

# STRUCTURED SETTLEMENTS



## WHAT ATTORNEYS NEED TO LEARN FROM *Grillo v Pettiete*

By Christopher R. Gullen

Attorneys are increasingly at risk for legal malpractice for not recommending a structured settlement instead of a lump sum settlement. The potential damages in such cases can be huge. That is the lesson to be learned from the recently settled bellwether case in this area, *Grillo v Pettiete et al.* Because the matter was resolved prior to trial, no precedent-setting court opinion will be published. But the case remains a wake-up call on this important new area of litigation against attorneys.

In 1982, Christina Grillo was injured at birth at a hospital in Texas. She suffered quadriplegia, blindness, and seizures allegedly resulting from negligence of the attending physician. Life care plans prepared for the child pegged the cost of caring for the child over her lifetime at about \$20 million. During the pendency of a medical malpractice lawsuit against the physicians, the defendants offered a structured settlement costing \$1.2 million that would,

## FAST FACTS:

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***Structured settlement payments are income-tax free.***

over the lifetime of the child, have paid out more than \$100 million. The child's representatives rejected the structured settlement proposal and, in 1990, settled the case for a cash payment of \$2.5 million. The cash settlement was recommended by both the child's attorney and by the attorney appointed by the court as the child's guardian ad litem.

Like most lump sum settlements, Christina Grillo's cash settlement was completely gone within a few short years, and the family (and the taxpayers) was left to pay tens of millions of dollars in treatment for many years.

The Grillo family sued the child's attorney and the guardian ad litem for negligence and legal malpractice, arguing that the child's case should never have been settled for cash, and that the attorneys should have insisted upon a structured settlement. Eventually the defendants in the legal malpractice case settled for a combined amount in excess of \$4 million (a sizeable portion of which was structured!)<sup>1</sup>

Since *Grillo*, other cases have been filed against attorneys and other participants in personal injury cases where lump sums were accepted instead of structured settlements. There appears to be a growing consensus that in certain types of injury cases lump sum settlements are simply inappropriate.

These cases illustrate the liability exposure of attorneys and guardians of injured parties associated with lump sum settlements. A key problem with cash settlements is early dissipation: the money is spent before the needs of the injured party are met. The settlements are often intended to cover future medical expense and to replace loss of income due to physical injury. A 1992 California study found that in that state, 90 percent of all personal injury settlements were dissipated within five years of the settlement.<sup>2</sup> The average person under the age of 85 has a life expectancy greater than five years.

Structured settlements typically include both an immediate cash payment to take care of current needs and future payments often continue for the injured party's life-

time. Sometimes a structured settlement will also include future payments of lump sum amounts to meet special needs, such as college education, medical equipment purchases, or retirement funds.

Another important risk associated with the lump sum settlement is poor investment performance. Those injured parties wise enough not to burn up their cash settlements in reckless spending may well invest a portion of the settlement for growth, preservation, or both. The investment choices are many, and each has a different level of risk. Funds put into stocks and bonds are at the mercy of market fluctuations. Whether in the end the value of the investments will turn out to have grown or to have diminished is totally unknown when the investment is made.

With a structured settlement, the annuity premium amount is "invested" in the annuity, which typically makes payments over time. Based on either a guaranteed payout period or a life expectancy calculation, the total amount that will be paid out can be calculated. The difference between the cost of the annuity and the greater amount of the total to be paid in the future is the internal rate of return of the annuity. Currently, it is not unusual for structured settlement annuities to have internal rates of return of five percent or more. Since structured settlement payments are income-tax free, the taxable equivalent yield would be higher (a 5 percent tax free yield for a taxpayer in the 28 percent tax bracket would be equivalent to a 6.95 percent taxable yield).

Indeed, the fact that investment returns on invested cash settlements are taxable, while no portion of the structured settlement payments are subject to income tax is another important source of liability exposure

for attorneys. Similarly, lump sum settlements are subject to depletion through the loss of governmental benefits based on the value of owned assets.

Once liability for malpractice in failing to recommend a structured settlement is established, damages must be determined. The measure of damages is the difference between

what the plaintiff actually received and the amount he or she should have received, and the potential is huge. In *Grillo*, the lump sum settlement was \$2.5 million and the proposed structured settlement would have paid more than \$100 million, so the arguable damages for the attorney malpractice totaled more than \$97 million.

All of those risks can be reduced or eliminated by structuring at least a portion of a personal injury settlement. At a minimum, the attorney for the injured party needs to advise the client of the risks and benefits of both lump sum and structured settlements. Dr. Joseph W. Tombs, of Texas Tech University, expects to see attorneys asking their clients to sign "Grillo Waivers" in every physical injury case that settles with a lump sum payment. The waiver would include client acknowledgement that:

- the benefits of a structure were explained
- the dissipation and investment risks were explained
- the settlement decision is irrevocable
- competent financial and tax advice was offered.

The legal efficacy of such a waiver is subject to debate. Clearer is the increased need for personal injury attorneys and their clients to have a good understanding of structured settlements. ♦

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### FOOTNOTES

1. *Grillo v Pettiette et al.*, 96-45090-92, 96th District Court, Tarrant County, Texas.
2. "California Practice Guide: Personal Injury," The Rutter Group, Ltd., 1992.