S. Government obligations instead of annuities. Because of the nature of this transaction, they submitted a request to the Securities and Exchange Commission on September 30, 1991, for what is commonly referred to as a no-action letter, stating that the product they were selling was not a security requiring registration pursuant to the various securities regulations. The request was written by Allstate's counsel and sent to the office of Chief Counsel, Division of Corporate Finance, at the Securities and Exchange Commission in Washington, D.C.

The procedure requires a written request for a no-action letter, supported by significant factual detail as to why the ruling is necessary and why it is justified. The SEC usually replies with a list of specific questions; the applicant then answers all the questions, and, if the SEC is satisfied with the response, they then issue the requested letter. Allstate followed this procedure, and received its letter.

In doing so, they were truthful and candid, as is required by the agency. Section A of Allstate's letter dated September 30, 1991, describes the purpose of the trust:

"...It is well known that recently some of the largest and sound corporations, and even established and supposedly sound insurance companies, have quickly and unexpectedly become insolvent.

The following paragraph goes on to say that "Injured individuals and their families (and society) should not, and will not have to, bear the business risks that jeopardize the ability of non-governmental defendants to fulfill their obligations many years into the future.

Subsequent to this September 30, 1991

submission, the SEC responded with a series of questions. Allstate's counsel responded to the SEC via letter on July 22, 1992. One of the questions asked was: "Why doesn't Allstate issue annuities to settling plaintiffs instead of going to the trouble to set up the trust? Allstate's answer to the SEC:

"Allstate is the second largest writer of annuity-funded structured settlements in the United States. It has been perceived that a more safe and secure alternative to conventional structured settlement vehicles is needed. The trustees desire to create the trust to provide structured settlements that are backed by government securities but which also offer flexible payment options..."

In recognition of the fact that no annuity, no matter how strong the issuer, is as safe and secure as government securities, the trust will not purchase annuities as funding assets, but will purchase only government securities. The purpose of the trust is to offer structured settlement arrangements that are second to none in terms of the safety offered to settling claimants. Because many claimants are severely injured, with little chance of ever holding gainful employment, they will have heavy ongoing medical expenses for the remainder of their lives. For such settling claimants, any possibility of not receiving the benefit payments specified in their settlement agreements is unacceptable. These are the claimants for whom the trust is designed."

Q: Has the insurance industry's recognition of increased risks involved with annuity-based settlements been communicated by them to plaintiff's counsel?

A: Not to date. For example, at the exact same time that Allstate's attorneys were making the above representation to the SEC, Allstate had national representation by structured settlement brokers who told plaintiffs attorneys how safe and secure Allstate annuities were, playing heavily on their ratings from the various ratings services.

Q: Given the lack of information from the annuity issuers themselves, and the inadequacies of the ratings services, how have plaintiff's counsel attempted to exercise due diligence in the recommendation of annuity-based structured settlements to injured plaintiffs?

A: Since the annuity failures of the early 90s, most attorneys who are still doing annuity-based structured settlements have started demanding higher quality issuers. The conventional wisdom has been that the big three were Prudential,

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Metropolitan and New York Life. As this is written, Prudential no longer receives the highest ratings from even one of the major rating services. Metropolitan has seen its ratings decline, and is on the watch list of more than one rating service for future downgrading. Only New York Life, who just re-entered the structured settlement industry in 1994, still has pristine ratings. But clearly, pristine ratings are no longer a reliable indicator. History has proven that due diligence simply cannot be achieved by using the ratings services.

Q: Does this compel the conclusion that there is no way a plaintiff's counsel can exercise due diligence while recommending an annuity-based structured settlement, and that such an attorney is *per se* placing the plaintiff at risk while exposing himself to potential malpractice?

A: That issue has not been settled at this time. Right now, this is a question that each plaintiff's counsel must consider individually. Fortunately, there are excellent alternatives to annuity-based structured settlements, so concerned attorneys have acceptable options that do meet the due diligence standards.

[For copies of the above in white paper format, please call or write Risa Lower at The Halpern Group.]

ABOUT THE HALPERN GROUP

The Halpern Group is a unique negotiation and settlement consulting group firmly allied to the goals and principles of the plaintiff's bar.

In addition to assisting in negotiations and case strategy, The Halpern Group has an unmatched track record for creating structured settlements and structured settlement alternatives that meet the special needs of injured plaintiffs, ensuring their long term welfare and security.

Halpern Group founder and president Richard Halpern is a long time teacher, lecturer, and practitioner in settlement negotiation techniques, and is also widely recognized as one of the country's foremost authorities on the financial and practical aspects of structured settlements.

It is most appropriate to use The Halpern Group in problem cases, cases involving substantial damages, class actions, and cases where the plaintiff's long term financial needs require careful planning. In general, it is useful to think of The Halpern Group as providing the same support to plaintiff's counsel that the defense routinely receives from the liability carrier or corporate risk-management personnel.

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medical malpractice cases are in low income brackets to begin with, and all but the most affluent and thoroughly insured victims see their earning ability and financial resources wiped out by catastrophic injury. Absent a judgement or a settlement that shifts the financial burden to the tortfeasor, the victim has no alternative but to rely on public assistance: welfare, Medicaid, food stamps. All come out of tax dollars. Our current system permits the financial burden of the injury to be shifted from the taxpayers (who had no part in causing the damages) to the defendants (who did cause the damages) in a successful tort action. *The major thrust of tort reform is to prevent that transfer, or severely curtail it.*

"Loser pays," and the limitation or elimination of the contingent fee system, despite superficial (and cynical) appeals to equity, are calculated to block recovery by victims of injury, whose worsened financial prospects make them unable to sustain the expenses of protracted litigation, no matter how grievous and legitimate the damages.

Defendant corporations and insurance companies will be able to turn the pressure of the plaintiff's legal fees to their advantage, waiting out a victim who is often already on welfare. The combination of dwindling resources and the risk of a loss in court (a risk that the plaintiff is far less able to tolerate than the defendant) will force a settlement that fails to meet the plaintiff's needs. Anything the low settlement doesn't cover will become the responsibility of the taxpayers, because the victim will either remain on or ultimately return to public assistance.

Caps on punitive damages and "pain and suffering" will completely disrupt the dynamics of the settlement process, and open a Pandora's box of consequences that will harm the public and expand the tax bill.

To the casual public observer whose knowledge of the subject has been formed by sound bites and inflated rhetoric, punitive damages and damages for pain and suffering appear to be blank checks for over-generous juries. But to corporate defendants and insurance companies, these factors represent uncertainty... factors they can't control, enemies to the bottom line. Without caps on these damages, corporations can only avoid uncertainty by making safer products. Cost-benefit calculations, which compare the liability costs of potential claims against lower expenses made possible by negligent

design and production, become impossible. The resulting uncertainty creates a powerful incentive for the defendant or its insurance company to reach an out-of-court settlement to satisfy the injured plaintiff's real needs. Not to do so is to risk a much larger jury award.

Under the current system, a jury has the means to punish defendants financially, if the jury finds their behavior unconscionable. By removing this threat to the defendant or its insurer, tort reform measures guarantee that:

- **There will be far fewer** early settlements, because the cost to the defendant of paying a now limited jury award, or settling for a fair and reasonable sum, will have been rendered identical.
- **The defendants and their insurers** will be able to use the passage of time as a weapon against the victim by not settling, and extending the time the plaintiff is on public assistance.
- **The amount of the tab** transferred to the tax payers will increase because victims will be on public assistance longer. At settlement or verdict, there would be a larger public assistance lien to be repaid, thus leaving a larger unpaid bill for the taxpayers. (Public assistance liens are never repaid in full, but instead are negotiated at some lower sum.)
- **More victims will have to return** to public assistance, and sooner, again increasing the tax burden.

Meanwhile, the growing number of victims seeking compensation will find themselves in a bind. With the uncertainty of punitive and pain and suffering damages removed, insurance companies will have little motivation to come to the bargaining table with a just settlement. The combination of more victims and fewer settlements would clog the courts, increasing costs to the system—exactly the opposite of the result claimed by tort reformers. Even if settlements continued at the current rate, plaintiffs would be increasingly forced to accept insufficient damages. In either scenario, the taxpayers pick up an extra burden.

I began by saying that this argument is easy to understand. Obviously, the mechanics by which tort reform measures will shift financial burdens to the taxpayers are quite complex, and creating a real

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understanding of them will require a degree of public enlightenment that is impossible in a public policy setting. The essence of the argument is simple, however: by restricting their own fiscal responsibility for the welfare of tort victims, wealthy - corporations, insurance companies and doctors are attempting to shift the financial burden of caring for injured plaintiffs not to the plaintiffs themselves, who have no resources, but to the taxpaying public through Medicaid and other public assistance. The costs to the public created by this shift will far outweigh any of the claimed savings of tort reform. Fiscal conservatives, rather than supporting tort reform, should vehemently oppose it.

Unlike the primary arguments now being used to counter tort reform proposals, this argument appeals directly to voter self-interest.

It appeals to common sense.

It will receive significant support from tax reform groups.

And it has one more distinct advantage over the contentions of the tort reform advocates.

It happens to be true.