STRUCTURED SETTLEMENTS
By Mark Hick of Wragge & Co.

This is a time of great interest and substantially reduced costs for Insurers and Underwriters who are concluding successful structured settlements. Initially the market's response to structured settlements was a mixture of caution and scepticism. Now that savings of in excess of £100,000.00 on individual claims have been achieved there is increasing interest as the market becomes more aware of the savings available to it.

What is a Structured Settlement?

Let's remind ourselves exactly what a structured settlement is. The only statutory definition is set out in Schedule 4 of the Social Security Act 1989. Instead of the Plaintiff receiving one lump sum payment in final settlement of his claim, he receives usually a combination of a lump sum payment with the balance of the claim being paid by a series of periodic payments. Two agreements are involved. The first creates an obligation on the liability Insurer (not the Insured) to pay an agreed sum in damages to the Plaintiff. The second is the purchase of an annuity by the Insurer from a separate Life Company whereby the liability Insurer receives a series of future payments linked to the life of the Plaintiff. The annuity payments are used to fund the liability Insurer's obligation to make periodic payments to the Plaintiff.

How Does a Structured Settlement Work?

The key financial benefits in a structured settlement are tax benefits. Under a conventional lump sum settlement the Plaintiff pays no tax on the damages award itself (Section 19(5) CGTA 1979 and Section 329 of the ICTA 1988), but the Plaintiff does pay income tax on the income arising from the investment of the damages. Whether the Plaintiff puts his damages into gilts or equities, or uses his lump sum to purchase an annuity the income arising will be taxable in the Plaintiff's hands. The incidence of this tax cuts deeply into the lump sum.

However the tax position in a structured settlement is rather different. The Inland Revenue have agreed to a scheme whereby the annuity payments can be made to a Plaintiff free of tax. The parties agree a total settlement figure and this is regarded, through using model agreements approved by the Inland Revenue, as the debt due from the Insurer to the injured Plaintiff. This debt is paid by a series of instalments which for income tax purposes are capital rather than income, and are not taxable in the hands of the Plaintiff. The effect of all of this is that the periodical payments are received free of tax. If in a lump sum settlement over a 20 year life expectancy a Plaintiff would pay £70,000.00 in tax, all of this would be saved in a structured settlement!

The Kelly Case

This well publicised case in 1989 was the first Court-approved Structured Settlement for a U.K. resident. It was agreed that the appropriate figure in a lump sum settlement was £427,500.00, based on recurring annual costs of £25,500.00.

A structured settlement was agreed, after negotiation, on the basis of £410,000.00, a saving of £17,500.00 on the conventional lump sum settlement figure of £427,500.00.

Of the £410,000.00, £300,000.00 was used to purchase an annuity for the remainder of the Plaintiff's life. The annual sum provided by the annuity was index-linked and guaranteed for a period of 10 years, so that the payments would continue for a 10 year period even if the Plaintiff died before that period expired.

It was established that after 12 years a conventional lump sum settlement would have been exhausted having regard to the effects of inflation and tax on the investment income. In contrast the tables showed that the annual sum provided by the annuity would be £45,906.00 after 12 years. The payments under the structured settlement would continue index-linked for the rest of the Plaintiff's life.

Recent Cases

There have been two recent cases which are likely to affect dramatically the market's attitude to structured settlements. Some Insurers took the view that the discount negotiated in *Kelly -v- Dawes*, some £17,500.00, was insufficient to warrant the additional costs and administrative expenses associated with the structured settlements. However in *Grimsley -v- Grimsley* and Meade the saving to Insurers was £102,000.00! This case was decided by McCulloch J. on 28th January this year. The Judge agreed that the appropriate figure for compensation on a conventional basis was £825,000.00, but he approved a structured settlement of £723,000.00. An annuity was purchased with a 5% annual increase in payment, guaranteed for 30 years. From the Plaintiff's point of view the conventional lump sum settlement would have been completely used up after 20 years.

Paul Heeley -v- Simon Britton was decided on 19th December 1990. The agreed figure for a conventional sum payment was £900,000.00. Mr. Justice Rougier approved a structured settlement whereby the cost to Insurers was a lump sum payment of £350,000.00 and then an additional £450,000.00 was used to purchase an annuity for the Plaintiff of £50,000.00 per year for life, which payment was index-linked. Insurers therefore paid out some £800,000.00 compared with a conventional lump sum settlement of £900,000.00 resulting in a saving of some £100,000.00.

These cases represent something of a shifting of the tide so far as structured settlements are concerned. Now the potential cash savings which can be achieved by Insurers are so large that we can expect the structured approach to be used increasingly.

When is a Structured Settlement Appropriate?

Structured Settlements are appropriate in claims of serious personal injury, or fatal accident claims involving substantial future losses/future dependancy. It is worth considering a structured settlement in any personal injury claim likely to involve a payment of over £200,000.00. Cases involving impaired lives are particularly appropriate. The risk of the Plaintiff living beyond his life expectation creates a strong incentive for Plaintiffs to prefer a structured settlement. It is simpler to arrange a structured settlement where there is no issue on liability but there is no reason why a structure could not be agreed after the Judge has decided liability. Indeed if quantum is in dispute the Judge could indicate the likely figure he would have in mind for a conventional settlement and then adjourn the case whilst the parties consider they could agree a more mutually advantageous structured settlement.

The Position of the Plaintiff

(i) The Plaintiff receives in real terms significantly higher damages then would be received in a lump sum settlement. The money which otherwise would have been paid out in income tax is shared by negotiation between the Plaintiff and the Insurers.

(ii) Structured settlements can be index-linked and therefore inflation-proofed, whereas in a lump sum settlement the Court cannot take future inflation into account.

(iii) The Plaintiff need not incur substantial recurring expenses in managing the investment of a large sum.

(iv) The Plaintiff is protected financially if he lives beyond the life expectancy allowed for in the assessment of damages.

The downside for the Plaintiff is that there is no ready access to capital if unforeseen circumstances arise. Hence a lump sum is usually set aside outside of the annuity to provide for contingencies.

The position of the Insurer

(i) The Insurer receives a negotiated share of the Plaintiff's gain. As we have seen the Courts have recently approved settlements with Insurers saving in excess of £100,000.00.

(ii) There ought to be some saving in Court of Protection fees. In brief, Court of Protection fees are based on "clear income" yet structured settlements involve only payments of capital. This should lead to considerably reduced Court of Protection fees.

(iii) If the Insurer has a separate Life Company within its Group then there may be additional savings. The Life Company would retain the use of the money and keep to itself any profit which it makes on the annuity.

(iv) Insurers will derive satisfaction to the extent that damages are less likely to be squandered in a structured settlement than in a conventional lump sum payment of damages. The Insurer may perceive some social benefit in its being involved in the continuing care and protection of an accident victim.

The disadvantages to Insurers need to be carefully considered. The first of these is of course that it is the top slice Re-Insurer who gets the benefit from the reduced damages paid to the Plaintiff! Several successful structures have been implemented involving the Lloyd's market. Indeed the top slice Re-Insurer may be persuaded to pass on some of the benefits to the primary layer Insurer who may bear much of the administrative burden of implementing the structured settlement. Furthermore there are some additional costs in setting up a structured settlement and this must be borne in mind when negotiating the reduction from an ordinary lump sum settlement. Some attempt has been made to minimise these costs in recent structured settlements by both parties instructing the same firm of accountants as independent experts with both sides having access to the accountants. In some cases Brokers are used to obtain annuity quotes. In other cases the additional costs of Brokers have been avoided.

There are continuing administration costs as a result of keeping a claims file open and maintaining a record of payments. Perhaps the most talked of disadvantage for the Insurer is the cumbersome system of reclaiming tax. The Liability Insurer will have purchased an annuity from a Life Office in order to fund the series of annuity payments. Under current tax legislation the Life Office will pay to the Liability Insurer the required annuity, but after deducting income tax. A Liability Insurer has to gross this up and pay to the Plaintiff the gross amount of the annuity. This results in a loss of cash flow to the Liability Insurer. Ultimately the arrangements are tax neutral because the Liability Insurer recovers the tax and obtains relief for the tax which it has to fund until its normal due date for corporation tax.

Arranging a Structured Settlement

I have found it helpful to arrange a joint conference attended by the Clients, Solicitors and Barristers on each side when the potential benefits of a structured settlement can be explored. A number of structured settlement consultants have emerged who specialise in providing assistance and also in obtaining competitive quotes for impaired lives and generally assisting in the design of a structured package.

The Inland Revenue have approved several different types of arrangement from 'basic terms' where pre-set payments continue for a fixed period to 'Indexed terms for life' where the payments are linked to the life of the Plaintiff and also to the index of retail prices. They have approved several alternative model agreements using these various alternatives.

No particular difficulties arise with the larger Companies which may have a distinct advantage if there is a separate Life Company within the Group. There have been a number of successful structures involving Lloyd's Syndicates. The position of mutuals, captives and overseas companies is more complicated.

Conclusions

A key attraction of structured settlements is what the Americans call a "win-win" position: the Plaintiff wins by getting more in real terms than he would in a conventional lump sum settlement, the Insurer wins by paying out less.

There has been a degree of understandable reluctance in the market to adopt a structured settlement approach. This is partly through reluctance to change but also a desire which must be fully endorsed to see an adequate return to Insurers. I expect that as the *Heeley* and *Grimsley* cases become more widely publicised the market will have a greater appreciation of the very substantial savings potentially available to it through structured settlements and become more relaxed with the mechanics of this type of settlement. Where an adequate return to Insurers is available there is much to commend structured settlements, especially to companies who are able to retain the damages within their Group through a subsidiary Life Company.

Structured settlements were touched on in both the House of Commons and the House of Lords following the (defeated) Rosie Barnes National Health Service Bill. The Secretary of State for Health, William Waldegrave, said that the Lord Chancellor's Department were considering structured settlements with the Law Commission. There was concern regarding claims where the Plaintiffs had died unexpectedly early leaving the family virtually millionaires overnight! This would not occur in a structured settlement where the payments are linked to the life of the Plaintiff.

Finally it is worth considering the remarks of Mr. Justice Rougier who approved the structured settlement in the Heeley case where there was a saving to Insurers of some £100,000.00 but gains to the Plaintiff of well in excess of that sum. He referred to the "hit and miss" basis of conventional lump sum awards and said "..I have absolutely no hesitation not only in approving the [structured] settlement, but giving it positive blessing".

SOFI -v- PRUDENTIAL ASSURANCE COMPANY LIMITED (1990)
Erosion of the Duty of Due Care?
By Deborah Tompkinson, Alsop Wilkinson, Solicitors

Those working in the Insurance field will be familiar with the duty of insureds to take all reasonable care to avoid loss, sometimes expressed as the duty to act as if uninsured. However, the question of what action is necessary to discharge the duty is a vexed one. The recent decision of the Court of Appeal in *Sofi -v- Prudential Assurance Company Ltd.* (1990) was assumed at first glance to be a watershed in favour of the insureds. The purpose of this article is to examine the decision and consider whether it is likely to have any significant impact on the applicable standard of care.

The Insurance

The insurance was a standard householder's policy with an All Risks extension for household contents. It also gave cover for third party liability, the importance of which will be seen.