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STRUCTURED SETTLEMENTS: ARE THEY HERE TO STAY?

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1. Introduction

Historically, monetary awards to an injured plaintiff, whether the result of an out of court settlement or a court judgment, have been made in a single, lump sum payment.¹ The use of the lump

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¹ *E.g.*, see Choulos, "Structured Settlements: Cure or Curse?" 16 *Trial* 73 (1980).

sum method of compensation has recently come under much scrutiny and criticism. The alternative which has been suggested is the structured settlement and statutes enabling judgments in the form of periodic payments. The primary concern of this article will be with structured settlements.²

Under the lump sum system of compensation, the present value of the injury or the loss of life must be determined. The award is to compensate for past losses, as well as for damages which would be sustained in the future (such as care expenses and economic loss). The size of the award is based on the exhausting fund principle. That is, "the court is faced with the task of determining the present value of a lump sum which, if invested, would provide payments of the appropriate size over a given number of years in the future, extinguishing the fund in the process".³

Comments on the inadequacy of this approach have come from many sources. Those representing the interests of insurers claimed that the awards were too large, and that plaintiffs typically squandered their awards. Legal writers commented on the lack of correlation between the injury and the compensation. There were comments that other jurisdictions had adopted alternatives to lump sum payments. Even our Supreme Court of Canada⁴ addressed the inadequacy of our current system.

A solution to this problem which has been used in Europe, the United States and Canada, is the structured settlement.

Basically, the structured settlement is an arrangement designed to meet the needs and desires of a plaintiff through an agreement in which payments are made in more than one instalment. They can range from an elementary plan consisting of one payment each year, to a sophisticated programme comprised of an initial lump sum payment, monthly indexed instalments, deferred payments,

² In this article I have drawn very heavily from the ideas of two structured settlement specialists, and from the lawyers that I have interviewed. I am grateful for the assistance provided by Frank McKellar and Bob McGlyn of McKellar Structured Settlements Inc., Leonard Feigman, Q.C., William A. Knights, W. Andrew McLauchlin, Richard J. Sommers and Brian H. Wheatley, Q.C. I am also grateful for the assistance provided by the Honourable Mr. Justice R. E. Holland, Rodney Hull, Q.C., Professor R. J. Gray, the partners of Woolley, Dale & Dingwall, Dr. L. Upenieks and John Upenieks.

I also acknowledge reliance upon material written by Frederick Luchak, Q.C. for the January 24, 1981 Law Society of Upper Canada Lecture on "Structured Damage Settlements".

³ *Keizer v. Hanna* (1978), 82 D.L.R. (3d) 449 at p. 462, [1978] 2 S.C.R. 342 at p. 352, 3 C.C.L.T. 316, 19 N.R. 209, *per* Dickson J.

⁴ See text accompanying footnote 18, *infra*.

endowments, and special provisions relating to the death of the insured. The funding of structured settlements is usually achieved through the purchase by the defendant insurer of an annuity.⁵

Although of only recent vintage, structured settlements are becoming increasingly popular. Most lawyers are enthusiastic as to their possibilities. One American lawyer has remarked that "the fact is that structured settlements are here to stay",⁶ and a Canadian lawyer has stated: "I believe one of the most significant changes in adjusting personal injury claims in this decade will be the use of the structured settlement".⁷

The structured settlement provides advantages to all parties. The plaintiff benefits from a guaranteed source of income for his lifetime without the attendant management expense, and from the fact that all payments received are tax free.⁸ A lump sum award is not taxable, but income generated from its investment is. On the other hand, the defendant obtains a cost savings since the total costs of the structure are usually less than those of the corresponding lump sum settlement.

We will examine here structured settlements as an alternative to lump sum settlements to resolve serious personal injury or fatal accident cases,⁹ with emphasis on their future utility. The history, advantages and disadvantages, and mechanics of structured settlements will be examined, as will the notion of judgments of periodic payments.

2. History

(1) Other Jurisdictions

The history of structured settlements is rather brief. Approxi-

⁵ An annuity is a financial vehicle designed to provide income payments on a regularly scheduled basis for a stated period of time, in return for a single premium paid in advance.

Annuities are the opposite of what is commonly known as "life insurance". A life insurance policy pays out *upon* the death of the insured, whereas an annuity pays *until* the death of the insured. As such, it is the annuity which is truly "life" insurance.

⁶ Choulos, *supra*, footnote 1 at p. 76.

⁷ Wheatley, "Structured Settlements", *The Canadian Independent Adjuster*, 10 (1980), at p. 10.

⁸ The income tax consequences of lump sum payments and of structured settlements are dealt with, *infra*, at pp. 411-12.

⁹ In practice, structured settlements have been primarily used to resolve serious personal injury or fatal accident cases. The reason for this is that such cases involve large awards and therefore make it financially feasible to incur the extra expenses necessary to set up a structured settlement.

mately 30 years ago, European countries initiated the use of annuities in the settlement of personal injury cases.¹⁰ Today, they remain the chief form of compensation for permanent disability and wrongful death in Sweden.¹¹ In fact, the Swedish position is that whenever compensation for permanent disability or death is of fundamental importance to the maintenance of the plaintiff, annuities are to be awarded unless there are special reasons for providing lump sums.¹² France, Australia, Germany and New Zealand also utilize periodic payments, but in those countries, settlement is most often by lump sum payments.¹³

Annuities have been used for approximately 25 years in the United States to settle catastrophic injury cases.¹⁴ Originally, structured settlements were entered into in order to protect minors or legally incompetent individuals,¹⁵ but they are now being used in many other cases of severe personal injury or death. In the late 1960's, structured settlements were used to dispose of some of the litigation concerning the thalidomide controversy.¹⁶

As the magnitude of verdicts in the United States increased, structured settlements were used with increasing frequency by casualty insurers as a cost-saving device. A recent survey of U.S. casualty insurers showed that 28% had utilized structured settlements, and that 21% had not, but wanted to do so.¹⁷ Proponents of structured settlements suggest that structured settlements would be more popular if it were not for plaintiff's lawyers who are unaware of the advantages of structured settlements, and believe that their contingent fee would be too low.

(2) The Experience in Ontario

In Ontario, structured settlements are no longer a theoretical possibility but rather a practical reality. Incentive was provided by proposals made by Mr. Justice Dickson of the Supreme Court of Canada. Dickson J. said the following:

The subject of damages for personal injury is an area of the law which cries

¹⁰ O'Connor and Smith, *Catastrophic Injury Annuities Revisited* (unpublished), p. 3 hereafter "O'Connor and Smith".

¹¹ *Ibid.*

¹² Skadestandslagen (1972:207), Chapter 5, s. 4.

¹³ O'Connor and Smith, at pp. 2-4.

¹⁴ *Ibid.*, at p. 1.

¹⁵ Paper presented by Leroy J. Grossman and John E. Norton at the 1979 ATLA Convention in Houston (August 1979), at p. 1.

¹⁶ Open Forum, "Annuities to Settle Cases", 42 *Ins. C.J.* 367 (1975), at pp. 370-7.

¹⁷ O'Connor and Smith, *supra*, footnote 10 at p. 1.

out for legislative reform . . . 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 difficulties are greatest where there is a continuing need for intensive and expensive care and a long term loss of earning capacity.¹⁸

Dickson J. made similar statements outside the court-room.¹⁹

Not surprisingly, structured settlements are being used more often. Settlements have been reported in newspapers and magazines,²⁰ and the Law Society of Upper Canada has held a special continuing education lecture to acquaint lawyers with this concept.²¹ Similarly, the Ontario Advocates' Society had a presentation on structured settlements.²² The Committee on Tort Compensation, chaired by Mr. Justice R. E. Holland, has reported on the desirability and feasibility of instituting a scheme in Ontario for the periodic payment of judgments and for the variation of judgments.²³ Judicial response to structured settlements has also been favourable.

3. Mechanics of a Structured Settlement

To comprehend the structured settlement and its uses, it is necessary to comprehend its basic components, and how it is typically negotiated. Reference should be made to the Appendix at the end of this article which shows the steps leading to a struc-

¹⁸ *Andrews v. Grand & Toy Alberta Ltd.* (1978), 83 D.L.R. (3d) 452 at p. 458, [1978] 2 S.C.R. 229 at p. 236, 3 C.C.L.T. 225, [1978] 1 W.W.R. 577, 8 A.R. 182, 19 N.R. 50.

¹⁹ Goodman Lecture, University of Toronto, 14 Law Society Gazette 138 (1979), at pp. 149-50.

²⁰ E.g., see Carriere and Matas, "Girl Get \$500,000 Annuity to Compensate for Accident", *The Globe and Mail*, November 27, 1980, at p. 5; *The Toronto Sun*, "Crippled Crash Victim Gets \$10M", November 28, 1980, at p. 21; Corner, "Annuity System Worked Out to Pay Disabled Girl's Award", *The Toronto Daily Star*, November 29, 1980; Brazao, "Disfigured Man, 26, Could Get \$14 Million", *The Toronto Daily Star*, December 16, 1980, at p. 2; Carriere and Mulgrew, "Disfigured in Blast, Man Gets \$16 Million Settlement", *The Globe and Mail*, December 16, 1980, at p. 5; Hollobon, "Out-of-Court Settlement Gives Man \$1.8 Million", *The Globe and Mail*, January 17, 1981, at pp. 1-2; Monopoli, "'Sued or Suing' Both May Win With Annuity", *Financial Post*, July 19, 1980, at pp. 1-2; *The Toronto Daily Star*, "Crippled Girl's Pain Can't be Lessened By Cash, Says Father", Wednesday, January 6, 1982, at p. 6; *Maclean's* "Passages", January 18, 1982, at p. 4.

²¹ Luchak, "Structured Damage Settlements", January 24, 1981, Continuing Education Programme of the Law Society of Upper Canada.

²² McKellar, "Structured Settlement Presentation for the Advocates Society" (Fall Convention, 1980).

²³ Ontario Committee on Torts Compensation (August, 1980).

tured settlement and a consent judgment for an actual fact situation.

(1) Funding the Settlement

The casualty company can fund the payments in several ways. Although significant savings for the casualty company result from negotiating the structured settlement and the cost of alternative methods of funding vary little,²⁴ it is nevertheless worthwhile to consider some of the funding options.

A trust fund can be set up for the claimant. The trustee, usually a trust company, will, in return for a fee for trust administration, invest the settlement money, and will make periodic payments from the income generated. The trust fund can prevent reckless dissipation of the estate, but one disadvantage is its vulnerability to general economic conditions.²⁵ The trust fund may be depleted and future payments cannot be guaranteed. A second disadvantage of the trust scheme is that all interest is taxable. Taxation of the payments distinguishes this scheme from what we commonly know a structured settlement to be.

A second possibility is to have the casualty company underwrite its own annuity plan. The casualty company could then make payments out of its reserves. Casualty companies are reluctant to adopt this approach because of problems of administration, the lack of finality, continuing contingent liability, the necessity to maintain adequate reserves and their general lack of expertise in this field.²⁶ Furthermore, under this scheme, the potential financial failure of the insurer is of concern to the plaintiff.

By far the most popular funding scheme is for the casualty insurer to purchase an annuity from a life insurance company. The casualty insurer pays the entire premium, and typically insists on being absolved of all further liability upon payment of that premium.²⁷ For the plaintiff to receive the payments free of any tax liability, the casualty insurer, and not the plaintiff, must be the owner of the annuity.²⁸ The defendant's casualty company is the

²⁴ Ringle Associates, Incorporated, "The Use of the Annuity in the Individually Designed Settlement of Severe Personal Injury Lawsuits" (Newport Beach: date unknown), p. 5, reports that alternatives for funding structured settlements vary only 2% to 5%.

²⁵ Verbeck and Michaels, "Structured Settlements and the Uniform Periodic Payments Act", 29 Fed. Ins. Coun. Q. 17 (1978), at pp. 18-19.

²⁶ Luchak, *supra*, footnote 21 at p. 9.

²⁷ *E.g.*, see para. 3 of the consent judgment in the Appendix, *infra*.

²⁸ See discussion at pp. 411-12, *infra*.

“owner” of the annuity and the “annuitant”, the plaintiff is the “payee”, and the “beneficiary” (if any) is the plaintiff’s estate.

The annuity must also be non-commutable and non-assignable.²⁹ This is to keep payments tax free, and to protect the claimant from dispersion of his award.

(2) Components of the Financial Package

The beauty of structured settlements is that they are flexible and can provide a financial package designed to meet the plaintiff’s specific needs. The basic annuity has been likened to a Christmas tree,³⁰ for on it can be hung various ornaments or features.

Most structures have a lump sum initial payment. This “up front” money is used as payment for outstanding medical and hospital bills not paid for by OHIP,³¹ lost wages to date, loss of services, out of pocket expenses incurred by the injured party, and legal fees.³² Up front money may also be provided for the purchase or construction of appropriate housing, automobiles and equipment. There will also usually be a net amount for the discretionary use of the claimant.

The periodic payments do not have to be paid annually, but may be paid on a semi-annual, quarterly, or monthly basis. There can be immediate payment, starting immediately after settlement or judgment, or deferred payments.³³ Payments may remain constant, but are usually indexed to be increased at a stated annual compounded rate of interest.

Annuity payments are usually made during the life of the plaintiff. As a safeguard against loss of capital, claimants may seek a guaranteed period. Should the claimant die before the expiry of this period, the remaining payments are made to a designated

²⁹ *E.g.*, see para. 3 of the consent judgment in the Appendix.

³⁰ Open Forum, *supra*, footnote 16 at p. 367.

³¹ It is interesting to note that structured settlements do not pose a problem for the Ontario Ministry of Health. Although the equitable right of subrogation is retained for occupier’s liability, professional negligence, and accidents involving vehicles other than motor vehicles, a “bulk subrogation agreement” has been entered into between the ministry and insurers. This agreement applies to motor vehicle accidents occurring after November 30, 1978. The ministry anticipates future medical expenses for injured plaintiffs by requiring a payment based on premiums collected by the insurance companies in previous years. Structured settlements do not impair the bulk subrogation agreement.

³² Evans, “Structured Settlements — A Useful Tool in Catastrophic Injury Cases”, 33 *Mo. B.J.* 419 (1977), at pp. 421-2 outlines the purposes of up front money.

³³ A deferred annuity is used where the plaintiff does not have any anticipated need for regular income. Such an annuity is often used for infant plaintiffs, as it was in the fact situation illustrated in the Appendix where the annuity payments only commence once the plaintiff attains the age of 19.

beneficiary. A similar feature available to the casualty insurer is a cash refund or reversionary interest. Upon the early death of the plaintiff, the casualty insurer can seek a partial return of the premium paid to the life insurer to purchase the annuity.³⁴

Furthermore, a structured settlement may include a deferred general damage payment. This may enable the claimant to purchase property or commence a business venture.

Two caveats should be noted. First, although negotiations allow much flexibility, once the structure has been determined, it may not be changed. Second, each feature increases the price of the structure. One insurer has stated that structured settlements "Provide for their [the claimants'] needs ... satisfy their wishes ... but at our price".³⁵ The more features in the structure, the smaller the periodic payments.³⁶

(3) When Structuring may be Appropriate

It is to be stressed that structured settlements are not a panacea; they are merely another means of resolving a claim for compensation for catastrophic injuries or death. From the claimant's standpoint the structured settlement may be useful in the proper circumstances, but it is not always advantageous. The plaintiff's lawyer must still estimate the maximum value of his case, and then comparatively evaluate the structure. The appropriateness of structuring is best left to bargaining between the parties.

None the less, some cases are more adaptable to structuring. A litmus test may be derived from the size of the award, and from the type of injury.³⁷ Be that as it may, a more telling guide-line obtains from scrutinizing the plaintiff's circumstances.

(a) Plaintiffs in a high marginal tax bracket

Even if the damages are low, if the plaintiff is in a high marginal

³⁴ When there is a cash refund or reversionary interest, the difference between the initial premium and the amount that has been paid out by the annuity company is returned. For example, if the annuity costs \$500,000 and only \$300,000 has been paid out, the casualty insurer would get a return of \$200,000. However, this feature increases the cost of the annuity.

³⁵ Ringler Associates, *supra*, footnote 24 at p. 10.

³⁶ This assumes that a fixed premium is used to fund the structure.

³⁷ Lilly has suggested a cut-off point of injuries with a dollar value of over \$100,000, where the injury is a dismemberment, permanent partial disability, permanent total disability, or temporary partial disability: Lilly, "Alternatives to Lump Sum Payments in Personal Injury Cases", 44 *Ins. C.J.* 243 (1977), at p. 244.

tax bracket, structuring may be preferable. Investment income from a lump sum award will be taxed at that marginal rate. For a taxpayer at the top combined tax rate of 62.78% for Ontario residents, a tax-free receipt of \$10,000 is equivalent to taxable investment income of over \$26,000.³⁸

(b) Receipt of large awards

Investment of a large award may create so much taxable income, that this income alone, or when combined with other sources of income, will put the plaintiff into a high income tax bracket.

(c) Infants' claims

These are dealt with later in this article.³⁹

(d) History of financial mismanagement

Where there is *bona fide* evidence that the plaintiff will be unable to manage his funds, the security of capital and the lifetime, guaranteed indexed income without the necessity of extensive financial planning may be preferable to the risks of improvident dissipation. This would be most appropriate where the plaintiff has long-term needs.

(e) Where the lump sum award exceeds the defendant's policy limits

There have been cases where the size of the conventional awards exceeds the defendant's policy limits, but where a structured settlement could be arranged for a premium at or below those policy limits. Such an arrangement would have advantages for all parties concerned. The defendant's personal assets will be sheltered from exposure, the casualty insurer has a cost saving to the extent that the premium is below the policy limits and the plaintiff is spared the risks of seeking recompense from the defen-

³⁸ This calculation is based on 1981 tax rates. Section 117(5.1)(m) of the *Income Tax Act* provides that the highest rate of federal tax is 43%. Grossing this figure up by the Ontario tax rate of 46% yields a combined tax rate of 62.78% (*i.e.*, 43% x 1.46). Approximately \$26,867 of pre-tax investment income is needed to yield \$10,000 of after-tax income (*i.e.*, \$26,867 x 37.22% = \$10,000). This calculation disregards other factors such as tax planning and medical deductions. For the 1982 taxation year, the Ontario provincial tax rate is 48% and the highest federal tax rate proposed in the November 12, 1981 budget is 34%.

³⁹ See discussion at pp. 412-15, *infra*.

dant's personal assets.⁴⁰ Although it may be an error in law to regard the ability of a defendant to pay as a relevant consideration in the assessment of damages, as a practical matter, the ability of most defendants to pay extends only to their insurance coverage and a few other assets.

(4) Negotiating the Structured Settlement

When structured settlements were first introduced into Ontario, it was the defendant's counsel who devised a structure and offered it to the plaintiff's counsel. Today, either counsel may initiate the process, and they typically do so through a structured settlement specialist.⁴¹

Although special considerations apply to the negotiation of a structured settlement,⁴² the basic negotiation principles applicable to settlements in general are applicable.⁴³

(a) Actual value of the case

For any personal injury or fatal accident case, the plaintiff's lawyer must first determine the plaintiff's needs and the actual value of his case. Data bases, economic forecasts and tax consequences must all be considered. A lawyer is doing a disservice to his client if he short-circuits this process.

(b) Present value of the settlement package

The cost of the annuity to the carrier or the present value of the annuity must be calculated so that this figure may be compared to the actual value of the case. Attractive though the package may seem at first blush (who is not impressed by figures like those in the Appendix), the plaintiff's lawyer must determine how much the package is really worth,⁴⁴ especially since the defendant is offering this package in an attempt to save money.

⁴⁰ Future litigation may involve the possible bad faith of a casualty insurer to merely offer a lump sum payment at the insured's policy limits, without exploring the possibility of protecting the insured's assets through use of a structured settlement. Likewise, negligence may be alleged against a plaintiff's lawyer who does not explore the possibility of a structured settlement. See McKellar, "Structured Settlements — A Current Review (1981, unpublished), at pp. 7-8."

⁴¹ For a discussion of the role of the structured settlement specialist, see p. 404, *infra*.

⁴² The special considerations applicable to negotiating and evaluating a structured settlement, discussed, *infra*, are those propounded by Tinsman, "What's it Really Worth: Evaluating Annuities for Settlement Purposes", 14 *Trial* 30 (1978); see also Appendix.

⁴³ *E.g.*, see Kelner, "Settlement Techniques Part One", 16 *Trial* 39 (February, 1980) and "Settlement Techniques Part Two", 16 *Trial* 35 (March, 1980).

The American view seems to be that defendant's counsel should not reveal the cost of the package, for the plaintiff should be concerned only with the benefits which will accrue to him, and not with the defendant's costs. Although an estimate may be available from other life insurers, the plaintiff should demand to know the defendant's costs for three reasons. First, costs of annuities vary significantly between companies. Second, this cost is necessary for comparison to the actual value of the structure. Third, negotiation demands good faith and fair play. The Canadian practice seems to be that plaintiff's counsel will not recommend a package to his client unless the costs thereof are revealed to him.⁴⁵

Plaintiff's counsel must not be overwhelmed by his client's potential tax savings. There is nothing wrong with the defendant seeking to share in these savings, but the defendant must not reap all the benefits. Plaintiff's counsel must evaluate whether, notwithstanding the resulting tax on investment income, the appropriate lump sum settlement would not yield fairer compensation.

(c) An adequate inflation factor should be provided

Once a settlement is reached, its terms cannot be varied. This principle, coupled with the stark reality that these periodic payments may be the plaintiff's only source of income, require an evaluation as to whether the rate of indexing will be sufficient to meet the demands of inflation. It is not enough to consider only the general rate of inflation. The increased costs of other significant items such as health care costs not reimbursed by OHIP must be evaluated.⁴⁶

⁴⁴ As a general rule in Ontario, a structured settlement is usually equivalent to a lump sum payment of between 1.5 and 2 times the cost of the settlement. That is, a settlement costing the defendant \$500,000 will provide the plaintiff with the same benefits as a lump sum payment of between \$750,000 and \$1,000,000. In the settlement in the Appendix, a settlement costing the defendant \$585,000 is equivalent to a lump sum award of \$1,163,000.

⁴⁵ The Canadian approach to structured settlements appears to be more advanced and civilized than in the United States. In the United States, structured settlements are seen as the solution to high personal injury awards. Defendants seem primarily interested in cost savings, and not in fair compensation nor in fair play during negotiations. In contrast, in Ontario all parties adopt a more frank and open approach in providing adequate compensation. Defendants do not resort to deception to maximize their savings.

⁴⁶ See footnote 85, *infra*.

(d) Guaranteed minimum payment

Structured settlements typically provide that a minimum payment will be made regardless of the premature death of the claimant.⁴⁷ This is intended to prevent a shortfall for the claimant. The settlement may specify the beneficiary who is to receive the balance of the guaranteed amount in the event that the plaintiff dies before the guaranteed amount is paid, but this is usually done outside the structure by will.

(e) Tax-free payments to the plaintiff⁴⁸

The basic advantage of structured settlements over purely lump sum awards from the plaintiff's viewpoint is the tax consideration. Plaintiff's solicitor must pay careful attention to detail to ensure that this benefit does indeed flow to the plaintiff, since the defendant benefited from a lower settlement cost in recognition of this saving.

(f) Scrutiny of the life insurance company

Plaintiff and defence counsel should be certain that the annuity company has the expertise to quote on non-standard lives.⁴⁹ Annuity payments are based upon life expectancies. If the plaintiff has a truncated life expectancy, he/she should be entitled to the concomitant higher periodic payments. Both counsel should also verify the financial security of the annuity company.⁵⁰

The plaintiff must be informed of the negotiations, and should participate in planning the settlement. The reason is the permanency of the structure, and because the final decision as to whether to accept a settlement offer is his.

(5) Emerging Role of the Structured Settlement Specialist

The field of tort compensation and structured settlements is becoming increasingly complex. To accommodate this complexity in the area of structured settlements, counsel often turn to a structured settlement specialist. This specialist must understand tort,

⁴⁷ The guaranteed cumulative minimum payment in the settlement in the Appendix is over \$1,700,000.

⁴⁸ See discussion at pp. 411-12, *infra*.

⁴⁹ *E.g.*, the injured plaintiff considered in the Appendix was medically rated as being 18 years older than her chronological age.

⁵⁰ See discussion at pp. 415-16, *infra*.

contract, tax and insurance law, how annuities work, the litigation process, the casualty company's method of reserving and methods of re-insurance, and possible alternative payment plans.⁵¹ He must provide the technical expertise required for the specialized negotiations. Because of the large sums involved, the structured settlement specialist's role is a vital one.

The specialist may be retained by counsel for either the plaintiff or the defendant.⁵² Although he cannot be completely neutral, he must be aware that his primary task is to provide for the needs of the plaintiff through creative and equitable settlements.

In the ordinary course of events, the casualty insurer asks the structured settlement specialist to devise a structure which can be purchased for a stated amount. The structured settlement specialist then works with an actuary and price quotations obtained from various annuity companies to construct proposed schemes of payment. These schemes are then offered to the plaintiff for approval.

4. Advantages Over Lump Sum Payments

Proponents of structured settlements have stated that structured settlements have many advantages over conventional lump sum awards. Critical analysis suggests that some of these advantages are not valid, or that they are over-emphasized.

Yet, four very real advantages are the plaintiff's tax savings, cost savings for the casualty insurer, a protection of the defendant's personal assets from exposure and the provision of a guaranteed source of income to a plaintiff who may be prone to financial mismanagement.

(a) Tax advantages

These are dealt with later in this article.⁵³

(b) Cost savings for the defendant

The casualty insurer can resolve a case more cheaply by demanding to share in the plaintiff's tax advantages, or by reason

⁵¹ McKellar, *supra*, footnote 40 at p. 9.

⁵² Although retained by counsel for either the plaintiff or the defendant, the structured settlement specialist receives his payment in the form of a commission from the annuity company.

⁵³ See discussion at pp. 411-12, *infra*.

of the plaintiff's unfamiliarity with structured settlements.⁵⁴ In addition, the settlement can be structured so that a portion of the funds may be returned to the casualty company if the plaintiff dies prematurely, thereby reducing the net settlement cost of the casualty insurer.⁵⁵

Structured settlements have been heralded as a solution to the high cost of insurance, particularly of malpractice insurance.⁵⁶ This thinking is most prevalent in the United States.⁵⁷

(c) Saving the defendant's personal assets from exposure

The appropriate lump sum award may exceed the policy limits of the defendant's insurance and may threaten his personal assets. A structured settlement may be arranged within those policy limits, thereby saving the defendant's personal assets from exposure.⁵⁸

(d) Safeguards against improvident disposition

An insurance industry survey which is often cited by those supporting structured settlements, found that the life span of a large cash payment to injured parties is as follows:

Within two months of settlement, 2.5 out of 10 have nothing left.

Within one year of settlement, 5 out of 10 have nothing left.

Within two years of settlement, 7 out of 10 have nothing left.

Within five years of settlement, 9 out of 10 have nothing left.⁵⁹

The argument is that the lump sum is often prematurely dissipated by the claimant, with the result that he becomes a ward of the state, dependent upon public support.⁶⁰ The calculation of the

⁵⁴ A naïve plaintiff's solicitor may fail to perform the analysis suggested at pp. 400-5, *supra*, and may merely look to the benefits which will accrue over the years.

⁵⁵ See, *supra*, footnote 34 and accompanying text.

⁵⁶ *E.g.*, see speech by Dr. Jamplis, President of the American Group Practice Association, to the 1975 National Conference on Medical Malpractice (Spring, 1975); Busek, "Those Lifetime Malpractice Settlements — They Make Sense", *Med Ec.* 1 (1974); Roth, "The Medical Malpractice Insurance Crisis: Its Causes, The Effects and Proposed Solutions", 44 *Ins. Couns. J.* 469 (1977), at p. 498.

⁵⁷ In Canada, due to the efforts of the Canadian Medical Protection Association and other factors, malpractice is not such a problem.

⁵⁸ See discussion at pp. 401-2, *supra*.

⁵⁹ *E.g.*, see Cave "Structured Settlements: An Alternative Resolution of Claims Involving Death or Substantial Personal Injury", 37 *The Advocate* 331 (1979), at p. 333. The interesting feature of this "survey" is that the actual survey cannot be found. Any references to the survey are merely references to sources in which it has been cited. The true origins of this survey remain a mystery. Although the incidence of dissipation seems high, one cannot dispute that dissipation none the less does occur.

⁶⁰ *E.g.*, see Krause, "Structured Settlements for Tort Victims", 66 *A.B.A.J.* 1527 (1980), at p. 1527.

adequacy of the lump sum requires not only protection of principal, but also a reasonable return on the investment to compensate adequately for the injury. The risk of the investment of the lump sum, plus any investment fees which must be paid,⁶¹ must be borne by the claimant. In comparison, a properly designed structured settlement not only protects the claimant, but also resolves many of his financial planning problems, as he is forced to adopt money management techniques. The danger of yielding to the temptation not to ration money intended for use over a long period of time is eliminated.

Be that as it may, is improvident use of the funds a proper concern or only a practical one? Is it not distasteful to restrict a claimant's options? Why should individuals be treated differently from corporations that sue one another? Are we not imposing paternalistic notions on our free enterprise system? Should we all be restricted in our spending so that we too do not become burdens to society? However, these concerns can be met by restating that structured settlements are only an option. Because they are not mandatory, plaintiffs can reject them.

Perhaps the proper approach is to avoid sweeping restrictions, and to consider only the real propensity to dissipate assets.⁶²

(e) Availability and affordability of insurance

The size of lump sum awards is said to affect the availability and affordability of insurance.⁶³ The public interest demands lower premiums. Cost savings from increased use of structured settlements could presumably be passed on to consumers.

None the less, it should be realized that the insurance lobby is a very powerful one, and is always claiming that settlements and judgments are too costly. Judgments of periodic payments should not be legislated until the proof of an insurance crisis is much stronger.

(f) Legal fees

As payment for their services in settling a claim, many

⁶¹ Lump sum awards often designate ¼ % of the total award as being for investment advice.

⁶² E.g., see Corboy, "Structured Injustice: Compulsory Periodic Payment of Judgements", 66 A.B.A.J. 1524 (1980), at p. 1526; Committee on Torts Compensation, *supra*, footnote 23 at p. 25.

⁶³ Henderson, "Periodic Payments of Bodily Injury Awards", 66 A.B.A.J. 734 (1980), at p. 734.

American lawyers elect a deferred receipt of their fees.⁶⁴ A separate annuity may even be purchased to fund legal fees. This is not a true advantage in Canada, because income must be reported as earned, not when received.

(g) Flexibility

Due to their flexibility, structured settlements can be tailored to fit the claimant's particular circumstances. However, once determined they cannot be changed. Like lump sum payments, they may fail to accurately reflect economic changes affecting the future value of awards. A great deal of speculation remains.

Structured settlements thus have only an initial flexibility. To be truly flexible, the payments must be reviewable.⁶⁵

(h) "Prophetic shortfall"

Under the lump sum system, the plaintiff who lives too long suffers from the inadequacy of the award. On the other hand, if the plaintiff dies soon after the award and much sooner than expected, although his heirs reap a windfall, he is unable to enjoy the benefit of this over-compensation. This situation has been termed the plaintiff's "prophetic shortfall".⁶⁶

Structured settlements seek a more equitable approach by continuing the annuity payments so long as the claimant lives (even past his life expectancy). Structured settlements can anticipate premature death by guaranteeing a minimum number of payments to victims or their families, notwithstanding the intervening death of the victim, and by providing for lump sum payments to members of the plaintiff's family upon his untimely death.

(i) Preference to regular payments

Periodic payments recreate the manner in which future income would have been received had the injury or death not occurred. Our welfare society has shown an increased use of regular payments (*i.e.*, social insurance payments, pensions, disability income and retirement income) to provide a financially secure future. Even so, this is not an adequate reason to depart from our conventional awards.

⁶⁴ *E.g.*, see Choulos, *supra*, footnote 1 at p. 75.

⁶⁵ Reviewable payments could be altered as the plaintiff's needs change.

⁶⁶ Prevett, "Actuarial Assessment of Damages", 35 *Mod. L. Rev.* 140 (1972), at p. 258.

(j) Speed of settlement

Structured settlements are said to enhance the probability of an early settlement by reducing the plaintiff's anxiety that his future depends on a single lump sum.⁶⁷ In a system of lump sum recovery, the plaintiff is thought to delay the trial in order to obtain the best evidence of the long-term effects of his injury.

This argument is not acceptable. First, even under a non-reviewable structure, compensation depends upon a once and for all award. Second, congestion in our courts is not a major problem. Third, fair compensation should be the measuring stick. Fourth, defendants themselves often desire delays. Fifth, plaintiffs often do not want a settlement until they are medically stabilized.

5. Advantages of Lump Sum Recovery

Critical analysis reveals certain deficiencies in the structured settlement approach.

(a) A trap for the unwary

Uninformed plaintiffs, unfamiliar with the impact of current inflation rates on future costs, and unskilled in the mathematics of present value calculations, may believe that the structure offered is fantastic, whereas it is actually grossly inadequate.⁶⁸ The plaintiff must also be concerned with the financial stability of the annuity company.⁶⁹

(b) Combating inflation⁷⁰

Some maintain that structured settlements are an inadequate protection against the ravages of inflation. Plaintiffs are "locked-in" to the structure, and the indexing rate fails to compensate for the inflationary spiral.

Capital awards, on the other hand, in the hands of a prudent investor (including one prudent enough to seek investment

⁶⁷ Patterson, "Areas Where a Life Insurer May Serve the Needs of the Casualty Insurer Using Inflation-Adjusted Life Insurance and Annuity Products" (1981, not yet published), at p. 5.

⁶⁸ *Ibid.*, at p. 4. See also discussion at pp. 400-5, *supra*.

⁶⁹ See discussion at pp. 415-16, *infra*.

⁷⁰ See discussion at pp. 414-15, *infra*.

advice) are not burdensome, and give the plaintiff many options. One writer has stated that these options are usually used in investments that are relatively impervious to inflation.⁷¹ *Quaere*, whether there are any long-term investments which safeguard against inflation.

(c) Appropriate compensation for future lost earnings

Canadian and British cases hold that a claim for future lost earnings is a claim for a capital asset.⁷² The plaintiff loses a capital asset, so he should be entitled to receive a capital sum in compensation.

(d) Unnecessarily large insurance policies

The press has "sensationalized" structured settlements.⁷³ Members of the public may be lured into increasing their insurance protection by reports of large awards, not realizing that the awards are only potential awards spread over many years.

(e) Restrictions on freedom of movement⁷⁴

Plaintiffs should be entitled to move to another jurisdiction as they desire. For the severely injured plaintiff, a warm southern climate is an attractive alternative to harsh Canadian winters.

For example, a plaintiff may renege on a move which is preferable for rehabilitation because he is unsure whether payments will continue in that other jurisdiction. Alternatively, he may choose a lump sum payment on the premise that periodic payments will not follow him into another jurisdiction.

However, this argument appears to be an academic, rather than a practical one. It is doubtful whether plaintiffs have such concerns. If they do, they should voice them to their counsel, so that they can be instructed that payments will continue regardless of their residential status.

⁷¹ Fleming "Damages: Capital, or Rent?", 19 U. Tor. L.J. 295 (1969), at p. 313.

⁷² *E.g.*, see *The Queen (in right of Province of Ontario) v. Jennings* (1966), 57 D.L.R. (2d) 644, [1966] S.C.R. 532; *Pickett v. British Rail Engineering Ltd.*, [1978] 3 W.L.R. 955 (H.L.).

⁷³ See footnote 20, *supra*.

⁷⁴ This advantage of lump sum payments was given by Professor Ison of Osgoode Hall Law School in an interview (April 7, 1981).

6. Special Considerations

(1) Tax Consequences

The position of Revenue Canada is that awards in respect of personal injuries or death will be treated as non-taxable receipts provided that they can reasonably be considered as compensation in respect of personal injuries or death.⁷⁵ This is true whether the method of payment is a lump sum award or a periodic payment.⁷⁶

However, where there is a lump sum award, the investment income generated from the award is subject to taxation just like other investment income. For a large award, there will be much investment income in subsequent years, and therefore much potential tax liability.

In contrast, where there is a structured settlement, none of the periodic payments are taxable. This is so even though the payments contain an interest element. Revenue Canada believes that the method of payment is not an important factor in determining the taxability of an award.⁷⁷

To ensure this tax-free benefit of structures, it is essential that the casualty company be both the owner of the annuity and the annuitant.⁷⁸ If the taxpayer or his representative uses the award to purchase an annuity, the amounts received will be considered to be annuity payments and will be taxed as such.⁷⁹

In the end result, an analysis of tax consequences shows that the claimant is often better off to receive periodic payments, none of which are taxable, than to receive a lump sum payment, the invested income from which will be taxable. This is but a general rule.⁸⁰ The plaintiff's circumstances must be taken into account.

⁷⁵ IT-365, "Damages, Settlements and Similar Receipts" (March 9, 1981), para. 5.

⁷⁶ *Ibid.*, at para. 6. See also: letter from Director, Non-Corporate Rulings Division of Revenue Canada Taxation to Mr. J. Fiorino of Price Waterhouse & Co. (June 2, 1980); letter from Director, Non-Corporate Rulings Division of Revenue Canada Taxation to Mr. Frank McKellar (April 23, 1980); letter from Director, Non-Corporate Rulings Division of Revenue Canada Taxation to Mr. Frank McKellar (July 2, 1980).

⁷⁷ IT-365, *supra*, footnote 75. Note also that annuity payments from structures are non-taxable in the United States (Rev. Ruling 79-220).

⁷⁸ IT-365, *supra*, footnote 75 at para. 13.

⁷⁹ The *Income Tax Act*, S.C. 1970-71-72, c. 63, as amended by S.C. 1979, c. 5, taxes annuity payments by including them as income under ss. 3 and 56(1)(d), but allowing a deduction for a "capital" element in accordance with s. 60(a). That is, the interest element of annuity payments is taxable income.

⁸⁰ See, *supra*, footnote 44.

It should however be noted that Revenue Canada's position is subject to change.⁸¹

(2) **Infant Plaintiffs**

The situation of infant plaintiffs warrants special consideration for three reasons. First, the inability of the lump sum payment to provide adequate and lasting compensation for the severely injured is amplified when the plaintiff is an infant. Proper planning attains increased importance. Second, special income tax provisions are involved. Third, the role of the official guardian bears scrutiny.

(a) **Heightened inadequacy of lump sum recovery**

Markell⁸² argues that the lump sum system leads ultimately to massive under-compensation of the child victim. This he attributes to the initial problem of assessing the economic value of the child's physical injury, and to the second problem of the optimal distribution of the award to the child.

The information necessary to assess the long-range needs of the infant plaintiff in order to determine present values is highly speculative due to large errors in the data base and in forecasting models. Long-range forecasts are inherently speculative because of the requirement of present assessment of all future damages and of the long period of time over which a child's disability may extend. The injured four year old without a shortened life expectancy must be compensated for 70 years' worth of damages in one lump sum. If the basic assumptions prove to be even slightly inaccurate, the consequences over the years are tremendous.⁸³ Errors in the data base mitigate against accurate long-term projections. Unlike adults, children have neither education nor work experience upon which to base a prediction of lost earning

⁸¹ None the less, there are no indications that the income portion of structured settlements will be taxable. Revenue Canada recognizes that structures serve a public need in providing income security. Furthermore, they do not represent a true loophole because restructuring your finances will not entitle you to this advantage; only being hit by a truck will.

⁸² Markell, "Children Take Their Lumps — The Sorry State of Children's Tort Recovery", 12 U.C.D.L. Rev. 797 (1979).

⁸³ Assuming, for example, at a 70-year period of expected disability and a 5% inflation and discount rate, an overcalculation of 1% in the inflation rate results in a 41% increase in the initial award. Similarly, a 1% overcalculation of the discount rate results in a 27% reduction in the initial award. If the disability period is overestimated by ten years, the award will be 23% too large. See Markell, *ibid.*, at p. 806.

capacity. As a result, courts have to resort to the objectionable practice of using average employment prospects, rather than seeking compensation for the individual. Future medical expenses are also difficult to estimate due to the plasticity and constant development of children's bodies.⁸⁴ Regardless of the plaintiff's age and the current state of his injuries, the trier of fact must still assess all future effects of the injuries at the time of trial.

Furthermore, current economic models do not produce correct predictions even over the short term. Lost earning capacity is difficult to predict, but the costs of future medical care may be even more difficult to forecast.⁸⁵

These assessment problems make compensation more a matter of speculation and chance than of informed analytical calculation.

Distributional problems mean that less income typically flows into the plaintiff's hands. This is an argument often made for lump sum payments to any plaintiff, but in the case of the infant plaintiff, improvident management of the fund and its early dissipation seem more likely.

(b) The importance of planning

The role of counsel is crucial, for he will essentially plan the infant's entire economic future. A budget for life must be implemented. A sufficiently large sum must be paid into court to provide for contingencies.⁸⁶ The periodic payments and deferred lump sums must also anticipate future economic trends and the plaintiff's needs.

(c) Special income tax status of infants

Moneys paid into court on behalf of injured infant plaintiffs earn interest which is tax free to the infant. When the infant reaches his provincial age of majority (18 years in Ontario) the whole fund can be paid out to him as a non-taxable amount. Investment income from this fund will then be taxable. Taxes on the investment income can be postponed for three years if the money is kept in an identifiable fund and is invested.⁸⁷

⁸⁴ *Ibid.*, at p. 811.

⁸⁵ *Ibid.*, at p. 807 where it is stated that in the last several years, the prices for medical services have increased at twice the rate of overall prices.

⁸⁶ *E.g.*, the settlement in the Appendix provides for seven annual payments of \$5,000 into court.

⁸⁷ Under s. 81(1)(g.1) of the *Income Tax Act* any income or taxable capital gain received

The capital sum plus accumulated interest will soon grow to a very large amount. Investment income from the capital sum may place the plaintiff in a high marginal tax bracket. This problem may be avoided by use of a structured settlement.

The structure could provide for a lump sum payment to the next friend to pay legal fees and accrued out of pocket expenses, and for another lump sum payment to be made into court. These funds would provide for the plaintiff's needs until he/she reached age 21. The bulk of what would be the conventional lump sum award could be used to purchase an annuity deferred to age 21. Periodic payments would commence at that time, and would not be taxable.⁸⁸

(d) Official guardian's concerns and requirements

Recognizing the complexities and variables affecting the minor's immediate and future interests, the Office of the Official Guardian has set out some of their concerns and requirements with regard to structured settlements.

The Office of the Official Guardian believes that each structured settlement should "provide the maximum financial benefit in a manner appropriate to the best interests of the minor".⁸⁹ To ensure this, they ask to be involved in every infant settlement from a very early stage so that they can provide an independent assessment of the proposal.⁹⁰

For the formulation of this assessment, the Official Guardian requires relevant background information on the infant's family background, as well as disclosure of the corresponding amount of the lump sum payment, and the cost of the annuity.⁹¹

(3) Combating Inflation

A criticism often made of structured settlements is that the

before a taxpayer attains the age of 21 years is excluded from income to the extent it represents income from property or taxable capital gains from disposition of property that was acquired as damages in respect of physical or mental injury or that is property substituted for property so acquired.

⁸⁸ There would be no tax payable because s. 81(1)(g.1) of the *Income Tax Act* provides that the fund will not be taxed until the infant reaches 21 years of age. After this time, the annuities will be tax free so long as the qualifications discussed in the text accompanying footnotes 77 to 79 are adhered to.

⁸⁹ Memorandum from the Ministry of the Attorney-General, Office of the Official Guardian, "Structured Settlements and the Official Guardian", at p. 1, para. 7.

⁹⁰ *Ibid.*, at paras. 3 and 4.

⁹¹ *Ibid.*, at p. 2, paras. 2, 3(a) and 3(b).

problem of inflation is not properly dealt with. An indexing rate is built into most structured settlements to account for cost of living increases. Although inflation has been high in recent years, the indexing rate is often only 3% to 5% per annum. Inflation quickly reduces the true value of the payments.

Insurers have two arguments against high annual compounding. First, future inflation is an unknown quantity, which despite recent trends, always remains prone to sudden downward turns. Second, the cost of a higher indexing feature would make the annuity economically unrealistic.

Two alternatives have been cited as providing protection against inflation. The first requires the plaintiff's lawyer to negotiate additional lump sum payments on a regular basis to supplement the periodic payments.⁹² For example, in the hypothetical in the Appendix, the plaintiff's lawyer could seek lump sum payments of \$100,000 every ten years. At any rate, this is only a rough-and-ready solution, not without increased costs to the plaintiff.

The second proposal is to annually adjust the payments to reflect the inflation rate.⁹³ The idea of inflation adjustments is admirable, but its use in practice is doubtful.⁹⁴ Inflation adjustments would be expensive; due to the impossibility of projecting long-range inflation rate increases, inflation-indexed annuities given by life insurance companies would have to be priced conservatively (*i.e.*, expensively) to compensate for risk. More important, it is doubtful that inflation-indexing can work in any system of private insurance. Inflation-indexing requires control over the economy.

(4) Security of Payment

In recent consent judgments, upon payment of the lump sum portions of the structure, and upon the filing of a certified copy of the annuity funding the remaining portion of the structure, the court has allowed full release of the defendant and his insurer.⁹⁵ The claimant must then look to the annuity company for his

⁹² Choulos, *supra*, footnote 1 at p. 75.

⁹³ Patterson, *supra*, footnote 67.

⁹⁴ Hellner, "Indexing of Tort Awards in Sweden", 36 A.J. Comp. L. 71 (1977), contains an excellent discussion of the problems clouding implementations of a scheme of inflation adjustments.

⁹⁵ For an example of such a release, see para. 3 of the consent judgment in the Appendix.

payments.⁹⁶ The plaintiff's lawyer then has a duty to ensure that the annuity company has a good rating so that risks of insolvency are slight. The chances of a major life insurance company becoming insolvent are almost non-existent.⁹⁷ The major life insurers are more solvent than banks.

7. Statutory Periodic Payments

At the pre-trial stage, the plaintiff can accept either a lump sum award, or a structured settlement which may have characteristics of both a lump sum award and an annuity. At the trial stage in Ontario, lump sum awards will be granted, unless the parties consent to some form of periodic payments. Periodic payments cannot be imposed against the will of the parties.

Some have recommended that Ontario should enact legislation permitting periodic payments of judgments for seriously injured plaintiffs where the awards include future damages, and that these payments should be subject to review.⁹⁸ The review feature is intended to provide fairer compensation and to reduce the speculation inherent in actuarial calculations.

Damages could be adjusted to reflect the plaintiff's actual physical condition and the present rate of inflation. However, based on the conclusions of the Committee on Tort Compensation, as well as the experience in other jurisdictions, statutory periodic payments of judgments do not seem to be on Ontario's legal horizon.

Thirteen American states have already enacted legislation allowing some form of periodic payments in medical malpractice actions.⁹⁹ There are, however, indications that these statutes have been ineffective.¹⁰⁰ In addition, California's statute has been ruled unconstitutional, as it violates equal protection guarantees to all personal injury claimants.¹⁰¹ The National Conference of Commissioners on Uniform State Laws has submitted many drafts

⁹⁶ This may create a problem where the plaintiff is considering a move for rehabilitative purposes to another jurisdiction. See text accompanying footnote 74, *supra*.

⁹⁷ *E.g.* see letter from R. B. Leckie, Valuation Actuary of The Manufacturers Life Insurance Company to Mr. F. McKellar (October 7, 1980); letter from Superintendent of Insurance Canadian Department of Insurance to Mr. F. McKellar (October 7, 1980).

⁹⁸ *E.g.*, see Dickson J. in *Andrews v. Grand & Toy Alberta Ltd.*, *supra*, footnote 18.

⁹⁹ Elligett, "The Periodic Payment of Judgments", 46 *Ins. C.J.* 130 (1979), at pp. 134-5.

¹⁰⁰ Podgers, "Periodic Payments Model Law Proposed", 66 *A.B.A.J.* 1199 (1980).

¹⁰¹ *Ibid.*

of the Model Periodic Payment of Judgment Act. Yet the model Act remains but a proposal. It has been described as rigid, cumbersome, complex and costly to implement and administer.

Sweden, France, Australia, Germany and New Zealand all have legislation permitting structured judgments. The public reaction in those countries has been less than enthusiastic; most litigants prefer lump sums.¹⁰²

The English Law Reform Commission rejected periodic payments due to vehement opposition from insurance interests, organizations representing plaintiff's interests, the Bar Council, and the Law Society.¹⁰³ Moreover, the commission believed that lump sums would be desired anyway.

The commission none the less recognized the difficulties inherent in the lump sum system, and proposed legislation permitting an award of "provisional damages", with the final assessment of the plaintiff's damages to be determined at a later date.¹⁰⁴

The Ontario Committee on Tort Compensation similarly concluded that the control of voluntary settlements would be neither justifiable nor practicable.¹⁰⁵ But they did conclude that the award may be open to review, and the defendant may be ordered to pay damages periodically, if both parties consent to these provisions.¹⁰⁶ The committee also recommended that to prevent dissipation of a lump sum award, the court is to have the discretion to direct that a portion of the award representing the cost of the future care of the injured plaintiff be paid to the Public Trustee, the Accountant of the Supreme Court, or another person approved by the court.¹⁰⁷

Although a scheme of variable payments which could be imposed on the parties against their will was rejected, the committee sanctioned the use of structured settlements.¹⁰⁸

A special committee of the British Columbia Branch of the

¹⁰² O'Connor and Smith, *supra*, footnote 10 at p. 4.

¹⁰³ English Law Commission, *The Law Commission, No. 56, Report on Personal Injury Litigation — Assessment of Damages* (London, H.M.S.O., 1973), at p. 10.

¹⁰⁴ *Ibid.* The notion of split trials has been proposed by others: e.g., Markell, *supra*, footnote 82 at p. 817.

¹⁰⁵ *Supra*, footnote 23 at p. 23.

¹⁰⁶ A reviewable judgment on consent was entered into in *Steeves v. Fitzsimmons* (1975), 66 D.L.R. (3d) 203, 11 O.R. (2d) 387 (H.C.J.).

¹⁰⁷ *Supra*, footnote 23 at pp. 25-6.

¹⁰⁸ *Supra*.

Canadian Bar Association has also rejected a mandatory scheme of periodic payments.¹⁰⁹ That committee also noted that the advantages of the scheme are available if the parties voluntarily agree to a structured settlement.

8. Conclusions

The history of structured settlements in Ontario has been a rather brief one. None the less, the flexibility of structured settlements, and the advantages available to all parties, point to a bright future for structured settlements. Furthermore, structures have been well received by plaintiffs enjoying their benefits, by insurance companies, by lawyers for both sides, and by judges granting the consent judgments.

The utility of structured settlements cannot be over-emphasized. They are not a universal remedy for all the ills of lump sum system of compensation. They are not always appropriate, but they are more suitable for certain plaintiffs. The disadvantages of structured settlements must be weighed against their advantages. In particular, they may be a trap for the unwary plaintiff's counsel. Plaintiff's counsel must still evaluate which form of payment is better for his client.

Another auspicious indicator is the degree of co-operation between both counsel. Although both counsel want their clients to participate in the tax savings, there is not the type of deception resorted to in the United States.

The legal profession has educated itself as to the merits of structured settlements. The next step is to participate in the education of the public. This vital task should not be left in the hands of our newspapers who seem fooled by the mathematics involved.

Although the future of structured settlements as a viable alternative hinges on their favourable tax status, there are no indications of, nor reasons for, any change in the taxation of the annuity payments.

Short-term prospects for the structured settlement specialist are bright. However, as the other participants in a structure become more sophisticated, the structured settlement specialist may become obsolete.

In the final analysis, under present conditions, it does indeed seem that structured settlements are here to stay.

¹⁰⁹ McCougherty, "Periodic Insurance Payments Should Not be Mandatory", *National*, March, 1981, at p. 24.

APPENDIX

Steps Involved in Arriving at a Structured Settlement

What follows is an illustration of some of the steps involved in resolving a serious personal injury accident, from the plaintiff's counsel's analysis of the facts, through to the consent judgment. This example is based on an actual settlement.¹¹⁰ The names have been changed to protect the privacy of the infant plaintiff.

Background information

Anne Case is an infant born April 16, 1969. On May 17, 1976, she was severely crippled in an automobile accident. As a result of fractures in the cervical spine and spinal cord damage, she was rendered a quadriplegic. A head injury caused brain damage and intellectual impairment. There is medical evidence that the plaintiff has a life expectancy of only 50 years.

Anne's parents are married, and her father is a factory worker earning approximately \$20,000 per annum. From this background, an occupation such as a secretary or teacher was thought to be the most likely possible occupation she would have attained if not for the accident. However, due to the extent of the injuries, no future employment was considered likely.

Full-time care would be necessary.

Plaintiff's counsel's analysis

Before any attempt to structure was made, the plaintiff's counsel saw her case as follows:

	<u>Amount</u>
Special Damages	\$ 38,000
Future Care	
— Special Equipment	40,000
— Daily Care for Her Lifetime	800,000
Prospective Loss of Earning Capacity	
— Commencing at age 20, actual work span of 32 years	
— Commencing at age 20, normal work span of 47 years	
After contingencies	100,000
Non-pecuniary General Damages	150,000
Management fee for Investments	35,000
TOTAL	<u>\$1,163,000</u>

Plaintiff's counsel would have relied on an actuary to determine the appropriate figures for this table.

¹¹⁰ The background information and annuity tables are from the files of Mr. Frank McKellar.

Proposals made by structured settlement specialist

Defendant's counsel asked a structured settlement specialist to use X dollars to devise a structure which would provide for the needs of the plaintiff and her parents (since they will be maintaining her). Plaintiff's counsel mentioned his concern that these payments be tax free.

Proposals:

Monthly payments of \$300 to her parents. These payments are to continue for the duration of Anne's life, but after she reaches age 19 they are to be blended with her monthly damages.

Seven annual general damage payments of \$5,000 to be paid to the Accountant of the Supreme Court of Ontario. These payments are to cover the possibility of extraordinary expenses arising for her parents during her infancy. The unused portion, plus accumulated interest, is to be paid to Anne at age 18. Considering the broad coverage provided by O.H.I.P., it is anticipated that Anne will receive the bulk (if not all) of the \$35,000, plus interest, upon becoming 18.

A general damage payment in the amount of \$150,000 is to be made to Anne at age 25 (April 16, 1994). Together with the monthly payments, this should enable Anne to purchase a house if she so desires.

A scheme of monthly damage payments is necessary. The amount of each payment and the cost of the annuity depends on the rate of indexing (if any). Three proposals are made: indexing at 5%, indexing at 4%, and no indexing (the level income option). Generally, the higher the indexing rate, the lower the initial payments, but the higher the later payments.

Monthly payments are guaranteed for 25 years (until age 44). Should the plaintiff die before this age, the payments are to continue to her beneficiaries.

A lump sum amount to pay plaintiff's party and party solicitor fees and out of pocket expenses.

Tables on the following pages give an indication of the effect of the indexing rate on the amount of both annual and cumulative payments.

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Anne Case
 Date of Birth: April 16, 1969
 (Medically Rated: April 15, 1951)
 This Segment of Structure Commences April 16, 1988
 Schedule of Damages

Year	Monthly Payment		Annual Payment		Cumulative Payments		
	4%	5%	4%	5%	4%	5%	
1	\$ 3,859.76	\$ 3,201.68	\$ 46,317.12	\$ 38,420.16	\$ 46,317.12	\$ 38,420.26	
2	4,002.15	3,346.76	48,025.80	40,161.12	94,342.92	78,581.28	
3	4,150.24	3,499.10	49,802.88	41,989.20	144,145.80	120,570.48	
4	4,304.24	3,659.06	51,650.88	43,908.72	195,796.68	164,479.20	
5	4,464.42	3,827.01	53,573.04	45,924.12	249,369.72	210,403.32	
6	4,630.99	4,003.36	55,571.88	48,040.32	304,941.60	258,443.64	
			----- On April 16, 1994 - Lump Sum Damages - \$150,000 -----				408,443.64
7	4,804.23	4,188.53	57,650.76	50,262.36	512,592.36	458,706.00	
8	4,984.40	4,382.96	59,812.80	52,595.52	572,405.16	511,301.52	
9	5,171.78	4,587.10	62,061.36	55,045.20	634,466.52	566,346.72	
10	5,366.65	4,801.46	64,399.80	57,617.52	698,866.32	623,964.24	
11	5,569.31	5,026.53	66,831.72	60,318.36	765,698.04	684,282.60	
12	5,780.09	5,262.86	69,361.08	63,154.32	835,059.12	747,436.92	
13	5,999.29	5,511.00	71,991.48	66,132.00	907,050.60	813,568.92	
14	6,227.26	5,771.55	74,727.12	69,258.60	981,777.72	882,827.52	
15	6,464.35	6,045.13	77,572.20	72,541.56	1,059,349.92	955,369.08	
16	6,710.93	6,332.38	80,531.16	75,988.56	1,139,881.08	1,031,357.64	
17	6,967.36	6,634.00	83,608.32	79,608.00	1,223,489.40	1,110,965.64	
18	7,234.06	6,950.70	86,808.72	83,408.40	1,310,298.12	1,194,374.04	
19	7,511.42	7,283.24	90,137.04	87,398.88	1,400,435.16	1,281,772.92	
20	7,799.88	7,632.40	93,598.56	91,588.80	1,494,033.72	1,373,361.72	
21	8,099.87	7,999.02	97,198.44	95,988.24	1,591,232.16	1,469,349.96	
22	8,411.87	8,383.97	100,942.44	100,607.64	1,692,174.60	1,569,957.60	
23	8,736.34	8,788.17	104,836.08	105,458.04	1,797,010.68	1,675,415.64	
24	9,073.80	9,212.57	108,885.60	110,550.84	1,905,896.28	1,785,966.48	
25	9,424.74	9,658.21	113,096.88	115,898.52	2,018,993.16	1,901,865.00	

----- Minimum Guaranteed Payment -----

Schedule of Damages — continued

Year	Monthly Payment		Annual Payment		Cumulative Payments	
	4%	5%	4%	5%	4%	5%
26	9,789.74	10,126.12	117,476.88	121,513.44	2,136,470.04	2,023,378.44
27	10,169.33	10,617.42	122,031.96	127,405.44	2,258,502.00	2,150,783.88
28	10,564.10	11,133.30	126,769.20	133,599.60	2,385,271.20	2,284,883.48
29	10,974.66	11,674.96	131,695.92	140,099.52	2,516,967.12	2,424,483.00
30	11,401.65	12,243.71	136,819.80	146,924.52	2,653,786.92	2,571,407.52
31	11,845.72	12,840.89	142,148.64	154,090.68	2,795,935.56	2,725,498.20
32	12,307.55	13,467.94	147,690.60	161,615.28	2,943,626.16	2,887,113.48
33	12,787.85	14,126.34	153,454.20	169,516.08	3,097,080.36	3,056,629.56
34	13,287.36	14,817.65	159,448.32	177,811.80	3,256,528.68	3,234,441.36
35	13,806.86	15,543.53	165,682.32	186,522.36	3,422,211.00	3,420,963.72
36	14,347.13	16,305.71	172,165.56	195,668.52	3,594,376.56	3,616,632.24
37	14,909.01	17,106.00	178,908.12	205,272.00	3,773,284.68	3,821,904.24
38	15,493.38	17,946.30	185,920.56	215,355.60	3,959,205.24	4,037,259.84
Age 57	AGE 57	----- Life Expectancy as Given by Medical Evidence -----				
39	16,101.11	18,828.61	193,213.32	225,943.32	4,152,418.56	4,263,203.16
40	16,733.15	19,755.04	200,797.80	237,060.48	4,353,216.36	4,500,263.64
41	17,390.48	20,727.79	208,685.76	248,733.48	4,561,902.12	4,748,997.12
42	18,074.10	21,749.18	216,889.20	260,990.16	4,778,791.32	5,009,987.28
43	18,785.06	22,821.64	225,420.72	273,859.68	5,004,212.04	5,283,846.96
44	19,524.47	23,947.73	234,293.64	287,372.76	5,238,505.68	5,571,219.72
45	20,293.45	25,130.11	243,521.40	301,561.32	5,482,027.08	5,872,781.04
46	21,093.18	26,371.62	253,118.16	316,459.44	5,735,145.24	6,189,240.48
47	21,924.91	27,675.20	263,098.92	332,102.44	5,998,244.16	6,521,342.92
48	22,789.91	29,043.96	273,478.92	348,527.52	6,271,723.08	6,869,870.44
49	23,689.50	30,481.16	284,274.00	365,773.92	6,555,997.08	7,235,644.36
50	24,625.08	31,990.21	295,500.96	383,882.52	6,851,498.04	7,619,526.88
51	25,598.09	33,574.72	307,177.08	402,896.64	7,158,675.12	8,022,423.52
52	26,610.01	35,238.46	312,320.12	422,861.52	7,470,995.24	8,445,285.04
53	27,662.41	36,985.38	331,948.92	443,824.56	7,802,944.16	8,889,109.60
54	28,756.91	38,819.65	345,082.92	465,835.80	8,148,027.08	9,354,945.40
55	29,895.18	40,760.63	358,742.16	489,127.56	8,506,769.24	9,844,072.96

Level Income Option

An alternative to indexing would be a level income commencing at age 19.

The payments would be \$7,039.06 monthly (\$84,468.72 per annum).

This would tend to produce more income than necessary in the early years (creating a need for investment counselling and exposing Anne to possible loss of capital) and less than indexed structures after year 18.

If Anne lives to age 57 (2026), as predicted by medical evidence, the level income will continue to be \$84,468.72 per annum.

2026	4% Will be:	\$185,920.56 per annum
2026	5% Will be:	\$215,355.60 per annum

In choosing between these alternative payment schedules, consideration should be given to a proper match of size of the payments and the likely needs to the plaintiff at that stage of her life. This is obviously a difficult task.

Comparing the alternative structures is difficult due to the fact that it entails many subjective conclusions. However, some comparisons can be made on a definitive basis. Damages paid to age 19 are identical for all structures.

Assuming an income commencement date of November, 1980, the damages are:

\$ 300 x 89 Months	\$26,700
\$5,000 x 7 Years	<u>35,000</u>
Total	\$61,700

It is also helpful to consider the cumulative payments under each of the three structures. The following table sets out these amounts. The indexed payments become more attractive the longer the plaintiff lives.

Commencing at age 19, the three structures illustrated compare as follows:

LEVEL INCOME — \$7,039.06 Monthly (\$84,468.72 per annum)	
Minimum Guaranteed:	\$2,111,718.00
To 2026 (life expectancy as determined by medical evidence)	\$3,209,811.30
To 2034 (age 65)	\$3,885,561.10
INDEXED AT 4%:	
Minimum Guaranteed:	\$2,018,993.16
To 2026 (life expectancy as determined by medical evidence)	\$3,959,205.24
To 2034 (age 65)	\$5,735,145.24
INDEXED AT 5%:	
Minimum Guaranteed:	\$1,901,865.00
To 2026 (life expectancy as determined by medical evidence)	\$4,037,259.84
To 2034 (age 65)	\$6,189,240.48

The Proposal Accepted

The proposal accepted was basically that of the monthly payments indexed at 4%, with a few minor changes. Both parents agreed that the initial monthly payment to the parents should be \$500 rather than \$300 and defendant's counsel asked that an amount less than X dollars be used to structure the settlement. This reduced the monthly payments to be paid to the infant plaintiff.

The consent judgment and the attached schedule on the following pages set out the structure which was finally agreed to.

Cost-Yield Analysis

It is interesting to compare the potential benefits flowing to the plaintiff, and the cost of those benefits to the defendant.

<u>Benefit</u>	<u>Yield</u>	<u>Cost to Defendant</u>
Lump Sum to Parents	\$ 50,000	\$ 50,000
Solicitor's Fees	35,000	35,000
Monthly Payments to Parents 8 years, 3 months at \$500	49,500	
Yearly Payments into Court 7 years at \$5,000	35,000	
Lump Sum to Infant at age 25	150,000	500,000
Monthly Payments - indexed at 4% - minimum guarantee	\$1,704,126	
Totals	<u>\$2,023,626</u>	<u>\$585,000</u>

Consent Judgment

IN THE SUPREME COURT OF ONTARIO

) Tuesday, the 21st day
THE HONOURABLE MR. JUSTICE COOL)
) November, 1981

BETWEEN:

ANNE CASE, an infant under the age of
18 years by her next friend, JOHN CASE,
and the said JOHN CASE personally and
MARY CASE

Plaintiffs,

— and —

JAMES SMITH and YONGE-BLOOR MOTORS (1968) LTD.,
SAM MARTIN and STEVE WARREN

Defendants,

— and —

THOMAS PRINCE, LUCY PRINCE

Third Parties.

JUDGMENT

THIS action coming on for trial this day at the sittings holden for the trial of actions with a jury, in the presence of counsel for all parties, upon hearing read the pleadings and the affidavits of John Case and Mary Case and Robert Jones, filed, and it appearing that the infant plaintiff Anne Case was born on April 16, 1969 and resides with her father and next friend at 2222 Second Line, Apartment 101, Oakville, Ontario, and upon hearing what was alleged by counsel aforesaid:

1. THIS COURT DOTH ORDER AND ADJUDGE that the defendants Smith and Yonge-Bloor Motors Ltd. shall pay:

(a) To the plaintiffs John Case and Mary Case forthwith the sum of \$50,000;

(b) To the plaintiffs John Case and Mary Case the sum of \$500 per month commencing on January 1, 1981, up to and including March 1, 1988;

(c) To the Accountant of the Supreme Court of Ontario the sum of \$5,000 per annum to the credit of the infant plaintiff as follows:

January 1, 1981	\$5,000
January 1, 1982	\$5,000
January 1, 1983	\$5,000
January 1, 1984	\$5,000
January 1, 1985	\$5,000
January 1, 1986	\$5,000
January 1, 1987	\$5,000

to be paid out to the infant plaintiff when she reaches the age of 18 years subject to such further order as this Honourable Court may in the meantime make;

(d) To the infant plaintiff the sum of \$150,000 on April 16, 1994;

(e) To the infant plaintiff commencing April 1, 1988 and on the 1st day of each and every month thereafter for a guaranteed period of 25 years, monthly payments of \$3,409.94 indexed at 4 per centum per annum compounded annually; and thereafter the said monthly payments shall be paid so long as the infant plaintiff shall remain alive. The said payments shall, without restricting the amount to be paid after year 65, be as set out in Schedule A attached to and forming part of this judgment.

2. THIS COURT DOTH FURTHER ORDER AND ADJUDGE that the said defendants do

pay to the plaintiffs' solicitors, Messrs. Ames, Barnes, the sum of \$35,000 for party and party costs, which sum is to be accepted by the plaintiffs' solicitors in full satisfaction of all costs payable in the action to them by the plaintiff either a between party and party or on a solicitor and client basis.

3. AND THIS COURT DOETH FURTHER ORDER AND ADJUDGE that upon filing with the court of a certified copy of the non-assignable, non-commutable annuity issued by the Manufacturers Life Insurance Company to make the payments set out in paragraphs 1(b), (c), (d) and (e) and a filing with the court of a satisfaction piece with respect to the amounts to be paid under paragraph 1(a) and paragraph 2, the liability of the defendants Smith and Yonge-Bloor Motors Ltd., and their insurer, the Universal Automobile Insurance Company, shall be forever discharged and released in full in all respects herein.

4. AND THIS COURT DOETH FURTHER ORDER AND ADJUDGE that the action against the defendants Sam Martin and Steve Warren be and the same is hereby dismissed without costs.

5. AND THIS COURT DOETH FURTHER ORDER AND ADJUDGE that the action against the third parties, Thomas Prince and Lucy Prince be and the same is hereby dismissed without costs.

JUDGMENT signed this 26th day of November, 1981.

Local Registrar S.C.O

Schedule A*

MCKELLAR STRUCTURED SETTLEMENTS INC.

Anne Case

Commencing April 1, 1988

Schedule of Damages

Index Rate: 4.000 %

YEAR	MONTHLY	PAYMENTS	
		YEARLY	CUMULATIVE
1	3,409.94	40,919.28	40,919.28
2	3,546.34	42,556.08	83,475.36
3	3,688.19	44,258.28	127,733.64
4	3,835.72	46,028.64	173,762.28
5	3,989.15	47,869.80	221,632.08
6	4,148.72	49,784.64	271,416.72
7	4,314.67	51,776.04	323,192.76

* Attached to, and forming part of the judgment of The Honourable Mr. Justice Coe dated April 21, 1981.

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Schedule of Damages — *continued*

YEAR	MONTHLY	YEARLY	CUMULATIVE
8	4,487.26	53,847.12	377,039.88
9	4,666.75	56,001.00	433,040.88
10	4,853.42	58,241.04	491,281.92
11	5,047.56	60,570.72	551,852.64
12	5,249.46	62,993.52	614,846.16
13	5,459.44	65,513.28	680,359.44
14	5,677.82	68,133.84	748,493.28
15	5,904.93	70,859.16	819,352.44
16	6,141.13	73,693.56	893,046.00
17	6,386.78	76,641.36	969,687.36
18	6,642.25	79,707.00	1,049,394.36
19	6,907.94	82,895.28	1,132,289.64
20	7,184.26	86,211.12	1,218,500.76
21	7,471.63	89,659.56	1,308,160.32
22	7,770.50	93,246.00	1,401,406.32
23	8,081.32	96,975.84	1,498,382.16
24	8,404.57	100,854.84	1,599,237.00
25	8,740.75	104,889.00	1,704,126.00
Minimum			
Guarantee			
26	9,090.38	109,084.56	1,813,210.56
27	9,454.00	113,448.00	1,926,658.56
28	9,832.16	117,985.92	2,044,644.48
29	10,225.45	122,705.40	2,167,349.88
30	10,634.47	127,613.64	2,294,963.52
31	11,059.85	132,718.20	2,427,681.72
32	11,502.24	138,026.88	2,565,708.60
33	11,962.33	143,547.96	2,709,256.56
34	12,440.82	149,289.84	2,858,546.40
35	12,938.45	155,261.40	3,013,807.80
36	13,455.99	161,471.88	3,175,279.68
37	13,994.23	167,930.76	3,343,210.44
38	14,554.00	174,648.00	3,517,858.44
39	15,136.16	181,633.92	3,699,492.36
40	15,741.61	188,899.32	3,888,391.68
41	16,371.27	196,455.24	4,084,846.92
42	17,026.12	204,313.44	4,289,160.36
43	17,707.16	212,485.92	4,501,646.28
44	18,415.45	220,985.40	4,722,631.68
45	19,152.07	229,824.84	4,952,456.52
46	19,918.15	239,017.80	5,191,474.32
47	20,714.88	248,578.56	5,440,052.88
48	21,543.48	258,521.76	5,698,574.64
49	22,405.22	268,862.64	5,967,437.28
50	23,301.43	279,617.16	6,247,054.44

Schedule of Damages — *continued*

YEAR	MONTHLY	YEARLY	CUMULATIVE
51	24,233.49	290,801.88	6,537,856.32
52	25,202.83	302,433.96	6,840,290.28
53	26,210.94	314,531.28	7,154,821.56
54	27,259.38	327,112.56	7,481,934.12
55	28,349.76	340,197.12	7,822,131.24
56	29,483.75	353,805.00	8,175,936.24
57	30,663.10	367,957.20	8,543,893.44
58	31,889.62	382,675.44	8,926,568.88
59	33,165.20	397,982.40	9,324,551.28
60	34,491.81	413,901.72	9,738,453.00
61	35,871.48	430,457.76	10,168,910.76
62	37,306.34	447,676.08	10,616,586.84
63	38,798.59	465,583.08	11,082,169.92
64	40,350.53	484,206.36	11,566,376.28
65	41,964.55	503,574.60	12,069,950.88

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