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Is Plaintiffs' Lawyer Liable for Not Offering Structured Settlement?

By Amy Johnson Conner

Plaintiffs' lawyers who won a $2.5 million medical malpractice settlement for a client have been sued by the client for, among other things, failing to propose a structured settlement rather accepting than a lump sum payment.

The lawyers settled the legal malpractice claim for $1.6 million – raising questions among the plaintiffs' bar about whether there is ever a duty to offer a structure.

Plaintiff Josephine Grillo claimed the lawyers (1) failed to inform her about a structured settlement that had been offered by the defense, and (2) failed to make a structured settlement proposal of their own.

While failure to communicate a settlement offer would constitute a traditional case of legal malpractice, it was heavily contested by defense lawyers who claimed to have the plaintiff's signature rejecting the offer. Grillo's attorney, Kevin Isern, says the second part of the claim – that Grillo's original lawyer was negligent in not developing a structured settlement offer of his own – carried equal weight in reaching the $1.6 million settlement.

"When you start out with the premise that they didn't inform them of the settlement, that obviously looks bad. But when you go onto the next step – that they settled the case for $2.5 million and after they took their attorneys' fees they still had enough money to do a structure and didn't do it – that is the more important aspect of it," says Isern. "Failing to do the structure lost all the Medicaid and Medicare benefits until [Grillo's daughter] turned 18."

Isern says he's had several similar cases presented to him since settling the Grillo case, but he hasn't yet decided whether to accept those cases.

"I don't think this is a unique situation," says Isern, partner in a four-lawyer firm in Amarillo, Texas.

Although the settlement means there will be no definitive ruling on whether a lawyer ever has a duty to propose a structure, some in the structured settlement industry think there may be such a duty.

"It was only a matter of time before someone sued their own lawyer for malpractice for failing to offer a settlement structure," says Richard Risk of Structured Settlement Services in Tulsa, Okla., who has been in the business for more than 15 years.

There is "a little more potential liability" for plaintiffs' lawyers, says Terry Taylor, president-elect of the National Structured Settlement Trade Association and owner of Plaintiff Structures in Austin, Texas.

The Underlying Case

Josephine Grillo's daughter, Christina, was born with cerebral palsy, cortical blindness and a host of other medical problems – allegedly because of negligent medical care. The medical malpractice case settled for $2.5 million.

"During the [medical] malpractice case, the defendant insurance company offered a structured settlement to the child and our allegation was that it was never relayed to the parents and, in fact, never relayed to the court," says Isern.

"That structured settlement proposal ... would have provided over $240 million for the child" over her projected lifetime of 68 to 70 years, Isern says. But the final settlement, after attorneys' fees were deducted, left the child with only $1.5 million.

While that was clearly the strongest allegation in the plaintiff's case, it was also contested by the defense, which produced a copy of the settlement offer with the plaintiff's signature indicating that she had rejected it.

Isern contends that the signature was not the plaintiff's, but concedes that it made this aspect of his case less certain if the suit went before a jury.

What wasn't contested, however, was that Grillo's original lawyers never developed a structured settlement proposal of his own, even though that arrangement would have provided their client with tax benefits, guaranteed lifetime care, and protection from poor financial moves that would compromise her future care.

"At that point, the lawyers didn't offer a structured settlement to the child," says Isern. "They had the money deposited into the registry of the court ... and she lost Medicaid" because she had more financial assets than the eligibility guidelines allowed.

Placing the money in the registry also caused the interest on that money to be taxed. "In a structured settlement, that does not occur," Isern says.

The lawyers also failed to set up a "special needs trust" for the child, Isern says. Any money in such a trust is not considered under Medicaid eligibility guidelines and therefore can be used to supplement government benefits.

"You have a child who has all these needs, requires 24-hour care and has no government assistance to help pay for it. She got taxed on all the money she gained," Isern says.

The case settled for a confidential amount, but Risk says that because of a filing error on the court's part, the amount is now a matter of public record. The suit against the lawyers settled for $1.6 million; a parallel suit against the child's guardian ad litem settled for $2.5 million.

What It Means

One lesson of the case is that lawyers should convey all settlement offers in writing.

"You need to make sure you have something in your file to show that you discussed the offer with your clients," says Taylor.

"Any settlement communication has to be in writing to the client and the client's response in writing also," says Gary Fox, a partner in a six-lawyer Miami firm who specializes in professional negligence cases. "Unless you do it in writing ... the lawyer is very much at risk and flat foolish. It doesn't take a lot of time and it doesn't take a lot of effort."

The second lesson is to strongly consider whether a structured settlement offer is appropriate.

"For lawyers not to recommend such a settlement I think is questionable, especially in circumstances where the plaintiff is unsophisticated and likely not able to manage the settlement proceeds," says Fox.

This is especially true since structures can not only help with Medicaid issues and avoid dissipation of assets, but have tax advantages as well.

Any type of settlement that provides compensation for personal injury is not taxable, but interest gained on a lump sum is. However, under a structured settlement, any interest earned on the money is tax-free.

The federal government made this clear in the Tax Code in 1999 to encourage structured settlements, which it reasoned would keep injury victims from becoming wards of society after wasting their award, Risk says.

There may also be tax benefits for attorneys, who can structure their fees into the settlement.

"When you get into the higher income brackets, a larger percent of income is taxed. By spreading it out over several years, you can avoid those peak-earning years and save money on taxes," Risk explains.

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Questions or comments can be directed to the editor at: bibelle@lawyersweekly.com

Structured Settlements: The Basics

By Amy Johnson Conner

Last year, the number of structured settlements nationwide increased by 25 percent and they are expected to rise another 20 percent this year, according to a survey by the National Structured Settlements Trade Association. Certainly the volatile investment market is a huge factor in the dramatic rise of structured settlements. But experts also suggest a growing awareness of the benefits of structures – and the potential risks associated with not offering one – has played a role in the boom as well.

A structured settlement, which usually consists of an up-front payment and periodic payments for the rest of the claimant's life, allows the parties to design a financial plan based on the injured person's needs rather than forcing the plaintiff to figure out how to spread a lump-sum settlement over a lifetime, says Randy Dyer, current president of the trade association.

It is probably impossible for anyone – even the most seasoned stockbroker – to make a lump sum last a lifetime, he says.

"Take a stockbroker and say to them, 'I'm going to give you a lump sum of money you have to live on for the rest of your life and you're never going to get any more money and I'm not going to tell you how long your life is,' I'm not sure he could do it," Dyer says.

The defendant assigns its obligation to pay the settlement to a third party, usually a life insurance company, which funds the payments with an annuity. An annuity has been the preferred way of funding because of its pricing and flexibility, but an alternative is a trust fund that invests only in United States Treasuries, according to the structured settlement association website.

The chance that plaintiffs or their guardians will squander a lump-sum payment is the foremost reason attorneys should offer structured settlements, according to Richard Risk of Structured Settlement Services in Tulsa, Okla.

In a case Risk is working on now, it has taken a family only six months to tear through millions of dollars of their daughter's settlement, he says.

"She's a quadriplegic and has a lot of monthly income and got a lot of cash, but her parents are buying cars for family members to come visit her and paying people to come visit her when they should be spending money on professional care and her nursing care," Risk says.

Structured settlements also offer significant tax benefits for the claimant.

Any type of settlement that provides compensation for physical injury is not taxable, but the interest gained on the lump sum is. However, under a structured settlement, any interest earned on the money is tax-free.

The federal government made this clear in the Tax Code in 1999 to encourage structured settlements, which it reasoned would keep injury victims from becoming wards of society after wasting their award, Risk says.

Some lawyers may believe that using a lump sum to purchase a certificate of deposit that offers a 10 or 11 percent return is better for the client, but "that's not better than a 7 or 8 percent return because of the tax situation with a structured settlement," says Kevin Isern, a lawyer who recently negotiated $1.6 million legal malpractice settlement for a client who's original lawyer failed to make a structured settlement offer.

Because of this tax benefit, lawyers and brokers warn their colleagues not to discount a structured settlement for wealthy clients, even though they may be financially savvy.

"If these people are already in the 40 percent tax bracket, they are going to love this. A 6 to 7 percent return tax-free in today's market ... equates to 11 percent [on a taxed gain]. And, it's guaranteed by a major life insurance carrier," says Terry Taylor, president-elect of the trade association and owner of Plaintiff Structures in Austin, Texas.

There are also tax benefits for attorneys, who can structure their fees into the settlement.

Before settlement documents are signed, the attorney fee agreement must be negotiated so that the annuity will pay the attorneys' fees from it.

All compensation attorneys receive from an annuity is taxable, but they only pay taxes on the amount they receive in a year. Under a structure, the attorney needn't pay taxes on the lump-sum settlement and the money can continue to grow in the annuity.

"When you get into the higher income brackets, a larger percent of income is taxed. By spreading it out over several years, you can avoid those peak-earning years and save money on taxes," Risk explains.

The IRS challenged such an arrangement in the early 1990s, but it lost in the U.S. Tax court and the Eleventh Circuit, and hasn't brought a similar challenge since.

Yet another benefit of a structured settlement is that it can keep an injured claimant eligible for Medicaid payments to help with the cost of their care, Risk says. If a claimant receives a lump sum, they will usually be too rich to meet Medicaid eligibility guidelines; that won't be the case if they receive a lower monthly income under a structure.

"If the attorney arranges a settlement and all those settlement funds do is replace Medicaid, then the injury victim isn't really any further ahead," Risk says.

Brokers and lawyers were hard pressed to name the disadvantages of structured settlements.

The disadvantage is "your money is tied up and you can't get to it. But the really *good thing* is that your money is tied up and you can't get to it," Taylor says.

"I see time and again people are finishing up the settlement and an uncle they haven't seen in 20 years all of a sudden is there with this idea that is a great way to make his dreams come true," Taylor says. "Then the uncle makes the people think they are greedy because they won't give him the money."

With a structured settlement, the claimants can truthfully tell the uncle they only get enough to live on each month, Taylor says.

Tips

While it may take additional time the first time through, learning the right way to structure a settlement is not that difficult, experts say.

"First, an attorney ought to ask for different quotes from different providers and see what the trade-offs are among various financial providers," Dyer says.

Lawyers might also want to contact a settlement broker before negotiations with the defense begin. This will help them become educated about the process, learn about the tax benefits and procure a preliminary proposal specific to their case.

"It doesn't cost you anything and it doesn't come out of your client's money," says Isern.

The brokers are paid with the commission on the annuity the defendant purchases to pay the settlement. Risk says if two brokers are involved in the deal for opposing sides, they either split the commission or end up in litigation to mete out which should receive it, but that litigation is no concern of the plaintiffs.

The majority of structured settlements are handled by brokers working for the defense, but that is neither a requirement nor should it be the norm, Risk says.

"I'd rather have my own broker, that way he's on the hook if he screws up," says Isern.

A broker is also useful to check the numbers offered in the opponents' structured settlement offer, he says.

But Dyer disagrees.

"Once a structured settlement specialist is there, he has to work with everybody in order to get both sides to agree and if you're working toward the goal of getting both sides to agree, what possible difference does it make what door you came in?" he says.

However, Risk notes that this issue – whether a broker for the defense or the plaintiff structures the settlement – could be the next to cause a malpractice risk for lawyers.

When looking for a structured settlement broker, Dyer suggests finding someone who has a proven track record, is knowledgeable about the particular area of the law and is backed by a strong company that will "be there for your client when they need them in the future."

Brokers should also keep lawyers informed about national, regional and local changes on the regulatory, legislative and court-specific levels that will affect structured settlements, Dyer says.

NSSTA offers a specialist certification and will refer lawyers to member specialists in their area.

Lawyers can contact the National Structured Settlement Trade Association at www.nssta.com or by calling 202-797-5108.