Approved April 1, 1986
Date

MINUTES OF THE House COMMITTEE ON Judiciary.

The meeting was called to order by Vice Chairman Robert Wunsch at
Chairperson

3:30 ~~xxxx~~p.m. on February 4, 1986 in room 313-S of the Capitol.

All members were present except:
Representatives Adam, Bideau, Douville, Duncan, Knopp and Teagarden were excused

Committee staff present:
Mike Heim, Legislative Research Department
Jan Sims, Committee Secretary

Conferees appearing before the committee:
Gary McCallister, Kansas Bar Association
Harold Riehm, Kansas Association of Osteopathic Medicine

Gary McCallister appeared before the Committee on behalf of the Kansas Bar Association in support of HB 2661 and in particular the sections pertaining to the Health Care Stabilization Fund (Attachment 1). Mr. McCallister said that the years of unlimited liability for the Fund is contributing to the present crisis with the Fund and a limit is needed on the liability of the Fund in the future as awards get larger. He indicated the future awards will continue to be large in light of rapidly escalating costs of providing health care. The Bar Association believes there is excess insurance available to health care providers for amounts needed beyond primary and Fund coverages. The Bar feels that limits on liability for the Fund could create a better market in Kansas for the availability of excess insurance. Mr. McCallister stated that the Bar supports experience rating and the averaging required by Section 25 of HB 2661 and indicated that that is done now within the JUA. Mr. McCallister presented the Committe with a letter from Robert A. Laing, CLU concerning the use of and tax consequences of annuities and structured settlements. (Attachment 2)

Harold Riehm of the Kansas Association of Osteopathic Medicine appeared before the Committee in support of lines 122-28 of Section 25 of HB 2661 concerning the averaging of the Health Care Stabilization Fund surcharge within each class of rate. (Attachment 3). He pointed out the inequities of the present premium structure and resultant surcharge premiums for various classes as they relate to members of his association.

The Vice Chairman adjourned the meeting at 4:45 P.M.

McCallister 2/4

A SECOND CENTURY OF SERVICE
1882
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HB 2661

Health Care Stablization Fund Issues

February 4, 1986

Mr. Chairman. Members of the House Judiciary Committee. I am Gary McCallister, a partner with the Topeka firm of Davis, Unrein, Hummer and McCallister. Our firm handles a broad range of legal matters, including medical malpractice. I am a member of KBA's Legislative Committee. Richard Hite, who is chairman of that committee, and Ron Smith, KBA's Legislative Counsel, asked that I make this presentation on behalf of the Kansas Bar Association. We appreciate the opportunity to speak to the sections of this bill which deal with the Health Care Stablization Fund.

The Insurance Commissioner's Office undoubtedly covered the history of the development of the Fund. KBA does have considerable interest in this historical development. The legislative history of the Fund can show why premium surcharges in Kansas are as high as they are.

Our position is straightforward: we generally support the provisions of HB 2661 relating to the Health Care Stabilization Fund, especially as noted below.

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Background

The limit on surcharging in the 1976 legislation, which was requested by health care providers after the Insurance Commissioner recommended that insurance coverage was mandatory, has proven to be a grave mistake. The legislation limited the ability of our Fund to get actuarially sound premium surcharges. This oversight has caused problems.

From Fiscal Year 77 through the present there has been a steady upward increase in the Medical Care Index. The MCI is a measure of the cost of goods and services within the medical community, and is a subcomponent of the Consumer Price Index. The MCI ran consistently higher through this period than the CPI and inflation as a whole.

This is significant because insurance planners and policy makers only needed to know two things to know that increases in premiums were going to be needed if indemnity was to keep pace with growth in the MCI: (1) that the cost of delivering medical services continued to grow faster than the rest of the economy, and (2) the biggest growth expenditure component in most <u>large</u> medical malpractice settlements and verdicts has been future medical care.

Obviously, if the cost of future medical care increases, there will be larger settlements and verdicts--if state policy remains that persons injured by another's negligence has a right to full compensation. The need for more future medical care does not change merely because structured settlements or structured verdicts are required by legislation.

However, from FY 1980 through FY 1983, while all national and state indicaters were showing higher potential verdicts, higher settlements, a Medical Care Index that was increasing almost 10 to 15% per year, the state's Health Care Stabilization Fund was providing <u>unlimited insurance liability coverage</u> for little or no premium.[1]

During the middle of this period, investment income was high for all property casualty insurance companies. The late 1970s and early 1980s was the most recent "boom" cycle in profits in what is traditionally a cyclical industry.[2] The Kansas Health Care Fund was no exception. For a time, investment income exceeded indemnity payouts from our Fund, and the Fund during this time was statutorily prohibited from surcharging premiums.

All this was contrary to advice from within the insurance industry. Malpractice companies and state funds were clearly warned by their reinsurance companies there was too much rate-rebating going on, too many dividends being paid, and not enough attention to the long term fiscal consequences of medical malpractice judgments and awards.[3]

Finally, when the commercial companies decide to charge a premium lower than necessary to fund liability, and allow investment income to cover the difference, such decisions have a direct bearing on the present solvency of the Kansas Fund. Since by law the HCSF surcharges against whatever amounts the commercial company's basic premium, if the basic premium is artificially low and the Fund has no independent means to judge adequacy of premiums being charged, it follows that the Fund's surcharge revenues during this period were probably lower than necessary to cover the higher risks being insured by the Fund.

The road back to an "adequate" Health Care Stabilization Fund balance will be fiscally hard, expensive and may take time. Actuaries hired by the HCSF told the summer interim committee that one third of the current 110% premium surcharge required by the Fund is "make up" for those three years when no premium surcharge was levied at all. Part of the anguish you hear from your physicians are the high premium surcharges.

Unfortunately, this fiscal anguish must be borne by Kansas health care providers. They were the beneficiaries of the unlimited insurance coverage by the Fund.

I.

KBA supports lowering the limit of liability for the Fund from its current $3 million per provider limit, to $1 million per provider, with a $3 million annual aggregate.

This is not supporting a total award limit of $1 million; rather it is a realization that Kansas is one of the few states requiring health care providers to carry insurance. We compound that problem by requiring they carry one of the highest amounts in the country.

KBA believes there is adequate excess insurance available in the current market for those providers wanting more than $1.2 million in coverage. Further, insurance experts believe that a market for Kansas medical malpractice excess insurance might be created if the commercial companies and the Fund levels were lowered to the amounts we recommend. Provisions of Section 24 carry this recommendation into effect.

While true that the current reinsurance market is soft, it is also true that the reinsurance market grows soft each time the industry's profits bottom out. Some insurance commissioners, however, recommend government regulation of a reinsurance pooling mechanism as an option for certain nonprofit businesses.[4] Reinsurance reform is also a subject being persued by Congress, primarily because current reinsurance so heavily relies on foreign sources.[5]

II.

KBA has supported "experience rating" of health care providers. Section 25 requires the Fund to "average" the surcharge rate of its insureds by class of health care provider. Further, Section 25(c), at line 165 on page 25, gives the Fund's Board of Governors and the Insurance Commissioner the opportunity to experience rate those health care providers with a "poor loss experience." This will be accomplished through rule and regulation through the Commissioner's authority, which gives all parties adequate input into the details of such experience rating. The Joint Underwriting Authority administrator, The Western Insurance Companies, of Fort Scott, indicate they currently experience rate within the JUA. They can bring their expertise to bear. We believe that physicians who practice good medicine and have a good experience record ought not pay as much as those few physicians who cause the bulk of the malpractice.

III.

Mr. Chairman, our final point is somewhat off the sections assigned for discussion, but involves the ability of the Fund to provide money through an annuity ordered under Section 12 or Section 14 of the bill, which begins on page 10.

Ron Smith has attached a letter from Robert Laing, a Wichita attorney who is also a CLU, and who has written a well researched article on the use and tax ramifications of structured settlements.

As Mr. Laing's letter indicates, the statutory language of HB 2661 regarding post-verdict court-approved purchase of annuities to fund long-term benefits may present an income tax problem to the plaintiff.

The area is a tax lawyer's haven and quite complicated, so I'll let Mr. Laing's recommendations speak for themselves.

Thank you.

Footnotes

1. See the Report of the 1985 Interim Committee on Medical Malpractice, at pages 833 through 835.

2. For a good discussion of risk in the overall Property-Casualty insurance business, see Investment Income and Profitability in Property-Casualty Insurance Ratemaking, J.R. Hunter and J.W. Wilson, 1983, Chapter 5.

3. Business Week of April 14, 1980 noted: "For medical malpractice carriers generally, today's numbers spell trouble. . . . 'I see too many of these (bedpan mutuals) companies decreasing rates and returning dividends,' says C. Frank Aldrich, President of Kemper Reinsurance Company, of Long Grove, Ill. which insures eight of the doctor companies . . . Aldrich warned a meeting of the Physician Insurers Association of America (PIAA): 'If you fail to recognize or are slow in recognizing the import of long-term development of malpractice losses . . . you may produce a second crisis for which the only alternative is government.'" Kansas insurers and the Fund were slow to react to such warnings. In Kansas, we did not make statutory changes requiring actuarially sound premium surcharges in the Fund until July 1, 1984, although the bill was requested in 1983.

4. Quoting a November 10th letter from Hazel Gluck, the New Jersey Commissioner of Insurance in the New York Times, December 8, 1985. Gluck argues the state should institute a backup system of liability insurance for nonprofit organizations, as it has for auto and fire insurance and workers compensation. This could include joint underwriting authority, risk-pool trusts for nonprofit groups and a state-supported reinsurance pool.

5. Economist Sean Mooney of the Insurance Information Institute said Lloyds of London has lost more than it wanted in the U.S. Market in recent years and wants to pull back, but admitted that since Lloyds has 15% of the American reinsurance market, its actions can have a "major impact." Associated Press Article dated January 6, 1986.

Mc Callister 2/4

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CONNECTICUT MUTUAL
A Family of Blue Chip Companies

January 17, 1986

Mr. Ronald D. Smith
Legislative Counsel
Kansas Bar Association
P.O. Box 1037
Topeka, Kansas 66601

Dear Ron:

Thank you for your letter of December 11th, sending me a copy of the proposed medical malpractice bill, and asking for my help in analyzing the tax aspects of the annuity required to be approved by the court for future economic loss. There follows my answer and analysis.

These comments regard an as yet unnumbered proposed bill by the special committe on medical malpractice, Re Proposal #47 new Section 14 (c), pg 11: "Benefits paid under an annuity contract, awarded pursuant to this section, or Section 12, shall not be assignable or subject to levy, execution, attachment, garnishment or any other remedy, or procedure, for the recovery or collection of a debt, and this exemption cannot be waived." It is the only language in the proposed bill which addresses the issues needing to be addressed in order for the proceeds from the annuity purchased to avoid income tax to the claimant, or injured plaintiff.

This language is insufficient to accomplish exemption of the annuity proceeds from federal income taxation. I would direct the attention of the committe drafting this legislation to my article in the winter of 1983 Journal of the Kansas Bar Association, What Every Lawyer Needs to Know About Structured Settlements, copywrit 1983 by Robert A. Laing, 52 Journal of the Kansas Bar Association 280. The article discusses the history of Internal Revenue Code Section 104, which exempts, from income tax, compensation for injuries or sickness, Treasury Regulation, Section 1.104-1(c) and several important revenue rulings: 79-220, 77-230, 79-313, 75-45, 65-29, as well as Internal Revenue Code, Section 130,created in 1982 by the Periodic Payment Settlement Act of 1982.

The principal requirement for nontaxability of annuity proceeds in a qualified, structured settlement under Internal Revenue Code, Section 130 (c), is that there be no actual or constructive receipt of the cost of the annuity, the annuity itself, nor possible advancement of annuity payments to the plaintiff. Thus, the injured plaintiff or claimant under the proposed 86 Medical Malpractice Legislation must not be awarded ownership of the court approved annuity received in compensation for future economic loss. The strategies used to meet this requirement include the following:

1. The defendant owns the annuity to fund the structured settlement;

2. The defendant's liability insurance carrier owns the annuity to fund the structured settlement;

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3. The defendant assigns the liability under Internal Revenue Code, Section 130(c), to a subsidiary of the annuity life insurance company, which thereafter owns the annuity that makes the payments to the injured plaintiff or claimant;

4. As is outlined in my article in the Kansas Bar Association Journal, the defendant assigns the liability under Internal Revenue Code, Section 130(c) to a trustee of an irrevocable trust, established by the defendant, and this assignee trust company owns the annuity for the benefit of the claimant, and then makes the payments to the claimant for the duration of the annuity. <u>The proposed act does not address this issue. It could do so by providing the medical malprac-tice fund with trust powers for this purpose so that the fund could own these annuities, and administer them.</u> Or it could authorize the appointment of a third party assignee as contemplated under Internal Revenue Code, Section 130(c), including Kansas trust Companies or the subsidaries of life insurance companies issueing such annuities as discussed above.

Specifically, the language which could be included is that from Internal Revenue Code, Section 130(c), describing a qualified assignment.

> "IRC, Section 130(c)(1982): <u>Qualified Assignment</u>. - For purposes of this section, the term qualified assignment means any assignment of a liability to make periodic payments as damages (whether by suit or agreement) on account of personal injury or sickness -
>
> (1) If the assignee assumes such liability from a person who is party to the suit or agreement, and
>
> (2) if -
>
> (A) such periodic payment are fixed and determinable as to an amount and time of payment,
>
> (B) such peridcal payments can not be accelerated, deferred, increased or decreased by the recipient of such payments,
>
> (C) the assignee does not provide to the recipient of such payment, rights against the assignee, which are greater than those of a general creditor,
>
> (D) the assignee's obligation on account of the personal injuries or sickness is no greater than the obligation of the person who assigned the liability, and
>
> (E) such periodic payments are excludable from the gross income of the recipient under Section 104 (a)(2)."

By rewording these requirements of the proposed act, I believe the act could achieve the nontaxability of the annuity benifits.

I offer these suggestions in the spirit of cooperation, with an effort to ease the medical malpractice crisis perceived in Kansas, even though I am not in total agreement with all the provisions of the proposed bill. Thank you very much for your interest in my views on this proposed legislation. Please feel comfortable to let me know if I can be of any further assistance to you in this matter.

Very truly yours,

Rob Laing

Robert A. Laing

CC: Representative Ken Grotewiel

RAL:sos

What Every Lawyer Needs to Know About Structured Settlements

By Robert A. Laing

Questions and Answers

1. What are they?
2. What is the income tax treatment of them?
3. Who needs them?
4. When are they used?
5. Why are they used?
6. Where are the pitfalls?
7. Where do I go for help if I've got one?
8. How do they work?
9. Sample Structured Settlement Agreement.

1. What Are They?

A structured settlement is a contract between the plaintiff and the defendant in personal injury litigation, in which the plaintiff agrees to accept settlement payments over a period of time rather than in one lump sum. In the four documents comprising the sample structured settlement agreement at the end of this article the concept is simple: The plaintiff agrees to release the defendant from its tort liability in return for the acceptance by the defendant, or its assignee, of a contractual liability to make a stream of future payments to the plaintiff. Thus a structured settlement is like the nest of the mythological Phoenix bird. Like the old Phoenix, the tort liability is consumed by the burning nest of the structured settlement, but, like the new Phoenix arising from the ashes of the old bird's nest, the contractual liability takes its place.

2. What Is The Income Tax Treatment Of Them?

HISTORY

Beginning with the Revenue Act of 1918, Section 213 (b) (6), applying only to individuals, taxable income did not include

> "*Compensation for injuries or sickness* . . . the amount of any damages received whether by suit or agreement on account of such" (personal) "injuries or sickness."

Then in the Revenue Act of 1928 the identical section was renumbered 22 (b) (5) and applied to both individuals and to corporations with an insurable interest.[1] In the 1954 Reve-

1. *Castner Garage, Ltd. v. Comm'r.,* 43 B.T.A.1 (1940).

nue Code the section was renumbered 104 (a) (2) and once again applied only to individuals. On January 14, 1983, President Reagan signed The Periodic Payment Settlement Act of 1982, Pub.L.97-473 (1982), amending, among others, IRC Section 104 (a) (2) for taxable years ending after December 31, 1982, to read as follows:

"Section 104. Compensation for injuries or sickness.

(a) In General — Except in the case of amounts" previously deducted as a medical expense, "gross income does not include— . . .

(2) the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness."

As you can readily see, the only real change to the exclusion in the sixty-five years was to add in 1983 the words, "and whether as lump sums or as periodic payments." The purpose of the 1983 addition, according to the original House of Representatives Bill 5470, portions of which eventually became P.L. 97-473, was to codify "prior law developed administratively and judicially." The Conference Report on the final version of the Bill states, "The conferees wish to emphasize that, as a result of this legislation, no negative inference should be drawn as to the appropriate tax treatment of such transactions under present law and administrative rulings." Thus prior regulations and rulings remain in effect. The important prior decisions, regulations and rulings will be discussed next, and the other relevant portion of the Periodic Payments Settlement Act of 1982 will be discussed after that.

ADMINISTRATIVE LAW

"Treas. Reg. Sec. 1.104-1(c) Damages received on account of personal injuries or sickness. Section 104 (a) (2) excludes from gross income the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness. The term "damages received (whether by suit or agreement)" means an amount received (other than workman's compensation) through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution."

Several important Revenue Rulings

About the Author

ROBERT LAING, CLU, *received his Juris Doctor degree from the University of Kansas in 1971. He is a structured settlement annuity broker with the life and health insurance group practice of Stowell, Stowell, and Goeller in Wichita. Other published articles include: "Structured Settlements: Ten Commandments for the Plaintiff's Attorney" in the* Journal of the Kansas Trial Lawyers Association *and "Structured Settlements: Considerations for Defense Counsel" in the Kansas Association of Defense Counsel* Newsletter, *a portion of ch. 102, "Settlements" in the Texas Litigation Guide, and a chapter, "Checklists on Oil and Gas Interests as Assets of Trusts and Estates," in the Kansas Bankers Association* Trust Administration Handbook. *He is a member of the Wichita Estate Planning Council, the Wichita Bar and the Kansas Bar Association.*

interpret this regulation. Are punitive damages taxable? No, the words "any damages received" mean both compensatory and punitive damages for personal injury or sickness,[2] even though other types of punitive damages, such as treble damages for antitrust violations, are taxable as income.[3] What is the important distinction between a lump sum settlement and periodic payments? While the lump sum itself is free of income tax, the income from investing the lump sum is taxable.[4] The important difference is that none of the periodic payment is taxable if the settlement agreement is in order.[5] We will look carefully at the requirements of this Revenue Ruling, 79-220, which carves out an exception from the usual tax treatment of annuity benefits: ordinarily that portion of each annuity payment to be regarded as a return of principal is determined by calculating an "exclusion ratio" for each annuity contract, and the balance of each payment is taxed as income to the recipient.[6]

Setting several requirements for the future payments to avoid income tax, Revenue Ruling 79-220 holds that the periodic settlement payments to a tort plaintiff for his life, or to his estate for twenty years, whichever is longer, are taxable neither to the plaintiff or his estate, because

1. The plaintiff (or his estate) "had a right to receive only the monthly payments and did not have the actual or constructive receipt or the economic benefit of the lump sum amount that was invested to yield that monthly payment."

From the facts of the case involved in the ruling come these additional requirements to avoid taxability:

2. the plaintiff should have no right to receive the discounted present value of the future payments at any time,
3. the plaintiff should have no right to control the investment of the funds to produce the future payments,
4. the plaintiff should be regarded as a general creditor of the defendant,
5. the defendant should retain all the "rights of ownership" of the annuity contract, "including the right to change the beneficiary."

It is not at all clear whether the words of this ruling, "rights of ownership," mean the same thing as the exhaustively litigated "incidents of ownership" which can subject insurance policy proceeds to federal estate tax in the insured's estate.[7] The cautious approach would be to assume that "rights" mean the same as "incidents of ownership." An additional requirement for avoiding taxability of the future benefits to the plaintiff comes from another ruling;[8]

6. The plaintiff should not have the right to accelerate any payment or increase or decrease the amount of the annual payments specified.

Various rulings have established that

The plaintiff should not have the right to accelerate any payment or increase or decrease the amount of the annual payments specified.

2. Rev. Rul. 75-45, 1975-1 C.B. 47.
3. Treas. Reg. Sec. 1.61-14(a); *Comm'r v. Glenshaw Glass Company*, 348 U.S. 426, 75 U.S. 473, 99 L. Ed 483 (1955).
4. Rev. Rul. 65-29, 1965-1 C.B. 59.
5. Rev. Rul. 79-220, 1979-2 C.B. 74.
6. IRC Sec. 72 (1982); Treas. Reg. Sec. 1.72-4.
7. IRC Sec. 2042(2) (1982); Treas. Reg. Sec. 20.2042-1(c).
8. Rev. Rul. 79-313, 1979-2 C.B. 75.

some other factors do not affect the exclusion of the payments from the plaintiff's taxable gross income. The defendant's source of funds can be an annuity,[9] a reversionary trust,[10] or general assets. The structuring of the future benefits can be level[11] or increasing in amount.[12]

NEW LAW

Where a defendant or trustee owns an annuity to fund structured settlement benefits, the defendant or trustee reports the receipt of the taxable portion of the annuity benefits as taxable income and then in some cases deducts the payments to the plaintiff; under IRC Sec. 651 for a trustee; or if as a trade or business expense, then under IRC Sec. 162(a) for a defendant. Some structured settlements are arranged so that the defendant assigns both the contractual liability for the future payments and the annuity or bonds to fund them to a third party who is not a trustee, but usually a corporation formed for the purpose, *e.g.*, by the broker of the annuity or bonds funding the agreement. Until the passage of the Periodic Payment Settlement Act of 1982, it was not clear whether the receipt of an annuity or bonds, or the cash to buy them, by the assignee from the defendant was taxable as income to the assignee. The Act sets out standards to be met in order that the assignment and funding of the agreement not create taxable income to the assignee. From the standards in the Act we can derive additional comfort regarding the six requirements set forth above for a plaintiff to avoid taxation of future benefits in a traditional structured settlement. The Act created new IRC Sec. 130 (1982), the pertinent part of which is

The Act sets out standards to be met in order that the assignment and funding of the agreement not create taxable income to the assignee.

"IRC Sec. 130(c) (1982): *Qualified Assignment.* — For purposes of this section, the term 'qualified assignment' means any assignment of a liability to make periodic payments as damages (whether by suit or agreement) on account of personal injury or sickness—

(1) if the assignee assumes such liability from a person who is a party to the suit or agreement,

and

(2) if—
  (A) such periodic payments are fixed and determinable as to amount and time of payment,
  (B) such periodic payments cannot be accelerated, deferred, increased or decreased by the recipient of such payments,
  (C) the assignee does not provide to the recipient of such payments rights against the assignee which are greater than those of a general creditor,
  (D) the assignee's obligation on account of the personal injuries or sickness is no greater than the obligation of the person who assigned the liability, and
  (E) such periodic payments are excludable from the gross income of the recipient under Section 104 (a) (2)."

Note the nearly perfect correlation between these requirements and those

9. Rev. Rul. 79-220, 1979-2 C.B. 74.
10. Rev. Rul. 77-230, 1977-2 C.B. 214.
11. Rev. Rul. 79-220, 1979-2 C.B. 74.
12. Rev. Rul. 79-313, 1979-2 C.B. 75.

of the prior rulings listed *supra*. The sample structured settlement agreement documents set forth at the end of this article attempt to encompass the stricter of both sets of requirements. Nonetheless in adapting the forms provided for use in any particular case, you may wish to seek expert tax advice regarding the effect of the law on the facts in your case.

Claims costs can often be lowered 20 to 40 percent or more by using a structured settlement instead of a lump sum.

3. Who Needs Them?

Not every case is appropriate for a structured settlement. What are the characteristics of a case suitable for a structured settlement? They are—

1. a personal injury
2. with substantial damages
3. and fairly certain liability
4. of a "target defendant" (that is one with a deep pocket, or good liability insurance, or both)
5. to a person with probable lifetime needs and probable inability or unwillingness to invest funds

   or

   to a person with no immediate need for funds, for example, a minor. If the payments are to be deferred, the minimum threshold amount of damages can be lower.

If you have a suitable case, who will benefit from a structured settlement? Depending on the facts of the case and the settlement, nearly every one associated with the case can benefit:

Plaintiff

1. Over time the plaintiff can receive more compensation from a structured settlement than the limits of the defendant's liability insurance policy, free of income tax (see Section two, *supra*).
2. The unsophisticated plaintiff avoids premature exhaustion of a lump sum settlement or judgment.
3. The plaintiff avoids the investment management duties and fees of a lump sum settlement or judgment.
4. The plaintiff enjoys the usual benefits of settlement: avoiding the delays and publicity of trial and of any appeal.

Plaintiff's Attorney

1. Counsel can maximize the after tax net return to the client.
2. Counsel can minimize unwise premature dissipation of the recovery.
3. Counsel can provide effective post accident financial planning for the victim or his survivors.
4. If a structured settlement is in the client's best interest, it provides an optional opportunity to defer counsel's fee for purposes of
   a. income averaging,
   b. retirement planning,
   c. estate planning,
   d. a deferred compensation program.

Defendant and his Counsel—

A structured settlement

1. Reduces negotiation time,
2. Increases negotiation flexibility, and
3. Eliminates trial costs.

Defendant's Liability Insuror—

A structured settlement

1. Lowers claim costs, claim reserves and cash reserve needs,
2. Improves the balance sheet by

lowering claims costs, which improves surplus, and
3. Enables the insuror to write more business and to enjoy a better combined ratio.

Claims costs can often be lowered 20 to 40 percent or more by using a structured settlement instead of a lump sum.

Society

1. Structured settlements provide more adequate and more prompt compensation to accident victims.
2. Use of a structured settlement can avoid the plaintiff becoming a ward of the state after prematurely spending or wasting a lump sum settlement or judgment.
3. The resulting reduced claims costs will be reflected in generally lower premiums and improved coverages for liability insurance.
4. More settlements will reduce congestion of court dockets and thereby reduce the taxes required to support the courts.

4. When Are They Used?

Structured settlements are used in any situation where a portion of the damages sought are not required for the immediate use of the plaintiff. They are appropriate to postpone payment of the benefits 1) until a minor reaches majority, 2) to prevent waste, and 3) to provide a lifetime financial plan for an accident victim or his dependents or both.

They are used to break a deadlock in settlement negotiations. Where the defense counsel's assessment of the value of the case is significantly below that of the plaintiff's counsel, a structured settlement can often provide a means to end an impasse in negotiations and to reach a settlement.

The more traditional sequence of events leading to a structured settlement begins with the defense counsel conferring with a broker of structured settlement annuities to design an affordable benefit structure to meet the plaintiff's demands. If the cost of the annuities to fund the deferred benefits is within the defendant's "budget," the defense counsel will communicate the offer to the plaintiff's counsel.

The offer is usually communicated in writing for the following reasons. First, the defense counsel can obtain the assistance of the annuity broker to prepare a written proposal designed to convince the plaintiff to settle, perhaps against the advice of plaintiff's counsel. Obviously a professionally prepared proposal can better drive any necessary wedge between the plaintiff and his counsel than can an oral offer or even most letters. Second, the plaintiff's counsel's duty to communicate all reasonable offers to the plaintiff arguably carries with it an implied duty to communicate the defendant's offer clearly and understandably. For this reason the plaintiff's counsel should insist on a clearly written proposal to assist him in performing this duty.

Less frequently the defense counsel will ask the plaintiff's counsel to formulate a structured settlement offer. The plaintiff's counsel must then retain a structured settlement annuity expert, usually on a fee basis. Many annuity brokers will not work for the plaintiff, presumably because they do not work on a fee basis. Working only for a commission from the sale of an annuity to fund the settlement, these brokers cannot, or at least do not work for a plaintiff. Even if the plaintiff's annuity expert also brokers annuities, he has no guarantee that the defendant will purchase the annuities through him. Many competitive annuity carriers will not provide an annuity price quote to an attorney or broker representing the plaintiff for the same reason: all sales are made to defendants.

5. Why Are They Used?

Structured settlements are used to facilitate settling personal injury litigation. How is this done? Here is an example of the use of a structured settlement to create a situation in which everyone wins. The plaintiff gets a larger net, after tax recovery than the damages originally sought in the action. The defendant pays much less for the benefits than it would for a judgment. Everyone wins. Even though the plaintiff's counsel's fee is lower for a structured settlement than the one projected for a judgment in the amount of the damages sought, it is certain. Winning the judgment usually isn't. Plus the time required for trial is avoided.

6. Where Are The Pitfalls?[13]

A. *For Plaintiff's Counsel*

(1)

Beware of an annuity for the life of the victim only. Protect the victim's family from his premature demise. For a plaintiff with disabilities sufficiently severe to be a burden on close family members, be certain that you discuss the advantages of obtaining a settlement structured to provide a 'period certain' of payments. There will be very little sacrifice of current income to the annuitant where the annuitant's life expectancy exceeds the guaranteed payment period. If the injured party is a minor you should have the conservator obtain the approval of the court to accept an annuity with a period certain to compensate the family for the additional burden.

For this purpose you probably will want to obtain alternative annuity quotes from a broker with several different periods certain depending on the life expectancy of the plaintiff. The periods of 10, 20 or 30 years are often used. (Note that life insurance companies often refuse to quote annuities on periods certain of longer than 20 or 30 years. This is presumably because such a long period certain so diminishes the significance of the life contingency that what is being sold may arguably be invest-

13. Laing, *Structured Settlements: Ten Commandments For The Plaintiff's Attorney*, 6 J Ks. Trial Law. A.5, (1982), hereinafter, JKTLA. Laing, *Structured Settlements: Considerations for Defense Counsel*, Ks. A Def. Couns. Newsletter, Nov. 1982, at 6.

EXAMPLE

COMPARISON OF BENEFITS FROM

	Judgment	*versus*	*Structured Settlement*
COST TO DEFENDANT	$860,000		$532,039
LESS ATTORNEY'S FEES	$344,122 (40%)		$159,612 (30%)
REMAINDER	$516,183		$372,427
INVESTED AT	8%		15 Year Period Certain Annuity
RATE OF CONSUMPTION	$ 35,000—First Year plus 10.71% Per Year Compound		$35,000 First Year + 10% Per Year Simple
LENGTH OF BENEFIT	Ten Plus Years		15 Years
AMOUNT OF BENEFIT	$615,953		$892,500
INCOME TAX—RATE	35%		0%
AMOUNT	$ 87,007		$0
NET BENEFIT	$528,946		$892,500

ment rather than annuity contracts.)

One additional advantage to a period certain for your client's annuity benefits is that you are assured that the defendant's premium dollars provide the benefit bargained for. Therefore your fee will be reasonable in relation to the client's benefits. Query—When the client dies long before the life expectancy used to calculate the annuity premium, what is your liability, if your fee has no life contingency, but the client's annuity does have one, and has no period certain?

One additional advantage to a period certain for your client's annuity benefits is that you are assured that the defendant's premium dollars provide the benefit bargained for.

One attorney who is cautious about avoiding 'constructive receipt' of the annuity premium for the reasons given in Section two, *supra* (on taxation) does not accept offers of structured settlements that are based in any way on a life contingency. He negotiates only for deferred future payments certain. That also reduces the problems discussed in this section and in Section Six A 3, hereinafter.

For a plaintiff with a dependent spouse you may wish to consider a joint lives and last survivor annuity for providing a lifetime income to both spouses. A lifetime amount to the plaintiff's surviving spouse of one-half to two-thirds the amount received by the plaintiff will usually keep the spouse in his or her world without a drastic decrease in standard of living. If the plaintiff does not have a diminished life expectancy the current income to the plaintiff often will not be too severely impacted from such an arrangement.

(2)

Beware of a default by the defendant or his assignee. Define default and provide for acceleration of the benefits in the event of default. Have any annuity used to fund the settlement written in a state with an insurance company guaranty association or fund. Warn your client that his future payments depend upon the financial integrity of the defendant, or the defendant's liability insuror, or their assignee, or the annuity insuror, or the state guaranty association or fund, or a combination of them.

(a)

In a traditional structured settlement, your client is a party to a contract, the structured settlement agreement with the defendant and the defendant's liability insuror. If either or both of them should become insolvent, any annuity contract purchased by the defendant(s) to fund the settlement would be an asset arguably reachable by the bankruptcy trustee and your client would be considered a general creditor. As a result of this exposure you should consider several steps. 1) Define default in the settlement agreement and provide in the event of default for the acceleration of the due dates of all future payments and their reduction to a judgment incorporating the terms of the structured settlement and payable in installments. This may discourage voluntary default.[14] Even this precaution may not protect you if the owner of the annuity or trust takes bankruptcy at or shortly after the time of default. 2) If your bargaining position is strong enough insist that all of the defendant(s) and their insuror(s) guarantee the payments due under the agreement. 3) To protect

14. Martin, *Structured Settlements: Protecting the Plaintiff*, 18 Trial 50, (February 1982).

the plaintiff and yourself against the failure of the life insurance company issuing the annuity, specify in the structured settlement agreement that any annuity purchased by the defendant(s) to fund the agreement will be purchased in a state having a life and health insurance guaranty association or fund.[15]

Be cautious that you do not imperil the tax free character of the plaintiff's benefits by securing them too well. For example, some settlement agreements specify that the agreed payments are to be entered immediately as a judgment against the defendant(s) in order that the plaintiff can have any advantages accruing to judgment creditors in the event of the future bankruptcy of the defendant(s). Most defendants will vigorously resist any judgment which would become a lien outstanding against their real property for the duration of a settlement agreement, in some cases many decades. For that reason, if you use this method, a lien waiver for title purposes but not bankruptcy purposes should be included in the Journal Entry of Judgment. Although immediately reducing a structured settlement to a judgment to acquire an advantage for the plaintiff in the event of the defendant's future bankruptcy has been recommended[16] by others, the plaintiff arguably risks providing the IRS with sufficient evidence of 'constructive receipt' of the present value of the settlement to lose part of the tax advantages of the deferred payments (see Section Two, above). However, in a case where the settlement offer cost exceeds the annual spending limitations (currently $300,000) of the Kansas Health Care Stabilization Fund (medical malpractice fund) you may want to reduce the settlement offer to a judgment in order to bind the fund to the deferred payments in the second and subsequent years, but beware of the income tax consequences to the plaintiff.

Although they are less commonly used than annuities, reversionary trusts are also used to fund structured settlements. They are frequently used for contingency funds, especially medical contingencies. In such a trust the funds are held by an independent trustee until the need for them has expired. The funds are then returned to the defendant. If more funds are required, the defendant adds them to the trust. The usefulness of such a trust is that the extent of the compensation need not be determined until a later date when the full extent of the damages is also known.

Although they are less commonly used than annuities reversionary trusts are also used to fund structured settlements.

Default would appear to be less of a concern with a properly organized reversionary trust. If the trustee is a bank or other regulated trust company, it will be required to segregate the assets on its books. If the bank or trust company became insolvent,

15. National Insurance Advertising Regulation Service, Official National Association of Insurance Commissions Model Laws, Regulations and Guidelines, at 520-1, *Life and Health Insurance Guaranty Association Model Act;* K.S.A. 40-3001 through K.S.A. 40-3018.

States which have adopted the NAIC Model Act in part or in whole with variations and revisions in the case of individual states as of March 30, 1983, includes Alabama, Arizona, Connecticut, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, KANSAS, Kentucky, Maryland, Michigan, Minnesota, Montana, Nebraska, Nevada, New Hampshire, New Mexico, North Carolina, Oklahoma, Oregon, Pennsylvania, South Carolina, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Puerto Rico. New York and Wisconsin have Life and Health Insurance Insolvency guaranty laws not based on the NAIC Model Act.

If you have been able to obtain the guaranty of the defendant's liability insuror of the future payments due under the structured settlement agreement, you will be pleased to know that all states have some form of insolvency guaranty association or fund legislation applying to property and casualty insurors. Note, however, that there are wide variations between states regarding deductibles and coverage limits. E.G., K.S.A. 40-2901 through K.S.A. 40-2919, Kansas Insurance Guaranty Association Act.

16. Martin, *supra* at 52.

the segregated assets would be turned over to a successor trustee. But if the settlor of the trust (*e.g.*, the defendant or the defendant's liability insuror) took bankruptcy, the trust would probably be an asset reachable by the bankruptcy trustee.

(b)

A non-traditional structured settlement using an assignee as contemplated in the Periodic Payment Settlement Act of 1982 is illustrated in the four documents comprising the sample structured settlement agreement at the end of this article. In addition to an assignment, an irrevocable trust is used. The defendant is released. Therefore the defendant's creditworthiness is of no further concern. Since the assignee is a trustee bank there is also greatly lessened concern regarding bankruptcy of the assignee, because usually a successor trustee would be named to hold the annuity contract.

If the assignee-trustee is a Kansas Bank, it can also be used as the owner-applicant of the annuity contract application as in the sample agreement. That ensures the applicability of the Kansas Life and Health Insurance Guaranty Association Act to the annuity carrier. This is a useful technique where the defendant is a non Kansan individual or corporation. Some other states' guaranty association acts have limitations on the amount of benefits guaranteed. The Kansas Act limits the life insurance benefits guaranteed, but not health or annuity benefits.

Take all the steps you can in order to protect your client. In order to protect yourself, inform your client that in spite of all these protective measures, the plaintiff remains subject to all normal business risks of a general creditor of the obligor(s) including bankruptcy. If you structure your fee, you too are subject to those risks.

(3)

Beware of the appearance of a conflict of interest. Do not accept too large a fee in relation to the plaintiff's benefits. Consider modifying your standard contingent fee agreement to accommodate structured settlements.

Some plaintiff's attorneys report that they have experienced situations in which they felt they were being offered such a large cash fee in relation to the probable premium paid for the annuity to fund the deferred benefits to the plaintiff, that the fee was too high and far exceeded what they would be entitled to under their contingent fee agreement. Naturally you must take immediate steps to terminate negotiations which place you in a conflict of interest with your client or else find other means to protect your client. The surest way to protect your client and yourself is to determine the correct approximate value of the offer. Among the other means to protect yourself are these:

a. One attorney requires the defendant's liability insuror to reveal the cost of any proposed annuity by creating a conflict of interest between the defendant and the defendant's liability insuror. He does this by threatening to cease negotiations unless the insuror reveals the annuity cost. Thereafter, having previously demanded exhaustion of the liability policy limits, he will proceed to sue the defendant for more than the limit of the liability insurance coverage. The liability insuror is advised that the plaintiff's counsel would view this nondisclosure as bad faith by the defendant's liability insuror towards the insured defendant. This would, of course, remove the limit from the liability policy, and the insuror would not be able to calculate a reserve for the liability. So far the liability insurors have always told him the cost of the annuity, and he applies his contingent fee agreement percentage accordingly.

b. Another attorney hires independent, expert actuarial assistance to evaluate the present value of the plaintiff's benefits for two reasons: a) to evaluate the adequacy of the offer, and b) to set his fee.

c. Another attorney insists that the defendant assure the judge that the fee offered is no more than the percentage fee specified in the contingent fee agreement applied to the present value of the plaintiff's benefits. Then he asks the court to approve the fee.

Beware that in learning the cost of the annuity premium too closely you may be exposing your client to future partial taxation of the annuity payments. The caution is raised (always by liability insurors and their counsel naturally) that the plaintiff's counsel should never even ask the amount of an annuity premium in order to avoid any possibility that at some future date the IRS could take the position that the plaintiff had enjoyed constructive receipt of the annuity premium and thereby subjected part of the future payments to an unnecessary exposure to income tax. Even when a defendant's counsel will voluntarily reveal the cost of the annuity premium, it is usually only for the purpose of helping the plaintiff's counsel determine his fee and designedly too late in the negotiations to affect the amount of the plaintiff's benefits. Since many structured settlement agreements will last several decades, you may wish to adopt a cautious approach to 'constructive receipt' since the IRS regulations may change.

You should carefully consider modifying your contingent fee agreement to specify the means of calculating a lump sum or structured fee in the event the plaintiff accepts a structured settlement and to encompass the possibility of receiving other than a lump sum fee. In this way you may prevent the potential creation of a conflict of interest as discussed above. You may want to provide that an independent actuary and/or broker will be hired at plaintiff's expense in order to arrive at a present value (or premium cost) of an offered settlement to which a contingent fee percentage would be applied.

Since many structured settlement agreements will last several decades, you may wish to adopt a cautious approach to 'constructive receipt' since the IRS regulations may change.

One attorney thinks it would be more fair to have a different, possibly higher, percentage contingent fee in the event the plaintiff accepts a structured settlement than in the event of a lump sum in order to reflect the fact that the true after tax benefit to a plaintiff is higher in a structured settlement than in a lump sum settlement which costs the defendant the same or less. Query—With such an arrangement do you create another potential conflict of interest with your client by giving yourself an additional incentive to promote the acceptance of a structured settlement? Defense counsel will sometimes argue that in a structured settlement negotiation everything is negotiable, including your fee. Do not forget the advantages listed above for structuring your fee.

(4)

Avoid subjecting a portion of the plaintiff's benefits to an unnecessary exposure to income tax. See Section Two, above. Consult with expert tax counsel to insure the income tax free character of the benefits to the plaintiff.

B. *For Defense Counsel*

(1)

Beware of a potential conflict of interest between the defendant, the primary liability carrier and any reinsuror. The defendant may have both a deductible and coinsurance without limit in his policy. If so, no conflict will likely occur. However, if the coinsurance is limited or nonexistent, a conflict may arise over whether to settle or try the case. Similarly, reinsurance treaties have not generally contemplated the use of structured settlements.

If a reinsurance treaty uses a proportional loss sharing formula, both the primary insuror and the reinsuror have identical incentives to settle a case regardless of the amount of the exposure. If, however, the primary carrier has a fixed amount retention, it will have little incentive to contain the cost of a settlement in excess of that amount. You should be aware that the primary carrier may have no interest in whether a lump sum or structured settlement is used for amounts over its retention limits, while the reinsuror is keenly interested in the lower cost settlement, usually a structured settlement. Query—What is your duty to the reinsuror if you represent the primary carrier? Some companies faced with this problem negotiate an apportioned savings from a structured settlement to both the primary carrier and reinsuror based on the savings in total expected payout between a lump sum and structured settlement. You may wish to suggest to your casualty carrier clients that they revise their reinsurance treaties with this problem in mind.[17]

(2)

Due to the potential conflicts between a primary liability carrier and a reinsurer discussed above, you have a duty to do some careful shopping for appropriate structured settlement annuities. Since there are over 1800 life insurance companies, careful shopping can become a fulltime job. Since the considerations affecting annuity issuers, the underwriting, balance sheet and tax considerations, all can change from time to time, you cannot shop carefully once and then not shop the next time. For this purpose a broker is invaluable.

The financial stability of the annuity carrier is a prime concern of both parties to a structured settlement where the plaintiff remains a general creditor of the defendant, who owns the annuity. Since the passage of the "Periodic Payments Settlement Act of 1982" the plaintiff will be very careful about the annuity carrier's financial stability before allowing an assignment of the defendant's liability. You must therefore become acquainted with the standard measures of life insurance company financial stability and size. Since 1899 Alfred M. Best Company has rated insurance companies as to relative financial strengths based upon industry averages and the sworn Annual Convention Statement each company must file with the various State Insurance Departments. The financial strength categories are:

The financial stability of the annuity carrier is a prime concern of both parties to a structured settlement where the plaintiff remains a general creditor of the defendant, who owns the annuity.

A+ and A	Excellent
B+	Very Good
B	Good
C+	Fairly Good
C	Fair

The size categories are based on policyholder surplus and range from Group I, the smallest, $250,000 or less, to Group XV, the largest, $100,000,000 or more. You should be explicit with your broker that you want quotes only from A+ companies. The size Group is not nearly so important as the financial quality of the company balance sheet.

There occurs sometimes a form of "forum shopping" among annuity brokers. Since the cost of any state premium tax is included in the net single premium to your client, some brokers suggest shopping for a state with no premium tax. Kansas has a premium tax. An additional consideration is whether the state has adopted the Model Life and Health Insurance Guaranty Association Act.[18] That Act provides that each and every foreign and domestic carrier in the state licensed for life, health, or annuity business stand behind the obligations of all other such carriers on the basis of an assessment proportional to premiums taken in. The existence of such a statutory association is a great deal more important than the annuity carrier's Best's Rating. The problem with the Guaranty Association Model Act is that its Section 19 prohibits the mention of the Act in the sale of any covered line of insurance, including

17. Thompson, et al, *Structured Settlements Joint Opportunity for Life and Property/Casualty Companies*, Session 408, Proceedings of the Insurance Accounting and Statistical Association, 1981, at 210.

18. *Supra*, note 15.

annuities. Kansas has adopted the Model Act, but it did not adopt Section 19. Instead Kansas adopted an earlier version of the model act making it a prohibited unfair trade practice to use in any manner the protection afforded by the act in the sale of insurance.

7. Where Do I Go For Help If I've Got One?

In addition to the usual tort experts such as economists or actuaries to help calculate or evaluate claims of the victim's damages, you may wish to consult other experts. In particular an expert in funding structured settlements, such as a specialist annuity or bond broker, may be helpful to counsel on both sides. He can help the defendant structure an affordable offer (see Section 6.B.(2), *supra*). He can help the defendant buy the most benefits for the plaintiff at the lowest cost to the defendant. And for the plaintiff's counsel he can opine regarding the cost of the benefits in order to assist the counsel in setting his fee and in deciding on the adequacy of the offer. As discussed in Section Two, *supra*, plaintiff's counsel may also wish to discuss the structured settlement offer with expert tax counsel in order to avoid adverse income or estate tax consequences to the plaintiff.

What will the annuity broker need to know? He will want to know about the plaintiff, his dependents, their needs, and the damages sought. For the plaintiff and any other life annuity recipient, be prepared to tell the broker the annuitant's name, sex, date of birth (the annuity carrier will require a copy of the best available written record, such as a birth certificate, with the application) and state of health (if the annuitant's life expectancy is impaired, provide a copy of all available medical records). If you are the defense counsel let the broker know what you think the case is worth and what the defendant's "budget" is for the benefits. Be sure to inform the broker of the plaintiff's counsel's fee agreement and any other expenses which need to be paid in cash at the date of settlement. Discuss with the broker what you need and when you need it and disclose whether you intend to use other brokers in order to obtain competitive annuity price quotes.

8. How Do They Work?

Traditional structured settlements, in which the defendant is not released from the tort liability, and the plaintiff remains an unsecured general creditor of the defendant, do not appear to be so attractive since the passage of the Periodic Payment Settlement Act of 1982 (see Section Two, *supra*). Forms and examples of traditional structured settlements are relatively readily available.[19]

Second, unless the irrevocable trust is deemed to have been created to defraud the defendant's creditors or otherwise treated as a general asset of the defendant, the use of an irrevocable trust, particularly with a bank as trustee, would nearly eliminate the plaintiff's concerns about the defendant's solvency.

19. Dorsaneo, *Texas Litigation Guide*, Chapter 102, Settlements (1983). *Thompson v MBPXL Transportation Co., et al*, No. 811385 (D. Kan. Mar. 10, 1982).

The advantages of the newer approach using an assignee are substantial. First, the defendant gets a release. Since many structured settlements will last for several decades, this is a very substantial advantage. Second, unless the irrevocable trust is deemed to have been created to defraud the defendant's creditors or otherwise treated as a general asset of the defendant, the use of an irrevocable trust, particularly with a bank as trustee, would nearly eliminate the plaintiff's concerns about the defendant's solvency. Third, the use of a Kansas bank as trustee to apply for and own the annuity brings the annuity within the coverage of the Kansas Life and Health Insurance Guaranty Association Act, a very powerful and comforting achievement. Fourth, since the bank is acting as trustee, it must segregate the annuity as a trust asset from its other assets. Therefore, in the event of the bank's insolvency, the annuity would probably remain separate from the bank's general assets and likely be transferred to a successor trustee. Fifth, if you remain concerned because the bank is the assignee of the defendant's contractual liability, and because therefore the annuity might be considered a general asset of the bank, study, use, and take comfort from the Kansas law exempting certain annuities as an asset in bankruptcy: K.S.A. 40-414a.

CONCLUSION[20]

Learn all you can about structured settlements. They are becoming more common as judgments in personal injury suits grow. Many examples of how structured settlement annuities work have been given in various sources including the Kansas Bar Association 1982 Annual Meeting Institute, numerous legal publications[21]

20. See Laing, JKTLA, *supra* at 13.
21. National Law Journal, July 12, 1982, at 9, Col. 1.

and even the popular press.[22] As the public becomes more aware of structured settlements, they will expect the trial bar to be sufficiently knowledgeable to advise them. You owe it to yourself and your clients to be well informed in this area.

22. Mount, *Chicago Housing Authority settles paralyzed woman's lawsuit for $21 million*, Chicago-Tribune, July 3, 1982, at section 1, p. 7, cited in The Wichita Eagle-Beacon, July 2, 1982, at 6D; Time, October 18, 1982, at 102, Col. 3.

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FORMS

GENERAL RELEASE OF ALL CLAIMS AGAINST DEFENDANT A A DIVISION OF ____________ CORPORATION AND DEFENDANT B AND SETTLEMENT AGREEMENT

WHEREAS, a claim has been made and suit filed in the District Court of ____________ County, Kansas by and between plaintiff, claiming that he was injured as a result of the negligence of defendant B while acting in his capacity as an employee of defendant A Corporation; and

WHEREAS, defendant B and defendant A Corporation have denied any liability or negligence,

NOW THEREFORE, the parties by and through their various representatives agree as follows:

1. The execution of this agreement shall in no way be construed as an admission of liability or negligence on the part of any defendant, but merely represents a compromise of plaintiff's claim against defendants A and B.

2. This agreement is intended to conform to the requirements of Internal Revenue Code sections 104 (a) (2), and 130 (c), and Revenue Ruling 79-220 (CFR 1.104-1) and this agreement shall be liberally construed to the end that it complies with the above stated laws and ruling.

3. Pursuant to the terms of a certain trust agreement entered into between defendant A, a division of ____________ Corporation, settlor and the ____________ Bank of ____________________, Kansas, trustee, and plaintiff, beneficiary, defendant A, a division of ____________ Corporation, on behalf of itself and on behalf of its employee at the time of the accident on (date 19) has agreed to pay to the trustee a sum necessary to purchase an annuity as will be further described in this agreement and to pay certain other sums as will be further described in this agreement and in consideration of the payments agreed to herein, the said plaintiff does hereby release, acquit and further discharge defendants, ____________ Corporation, and their subsidiary defendant A, and defendant B, their subsidiary and affiliated corporations, their successors and assigns, together with all agents, servants, employees and representatives and any other person, corporation or entity involved in any way with the defendants, from any and all claims, actions, causes of action, demands, rights and damages, costs, loss of services, expenses, and compensation, including expenses which the undersigned has now or which may hereinafter accrue on account of, or arising from any known or unknown, forseen or unforseen damages, bodily and mental injury,

death, including any claims for punitive damages, or increased damages for aggravating circumstances and consequences thereof, as a result of the accident wherein the said plaintiff sustained personal injury which occurred in ____________ County, Kansas, near ____________, Kansas, on (date) which is the subject matter of the case presently pending in the District Court of ____________ County, Kansas "Plaintiff ______ vs. __________ Corporation and defendant B ", Case Number________.

4. In consideration for this release, defendant A on their own behalf and on behalf of their employee, defendant B , agrees to make the following payments:

(a) defendant A agrees to pay the ____________ Bank of ______________________, Kansas, trustee of the plaintiff's name Trust, an amount necessary to purchase an annuity from a major life insurance company rated "A Plus" by A. M. Best Company. The annuity shall pay the said plaintiff the amount of ________ Hundred Dollars ($__________) per month beginning thirty (30) days after the purchase of the annuity for life and for ________ (____) years certain with a ____ (____) per cent compound per year anti-inflation factor.

5. Pursuant to the language of Internal Revenue Code Section 130 (c) (1982), the ______________________ Bank of ______________, Kansas agrees to become the assignee of ____________________ Corporation and their subsidiary, defendant A and further agrees to assume the liability for periodic payments as described herein. This agreement is subject to the following:

(a) The periodic payments from the assignee set forth in paragraph 4 (a) above are fixed and determined as to amount and time and cannot be accelerated, deferred, increased or decreased by the recipient of such payments, plaintiff ;

(b) The assignee does not provide to the recipient of such payments rights against the assignee that are greater than those of a general creditor;

(c) The assignee's obligation on account of the personal injuries or sickness is no greater than the obligation of the person originally liable (whether by suit or by agreement) for payment of such damages and from whom the obligation was assigned.

(d) The assignee possesses all rights of ownership of the annuity used to fund the periodic payments to the plaintiff. At no time shall the plaintiff have the right to receive the discounted present value of the future payments or to direct the investment of the corpus of the trust;

(e) No settlement alternative involving a lump sum payment of the corpus of the trust; payment for damages was ever considered in the negotiation process or the documents comprising the settlement agreement.

6. In addition to the annuity purchased herein, ________________ Corporation and their subsidiary defendant A agree to pay on behalf of themselves and their employee, defendant B , the sum of ________ Thousand ________ Hundred and ________ Dollars and ______ Cents ($__________) made payable to plaintiff, ______________, plaintiff's attorney, ______________, and ________________ Casualty Company for reimbursement of PIP.

7. Further, the defendant ______________ Corporation on behalf of their subsidiary, defendant A , and their employee, defendant B ,

agrees to pay to the plaintiff, ______________, the United States of America and ______________, plaintiff's attorney, the sum of __________ Thousand __________ Hundred and __________ Dollars and __________ Cents ($__________), said sum to be used to defray the medical expenses of plaintiff and the remainder to be held by the plaintiff, ______________, as an initial lump sum payment.

8. Lastly, defendant agrees to pay to the plaintiff, __________, and his attorney, ______________, the sum of ________ Thousand Dollars ($________) towards the satisfaction of plaintiff's attorney fees.

9. Upon receipt of the funds set forth in the above sections, and upon receipt by the trustee of the annuity contract as specified herein, the said plaintiff agrees to file with the District Court of __________ County, Kansas, a dismissal of the law suit entitled, " plaintiff vs. Corporation and defendant A , et al.", Case Number ______________. Said dismissal is to be with prejudice.

10. The said payments contained herein are in consideration for and in exchange for a full, final and complete release from plaintiff to ______________ Corporation, defendant A , and defendant B and all claims he may have against them now or in the future arising out of the automobile accident which occurred in __________ County, Kansas, at or near __________, Kansas on or about (date) .

11. This release and settlement agreement shall be interpreted liber-

ally so that it may be construed to conform with revenue rulings and Public Law 97-473, commonly entitled, "Periodic Payment Settlement Act of 1982" and the releasees agree to cooperate, as necessary, to insure and retain the tax free qualification of said annuity payments.

12. The undersigned declares that the representations contained herein contain the entire agreement of the parties and that the terms of this release are contractual and not a mere recital.

The parties hereto have signed this Release and Settlement Agreement as of the day and year shown beside each signature.

	__Defendant A__, A Division of __________ CORPORATION
Date Signed: __________	By: __________ Authorized Representative
Date Signed: __________	__________
	__Plaintiff__ __________ BANK OF __________, KANSAS
Date Signed: __________	By: __________ Authorized Representative

AGREEMENT — ASSIGNMENT OF LIABILITY

THIS AGREEMENT made and entered into as of this ______ day of __(date)__, by and between THE __________ BANK OF __________, OF __________, KANSAS, hereinafter referred to as "First Party"; THE CORPORATION and their Subsidiary, __Defendant A__, hereinafter called "Second Party" and __plaintiff__, hereinafter called "Third Party,"

WITNESSETH:

For good and valuable consideration, the receipt of which is hereby acknowledged, second party assigns and first party accepts the assignment of liability arising out of a certain automobile accident which occurred on or about __(date)__, in __________ County, Kansas, near __________, Kansas, which is the subject matter of a certain law suit now pending in the District Court of __________ County, Kansas, entitled __"plaintiff vs. __Defendant A__ Corporation and __Defendant B,__ et al.", Case Number __________. Acceptance of liability is strictly premised upon the following by the __________ Bank of __________, Kansas.

1. Third party herein agrees that in the event of a default of the insurance company from whom the annuity contract is or has been purchased, then his cause of action shall inure directly against the insurance company and/or arise out of the statutes of the State of Kansas, namely the Life and Health Insurance Guaranty Association Act found generally at Kansas Statutes Annotated 40-3001, et seq. Third party shall have no claim for liability or cause of action against the Bank herein named, acting in good faith in the event of bankruptcy or default by the insurance company obligated to pay the annuity purchased herein.

2. The bank named herein shall have no responsibility for the payment of interest or late charges or otherwise in the event that payments from the insurance company arrive late, other than those delays caused

by their own misfeasance or malfeasance. And, the said third party shall have no cause of action or claim otherwise against the said bank for any malfeasance or misfeasance by the insurance company from whom the annuity is purchased.

3. In the event of default of the insurance company, the first party agrees to cooperate with the third party to pursue any remedy in law or equity, available to the first party or the third party against said insurance company. The third party agrees to pay first party for all expenses incidental thereto.

4. First Party, Second Party and Third Party agree to be specifically bound by the terms and conditions and stipulations as contained herein and with the stipulations as contained herein, first party, The __________ Bank of ____________________, Kansas, hereby accepts assignment of liability from __________ Corporation and their subsidiary, defendant A and their employee, defendant B.

IN WITNESS WHEREOF, the parties hereto have set their hands as of the day and year first written above.

1st Party: THE __________ BANK
__________, KANSAS
By: ____________________
Authorized Representative

2nd Party: THE ________ CORPORATION and their Subsidiary, Defendant A
By: ____________________
Authorized Representative

3rd Party: ____________________
Plaintiff

IRREVOCABLE TRUST AGREEMENT

PREAMBLE: It is the intent and desire of Defendant A, a division of ______________ CORPORATION, whose present address is __________, __________, __________, __________, __________ to create an irrevocable trust for the benefit of plaintiff, (address), __________, Kansas. The corpus of the trust will consist of an annuity to be purchased from an insurance company chosen by defendant A which will be owned by the trustee named herein. This irrevocable trust is created as a result of settlement negotiations involving an automobile accident which occurred on or about (date), in __________ County, Kansas near __________, Kansas as more particularly described in Case Number __________ in the District Court of __________ County, Kansas entitled, __________, Plaintiff vs. ______________ et al., Defendants. Which negotiations resulted in the creation of a General Release and Settlement Agreement, and an Assignment of Liability, copies of which are attached hereto marked Exibit "A" and made a part hereof by reference.

CREATION OF TRUST: Defendant A, a division of __________ CORPORATION does hereby give and transfer to the __________ Bank a banking institution located in ____________________, Kansas and possessing trust powers and operating under the laws of the State of

Kansas a sum of money which will enable said named trustee to purchase an annuity which will pay the following amounts to the beneficiary of the trust, plaintiff .

Starting the first month after the effective date of the settlement agreement, the sum of ____ Hundred Dollars ($______) per month increasing at the rate of ____ per cent per year for the natural life of the beneficiary, plaintiff , and in any event, and for a period certain of _____ (___) years, as shown by the schedule of payments marked Exhibit "B" and made a part hereof by reference.

BENEFICIARY OF THIS TRUST: This trust shall inure only to the benefit of plaintiff whose address is stated herein. The said plaintiff will keep the trustee advised and informed as to his address so that all payments made hereunder may be properly credited and distributed to him as further described herein. No beneficiary hereunder shall be deemed to be a secured creditor of the trustee by virtue of the trust or by virtue of any of the terms of this trust.

TERM: This trust created will continue in existence until the death of plaintiff , and if said plaintiff dies prior to ______ (_____) years from the date of the beginning of the payments from the annuity which is the corpus of this trust, then this trust shall last for a period of _________ (_____) years from the first payment received as a result of the annuity described herein.

USES: This trust is created for the benefit of plaintiff . The trustee named herein, The ______________________________ Bank ___________________, Kansas, is authorized to transfer all moneys from the annuity payments described herein to plaintiff as the said plaintiff desires. Neither the trustee nor plaintiff is authorized or empowered to in any way sell, transfer or exchange the corpus of this trust (the annuity) nor do they have any right to pledge the said corpus of the trust for collateral upon any loan or any dealing whatsoever, neither does the beneficiary nor the trustee have any right to receive the discounted present value of the annuity which is the corpus of said trust.

EXPENSES: This trust is specifically designed to comply with federal law, particularly Public Law 97-473 of the United States of America entitled, "Periodic Settlement Act of 1982" which was signed into law on January 14, 1983. Particularly, settlor, defendant A , a division of _____________ Corporation, the trustee and the beneficiary each expect, under the terms of Public Law 97-473 and pursuant to the terms of Internal Revenue Ruling 79-220 (26 CFR 1.104-1), that all monthly payments made pursuant to the terms of this annuity shall be non-taxable income to the beneficiary, (plaintiff) , and shall further be non-taxable income to the trustee, all as contemplated by Internal Revenue Ruling 79-220 and Public Law 97-473.

DEFAULT OF THE ANNUITY CARRIER: In the event of the default in payment of the benefits due under the terms of the annuity which is the corpus of this trust, the trustee bank has no liability to continue the payments to the beneficiary from its own funds, however, trustee agrees in such event to bring any action the beneficiary deems necessary against the annuity carrier, the Kansas Life and Health Guaranty Association and/or the Kansas Insurance Commissioner at the beneficiary's expense.

ASSIGNMENTS, ETC.: This trust is created for the use and benefit of plaintiff. Any assignment of funds or attempted assignment thereof shall be null and void and not binding on the trustee. The funds in the hands of the trustee shall not be liable to legal process, attachment, assignment, garnishment or execution.

SITUS: This trust is created pursuant to the laws of the State of Kansas and the laws of the State of Kansas are applicable to the trust and the situs of the trust for all legal purposes shall be Kansas, regardless of the residence or domicile of the beneficiaries, the settlor or the trustee. Except as otherwise provided herein, the trustee shall have all powers conferred upon a trustee by the laws of the State of Kansas.

TRUSTEES FEE: The Trustee shall receive as a fee for services, the sum of $100.00 per year during the term of the trust, and the beneficiary hereby agrees to pay the trustee said fee on the 1st day of March of each year during the term of the trust.

BOND: The ________________ Bank of ____________________, Kansas, shall not be required to post a bond in its capacity as trustee. It has a blanket fidelity bond which covers its fiduciary capacity herein and no further bond is required pursuant to Kansas law.

MODIFICATION: This is an irrevocable trust and settlor has no power of modification.

IN WITNESS WHEREOF, the settlor, defendant A, A Division of ____________ CORPORATION has signed this Trust Agreement, and trustee, THE ______________________ BANK ________________, KANSAS, has accepted the trust and further the beneficiary, plaintiff, has further signed herein and accepted the terms and conditions of the trust as of the day and year shown beside each signature herein.

defendant A, A Division of
______________ CORPORATION

Date Signed: ________________ By: ______________________

THE __________________ BANK
________________, KANSAS

Date Signed: ________________ By: ______________________

Date Signed: ________________ ______________________

Plaintiff

SCHEDULE "A"

Starting the first of the month after the effective date of the settlement agreement you will start to receive $________ per month increasing ____% compound per year for the rest of your natural life. From the date of the settlement agreement these payments will continue for at least ____ years to a beneficiary of your choice in the event you do live for ____ years beyond the settlement agreement.

YEAR	MONTHLY BENEFIT	ANNUAL BENEFIT	CUMULATIVE BENEFIT
1	$________	$________	$________
2	$________	$________	$________

Riehm 2/4

FEBRUARY 04, 1986

TESTIMONY OF THE KANSAS ASSOCIATION OF OSTEOPATHIC MEDICINE ON H.B. 2661

The Kansas Association of Osteoapthic Medicine will testify on several matters in HB 2661, the week of February 9. At this time, however, we wish to express our support for one provision of the bill since testimony was presented on February 3 that may still be fresh in the minds of Committee members.

Sec. 25, Lines 122-128, of the Bill call for an average Health Care Stabilization Fund surcharge within each class of rates. We support that provision.

We are aware of the logistical problems this would create, as testified to by Mr. Todd, and we are aware that some physicians will lose (i.e., pay higher rates) while others will gain, as pointed out by The Medical Society. Yet the basic issue here is one of fairness. The inequities that the current system creates, are compounded everytime there is an increase in rates, and particularly everytime there is an increase in the rates of St. Paul greater than the other large carrier in the State.

What is happening with increasing frequency is that osteopathic physicians are being forced into the JUA through no reason other than the lack of availability of coverage elsewhere. Frequently these physicians have no claims history.

Coverage through the JUA automatically has a penalty attached., in that premiums are based on St. Paul rates, plus a 20% surcharge. For osteopathic physicians, this compounds two other developments, and perhaps three.

(1) First, that the D.O. may have been denied access to a Company with lower rates because of the nature of his or her practice. (Example: Medical Protective will not insure a D.O. that does obstetrics.)

(2) Second, it is predetermined that the Fund surcharge will be based on his or her base premiums, which compounds the 20% surcharge over St. Paul paid by JUA covered providers.

(3) For a provider that is in the JUA, that also has some past claims history, an additional claims experience surcharge may be applied, which can raise the premium an additional 50% to 500%. A rate increased by this type of surcharge is again compounded in that the Fund surcharge applies to the total base premium.

We think averaging the Fund surcharge within each rate is a fair way of eliminating this compounding of other inequities or even of compounding other fair rates, particularly when the physician is in the JUA from no fault of his or her self.

There may be other approaches to resolving these. Perhaps the 20% addition to St. Paul's rates should not be imposed for all JUA covered providers. Or, perhaps the Fund surcharge should apply only to the base rate prior to adding the 20% surcharge. The JUA, of course, is structured by law and changes in this policy could be made at any time, by either the JUA Governing Board, or this legislature.

We understand that the purpose of high JUA rates is to depopulate the JUA. But when providers are there not because they make no effort to seek coverage elsewhere, but because that coverage is not available, it seems unfair and contrary to State policy to punish them through higher rates. For these reasons, we support the averaging of Fund surcharges within each class.

Attachment 3
House Judiciary
2-4-86

KANSAS ASSOCIATION OF OSTEOPATHIC MEDICINE
TESTIMONY ON HB 2661 - FEBRUARY 04, 1986

COMPARISON OF SELECTED MEDICAL MALPRACTICE PREMIUMS WITH AND WITHOUT "FUND" SURCHARGES

SELECTED CLASS OF COVERAGE (1)	PREMIUM FOR BASE COVERAGE (1)				TOTAL PREMIUM - BASE + 110% FUND SURCHARGE (1)				TOTAL PREMIUMS (BASE + FUND SC) ASSUMING APPROVAL OF SUGGESTED '86-87 RATE INCREASES (2)			
	MED PRO	ST. PAUL	MED DEF	JUA	MED PRO	ST. PAUL	MED DEF	JUA	MED PRO	ST. PAUL	MED DEF	JUA
PHYSICIANS, NO SURGERY OR MINOR SURGERY	$ 3,408	$ 4,596 (3)	$ 2,893	$ 5,515	$ 7,157	$ 9,562	$ 6,075	$ 11,582	$ 9,304	$ 13,995	---	$ 16,794
(50% Cl Hist. SC)(4)				$ 8,273				$ 17,372				$ 25,190
GENERAL PRACTITIONERS	1,363	2,676	1,330	3,211	2,862	5,620	2,793	6,743	3,721	8,148	---	9,778
(50% Cl Hist. SC)				4,817				10,115				14,666

NOTES: (1) Source: Information provided in Interim Committee Report, Pages 840-41.

(2) Source: In testimony presented to the House Judiciary Committee on February 3, it was indicated the Medical Protective and St. Paul Companies either had requested, or planned to request, annual premium increases as follows: Medical Protective, 30%; St. Paul 45%. These increaes are subject to change and have not been approved by the Kansas Insurnace Department. They are offered for illustration purposes only. Information not available on increases of Medical Defense Company. JUA rates based on the assumption of 45% increase in rates of St. Paul.

(3) Where a range of premiums is presented in the Interim Report, a mid point figure is used.

At present time, only these four sources are available to osteopathic physicians for medical professional liability insurance. St. Paul, as of January 1, 1986, is writing no new business in Kansas (or nationwide), and Medical Protective Company will not insure any D.O. that does obstetrics.

During 1985, a company that worte approximately one-fourth of all D.O.s in Kansas, lost its license to write in Kansas, due to insufficient reserves.

(4) The JUA currently utilizes a claims history surcharge. If within a six year period a provider accumulates 4 or more "points", a surcharge is assessed. 4 points activates a surcharge of 50%; 5 points, 100%; up to 10 or more points, 500%. One point is assessed if reserves in excess of $20,000 have been set aside to cover a claim; two points if in excess of $20,000 has been paid out in a claim. Premium figures in the boxes, above, assume an accumulation of 4 points (which could be total payouts of $40,002.00) & imposes a 50% SC.