STRUCTURED SETTLEMENTS

> The subject of damages for personal injury is an area of the law which cries out for legislative reform. The expenditure of time and money in the determination of fault and of damage is prodigal. The disparity resulting from lack of provision for victims who cannot establish fault must be disturbing. When it is determined that compensation is to be made, it is highly irrational to be tied to a lump sum system and a once-and-for-all award.
>
> The lump-sum award presents problems of great importance. It is subject to inflation; it is subject to fluctuation on investment; income from it is subject to tax. After judgment new needs of the plaintiff arise and present needs are extinguished; yet, our law of damages knows nothing of periodic payment. The difficulties are greatest where there is a continuing need for intensive and expensive care and a long-term loss of earning capacity. It should be possible to devise some system whereby payments would be subject to periodic review and variation in the light of the continuing needs of the injured person and the cost of meeting those needs ...

By now this passage from the 1978 decision of the Supreme Court of Canada in Andrews v. Grand & Toy Alberta Ltd. et al.[1] is familiar to most practitioners and judges involved in personal injury litigation in Canada, and many of them know from first hand experience how grave these problems really are. Many also know that in his reasons for judgment, Dickson J. (as he then was; now C.J.C.) only touched on a few of the many problems that have made large lump sum awards in serious personal injury cases an inappropriate means of properly compensating the victim.

PROBLEMS WITH LUMP SUM AWARDS

Other aspects of the lump sum award have also been the subject of criticism in recent years by courts, practitioners and academics. The deduction from future

earnings for contingencies is one such target of criticism. For instance, in his reasons for judgment in McLeod v. Palardy (1980), 4 Man. R. (2d) 218 at p. 250, Kroft J. of the Manitoba Court of Queen's Bench refused to "make an arbitrary percentage reduction based on some imprecise theory of contingencies." Kroft's judgment was followed shortly thereafter by another judge of the Manitoba Queen's Bench, Hewak J., in MacDonald v. Alderson and Manitoba, Province of (1980), 8 Man. R. (2d) 202.

The discount rate has also been the subject of much criticism lately, as well as a source of great confusion. The discount rate, also referred to as the "real" rate of interest, represents the difference between the rate of interest expected to be earned in the future on a lump sum award, and the rate at which inflation is expected to eat away at those future investment earnings. The Supreme Court of Canada in the now famous "trilogy"[2] applied a rate of 7% on the assumption that future interest rates would stay ahead of inflation 10% to 3%. The Ontario Supreme Court Rules of Practice prescribed a rate of 2 1/2%, subject to review in specific cases. Other courts have been seen to apply rates ranging from 1.5% to 5%. Hewak J. in MacDonald v. Alderson, supra, applied two different rates —a higher rate of 3% for non-wage related expenses and a lower rate of 1.5% for wage related expenses, likely on the not unreasonable assumption that wages are better able to stay ahead of inflation than most other price increases. Finally, at least one author advocates discontinuing the practice of discounting altogether because it implies an assumption that the injured person was a substantially below average worker who would not have shared in the productivity gains of the economy had he been able to continue working.[3]

Another criticism of the lump sum award that has been heard with increasing frequency in recent years is that the size of awards is simply skyrocketing. As Spence J. said in Arnold v. Teno (S.C.R. at p. 333):

> ...The very real and serious social burden of these exorbitant awards has been illustrated graphically in the United States in cases concerning medical malpractice. We have a right to fear a situation where none but the very wealthy could own or drive automobiles because none but the very wealthy could afford to pay the enormous insurance premiums which would be required by insurers to meet such exorbitant awards.

This perceived upward spiral of damage awards led the justices in all three of the cases that comprise the trilogy to impose, as a matter of policy, an upper limit or "ceiling" of $100,000 on damages to be awarded for non-pecuniary losses, although they "left the door open" for higher awards in "exceptional cases". This "ceiling" on damages became the subject of further criticism by academics[4] and led to attempts by various courts to circumvent it by claiming "exceptional circumstances". One such case was that of Lindal v. Lindal[5] in which the B.C. Supreme Court awarded $135,000, the exceptional circumstances being the severity and consequences of the plaintiff's injuries, his depression and suicidal tendencies, and the undesirable side effects of the anti-spasmodic drugs he was required to take. The B.C. Court of Appeal reduced the award to the ceiling figure of $100,000, and that decision was affirmed on appeal by the Supreme Court of Canada which complicated the issue in dicta by suggesting that while inflation was not a factor in this case because the trilogy decisions were so recent, a court might breach the upper limit in the presence of changed economic conditions and erosion of money value.[6]

The courts, however, that have exceeded the ceiling seem yet constrained. None have dared much higher than about $160,000, and so it would appear that there is a silent consensus that there exists a need to prevent damage awards from increasing beyond acceptable limits, and to maintain some degree of control over the size of the awards. Still, the fact that plaintiffs' counsel and some judges strain against the $100,000 limits seems to indicate that there exists also a sense of indignation, of rebellion against the imposition of an arbitrary upper limit on damages for non-pecuniary losses. These simultaneous reactions may only be a manifestation of the conflict felt by the courts between the need to adequately compensate and provide for the injured in our society and the need to protect society generally from the staggering economic effects of the potentially enormous awards in personal injury litigation.

There has been, moreover, another reaction to the ceiling imposed by the Supreme Court of Canada in Andrews. In addition to finding reasons to exceed the limit on non-pecuniary damages, litigants and courts are placing far more emphasis on increasing the amounts awarded under the various heads of pecuniary damages, particularly cost of future care and loss of future earnings. The Supreme Court of Canada itself seems to be giving back in pecuniary damages what it took away in non-pecuniary damages. Again in Lindal (D.L.R., at 268) Dickson J. giving reasons for the court wrote the following passage:

> A number of secondary principles flow from the basic precept of compensation. The first is that anything having a money value which the plaintiff has lost should be made good by the defendant. If the plaintiff is unable to work, then the defendant should compensate him for his lost earnings. If the plaintiff has to pay for expensive medical or nursing attention,

> then this cost should be borne by the defendant. These costs are "losses" to the plaintiff, in the sense that they are expensès which he would not have had to incur but for the accident. The amount of the award under these heads of damages should not be influenced by the depth of the defendant's pocket or by sympathy for the position of either party. Nor should arguments over the social costs of the award be controlling at this point. The first and controlling principle is that the victim must be compensated for his loss.

Earlier, in the Andrews decision (C.C.L.T. at p. 241) he said:

> I do not think the area of future care is one in which the argument of the social burden of the expense should be controlling, particularly in a case like the present, where the consequences of acceding to it would be to fail in large measure to compensate the victim for his loss.

And in support of that position he cited the following passage from the decision of Salmon L.J. in Fletcher v. Autocar and Transporters Ltd., [1968] 2 Q.B. 322, [1968] 1 All E.R. 726 at 750:

> Today, however, virtually all defendants in accident cases are insured. This certainly does not mean compensation should be extravagant, but there is no reason why it should not be realistic.... It might result in some moderate increase in premium rates, which none would relish, but of which no-one, in my view, could justly complain. It would be monstrous to keep down premiums by depressing damages below their proper level, i.e., a level which ordinary men would regard as fair — unprejudiced by its impact on their own pockets.

In fact, one writer, in a review of the book Personal Injury Damages in Canada by Cooper-Stephenson and Saunders, warns "[n] ow that the Supreme Court

of Canada has placed a cap of $100,000 on general damages, plaintiffs' counsel will have to argue much more carefully the pecuniary losses. This book shows you how".[7]

A cursory review of the handful of cases cited thus far in this paper will confirm that counsel are indeed arguing much more carefully the pecuniary losses. Plaintiffs' counsel are assembling small armies of expert witnesses including, in addition to the broad range of medical specialists, actuaries, economists, therapists, counsellors, representatives of handicap associations, vocational rehabilitation specialists, psychiatrists, psychologists, sociologists and social workers. And to meet this onslaught, defence counsel are beginning to assemble their own small armies of experts to testify, specialist for specialist, report for report. In addition, counsel are becoming more clever in their attempts to turn what used to be considered non-pecuniary losses into pecuniary losses. Instead of leading evidence regarding "loss of amenities", plaintiffs' counsel are calling employment counsellors as expert witnesses to testify that various types of handicaps directly result in certain employment rejection rate increases.[8]

In Ontario, one manifestation of this progression toward more thorough proof of pecuniary losses is that defence counsel are beginning to apply for and obtain orders permitting lengthy examinations of the plaintiff victim by vocational rehabilitation experts retained by the defence. The orders are granted under s. 77 of the Judicature Act, R.S.O. 1980, c. 223, which permits medical examinations, even though the specialists are not necessarily (but sometimes are) doctors.[9]

STRUCTURED SETTLEMENTS AS A SOLUTION

One relatively recent development in the practice of personal injury litigation — that of the structured settlement — has proved to be a very good solution to many of the problems associated with lump sum awards. Stripped to its bare essentials, a structured settlement usually consists of an immediate cash payment and an annuity, but as practice in the area develops, the terms of these settlements become increasingly sophisticated. In U.S. practice they have been likened to a Christmas tree on which one can hang the necessary ornaments, one by one.[10]

Because they have been so capably described in numerous prior journals and publications, this paper will not discuss in great detail the various terms that might be included in a structured settlement in any particular case, but the following is a brief list of the various "ornaments" most commonly employed.

COMPONENTS OF STRUCTURED SETTLEMENTS

IMMEDIATE LUMP SUM — Sometimes referred to as "front money", an initial cash payment is usually paid to cover special damages incurred before trial including lost wages and out-of-pocket expenses, legal fees, immediate capital needs to pay for items such as a specially-equipped house or condominium, wheelchair, van or prosthetic devices, real estate commissions, or payment of existing debts such as mortgages.

ADDITIONAL FUTURE LUMP SUMS — Further payments of additional cash may be scheduled to be paid at specific points in the future to pay for a home or retirement property, vacations, replacement of equipment, or university educations for the victim or his/her dependants.

ANNUITY — In order to fund a stream of ongoing periodic payments to or for the benefit of the plaintiff, the defendant's casualty insurer usually purchases an annuity from an independent life insurer. Occasionally the casualty insurer will wish to "self-fund" the annuity itself or through its life insurance division because it feels it can do so at a lower cost to itself, but property and casualty insurers are far riskier than the life insurance companies (which will be discussed in more detail further on) and so plaintiffs' counsel and judges approving these settlements should and usually do veto the idea except in rare cases in which the amount is small or the plaintiff is either sophisticated and able to assume his or her own risk, otherwise financially independent, or elderly and likely to have a short life span so that risk of future insolvency is of minimal importance.

In Canada (the practice is similar but not precisely the same in the U.S.) the casualty company must be named as the owner and annuitant of the policy in order for the tax benefits to flow to the plaintiff (more will also be said further on about the tax implications), and the casualty insurer gives the life insurer an irrevocable direction to make the payments directly to the claimant/plaintiff so that the payments cannot fall into the hands of creditors in the event of bankruptcy of the casualty insurer.[11] Futhermore, partly to prevent the claimant from becoming the absolute beneficial owner for tax purposes (again to ensure the favourable tax

treatment) and partly to ensure protection of the injured person from either his own imprudence or the chicanery of others, the annuity must be non-commutable or non-terminable and non-assignable or non-transferable — various terms are used — so that the claimant is not able to convert the annuity into a lump sum either by cashing it in at a discount or by borrowing against it, and then dissipate the funds prematurely, alone or with the help of outsiders.

ADDITIONAL FEATURES OF STRUCTURED SETTLEMENTS

INDEXING — Additionally, there are a number of optional features or ornaments that may be hung on the annuity. The payments may, for instance, be indexed to increase at a stipulated rate so as to compensate for the deleterious effects of inflation on any future stream of payments. Inflation has become such an accepted fact of life that indexing is more of a standard feature these days than an option.

It is possible to index annuities according to the Consumer Price Index so as to eliminate altogether the risk that inflation will erode the purchasing power of the payments but to do so is an expensive option and so it is usually necessary to reduce the level of the initial payments so much that it takes 25-30 years to catch up with a scheme composed of higher initial payments and a predetermined indexing factor. At the moment inflation is running at about 4.7% - 5% and so a 6% indexing factor is currently considered sufficiently aggressive to compensate for inflation.

GUARANTEE PERIOD — A guarantee period may be included in the terms of the annuity so that payments continue to be made to a designated beneficiary

after the premature death of the claimant. The payments may also be designated to be paid to the estate of the claimant but they would then be subject to the claims of creditors and then the usual heirs of the claimant (who may not always need the money). However, because any of these options increases the cost of the annuity, if there is no specific beneficiary such as a dependant spouse or child who will require the payments to continue after the death of the claimant, it would make more sense to apply the cost of the guarantee period toward increasing the periodic payments or improving the indexing scheme instead. Where there are dependants the claimant wishes to benefit, another alternative to the guarantee period would be a simple death benefit payable to the designated beneficiaries upon the death of the claimant, or payable to the estate for the purposes of paying capital gains taxes on the deemed dispositions of any capital assets that will result on death.

DEFERRAL — Payments under the annuity may also be deferred where the income is not required immediately by or for the benefit of the claimant, such as where the claimant has other sources of income. Deferral of payments is frequently used in settlement of infants' claims both in personal injury cases and in claims under the various fatal accidents acts. It should also be noted that deferred payments received by adult plaintiffs may be subject to taxation if Revenue Canada perceives that the deferral was too lengthy and without valid justification so that it appears that the deferral was an attempt to manipulate tax liability. An example of this kind of scheme might be a doctor who is injured at age 35 but, because he has other income, defers the payments to age 65 in an attempt to create a tax free "pension" for himself. Most deferral proposals are not as obviously unjustifiable as this type of scheme. Consider, for instance, a case in

which the injuries were such that the plaintiff would be able to work for another ten years but after that would be forced by his condition to cut back or stop entirely. In that instance the deferral would be more justified but, because of the length of time involved, it might be perceived by Revenue Canada as an attempt to avoid taxation and so, in any proposed settlement that involves deferral of payments to an adult plaintiff, it is recommended that counsel obtain an advance tax ruling on the proposal so as to avoid an adverse assessment later on when it is too late to adjust the terms.

REVERSIONARY ENDORSEMENT — Another feature that is not as common in Canada as in the U.S. is called a "reversionary endorsement", which is another type of guarantee but in which the casualty insurer designates itself to receive the balance of the capital, the death benefit, or the continued payments in the event that the claimant dies prematurely. In the U.S., reversionary endorsements are considered to reduce the cost of the structure to the casualty insurer even though (in both the U.S. and Canada) the payment would be taxable as income to the casualty company. In Canada, however, where there is more complete disclosure between litigants of the terms of these settlements, reversionary endorsements are not used, partly because they are considered "vulturous" and partly because they cause plaintiffs to decline the settlements so that, to the extent that in the long run casualty insurers can generally reduce costs by implementing structured settlements, reversionary endorsements actually increase their costs by preventing them from successfully settling claims and forcing them instead to go through lengthy and expensive trials and pay lump sum judgments.

IMPAIRED LIFE RATE — One final feature of annuities that should be mentioned here is that if the plaintiff's injuries are such that his expected life span is shortened, then by dealing with a life insurer that has experience with substandard or impaired life annuities, it may again be possible either to reduce the cost of the proposed settlement or to improve the other benefits provided by it such as the payment level, the indexing rate, or the death benefit.

ADVANTAGES OF STRUCTURED SETTLEMENTS

TAX FREE STATUS

There are a number of significant advantages to be gained by all parties by implementing structured settlements rather than lump sum settlements or judgments. The advantage first and most often cited is that the payments are tax-free in the hands of the plaintiff, which obviates the practice of "grossing-up" awards when calculating the award or settlement. Furthermore, in the case of infants, interest on damages awarded for an infant's own personal injury is not taxable until age 21 - and at age 21, the amount involved can be substantial because of the accumulation of compounded interest over a number of years - but interest on damages awarded for an infant's fatal accident claim, for the death of a parent for instance, is immediately taxable pursuant to s. 81(1)(g.1) of the Income Tax Act. In either case, however, if the damages are paid as periodic payments commencing at age 21 pursuant to a structured settlement, the payments, including the portion attributable to interest, continue to enjoy tax free status after age 21 because they are damage payments legitimately deferred until the infant reaches the age of majority. The payments would only be taxed on any interest generated if the payments were themselves invested rather than spent.

INCOME SECURITY

Although the tax-free status of the payments is the advantage most often cited first, in a recent conversation, Frank McKellar of McKellar Structured Settlements Inc. in Guelph, Ontario said that income security is now the best feature he has to offer a plaintiff. The tax-free status is the "grabber", the best selling point, but the fact that every month a cheque arrives in the mail is the aspect that people seem to appreciate the most in the long run. He said that in his dealings with these settlements over the years he has found that people do not relate as well to the concept of $300,000 as they do to the concept of $25,000 a year for life, and that they feel as though their losses — their inability to bring home a paycheck and the increased medical costs they know they will incur — are more directly compensated by the receipt of annual or monthly payments. During that conversation he told of an elderly lady of average means who became widowed and was afraid to receive a large sum of money as compensation for her husband's death because she was afraid that her grown children would perceive her as independent, financially and otherwise, and no longer in need of their companionship and attention and therefore would drift away. She was also afraid that if they thought she was wealthy they would want to borrow large amounts to pay off debts and mortgages and to make large purchases, that she would not be able to say no, and that her means of support would be dissipated. Instead, she chose to receive a structured settlement which she described to her family as a "pension" she was receiving as a result of her husband's death, and she reported later that she was completely satisfied with the arrangement because her relationship with her family remained exactly the same as before.

This story points out two more of the advantages of structured settlements. One is that the losses incurred by the victim are more adequately compensated in

the sense that losses that occur in the future — lost earnings and medical costs — are more realistically replaced by payments in the future.

PROTECTION FROM PREMATURE DISSIPATION OF AWARDS

The second, mentioned above in relation to the non-commutability of annuities is that they result in a lower incidence of premature dissipation of their awards by accident victims through squandering, unwise investments, or otherwise improvident disposition with the consequence of such victims and their dependants ending up on welfare, which may in itself be a sufficiently compelling reason for imposing these schemes either judicially or legislatively. Frank McKellar mentioned that the income security aspect of these annuities is so appreciated by the thousands of recipients with whom his company continues to deal after their settlements have been implemented that not only does he continue to receive positive feedback in respect of that aspect of the schemes, but in all of the years that he has been involved in structured settlements, he has only received two or three inquiries as to the possibility of unwinding them into a lump sum.

There is an insurance industry survey that is cited in many of the articles written about structured settlements[12] (although the original source of the survey is unknown) which found that in cases in which a large cash settlement is paid to a personal injury victim, within two months 25% have spent all of it, within one year 50% have spent all of it, within two years 70% have nothing left, and within five years 90% have nothing left.

A few writers have expressed concern about imposing paternalistic attitudes and schemes on personal injury victims and their dependants but not on

corporations or on the rest of society which may have similar inclinations to squander resources and become dependent on public support.[13] These arguments usually neglect to consider that the rest of society does receive periodic payments in the form of salary, wages, workmen's compensation, mother's allowance, unemployment insurance, welfare, alimony and child support payments, and that corporations are not potential candidates for welfare and are usually in the business of making money and so are better capable of managing a large lump sum payment.

One American[14] expert writing about this issue made the following observation:

> ...Stories are legion as to how some unsuspecting plaintiff, upon receiving an enormous judgment or settlement, promptly lost it through squandering, someone else's chicanery, or just plain financial ineptitude. Many of these investments may have been well intentioned, but the result was the same. Sad it is for the plaintiff, but even sadder for the premium-paying public. Their policy payments did not go for the lifetime use of the tortious party, but rather were dissipated, squandered, and generally used up in a short time. The taxpayer thus ends up paying twice, as the ex-plaintiff now turns to welfare and Medicare coverage.

COST SAVINGS

Another major advantage to structured settlements is that they are a more efficient application of funds available for compensation of tort victims in that they are cheaper from the perspective of the defendant, while more value is ultimately conferred on the plaintiff in both monetary and non-monetary terms. This is partly because of the tax savings already mentioned, but there are a number

of other reasons that structured settlements are such an efficient, cost effective tool for compensation of personal injury victims. One reason is that, because investment management and its accompanying transaction and administrative costs are already factored into the single-premium price of the annuity, there is no need to include a management fee in the award. Related to that is the fact that institutions and particularly life insurance companies, because of the size of their investment operations, get better returns on investment than individuals generally can, get volume discounts on brokerage commissions, and are better able to diversify against risk than individuals can.

Another reason structures are more efficient than lump sums is that, because all of the statistically relevant contingencies are factored into the equation by the actuaries, no arbitrary contingency deduction need be made from the award, thereby reducing the likelihood of over- or undercompensation. There is also no need to struggle with any determination of the appropriate discount rate, since the parties negotiating the structured settlement instead choose between them a percentage or dollar amount by which to index against inflation.

Another general advantage to structured settlements is that, like any settlement, they can be expected to save the costs of trial. To the extent that they enable the parties to settle cases early, they will save the plaintiff and his family and friends the agony of having to relive the accident on the witness stand, and the insecurity of wondering how they will meet daily living expenses and future medical costs to be incurred. Both or all litigants will save a good deal of the cost of lawyers' preparation and trial time and the expert witness fees, all of which is now increasing as these trials become more lengthy, sophisticated and complex.

Similarly, the public will be saved the cost of court time, also now increasing with the complexity of these and other types of issues.

INSURANCE POLICY LIMITS

Structured settlements can also frequently protect the defendant's personal assets from exposure by facilitating settlement within the policy limits even where the "assessed lump sum value" exceeds the policy limits. This is crucial where the defendant has personal assets such as a home, investments and savings and is particularly important where the defendant and his family rely on the assets for their livelihood such as where the defendant is a farmer or small businessman. This advantage is acquiring increasing importance as the average size of judgments climbs past the level of average liability coverage. While many people carry a $1 million liability coverage, a great many people still only carry $500,000, or the current minimum of $200,000 and so are exposing themselves to the risk of an accident and consequent judgment that will ruin them financially. Part of the reason that insurance coverage is often inadequate is that there is a time lag not only between the time the policy is purchased and the time of judgment, but also between the date of the accident and the date of judgment. While the policy holder may have thought that he was adequately covered when he bought the policy ten or twenty years ago at $500,000, and he may have thought he was protecting himself in 1979 when he increased his coverage to $1 million, he is unaware that in the last couple of years the size of judgments has increased so much that he may not be adequately covered. Even if the accident occurred in 1980, the judgment will be in 1984 proportions. Occasionally defendants have attempted to turn around and claim over against the insurance agent for negligence in failing to recommend an

adequate level of coverage, but the complete defence has been that at the time the policy was purchased and at the time the accident occurred, the coverage was appropriate. The result is that now $1 million coverage is not adequate to protect the completely risk-averse person from exposure to personal liability but most casualty companies do not offer $2 million and most agents do not have authority to bind that level of coverage. Structured settlements offer a means of keeping the size of the award within the policy limits, and we might expect to see with increasing frequency in the coming years lawsuits commenced against casualty insurers alleging bad faith for failing to settle within the limits, resulting in judgments exceeding the limits.

FAVOURABLE CLIMATE FOR STRUCTURED SETTLEMENTS

The climate is favorable these days for increased implementation of these settlements. As just mentioned, there is increased pressure on defendants and their casualty insurers to "structure the limits" so as to avoid the possibility of a judgment significantly in excess of the policy limits. Additionally, the increasing involvement of experts such as actuaries, therapists, economists and vocational rehabilitation experts in preparation for personal injury litigation should encourage and facilitate structured settlements because the kind of information needed to set up a structure is largely the same as is becoming necessary to prove the heads of pecuniary damages, future care and future earnings, and so the trend should result in more initiation by plaintiffs' counsel of negotiations for settlement and increased ability by counsel for both sides to intelligently negotiate and advise with respect to structures.

Further, the use of pre-trials encourages settlement negotiation and communication generally between counsel and enables the pre-trial judge to either

make these recommendations or encourage discussion of the possibility. On this subject, Frank McKellar, who has extensive experience with litigation lawyers in both the U.S. and Canada, says that in his experience Canadian lawyers have proved to be far more ethical and communicative than their counterparts in the U.S., leading to a higher degree of disclosure in pre-trial preparation so that the proportion of cases that are successfully settled with the use of structures is remarkably higher than in the U.S. The ability of judges to encourage these kinds of settlements at pre-trials where counsel appear not to have canvassed the possibility themselves presupposes that the judges themselves are sufficiently familiar with them to be able to discuss them with counsel. This will be particularly important when counsel are less experienced in personal injury litigation and so might not themselves be aware of the possibilities. However, the potential savings in court time and the costs of trial to the litigants and the public make it worthwhile for any judge involved with pre-trials to acquaint himself or herself with the advantages to both sides as well as the basic features of structured settlements.

REMAINING PROBLEMS, CRITICISMS, OBSTACLES

TAX-RELATED PROBLEMS

A number of problems, criticisms and obstacles remain which prevent structured settlements from being a panacea for the problems associated with personal injury litigation and lump sum awards. A few of those difficulties are tax-related. To begin with, because and to ensure that the plaintiff receives the tax benefit of the periodic payments, the casualty insurer must retain ownership and therefore also the theoretical "tax liability" of reporting the income from the

annuity, which is immediately offset either as an expense by the payment made under the structure or the reserve the casualty company sets up to meet the payment. This results in extra administrative costs, however, and so the casualty insurer, although released from liability for all practical purposes, continues to incur some cost. The single premium price of the annuity must therefore be sufficiently lower than the assessed lump sum value of the case to make the continuing administrative cost worthwhile. There is another argument, however, that the administrative cost is negligible due to the fact that the bookkeeping can be set up on the computer to be performed automatically.

It is also necessary to ensure that the documentation complies with the requirements of Revenue Canada if the plaintiff is to continue to enjoy the tax free status of the receipts. Specifically, Revenue Canada announced last fall that the judgment cannot purport to fully discharge the defendant or casualty insurer or the plaintiff will be exposed to tax liability. Up until that time the practice had been to release the insurer upon the filing of proof of payment of the cash portion of the award along with a certified copy of the annuity purchased. It was announced at that time, however, that settlements entered into before that time which did release the casualty insurer would be grandfathered and so would continue to enjoy the favourable tax position. It is recommended, however, that if there is any doubt about the wording of the proposed settlement documentation, an advanced ruling should be obtained so as to confront any problems at the ruling stage rather than at the assessment stage.

RISK OF BANKRUPTCY

Another problem occasionally cited by critics of structured settlements is the risk of the life insurance company going bankrupt, and one solution that has

been suggested is that the casualty insurer "guarantee" the annuity. Casualty insurers have resisted that solution because it leaves them with a contingent liability on their books, but since the announcement of Revenue Canada last fall that the documentation may no longer purport to fully release the casualty insurer, that reasoning loses its force.

The short answer to the problem is that it has never happened and is not likely to. Since Confederation, no payment obligation has failed to be made because of the insolvency of a federally licensed life insurance company. The strict federal supervisory process and the restrictions of the Canadian and British Insurance Companies Act, under which all federally incorporated life insurance companies operate, makes insolvency a risk of negligible proportions.[15] In a sense then, because casualty insurers are less financially stable than life insurers, by shifting the responsibility for payment from the casualty insurer to a life insurer a year or more prior to the time judgment would issue, the risk of non-payment of the judgment debt is actually reduced. Nevertheless, many counsel make it a practice to ensure that annuities are purchased only from life insurance companies with stated assets in excess of $3 billion and some judges have been heard to say that, particularly where infants are involved, they will not approve any settlement with a life insurance company having less than $3 billion published assets.[16]

LACK OF COMMUNICATION

A more significant problem with structured settlements is that they cannot be imposed by the court, they must be negotiated, and counsel do not always communicate openly enough to achieve early settlements. Specifically, each

counsel is afraid of conveying the impression that his or her case is weak and hence is reluctant to be the first to suggest settlement. However, one county court judge in Northern Ontario, after hearing all of the evidence but prior to giving his judgment, adjourned the trial for the express purpose of permitting counsel to negotiate a structured settlement.[17] In another action in the Supreme Court of Ontario, the court adjourned for other reasons following a pre-trial motion and counsel were able to agree on a structured settlement prior to the return date.[18] In another action in the Supreme Court of Ontario, Yepremian v. Scarborough General Hospital (No. 2),[19] counsel negotiated a structured settlement after the appeal was heard by the Ontario Court of Appeal and pending appeal to the Supreme Court of Canada, and the Ontario High Court was asked to approve the minutes of settlement. And so while these settlements cannot be imposed by the courts, judges can have significant influence in encouraging their implementation.

LACK OF FAMILIARITY WITH STRUCTURES

Closely related to the problem just mentioned is another problem, the fact that not enough lawyers are sufficiently familiar with structured settlements to feel comfortable either negotiating them or discussing them with clients. This is due in large part to the fact that many lawyers do not know how to read financial statements and do not understand the concept of present value. Because of lawyers' infamiliarity with structured settlements and their component parts, the lump sum award retains its position of importance in personal injury litigation in spite of all of the problems surrounding the lump sum award. Not only are many cases still being tried without any consideration of the possibility of a structured settlement, even where the latter would be a more appropriate solution, but even in

the negotiation of structured settlements, the lump sum retains a residual influence by virtue of the fact that counsel are unable to assess the value of a proposed structure without comparing it to the "assessed lump sum value" of the case.

A number of recent lectures and articles have recommended, in fact, from a practice perspective, that counsel for the plaintiff should assess the value of a defendant-proposed structure by comparing its present value to the assessed lump sum value of the case.[20] However, in order to do that, since most counsel do not know how to calculate present value and since the present value of any particular future payment depends largely on the assumptions made by the life insurer regarding future interest and inflation rates, plaintiffs' counsel are demanding to know the cost to the defendant or his casualty insurer of the proposed structure, and many counsel take the position that the cost to the defendant should closely approximate the "assessed lump sum value" of the case, so that all or nearly all of the benefit of implementing a structure accrues to the plaintiff, none to the defendant.

The practice of comparing structured settlements to "assessed lump sum values" is similar to the problems people face with metric conversion or learning a new language. Before they are able to think metric or think French, people go through an intermediate phase during which they need to translate in their minds in order to figure out what they are dealing with or talking about. The difference with structured settlements and comparing them to "assessed lump sum values" is that too many assumptions have to be made and too many significant differences, such as tax treatment, have to be ignored in the conversion process. The translation of structures to lump sums is not the neat calculation of yards to

meters and pounds to kilos. Factors like management fees, tax consequences, contingency deductions and especially non-monetary benefits like reduced risk of imprudent management, squandering, and unwise investment are simply ignored by plaintiffs' counsel in the process of making such comparisons.

The result is that emphasis is placed on cost to the defendant rather than compensation of the plaintiff and at that point one of the basic principles of tort compensation — restitutio in integrum — is abandoned and replaced with another, that of punishing the defendant or his casualty insurer, and one of the principal advantages of this new system is lost — that of helping to stem the upward spiral of insurance premiums so that we do not find ourselves in the situation envisioned by Dickson J. in Andrews v. Grand & Toy in which only the wealthy can own and operate cars because only the wealthy can afford the insurance premiums.

Some writers maintain that the plaintiff is still entitled to call for a lump sum — depending on whether that is "more favourable" to the plaintiff, and so the plaintiff should demand to know what the cost will be to the defendant. Assuming, however, that the plantiff's losses will be fully compensated under the proposed structure (as nearly as that can be done with money) the cost to the defendant ought not to be relevant. It is interesting to note that in the U.S. it is the practice of defence counsel to refuse to disclose its cost.

More particularly, the plaintiff ought not to be able to extort a more-than-compensatory structured settlement out of the defendant's insurer by threatening to assert his right to a lump sum until he has garnered to himself all or nearly all of the cost savings afforded by structures over lump sums. Another passage of

Dickson J. from Andrews v. Grand & Toy pertains:

> Contrary to the view expressed in the Appellate Division of Alberta, there is no duty to mitigate, in the sense of being forced to accept less than real loss. There is a duty to be reasonable. There cannot be 'complete' or 'perfect' compensation. An award must be moderate and fair to both parties. Clearly, compensation must not be determined on the basis of sympathy, or compassion for the plight of the injured person. What is being sought is compensation, not retribution...

The solution to this set of problems of course is for lawyers to acquaint themselves with structured settlements and their component parts so that they can negotiate and advise intelligently with respect to them. To a limited extent this will occur naturally over time, but it would be asking too much to expect the legal profession to be able to converse fluently about structures immediately, and so for some period it is inevitable that structures will be assessed by comparing them to the lump sum value of the case. The various law societies and bar associations have a role to play as well, by educating their members in this emerging area of law. In the meantime, however, it is important that we not lose sight of the primary intention of tort compensation, that of compensating and caring for the victim, and let it be displaced by the aim of punishing the defendant.

INFLEXIBILITY OF STRUCTURES

One final and very real problem with structured settlements is that once they are implemented, they are unreviewable and so, to the extent that they fail to anticipate changes in the plaintiff's needs or changes in the economy, they will continue to fall short of being the perfect solution. One writer[21] has suggested

that structured settlements may, in this respect, subject lawyers to actions in the future for inadequacy of settlements far more than lump sum settlements have, simply because they will be subject to scrutiny over a number of years so that if the plaintiff's lawyer has failed to take some important factor into consideration, he may find himself the target of a negligence action.

Some writers in response to this problem have advocated setting up a public agency to review the awards from time to time, along the same lines as Workmen's Compensation or Unemployment Insurance, but this writer's view is that the costs and inefficiencies of yet another government agency would unnecessarily eat into the resources available to compensate the injured and that subjecting our handicapped to the same procrustean treatment to which we subject our unemployed would be inhumane. It would literally add insult to injury. It would be better if any proposed system of review and variation were an incremental extension of the present system which is being administered efficiently and effectively by the private sector.

Another option that has been discussed in the U.S. is to "restructure" the package within the annuity without adjusting the money that was put in to buy it, e.g., by giving up a guarantee period or death benefit, it may be possible to increase the size of the current payments, or where a dependant child or spouse dies or grows up or otherwise becomes independent from the injured plaintiff, by discontinuing payments associated with that dependant it may be possible to increase payments or provide a lump sum for some unanticipated need of the victim.[22]

For now, probably the cheaper and more humane solution to the inflexibility, unreviewability of structured settlements is to err on the side of generosity, in