

Chapter 593: A Structure for the Transfer of Structured Settlements

Corrie Erickson

Code Sections Affected

Insurance Code §§ 10134, 10135, 10136, 10137, 10138, 10139, 10139.3, 10139.5 (amended).
SB 510 (Corbett); 2009 STAT. Ch. 593.

I. INTRODUCTION

At just three years of age, Orion Olson began experiencing vision and neurological problems associated with injuries sustained from a dog bite.¹ He continued to encounter hardship, dropping out of high school in his teens and later finding himself homeless.² Hope, however, lingered on the horizon. When Olson turned eighteen, he would begin collecting periodic payments totaling \$75,000, an amount he obtained in the settlement of a lawsuit relating to the dog attack.³ Unfortunately, after receiving his first payment of \$7,500, Olson discovered that the money was not enough to sustain him.⁴ After watching a television advertisement for a company offering cash in exchange for settlements like his, he sold the remaining \$67,500 balance of his settlement to a finance company for a meager \$16,500.⁵ “I needed money,” Olson reflected, “[i]f I could get the money out like they were saying on TV, I wouldn’t have to worry about being on the street anymore.”⁶ Regrettably, he was wrong.⁷ Just six months later, the money was gone, and Olson was living out of his car.⁸

For the past twenty-five years, the federal government has encouraged the use of structured settlements⁹ for compensating injury victims.¹⁰ These settlement

1. Margaret Mannix, *Settling for Less: Should Accident Victims Sell Their Monthly Payouts?*, U.S. NEWS & WORLD REP., Jan. 25, 1999, at 63, available at http://www.usnews.com/usnews/biztech/articles/990125/archive_000140.htm.

2. *Id.*

3. *Id.*

4. *Id.*

5. *Id.*

6. *Id.*

7. Mannix, *supra* note 1.

8. *Id.*

9. “Structured settlements” are periodic payment arrangements, often financed with single-premium annuity contracts, that compensate victims for their injuries over time, rather than in one lump sum. SENATE JUDICIARY COMMITTEE, COMMITTEE ANALYSIS OF SB 510, at 2 (Apr. 28, 2009).

10. Nat’l Structured Settlements Trade Ass’n, Learn More About Structured Settlements, <http://www.nssta.com/i4a/pages/index.cfm?pageid=3290> (last visited Feb. 27, 2010) (on file with the *McGeorge Law*

arrangements cut down on societal costs by “minimizing the risk that lump sum recoveries will be dissipated, leaving victims of disabling injuries to fall back on public assistance.”¹¹ Nevertheless, private market forces often supplant the public benefits of structured settlements.¹² In the early 1990s, a secondary market developed in which financial companies began to purchase from structured settlement holders (payees) their rights to collect future payments.¹³ These companies, now commonly known as structured settlement factoring companies, use aggressive advertising to convince payees to “trade [their] future payments for present cash.”¹⁴ The factoring companies’ exploitive tactics sparked a great deal of controversy.¹⁵ One article noted that “factoring companies often charged sharp discounts to payees who were ill equipped to appreciate the value of their future payments”¹⁶ and “[i]n some cases, factoring companies charged discounts equivalent to annual interest rates as high as 70 percent.”¹⁷

Before long, state legislatures saw a need for regulation.¹⁸ Since 1997, nearly all states have passed some form of the Structured Settlement Protection Act (SSPA), which makes the transfer of structured settlement payment rights ineffective without prior court approval.¹⁹ Chapter 593 adds to the protections of the current California SSPA by increasing the notification requirements associated with the transfer and by specifying the factors a court must consider when determining whether a structured settlement sale is in the “best interests” of the payee.²⁰

II. LEGAL BACKGROUND

A. Existing California Law

In 1999, the California Legislature followed the lead of several other states and enacted the California SSPA to defend its citizens against the abuses of unfair factoring transactions.²¹ The legislation’s sponsors hoped that it would

Review).

11. Daniel W. Hindert & Craig H. Ulman, *Transfers of Structured Settlement Payment Rights: What Judges Should Know About Structured Settlement Protection Acts*, 44 JUDGES’ J. 19, 19 (2005), available at http://www.abanet.org/jd/publications/jjournal/2005spring/hindert_ulman.pdf (on file with the *McGeorge Law Review*).

12. *Id.*

13. SENATE JUDICIARY COMMITTEE, COMMITTEE ANALYSIS OF SB 510, at 2 (Apr. 28, 2009).

14. Hindert & Ulman, *supra* note 11, at 19.

15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.* at 20.

19. *Id.* at 19; DANIEL W. HINDERT ET AL., STRUCTURED SETTLEMENTS AND PERIODIC PAYMENT JUDGMENTS § 16.04 (Law Journal Press 2009) (1986).

20. SENATE JUDICIARY COMMITTEE, COMMITTEE ANALYSIS OF SB 510, at 1 (Apr. 28, 2009).

21. *Id.* at 2-3; *see also* HINDERT ET AL., *supra* note 19 (describing the general legislative scheme

prevent payees from “being preyed upon by unscrupulous ‘factoring companies’” and suppress fears that the transfers would “threaten the favorable tax treatment given to the parties . . . under a structured settlement if the periodic payment rights [were] sold to another.”²²

The California SSPA ensures fairness in factoring transactions by rendering a transfer agreement ineffective unless it meets several conditions.²³ Initially, the transferee must present the payee with “a separate written disclosure statement” clearly detailing the terms of the agreement and encouraging the payee to seek “independent professional advice” in negotiating the transfer.²⁴ The transfer must also satisfy what is commonly known as the “best interests” test, meaning that it is “fair and reasonable and in the best interest of the payee, taking into account the welfare and support of his or her dependents.”²⁵ Even if the transfer is in the “best interests” of the payee, it must not “contravene other applicable law.”²⁶ Transfer agreements containing certain provisions, such as forum selection clauses or terms of indemnity, may also render the arrangement “void and unenforceable.”²⁷ Finally, a transfer that complies with all of the enumerated requirements will not take effect until the court approves it “in a final court order based on express written findings.”²⁸

To obtain approval, the transferee must file an application with the court and all interested parties.²⁹ The application must include a copy of the transfer agreement, the required disclosures, the annuity contract, the underlying structured settlement agreement, any qualified assignment agreement, and a listing of each of the payee’s dependents.³⁰ The notice must also include a statement that interested parties are invited to partake in the court’s approval of the agreement, either in writing or in person, and the time and place of the hearing.³¹

reflected by the current Structured Settlement Protection Acts in the different states).

22. ASSEMBLY COMMITTEE ON JUDICIARY, COMMITTEE ANALYSIS OF SB 491, at 5 (July 13, 1999); *see also* Hindert & Ulman, *supra* note 11, at 19 (“Under federal tax rules designed to encourage the use of structured settlements, the full amount of each periodic payment, including the amount attributable to earnings under the annuity contract, is excludable from the settlement recipient’s income under IRC section 104(a)(1) or (2).”).

23. CAL. INS. CODE § 10136(a) (West 2005).

24. *Id.* § 10136(b). For the definition of “independent professional advice,” *see id.* § 10136(a). *See also id.* § 10139.5(a)(2) (indicating that before a court can approve the transfer, it must make an express written finding that the payee “has either received that advice or knowingly waived that advice in writing”).

25. *Id.* § 10137(a); HINDERT ET AL., *supra* note 19, at 16-64 to 16-65.

26. CAL. INS. CODE § 10137(b) (West 2005).

27. *Id.* § 10138.

28. *Id.* § 10139.5(a); *see also id.* § 10139.5(a)(1)-(6) (listing the express findings a court must make).

29. *Id.* § 10139.5(c)(1), (c)(2)(A)-(H).

30. *Id.*

31. *Id.* § 10139.5(c)(2)(H)-(I).

B. Federal Regulations

California and other states with laws paralleling the California SSPA were not alone in noticing the problems associated with transfers of structured settlement payment rights. Organizations at the federal level moved to address the abuses as well.³² In 1999, the U.S. Treasury Department urged Congress to supplement the protective frameworks of the states by imposing a punitive tax on certain structured settlement transfers.³³ Congress later adopted and enacted this proposal as part of the Victims of Terrorism Tax Relief Act of 2001, now codified as section 5891 of the Internal Revenue Code.³⁴ Section 5891 imposes a forty-percent tax on any party who acquires structured settlement payment rights through a factoring transaction.³⁵ It does not, however, apply to a “factoring transaction in which the transfer of structured settlement payment rights is approved in advance in a qualified order.”³⁶ Through this savings provision, section 5891 works with the laws enacted in many states by ensuring that “no informed party that is subject to the taxing authority of the United States will seek to acquire structured settlement payment rights without obtaining approval of the transaction under the appropriate [SSPA].”³⁷

III. CHAPTER 593

A. Redefining the Court’s Role

Chapter 593 makes several changes to existing law, but perhaps the most significant change involves a clarification of the court’s role in making the “best interests” determination.³⁸ Chapter 593 directs the court to determine that all required conditions of the statute are met before approving a petition to transfer

32. Hindert & Ulman, *supra* note 11, at 20.

33. *Id.*

34. *Id.*

35. 26 U.S.C.A. § 5891(a) (West 2002); *see also* Hindert & Ulman, *supra* note 11, at 20 (explaining that the exact amount of the tax assessed by section 5891 is calculated as forty percent of the factoring discount received by the buyer in the settlement transfer transaction).

36. 26 U.S.C.A. § 5891(b); Hindert & Ulman, *supra* note 11, at 20-21. For the purposes of section 5891, a “qualified order” is a judgment which finds that the transfer of payments under a structured settlement arrangement complies with all of the following: it “does not contravene any Federal or state statute” or court order, it “is in the best interest of the payee, taking into account the welfare and support of the payee’s dependents,” and it is issued “under the authority of an applicable State statute in an applicable State court” or qualified administrative authority. 26 U.S.C.A. § 5891(b)(2).

37. *See* Hindert & Ulman, *supra* note 11, at 21 (“[T]he conditions for exemption from the [forty] percent federal excise tax coincide with the . . . conditions for an effective transfer of payment rights under the SSPAs.”).

38. *See* ASSEMBLY COMMITTEE ON JUDICIARY, COMMITTEE ANALYSIS OF SB 510, at 1-5 (June 30, 2009) (reviewing the several changes made by Chapter 593, yet focusing on the impact of “best interests” criteria).

structured settlement payment rights.³⁹ In determining whether the transfer should be approved, the court must consider whether it is “fair, reasonable, and in the payee’s best interest.”⁴⁰ Under Chapter 593, this determination involves considering several criteria that make up the “totality of circumstances” surrounding the proposed transfer.⁴¹ Chapter 593 also mandates that the petition for transfer include certain personal and financial information about the payee.⁴²

B. Notice Requirements

Chapter 593 expands on current law by requiring the transferee to disclose more information in its notice to the payee.⁴³ Specifically, the notice must explain that the discount rate applied in the factoring transaction is higher than the rate used by the Internal Revenue Service to calculate the present value of the settlement.⁴⁴ Chapter 593 also amends the procedure that the transferee must follow when filing its petition for transfer with the court.⁴⁵ Under Chapter 593, the petition for transfer must include the disclosure statement provided to the payee and any prior transfer petitions “whether approved or withdrawn.”⁴⁶ A copy of this petition must also be provided to certain interested parties.⁴⁷ Chapter 593 confines the class of annuity beneficiaries that fall within the definition of “interested parties” to include only those beneficiaries that are “irrevocably” designated in the underlying annuity agreement.⁴⁸ Furthermore, Chapter 593 expands notice requirements with respect to the payee’s former attorney.⁴⁹ If the attorney of record at the creation of the structured settlement is licensed to practice in California, then he or she is required to be notified of the pending

39. CAL. INS. CODE § 10139.5(a)(3) (amended by Chapter 593).

40. *Id.* § 10139.5(b) (amended by Chapter 593).

41. *See id.* (defining the “totality of the circumstances” analysis). The “totality of the circumstances” analysis includes: the desire of the payee to go through with the transaction, taking into account his or her “age, mental capacity, legal knowledge and apparent maturity level”; the purpose, fairness and terms of the factoring transaction; whether the funds were related to an injury that requires future and continued medical care and whether the payments are still needed for that purpose; whether the funds are needed for present or continued care of the payee’s dependents; whether the payee was involved in previous transactions regarding his or her structured settlement payments, and whether he or she was satisfied with those transactions; and additional factors as enumerated in the statute. *Id.*

42. *See id.* § 10139.5(c) (amended by Chapter 593) (defining this information to include payee’s name, address, age, marital status, family composition, financial resources, and several other factors as enumerated in the statute).

43. *Id.* § 10136(b) (amended by Chapter 593).

44. *Id.*

45. CAL. INS. CODE § 10139.5(f)(2) (amended by Chapter 593).

46. *Id.* § 10139.5(f)(2)(A)-(B) (amended by Chapter 593).

47. *Id.* § 10139.5(f)(2) (amended by Chapter 593).

48. *Id.* § 10134(g) (amended by Chapter 593).

49. *Id.* § 10139.5(f)(2)(L) (amended by Chapter 593).

transfer if it takes place within five years of the date of the original structured settlement agreement.⁵⁰

C. *Additional Limits on the Scope of Existing Law*

Chapter 593 restricts application of the California SSPA to agreements in which the payee is domiciled in California at the time the transfer agreement is signed, or either the obligor or annuity insurer of the settlement is domiciled in a state with no statute regulating the transfer of structured settlements.⁵¹ It also relieves transferees from providing the court with certain documents if they are unavailable or cannot be located, so long as the transferee shows that he or she has made a reasonable attempt to locate the document, “including making inquiry with the payee.”⁵² If the documents are available but subject to a confidentiality provision, Chapter 593 allows the transferee to summarize “the payments due and owing to the payee,” pending any further requests for production of the documents by the court.⁵³

IV. ANALYSIS

A. *Support and Opposition to Chapter 593*

Chapter 593 was sponsored by Consumer Attorneys of California (CAOC), an organization of over 3,000 attorneys who represent the interests of plaintiffs and consumers.⁵⁴ CAOC maintains that Chapter 593 will provide “further substantive and procedural protections” for those consumers engaging in structured settlement transfers.⁵⁵ The Governor’s Office of Planning and Research, however, expressed concern with the addition of new criteria to the existing protections of the California SSPA.⁵⁶ It argued that Chapter 593 will “impose numerous and nebulous criteria to obtain court approval for a sale of structured settlements” and will “create more problems and procedures than guidance for a court and individuals seeking to legitimately sell or buy an asset.”⁵⁷

50. *Id.*; ASSEMBLY COMMITTEE ON JUDICIARY, COMMITTEE ANALYSIS OF SB 510, at 2 (June 30, 2009).

51. CAL. INS. CODE § 10135(c) (amended by Chapter 593). Forum selection provisions limiting jurisdiction to a court other than a California court or choice-of-law provisions that mandate law other than that of California to be controlling are grounds to find a structured settlement agreement void and unenforceable with respect to those agreements arising out of the first situation described in the text accompanying this note. *Id.* § 10137(a)(9)-(10) (amended by Chapter 593).

52. *Id.* § 10139.5(f)(2)(H) (amended by Chapter 593).

53. *Id.*

54. SENATE FLOOR, COMMITTEE ANALYSIS OF SB 510, at 4 (Aug. 26, 2009); Consumer Attorneys of California, About CAOC, <http://www.caoc.com/CA/index.cfm?event=showPage&pg=history> (last visited Feb. 27, 2010) (on file with the *McGeorge Law Review*).

55. SENATE FLOOR, COMMITTEE ANALYSIS OF SB 510, at 5 (Aug. 26, 2009).

56. *Id.* at 5-6.

57. *Id.* at 6.

B. The “Best Interests” Test

Although Chapter 593 makes several changes to the California SSPA, the most consequential change will likely be the expansion of the “best interests” test criteria.⁵⁸ Current California law protects potential victims of predatory structured settlement transactions by requiring the court to find that the transaction is in the “best interests” of the payee.⁵⁹ However, prior to Chapter 593, California law did not prescribe any concrete criteria for making this determination.⁶⁰ Chapter 593 fills this void by instituting the “totality of the circumstances” test for court approval of a petition to transfer structured settlement payment rights.⁶¹ This test reflects patterns in other state legislatures and courts of other jurisdictions.⁶²

Recognizing the need to protect structured settlement holders against the abusive practices of factoring companies, nearly all states have enacted some form of SSPA.⁶³ The SSPAs are not identical from state to state, but most are derived from the Model Structured Settlement Protection Act created by the National Structured Settlement Trade Association.⁶⁴ While only some SSPAs add supplemental protections for payees, such as mandatory choice of law provisions, most require the factoring company to make certain written disclosures to the payee, and all of the SSPAs provide that no sale of a structured settlement is effective without prior court approval of the transfer.⁶⁵ Court approval must be based on a finding that the transfer “will serve the best interests of the payee and the payee’s dependents.”⁶⁶ However, the term “best interests” is often ill-defined.⁶⁷ Although some states, such as New York, provide a more detailed explanation of the term, most use the simple definition set forth in the Model Act.⁶⁸

58. See The Dolan Law Firm, Protecting Californians from Predatory Settlement Purchases, http://knowledgebase.findlaw.com/kb/2009/Jun/1126938_1.html (last visited Feb. 27, 2010) [hereinafter The Dolan Law Firm] (on file with the *McGeorge Law Review*) (noting that Chapter 593 will protect consumers by providing guidance for the court in applying the “best interests” test).

59. *Id.*

60. *Id.*

61. Senate Bill (Structured Settlements), Fact Sheet, www.aclhic.com/SB_510_Fact_Sheet.doc (last visited Feb. 27, 2010) [hereinafter Fact Sheet] (on file with the *McGeorge Law Review*).

62. *Id.*

63. See HINDERT ET AL., *supra* note 19, at 16-47 n.1.1 (“As of early 2008, only New Hampshire, North Dakota, Vermont and Wisconsin do not have an SSPA.”).

64. *Id.* at 16-49.

65. *Id.* at 16-50 to 16-52.

66. *Id.* at 16-51.

67. *Id.* at 16-51 to 16-52.

68. Compare N.Y. GEN. OBLIG. LAW § 5-1706(b) (McKinney 2004) (establishing that the transfer must be in the best interest of the payee, taking into account additional factors such as whether the terms of the transaction and the discount rate are fair and reasonable, and noting that financial hardship is not required for approval), with MODEL STATE STRUCTURED SETTLEMENT PROTECTION ACT § 4(a)(i) (2000) (noting only that the transfer must be in the best interest of the payee, taking into account the welfare and support of the payee’s dependents).

This lack of definitional detail has resulted in various judicial interpretations of the state statutory schemes.⁶⁹ While some courts seem to demand a showing of “an unforeseeable change in circumstances” before approving a transfer, other courts take a more variable approach.⁷⁰ For example, in a 2002 case, the Minnesota Court of Appeals stated that “the best interests determination involves a more global consideration of the facts, circumstances, and means of support available to the payee and his or her dependents.”⁷¹ Another area of confusion for the courts in the “best interests” analysis arises when attempting to evaluate the reasonableness of the exorbitant discount rates that are often attached to structured settlement transfers.⁷² While some courts have “impos[ed] de facto caps on allowable discount rates,” others have acknowledged that in certain circumstances, greater financial need may justify a steeper discount rate.⁷³

As one scholar put it, “[n]either the SSPAs nor the decisional law that has emerged under those acts gives any precise formula for applying the best interest test.”⁷⁴ Chapter 593 directly addresses this shortcoming in California’s laws by prescribing specific criteria for the court to consider when making the “best interest” determination.⁷⁵

V. CONCLUSION

“Anyone who watches daytime television is bombarded with advertisements seeking to buy out structured settlements.”⁷⁶ But what people are not told is that they will be subjected to lengthy court review before completing their transactions, a process that requires legal sophistication and patience to understand.⁷⁷ For these individuals, Chapter 593 may be more than just an evaluation mechanism for the courts.⁷⁸ If the criteria of Chapter 593 provides clearer guidelines, it will assist the payee in “understand[ing] the significance of their decision, creating a time and process for reflection.”⁷⁹ Ultimately, Chapter 593 may be a way to ensure that “desperate” and “financially unsophisticated people” truly get what they bargained for.⁸⁰

69. HINDERT ET AL., *supra* note 19, at 16-64.

70. *Id.* at 16-65.

71. Settlement Capital Corp. v. State Farm Mutual Auto. Ins. Co., 646 N.W.2d 550, 556 (Minn. Ct. App. 2002).

72. HINDERT ET AL., *supra* note 19, at 16-67.

73. *Id.*

74. *Id.* at 16-69.

75. Fact Sheet, *supra* note 61.

76. *Id.*

77. Hindert & Ulman, *supra* note 11, at 20.

78. The Dolan Law Firm, *supra* note 58.

79. *Id.*

80. *Id.*