

New York 50A and B Award and Valuation Strategic Update

In ordinary times, market forces and market conditions should not materially affect the resolution of personal injury and wrongful death actions. But, these are not ordinary times. The market is being roiled by runaway leveraged investments in sub-prime securities, and media hysteria.

The effects on case settlement of market forces and conditions fall into three categories

1. A slowdown in settlements allowing the liability carriers to marshal cash resources, and delay liquidation of questionable investments.
2. Challenges to the reserves backing annuity payments.
3. A flight to the safety of 10-Year Treasury notes.

While you can do little to hedge against these conditions, it is time to take a strong proactive approach to settlement of personal injury and wrongful death actions.

- ◆ Push the defense by making a detailed, complete settlement offer using some average discount rate rather than the lower current yields. Challenge them to display good faith, limit the ability to defer while individual adjustables are resolved, and limit the referral to higher authority delays. If they pass on settlement for an average, they face the prospect that the yield at resolution will produce a higher cash Award.
- ◆ Analyze the components of future damages to determine which elements offer significant tax advantages as annuities. Propose to take the rest as cash in any settlement.
- ◆ If substantial, place these cash proceeds in a trust and add portions of past Pain and Suffering and Lump Sums, as appropriate.

If you are a glutton for mind numbing detail, read on.

Market Conditions

Current market uncertainties have impacted banks, insurance companies and annuity providers in ways yet to be defined. Those of most interest to plaintiffs' attorneys would seem to be,

1.) Liability carriers invest in various instruments including mortgage backed securities, and some even leverage those investments. When mortgages defaulted and the value of notes became questionable, the choice was simple, defer redemption of investments, slow settlements and marshal cash. Eventually, any mark to market might catch up, but not for a while. (now never?)

2.) Annuity companies invest their reserves in various instruments, and these securities are part of an illiquid market and have declined in value. The result may be a weakening in reserve values and a rise in the cost of annuities.

3.) Investors are herded toward Treasury investments as they look for the safest haven for their money. At a time when the rates/yields should be rising with the climb in essential inflation, the rates/yields have fallen. The net effect of this flight to safety can be seen in the yields on 10-Treasuries, and the strong downward bias both over the most recent months and in this past month. In the last completed 10 calendar years, the simple average annual yield has been 4.86% (for those who like statistics, the mean has been 4.857%). For the last 12 months, the simple average has been 3.99% (the mean, 3.988%). These do not reflect any volume weighting, but downward yield is an indicator of increased demand.

Anyone who expects that the proposed bail out will fix the issues of liability carrier reserves, annuity investments and the flight to safety must first answer three questions,

- Do you really understand the problem and its extent?
- How does the government intend to fix the problem?
- Does the solution address the problem?

The Impact of Treasury Rates on Personal Injury and Wrongful Death Awards

The discount rate is employed to determine only the value of the Award.

Prior to the Amendment of 50A in 2003, 50A and 50B specified that discount rates were to be applied against each element's future damage Award after deduction of lump sums. This would be achieved by determining the initial monthly/ annual payment and then factoring that amount by 4% for each full or partial year after the first year. The resulting stream would then be discounted to produce a present value from which discounted Collateral Source offsets were deducted, then pro-rated litigation expenses and finally contingent fees to arrive at the net element future Award valuation.

The amendment to 50A specified that the discount rate was to be indexed to the 10-Year Treasury Bond rate in effect on the date of the verdict. For elements where the period of future loss is 20 years or less the discount rate would be the 10-Year Treasury 'bond rate in effect', and for those with future payment periods greater than 20 years, the weighted average of the 10-year Treasury for the first 20 Years and 2% points above the 10-Year Treasury rate for each year beyond 20 Years.

Amended 50A specified that discount rates were to be applied against each element's future damage Award after deduction of lump sums. Lump sums for each element were to be determined as follows,

- The greater of the first \$500,000 or 35% of Future Pain and Suffering is assigned to lump sums. The remainder is the Net undiscounted Future Award. Discount rates were to be applied against the Net undiscounted future Award. This would be achieved by determining the initial monthly/ annual payment and then factoring that amount by 4% for each full or partial year after the first year. The resulting stream would then be discounted to produce a present value from which pro-rated litigation expenses and then contingent fees were deducted to arrive at the net element future Award valuation.
- For each remaining element of future loss, 35% is deducted from the Award to produce a net undiscounted Award. The 35% is then discounted to produce the element's Lump Sum. Discount rates are then to be applied against the net undiscounted future Award. This would then be discounted to produce a present value from which discounted Collateral Source offsets were deducted, then pro-rated litigation expenses and finally contingent fees to arrive at the net element future Award valuation.

The initial monthly/annual payments are determined by dividing the net undiscounted future Award by the period over which those payments were to be made. Future payments are the sum of initial payments as factored by the 4% inflation factor, as specified in the statutes. These are the streams of future payments that the Defendant guarantees, and for which it offers annuities.

Selection of 10-Year Treasury Notes

Discount rates are set by reference to the 10-year Treasury 'Bond rate in effect' on the date of the verdict. At the time that 50A was amended, the 30-year Treasury had been suspended, and the 10-year Treasury note was the most prevalent and stable vehicle for longer term Federal borrowing. There were regular quarterly auctions, with the occasional interim auction where the notes were offered at the last regular auction rate but at an updated auction yield.

Since the amendment to Article 50A is the first and only guidance on the subject of discount rates, the prevailing practice has been to apply the guidance to all 50A and 50B cases, and to use the daily yield on the verdict date.

First, there are no 10-year Treasury Bonds, and next there are three rates related to 10-Year Treasuries

- The only rate in effect is the stated auction rate. Unfortunately, there are some forty issues in the market at any time, and all have somewhat different stated rates.
- There is the yield at auction, or how much a willing buyer will pay for a 10-year Note of a given amount with a stated rate. This varies from the stated rate depending upon the demand for the instruments.

- There are periodic daily, weekly, monthly and annual yields . They are the historical averages of the transactions processed during a given period.

For much of the period around and since the passage of Amended 50A, the 10-Year Treasuries track record was as follows,

- For the past 10 years, the monthly yields on 10-Year Treasuries has mostly moved between 3.5% and 6.5% with most entries in the range of 4.0 to 6.0%.
- Regular auction rates have moved within a small range of 3.50 and 5.13% with a simple average of 4.36%.
- Regular auction yields have moved between 3.62 and 5.14% with a simple average of 4.42%.

This reflected the relative stability and predictability for any rate or yield, until the flight to safety.

- 65% of weekly yields in this last year were below 4.00%,.
- 73% of weekly yields over the last six months were below 4.00%.

The following is a listing of the daily yields for September 2008 as provided by the Federal Reserve,

09/01/2008, ND 09/02/2008, 3.74 09/03/2008, 3.71 09/04/2008, 3.64 09/05/2008, 3.66 09/08/2008, 3.66 09/09/2008, 3.62 09/10/2008, 3.65 09/11/2008, 3.64 09/12/2008, 3.74 09/15/2008, 3.47 09/16/2008, 3.48 09/17/2008, 3.41 09/18/2008, 3.54 09/19/2008, 3.78 09/22/2008, 3.83 09/23/2008, 3.85 09/24/2008, 3.80 09/25/2008, 3.88 09/26/2008, 3.85 09/29/2008, 3.61 09/30/2008, 3.85

The range in these daily 10-Year Treasury yields, is 47 basis points (3.41-3.88%).

[In the realm of unanticipated consequences, any future loss element that has a duration of less than 20 years and an attached 4% inflation factor will produce a higher discounted Award amount than the undiscounted Award Amount if the discount rate is less than 3.625%. As you will note The bottom of the September yield range was 3.41%, and on 5 different days the average yield was below 3.625%.]

Use of daily yields, as above, seem to violate the dual principles of stability and predictability. They also raise the possibility of the unanticipated consequence. That would seem to dictate use of some other 10-year rate. Use of weekly or monthly yields may have the same problems as the daily yields, but with lower volatility. The annual yields may be distant from the current market, and the 'rate in effect' may wait for several months from a verdict.

Faced with these conditions, we have come to propose the use of some average rate or yield. We chose to provide the simple average of regular auction rates and yields (since passage of Amended 50A), and to update the yields for any interim auction plus weekly yields as an estimate of the next regular auction yield. We added a weighting option to place the greatest emphasis on the most recent auction rates and yields. The rates and yields remain relatively stable over time, and are very predictable, whatever the choice.

The following is the latest set of averages with a .5 weighting (oldest rate/yields weight is 1, next oldest 1.5, next 2.0 etc.)

	Rate	Yield	Update	Weighted		
				Rate	Yield	Update
All Years	4.35%	4.42%	4.38%	4.33%	4.41%	4.34%
2 Year	4.27%	4.35%	4.23%	4.13%	4.22%	4.07%
1 Year	3.91%	4.00%	3.82%	3.89%	3.98%	3.83%

Impact of Different Discount Rates on Cash

The original models were based on a Treasury rate of 4.22%. We then input the range parameters of daily yields for September of 3.41% and 3.88%. Finally, we chose The 2 year updated, weighted, average yield of 4.07%.

The impact of those discount rates can best be seen by looking at the cash that the defendant is expected to surrender, as the true Award. Attachment A. The cash summary includes,

- Past damages and Lump Sums net of pro-rate Litigation Expenses and Attorney fees.
- Discounted future damages net of discounted Collateral Source offsets, pro-rata Litigation Expenses and Attorney fees.
- Allowed Litigation Expenses.
- Attorney fees.

With a reference base of 4.22%, the results are as follows (for details see Attachment A);

If a 10-Year Treasury yield of 3.41% were used

- Cash to be paid out would increase by 5.5% under Amended 50A
- Cash to be paid out would increase by 7.9% under Original 50A
- Cash to be paid out would increase by 8.9% under Original 50B

If a 10-Year Treasury yield of 3.88% were used

- Cash to be paid out would increase by 2.2% under Amended 50A
- Cash to be paid out would increase by 3.2% under Original 50A
- Cash to be paid out would increase by 3.2% under Original 50B

If a 10-Year Treasury yield of 4.07% were used

- Cash to be paid out would increase by 1.0% under Amended 50A
- Cash to be paid out would increase by 1.4% under Original 50A
- Cash to be paid out would increase by 1.6% under Original 50B

Award Composition

To put the change in payments in perspective, we have included the Award composition (Attachment B). Under Original 50A and 50B, Lump Sums are not affected by discount rates. Under Amended 50A, Lump Sums are in part affected by the discount rates.

Loss of Services and Consortium are part of Lump Sums under both the Original and Amended 50A, and future loss items under 50B.

Any combination where 50% of future losses are in elements with a future period of approximately 25 years, 25-30% of future losses are in elements with a future period of approximately 15%, you can employ the rule of thumb of the impact on total cash paid out as 10 times the change in discount rate.

Under the Original 50A above

- At 3.41% a change of 81 basis points produced a change in cash of 7.9%
- At 3.88% a change of 34 basis points produced a change in cash of 3.2%
- At 3.41% a change of 15 basis points produced a change in cash of 1.4%

The actual impact can only be determined by applying the new rate and actually valuing the Award. Our tools give the cash outlay in two in two places,

- At the end of the reconciliation or Negotiation Worksheet
- On the Comparison of Key Components

Payments versus Costs

The comparison of Total future payments to the elements net discounted value provides the return that would otherwise be taxed if the annuity payments were taxable. Once the period for payment and total element Award are established, the statute determines the initial monthly/ annual payments and the application of discount rate and adjustments determine the cost. Invert, the process and you find that the % return is for an element is the discount rate employed as long as there are no associated Collateral Source offsets.

The overall return for any element is nothing more than discount rate multiplied the period over which future payments are to be made. As a rule of thumb, the overall return is also the percentage of each payment that would be taxed, if these were taxable annuities, and

- If the return percentage is less than 20%, the recipient is gaining little more than the money invested
- If the return percentage is less than 30%, the gain is not as much as a normal return on AAA and Baa bonds, even after taxes.
- If the return is less than 40%, the return is a push, slightly better or slightly worse depending on the investment vehicle, costs for administering the trust and whether tax deductible expenses are funded.
- If beyond 60 or 70 percent, the tax deductibility associated with annuity payments would produce an advantage.

Attachment C provides the percentage gains by element, by discount rate, and the overall increase in cash as compared to the total cash produced after application of 4.22% to future damages.

Initial monthly payments are largely independent of discount rate, except that the litigation expense percentage and the 50A legal expense percentage change. Therefore, an element's total payments are slightly different. Attachment C. shows the total payments for a 4.22% discount rate, but uses the individual discount rate payments for the calculation of returns.

Unless there is a substantial from tax exemption, annuities offer a lower return and a guarantee of payment.

- They do not adjust to changing market conditions,
- They are not set up to meet expected needs,
- They cannot be changed to meet unanticipated needs,
- Protection substantial lump sums and some past damages require a separate taxable trust.

Strategic Approach to Settlements

As liability carriers slow the settlement process to a crawl, it becomes essential that plaintiffs' Attorneys take an aggressive proactive stance by offering a detailed settlement that

- Incorporates a valued Award using an average discount rate in all cases other than 50A Wrongful Death,
- Includes Collateral Source offsets and taxes against lost or impaired earning, as appropriate,
- Selects the cash option for those elements where the return is not material, and
- Includes any interest from the point that liability was established (50A Wrongful death or a prior liability verdict).

A complete settlement offer puts the onus on the defense to make a good faith response, places a cap on the settlement, and, perhaps, alleviating the need for post-settlement approval. The alternative is to do nothing, and wait until the liability carrier is ready to resolve the case.

In those cases where Court approval is required, the settlement can incorporate the trust proposal.

Summary

While the market remains uncertain, treasury yields continue to fluctuate and liability carriers display a reluctance to settle, the role of the plaintiff in resolving cases must change. To this point, plaintiff largely waited for defense overtures at settlement. Now, they should be more proactive by

- Making definitive resolution offers
- Selecting which elements of future loss should be resolved with cash, and
- Utilizing a trust to deploy and protect cash proceeds.

Attachment A.**Total Cash Payout by Discount Rate****Cash Payout Amended 50A**

	<u>@4.22%</u>	<u>@3.41%</u>	<u>@3.88%</u>	<u>@4.07%</u>
Net Future Damages	\$4,740,759	\$5,109,843	\$4,889,815	\$4,805,520
Net Lump Sums and Past	\$5,072,816	\$5,267,064	\$5,151,204	\$5,106,863
Litigation Expenses	\$235,000	\$235,000	\$235,000	\$235,000
Total Attorney fees	\$1,257,064	\$1,319,656	\$1,282,335	\$1,268,043
Total Cash Distribution	\$11,305,639	\$11,931,563	\$11,558,354	\$11,415,426
<u>Increase in Cash</u>		\$625,924	\$252,715	\$109,787
% Increase		5.54%	2.24%	0.97%

Cash Payout Original 50A

	<u>@4.22%</u>	<u>@3.41%</u>	<u>@3.88%</u>	<u>@4.07%</u>
Net Future Damages	\$10,693,955	\$11,776,911	\$11,128,683	\$10,882,381
Net Lump Sums and Past	\$2,634,636	\$2,639,898	\$2,636,847	\$2,635,611
Litigation Expenses	\$235,000	\$235,000	\$235,000	\$235,000
Total Attorney fees	\$1,647,621	\$1,768,534	\$1,696,170	\$1,668,666
Total Cash Distribution	\$15,211,212	\$16,420,343	\$15,696,700	\$15,421,658
<u>Increase in Cash</u>		\$1,209,131	\$485,488	\$210,446
% Increase		7.95%	3.19%	1.38%

Cash Payout 50B

	<u>@4.22%</u>	<u>@3.41%</u>	<u>@3.88%</u>	<u>@4.07%</u>
Net Future Damages	\$10,715,586	\$11,849,350	\$11,168,503	\$10,921,662
Net Lump Sums and Past	\$1,872,423	\$1,874,424	\$1,872,949	\$1,872,796
Litigation Expenses	\$235,000	\$235,000	\$235,000	\$235,000
Total Attorney fees	\$5,394,861	\$5,881,617	\$5,515,161	\$5,479,482
Total Cash Distribution	\$18,217,870	\$19,840,391	\$18,791,613	\$18,508,940
<u>Increase in Cash</u>		\$1,622,521	\$573,743	\$291,070
% Increase		8.91%	3.15%	1.60%

Attachment B.**Award Composition****Amended Fifty A**

	<u>Amount</u>	<u>% of Tot. Damages</u>	<u>Avg. Fut. Per. Yrs.</u>
<u>Future Damages</u>			
Pain and Suffering	\$1,141,400	9.63%	8.0
Medical Expenses	\$1,764,530	14.89%	15.7
Economic Loss	\$6,297,921	53.15%	30.8
Total Future Damages	<u>\$9,203,851</u>	77.67%	
Past Damages	\$2,646,074	22.33%	
Lump Sums	\$3,410,097	28.78%	
Total Damages	<u>\$11,849,925</u>	100.00%	

Fifty A

	<u>Amount</u>	<u>% of Tot. Damages</u>	<u>Avg. Fut. Per. Yrs.</u>
<u>Future Damages</u>			
Pain and Suffering	\$1,724,997	10.42%	8.0
Medical Expenses	\$2,666,733	16.11%	15.7
Economic Loss	\$9,518,041	57.49%	30.8
Total Future Damages	<u>\$13,909,771</u>	84.02%	
Past Damages	\$2,646,074	15.98%	
Lump Sums	\$360,696	2.18%	
Total Damages	<u>\$16,555,845</u>	100.00%	

Fifty B

	<u>Amount</u>	<u>% of Tot. Damages</u>	<u>Avg. Fut. Per. Yrs.</u>
<u>Future Damages</u>			
Pain and Suffering	\$1,731,594	8.57%	10.0
Medical Expenses	\$2,676,933	13.25%	15.7
Economic Loss	\$13,329,112	65.99%	30.7
Total Future Damages	<u>\$17,737,639</u>	87.82%	
Past Damages	\$2,459,845	12.18%	
Lump Sums	\$250,000	1.24%	
Total Damages	<u>\$20,197,484</u>	100.00%	

Amended 50A Model

	Yrs	Mos	Future Payments	<u>4.22%</u> <u>Value</u>	<u>3.41%</u> <u>Value</u>	<u>3.88%</u> <u>Value</u>	<u>4.07%</u> <u>Value</u>
Pain and Suffering	8	0	\$1,141,140	\$965,072	\$997,329	\$976,411	\$970,921
Long Term Medical Care	151	0	\$1,024,791	\$783,758	\$829,161	\$802,339	\$791,873
Rec/Corr. Surgery	15	0	\$207,433	\$154,853	\$163,558	\$158,419	\$156,411
Orthotics and Prosthetics	14	0	\$11,474	\$8,726	\$9,188	\$8,916	\$8,809
Ambulatory Devices	15	0	\$17,897	\$13,361	\$14,112	\$13,669	\$13,495
Plaintiff Lost Earnings	301	0	\$5,394,915	\$2,814,989	\$3,096,496	\$2,928,063	\$2,864,010
				<u>% Gain</u>	<u>% Gain</u>	<u>% Gain</u>	<u>% Gain</u>
Pain and Suffering	8	0		18.24%	14.64%	16.73%	17.57%
Long Term Medical Care	151	0		30.75%	23.90%	27.86%	29.47%
Rec/Corr. Surgery	15	0		33.95%	27.07%	31.05%	32.67%
Orthotics and Prosthetics	14	0		31.48%	25.13%	28.80%	30.30%
Ambulatory Devices	15	0		33.95%	27.07%	31.05%	32.67%
Plaintiff Lost Earnings	301	0		91.65%	74.57%	84.40%	88.44%

Original 50A Model

	Yrs	Mos	Future Payments	<u>4.22%</u> <u>Value</u>	<u>3.41%</u> <u>Value</u>	<u>3.88%</u> <u>Value</u>	<u>4.07%</u> <u>Value</u>
Pain and Suffering	8	0	\$1,740,915	\$1,472,307	\$1,521,616	\$1,492,706	\$1,481,254
Long Term Medical Care	151	0	\$2,415,388	\$1,738,818	\$1,853,568	\$1,785,714	\$1,759,287
Rec/Corr. Surgery	15	0	\$422,442	\$305,990	\$325,053	\$313,791	\$309,397
Orthotics and Prosthetics	14	0	\$22,871	\$16,943	\$17,928	\$17,347	\$11,120
Ambulatory Devices	15	0	\$36,449	\$26,401	\$28,046	\$27,074	\$26,695
Plaintiff Lost Earnings	301	0	\$15,829,532	\$7,133,496	\$8,030,700	\$7,492,050	\$7,288,639
				<u>% Gain</u>	<u>% Gain</u>	<u>% Gain</u>	<u>% Gain</u>
Pain and Suffering	8	0		18.24%	14.64%	16.73%	17.57%
Long Term Medical Care	151	0		38.91%	30.60%	35.39%	37.35%
Rec/Corr. Surgery	15	0		38.06%	30.22%	34.74%	36.59%
Orthotics and Prosthetics	14	0		34.98%	27.82%	31.95%	33.64%
Ambulatory Devices	15	0		38.06%	30.22%	34.74%	36.59%
Plaintiff Lost Earnings	301	0		121.90%	97.51%	111.46%	117.26%

Original 50B Model

	Yrs	Mos	Future Payments	<u>4.22%</u> <u>Value</u>	<u>3.41%</u> <u>Value</u>	<u>3.88%</u> <u>Value</u>	<u>4.07%</u> <u>Value</u>
Pain and Suffering	10	0	\$1,436,246	\$1,162,790	\$1,210,109	\$1,182,310	\$1,171,342
Long Term Medical Care	151	0	\$1,855,311	\$1,376,681	\$1,466,215	\$1,413,280	\$1,392,657
Rec/Corr. Surgery	15	0	\$334,337	\$242,172	\$257,029	\$248,254	\$244,828
Orthotics and Prosthetics	14	0	\$18,101	\$13,409	\$14,176	\$13,724	\$13,547
Ambulatory Devices	15	0	\$28,848	\$20,895	\$22,177	\$21,420	\$21,125
Plaintiff Lost Earnings	301	0	\$17,341,298	\$7,824,837	\$8,800,253	\$8,214,732	\$7,993,544
Household Support	151	0	\$62,510	\$44,422	\$47,304	\$45,600	\$44,936
Loss of Consortium	151	0	\$40,007	\$28,430	\$30,275	\$29,184	\$28,759
				<u>% Gain</u>	<u>% Gain</u>	<u>% Gain</u>	<u>% Gain</u>
Pain and Suffering	10	0		23.52%	18.82%	21.53%	22.64%
Long Term Medical Care	151	0		34.77%	26.70%	31.35%	33.25%
Rec/Corr. Surgery	15	0		38.06%	30.22%	34.74%	36.59%
Orthotics and Prosthetics	14	0		34.98%	27.82%	31.95%	33.64%
Ambulatory Devices	15	0		38.06%	30.22%	34.74%	36.59%
Plaintiff Lost Earnings	301	0		121.62%	97.27%	111.20%	116.99%
Household Support	151	0		40.72%	32.29%	37.15%	39.14%
Loss of Consortium	151	0		40.72%	32.29%	37.15%	39.14%