

New York 50A and 50B - A Strategic Approach to Case Resolution

The participants in New York 50A and 50B matters have largely taken a tactical approach to resolving their cases. They have reached a verdict or received a defense generated settlement offer, and waited for the valuation, together with any adjustments. The parties would then negotiate discount rates, the adjustments and their components and the application of interest. Finally, the defense would provide annuities to cover the elements of future damages, and the matter would be resolved.

- Did it matter that the case remained unresolved for too long a period?
- Did it matter that the stream of future payments bore no relationship to the expected needs of the plaintiff or claimant?
- Did it matter that touted tax benefit from annuities was often illusory?
- Did it matter that the future damages payments did not really adjust for rising inflation?
- Did it matter that a large and increasing portion of the Award was in cash, and would be unprotected?

After all, the matter was resolved, the apparent intent of the statutes had been met, and everyone could move on.

But what if all of those questions mattered where would they lead?

A Proactive Strategic Approach to 50A and 50B Case Resolution

Where the parties exchange comprehensive valuations, including element terms, discount rates, adjustments and their components, and the application of interest an amount that may be the subject of a second level of discounting.

Where the plaintiff chooses those elements where the 'annuity tax benefit' is beneficial, reduces the remaining elements of future loss to cash, and combines them with lump sums and other cash items to be placed in a taxable trust.

Where payout under the trust is fit to major anticipated needs, where the principal is somewhat protected for plaintiff's future needs, and where premature withdrawal is permitted with a modest non-confiscatory penalty.

Statutory Directives

There is an often promoted view that the statutes require use of annuities to pay out net future loss annual payments as determined by the valuation. The key phrase is "...required to offer and to guarantee the purchase and payment of an annuity contract to make annual payments in equal monthly installments of the remaining streams of payments specified in such subdivisions (c) and (d)...". The defendants are required to offer, but plaintiff is not required to accept any or all of the annuities offered. In fact, this seems to be emphasized by the removal of the phrase "The court, as part of its judgment, shall direct that ..." when Article 50A was amended.

Liability carriers, for their part, have been known to offer cash when the cost of an annuity exceeds the element's net Award amount.

The Court has long recognized that the manner in which all elements of future loss are converted to periodic payments, and are then adjusted, leaves little doubt that the resulting payment schedules were not meant to meet plaintiff's projected needs.

Each statute contains a section promoting settlement, as follows "Nothing in this article shall be construed to limit the right of a plaintiff, defendant or defendants and any insurer to settle ...claims...". that seems to leave settlement as an option even after a verdict, and the parties would seem to be free to settle some

portion of the claims through annuities and others through cash.

Attachment A incorporates selected statutory references from New York 50A and 50B.

Illusory 'Tax Benefits'

To the extent that the provisions of Section 130 are met, "... amounts received for agreeing to a qualified assignment shall not be included in gross income...". The abiding principle for excluding all of these payments from taxable income is that they are payments of a loss over time, since the amount that purchases an annuity or is placed in a qualifying trust is the Discounted value of the Award Loss.

A great deal is made of these benefits without determining their worth. That value is best determined by comparing an elements future lost payments to the amount deposited to purchase them. In most cases, the amount paid is determined by the amount deposited, the imputed interest rate or rates and the period of payment. In New York, the amount paid out is determined by statute, the undiscounted value of the future loss element, the period over which the payments are made, and select application of 4% inflation rates.

The shorter the period the lower the premium paid on the funds deposited, and the lower the discount rate the higher the amount deposited to produce the stream of payments. In the environment where the payments and the discount rates are set by statute, the shorter the payout period the less attractive the payment of funds.

The simplest way of determining the relative benefit from the exemption is to sum all of the payments for an element of loss over the future damage period and divide it by the cost or the net discounted value after adjustment for litigation expenses and contingent fees.

With taxable annuities, the cost and premium over cost are amortized over the payment period, and taxes are applied to the premium. In the longer periods the premium is often larger than the cost component, and the tax effect is larger. The longer payout term the larger the premium, and the greater the taxes associated with the annuity payment.

Elements of Loss are discounted by a rate indexed to a 10-Year Treasury rate of 4.22%. Elements with payment periods of 10 Years or less pay, premiums are less than 25%. Elements of loss with approximately 16 Years or less have premiums of 41% or less. And, Elements with more than 30Years have premiums of 90 to 122%.

With regard to structured settlement elements, the premiums are the tax exempt benefits and the net benefit is the premium percentage multiplied by an expected tax rate. A more extensive way evaluate the return is to compare some part of the structure to a taxable trust that makes the same payments as the annuities, earns at the monthly average AAA bonds, pays taxes at a going rate, and pays for administration and incremental tax preparation. Extended Lost or Impaired Earnings were removed from consideration since approximately ½ of the payment amount is premium which would otherwise be taxed.

After investment at 6.45% (Average Monthly AAA Yield), a broker fee of 4%, tax of gains at 26.25%, an annual administrative cost of 25 basis points on opening balances, and a contribution of \$400 per year for incremental tax advice, there is either a minimal deficit or minimal surplus. With a taxable trust, there is flexibility

- To shift to higher yield vehicles over the life of the trust,
- To structure a payment schedule that more closely matches future needs, and
- To accelerate payments to meet unanticipated needs for a fee that is not confiscatory.

Attachment B lists various elements of future loss and the premium percentages associated with each.

Extending Trust Coverage to Lump Sums and Other Cash Components

Even before the amendment of 50A, Awards contained substantial amounts of cash in the form of past damages and lump sums. With the application of Amended 50A, the amount of cash has increased markedly.

Under Original 50A, cash includes,

- \$250,000 in lump Sums
- Future Loss of Services and Consortium added to lump sums
- Past Pain and Suffering
- Other past damages that are normally directly connected to expenses incurred.

Under Amended 50A, cash includes

- The first 35% of Future Pain and Suffering or \$500,000 whichever is greater
- 35% of the discounted value of each element of Future loss other than Pain and Suffering
- Future Loss of Services and Consortium added to lump sums
- Past Pain and Suffering
- Other past damages that are normally directly connected to expenses incurred.

The effect of the conversion of lump sum calculations to percentages of future damages has the effect in the model of increasing lump sum cash by 8.8 times while that conversion and the selected removal of the 4% inflation factor has the impact of reducing the net cash disbursed by the defendant by 25.8%. Put another way, the cash increase in lump sums is approximately 63% of the cash reduced from the amount disbursed by the defendant, or of the total adjustment or recategorization of the Award, 39% goes to the plaintiff's cash and 61% goes to the defendant.

Under Original 50B, cash includes,

- \$250,000 in lump Sums
- Past Pain and Suffering
- Other past damages that are normally directly connected to expenses incurred.

No effort has been made to incorporate the various additions of interest to any Award.

With these substantial funds, the trust can meet most anticipated future needs, provide a regular and substantial periodic payment flow, continue payment schedules for plaintiff's beneficiaries, and provide for unanticipated needs at a fee that is not confiscatory.

Summary

There are four points to a strategic approach to achieving successful resolution of a personal injury or wrongful death action under either 50A or 50B,

- Make comprehensive, fully valued settlement offers that challenge the good faith of the other party
- Select and accept annuities for those elements that have clear tax benefits through larger premium percentages (Payment periods of more than 20 years)
- Place the remaining elements of loss in a taxable trust that provides earnings and payment flexibility, and adds available cash to the trust res
- Design a payment schedule and payout period that meets expected needs and provides for beneficiaries

Attachment A: 50A and 50B Statutory References

Amended 50A

5031(g)

The defendants and their insurance carriers shall be required to offer and to guarantee the purchase and payment of an annuity contract to make annual payments in equal monthly installments of the remaining streams of payments specified in such subdivisions (c) and (d), after making the deductions and adjustments prescribed in subdivision (f) of this section.

5037

Settlements. Nothing in this article shall be construed to limit the right of a plaintiff, defendant or defendants and any insurer to settle dental, medical or podiatric malpractice claims as they consider appropriate and in their complete discretion.

Original 50A

5031(e)

The court, as part of its judgment, shall direct that the defendants and their insurance carriers shall be required to offer and to guarantee the purchase and payment of such an annuity contract. Such annuity contract shall provide for the payment of the annual payments of such remaining future damages over the period of time determined pursuant to this subdivision.

5037

Settlements. Nothing in this article shall be construed to limit the right of a plaintiff, defendant or defendants and any insurer to settle dental, medical or podiatric malpractice claims as they consider appropriate and in their complete discretion.

5041(e)

The court, as part of its judgment, shall direct that the defendants and their insurance carriers shall be required to offer and to guarantee the purchase and payment of such an annuity contract. Such annuity contract shall provide for the payment of the annual payments of such remaining future damages over the period of time determined pursuant to this subdivision.

5047

Settlements. Nothing in this article shall be construed to limit the right of a plaintiff, defendant or defendants and any insurer to settle property damage, personal injury or wrongful death claims as they consider appropriate and in their complete discretion.

Attachment B Elements of Future Loss and Premium Percentages and Alternate Trust Source for Payments

Premium amounts as a Percentage of Element Costs

<u>Element</u>	<u>Period</u>	<u>Orig. 50A</u>	<u>Amended 50A</u>	<u>Orig. 50B</u>
Pain and Suffering	10 Years			23.52%
	8 Years	18.24%	18.24%	
L.T. Medical Care	15Yr-10Mo.	38.91%	30.75%	34.77%
R & C Surgery	15 Years	38.06%	33.95%	38.06%
Orthotics & Prost.	14 Years	34.98%	31.48%	34.98%
Ambulatory Devs.	15 Years	38.06%	33.95%	38.06%
Lost Earnings	30Yr-10Mo.	121.90%	91.65%	121.62%
Household Support	15Yr-10Mo.	*	*	40.72%
Loss Of Consortium	15Yr-10Mo.	*	*	40.72%

* Future Damages related Loss of Services and Lost Consortium are Treated as additions to Lump Sums under 50A, but not 50B.

The discount rate is indexed to a 10-Year Treasury rate of 4.22%. Long Term Medical Care and Lost Earnings incorporate Collateral Source Offsets and the premium percentages differ from other elements of future loss with similar payment periods.

Alternate Trust Source for Payments

	<u>Orig. 50A</u>	<u>Amended 50A</u>	<u>Orig.50B</u>
Amount reserved for Trust	\$3,560,458	\$1,925,771	\$2,888,799
Structure Fee @ 4%	\$ 136,941	\$ 74,068	\$ 111,108
Net Invested	\$3,423,517	\$1,851,702	\$2,777,691
Total Payments	(\$4,638,063)	(\$2,402,735)	(\$7,550,708)
Total Earned @ 6.45%	\$1,607,993	\$ 740,191	\$2,911,861
Taxes @ 26.25%	(\$ 402,504)	(\$ 184,289)	(\$ 708,006)
Administration 00.25%	(\$ 68,115)	(\$ 31,666)	(\$ 122,288)
Tax Preparation	(\$ 6,400)	(\$ 6,400)	(\$ 6,400)
Remainder	(\$ 83,195)	(\$ 32,870)	\$ 25,542

A number of elements in the model were payments for future medical expenses, and those would be tax deductible expenses, reduce the tax on the earned accumulation and improve the remainder.

There are no restrictions on deploying and redeploying the principal within select categories of investment that could produce improved yields and, again, improve the remainder.

The manner in which all elements of future loss are converted to periodic payments, and are then adjusted, leaves little doubt that the resulting payment schedules were not meant to meet plaintiff's projected needs, and the Court has said as much. Combine that with the fact that the actual costs of future needs will move independently of the Award. The latter is particularly important as inflation returns to the economy in a way yet to be defined.