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Resolving the Modern Day Esau Problem Amongst Structured Settlement Recipients

Michelle M. Marcellus

NOTE

RESOLVING THE MODERN DAY ESAU PROBLEM AMONGST STRUCTURED SETTLEMENT RECIPIENTS

I. INTRODUCTION

In 1990, a New York City subway train hit Raymond White.[1] As a result of the accident, White lost his leg.[2] White, who was homeless, brought a civil suit against New York City and won.[3] New York City rewarded White with a structured settlement agreement[4] that guaranteed that White would be financially set for the rest of his life.[5] The agreement stipulated that the defendant would pay the victim monthly installments of $1100.[6] The agreement also assured White a three percent increase for annual living expenses.[7]

Unfortunately in 1996, White fell prey to the tactics of a factoring company.[8] A factoring company is a company that specializes in the buying of structured settlements in exchange for quick cash at a steep price.[9] White made the decision to sell his guaranteed payment stream to a factoring company for a low cash value.[10] After six factoring transactions, White sold off fifteen years of guaranteed future payments.[11] He traded in a total of $198,000 in tax-free future income for $54,000 in immediate taxable cash.[12] White used the cash to purchase

1. Philip H. Corboy, *Structured for a Reason*, A.B.A. J., June 2000, at 116, 116; Margaret Mannix, *Settling for Less: Should Accident Victims Sell Their Monthly Payouts?*, U.S. NEWS & WORLD REP., Jan. 25, 1999, at 62, 64.

2. Corboy, *supra* note 1, at 116; Mannix, *supra* note 1, at 64.

3. Corboy, *supra* note 1, at 116; Mannix, *supra* note 1, at 64.

4. BLACK'S LAW DICTIONARY 1497 (9th ed. 2009) ("A settlement in which the defendant agrees to pay periodic sums to the plaintiff for a specified time."); Corboy, *supra* note 1, at 116.

5. *See* Corboy, *supra* note 1, at 116; Mannix, *supra* note 1, at 64.

6. Corboy, *supra* note 1, at 116; Mannix, *supra* note 1, at 64.

7. Corboy, *supra* note 1, at 116; Mannix, *supra* note 1, at 64.

8. Corboy, *supra* note 1, at 116; Mannix, *supra* note 1, at 63-64.

9. Corboy, *supra* note 1, at 116; Mannix, *supra* note 1, at 62.

10. Corboy, *supra* note 1, at 116; Mannix, *supra* note 1, at 64.

11. Corboy, *supra* note 1, at 116; Mannix, *supra* note 1, at 64.

12. *See* Corboy, *supra* note 1, at 116; Mannix, *supra* note 1, at 64.

a car and place a down payment on a house in Florida.[13] Later that year, White fell behind in his car and house payments.[14] Soon after, White's car was repossessed and the bank foreclosed on his home.[15] As a result, White, now handicapped, had to turn to public assistance in order to make ends meet.[16]

Similarly, in 2007, Charlotte Whitney, the beneficiary of a structured settlement with a lifetime guaranteed monthly income to be paid out over sixty-six years, sought to sell her monthly payments to a factoring company.[17] The court approved the transfer and Whitney sold two of her future payments totaling $60,000 for $29,000.[18] In her petition for the transfer, she alleged that she needed the cash to buy an apartment, pay off her bills, purchase furniture, and make necessary repairs to her automobile.[19] Less than one year later, Whitney re-appeared before the court to request the transfer of future payments amounting to $132,000 due to her from January 2009 through August 2017, in exchange for $48,404 in immediate cash.[20] This time she alleged that she needed the cash to move to North Carolina to be closer to her family.[21] The court approved the second transfer.[22] Subsequently, on or about September 27, 2009, Whitney made a third request to sell her monthly future payments due to her from 2012 through 2022.[23] The factoring company paid her a lump sum of $15,001.53 in exchange for $60,000.[24] Whitney indicated in her application that she would use the money to pay medical bills, pre-pay her rent, and buy furniture to accommodate her nephew, who planned to live with her.[25] Although the 2007, 2008, and 2009 applications had the same address and revealed that Whitney had not used the cash to move to North Carolina, as indicated in her second transfer application, the court approved the transfer.[26] Despite evidence that Whitney would not use the lump-sum payments she received from the factoring transactions in the manner

13. Corboy, *supra* note 1, at 116; Mannix, *supra* note 1, at 64.
14. *See* Corboy, *supra* note 1, at 116; Mannix, *supra* note 1, at 64.
15. Corboy, *supra* note 1, at 116; Mannix, *supra* note 1, at 64.
16. Mannix, *supra* note 1, at 64.
17. *See* Whitney v. LM Prop. & Cas. Ins. Co., No. 3375/2011, 2011 WL 2654028, at *2 (N.Y. Sup. Ct. June 24, 2011).
18. *Id.*
19. *Id.*
20. *Id.*
21. *Id.*
22. *Id.*
23. *Id.*
24. *See id.*
25. *Id.*
26. *Id.*

indicated in her petitions, the court allowed Whitney to sell a significant portion of her guaranteed lifetime monthly payments within three years.[27]

For the past three decades, structured settlements have provided tort victims and their families with long-term financial security,[28] because tort victims are typically unaccustomed to handling large sums of money.[29] Statistics indicate that approximately thirty percent of settlements paid in a lump sum are exhausted within two months, and ninety percent are depleted within five years.[30] As a result, structured settlements were specifically designed to solve the recipient's problem of premature dissipation of lump-sum settlement payments.[31]

Basically, a structured settlement converts a lump-sum settlement award into a series of periodic payments, typically over the course of the victim's lifetime.[32] For that reason, the structured settlement recipient's financial circumstance "can best be described as financial peace of mind."[33] For example, this "financial peace of mind" may come in the form of a lifetime of guaranteed income for accident victims who can no longer provide for themselves as a result of a serious injury.[34] Hence, it comes as no surprise that Congress endorses the use of structured settlements through its assurance that all monies set aside for the structured settlement are exempt from taxation.[35]

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27. *Id.* at *2, *5-6.

28. Laura J. Koenig, Note, *Lies, Damned Lies, and Statistics? Structured Settlements, Factoring, and the Federal Government*, 82 IND. L.J. 809, 823 (2007). *See also* Daniel W. Hindert & Craig H. Ulman, *Transfers of Structured Settlement Payment Rights: What Judges Should Know About Structured Settlement Protection Acts*, JUDGES' J., Spring 2005, at 18, 19. The tort victim's cause of action typically arises out of a claim for physical injuries, sickness, or workers' compensation. *Id.*

29. *See* Hindert & Ulman, *supra* note 28, at 19; T.V. Mangelsdorf, *Structured Settlements in Review: The Fundamental Concept*, 4 AM. J. TRIAL ADVOC. 559, 560 (1981). Professor T.V. Mangelsdorf states:

> Whether the settlement annuity is used to protect a person unschooled in financial matters, who would be inept at managing the large sum of money which a non-structured settlement would produce, or it is used to provide for the well being and education of a child left without a provider, its use is frequently appropriate.

Id. See also Leo Andrada, Note, *Structured Settlements: The Assignability Problem*, 9 S. CAL. INTERDISC. L.J. 465, 468 (2000).

30. Andrada, *supra* note 29, at 468.

31. *See* Adam F. Scales, *Against Settlement Factoring? The Market in Tort Claims Has Arrived*, 2002 WIS. L. REV. 859, 865; Andrada, *supra* note 29, at 468.

32. James E. Ciecka, *A Comparison of Lump-Sum and Structured Settlements*, *in* 27 THE TRIAL LAWYER'S GUIDE 450, 450-51 (John J. Kennelly ed., 1983); Andrada, *supra* note 29, at 467.

33. Mangelsdorf, *supra* note 29, at 561.

34. *See id.*

35. *See* Hindert & Ulman, *supra* note 28, at 19. The tax exemption essentially creates a favorable interest rate for the structured settlement recipient. Andrada, *supra* note 29, at 469.

However, by purchasing structured settlements from tort victims, factoring companies thwart Congress's intention of preventing the victims from prematurely dissipating their awards.[36] Again, factoring companies specialize in transforming guaranteed future payments received through structured settlements into quick cash at a steeply discounted rate.[37] As a result, the factoring companies have successfully created a largely unregulated and thus profitable market.[38] The factoring transactions are very lucrative because they sometimes charge discount rates as high as seventy-two percent on relatively low risk investments.[39] However, if these rates were applied to credit cards and loans, a court would surely deem the rates "usurious."[40]

The factoring companies' practices undermine the public policy of protecting tort victims and undo the benefits provided by the legal development of structured settlements.[41] For the financially unsophisticated, the factoring companies' practices can be deceiving.[42] They do not understand that structured settlement agreements are tailored specifically to provide for their long-term needs, including loss of income, future medical expenses, education, and housing.[43] For those like White and Whitney, the thought of immediate cash, rather than having to wait for future income, seems like a blessing.[44] In reality, these transactions can be likened to a "modern-day Esau trading his inheritance for a bowl of soup."[45] Similarly, the financially unsophisticated consumer is actually selling his lifetime sustenance for a few quick dollars.[46] The unfortunate result is a surge in the number of recipients demanding governmental assistance.[47]

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36. Mannix, *supra* note 1, at 62.

37. *Id.* The discount rate is comparable to an interest rate, paid by the settlement recipient, which reflects the capital costs calculated by the factoring company. Scales, *supra* note 31, at 899.

38. *See* Corboy, *supra* note 1, at 116; Mannix, *supra* note 1, at 62.

39. *See* Corboy, *supra* note 1, at 116.

40. *See* Corboy, *supra* note 1, at 116; Mannix, *supra* note 1, at 62 (indicating that federal and state legislators agree that the interest rates factoring companies charge are "usurious").

41. *See* Mannix, *supra* note 1, at 62.

42. *See, e.g., id.* at 65 (discussing Christopher Hicks, an Oklahoma man who fell prey to factoring transactions, sold his entire structured settlement for quick cash and claimed that factoring companies "make you think you are doing the right thing in the long run . . . but you are really messing up your life").

43. *See, e.g.*, Koenig, *supra* note 28, at 823; Andrada, *supra* note 29, at 468-69.

44. *See supra* Part I.

45. Mannix, *supra* note 1, at 62. Esau is an individual who sold his inheritance to his brother Jacob in exchange for red lentil soup. *Genesis* 25:29-34.

46. Mannix, *supra* note 1, at 62.

47. *See, e.g., id.* at 64 (explaining that White had to turn to public assistance in order to support himself).

Nearly every state has adopted some sort of structured settlement protection act requiring judicial approval in order to effectuate the factoring transaction.[48] Although New York State has adopted the Structured Settlement Protection Act (the "N.Y. SSPA"),[49] the statute does little to protect structured settlement recipients from factoring companies.[50] Scant interest has been devoted to actually creating a concrete standard for judges to follow.[51] Additionally, the N.Y. Legislature (the "Legislature") has not created any parameters as to whether factoring transactions are in fact reasonable.[52] Some critics have suggested that the factoring industry should be banned.[53] However, this proposal is too extreme. Factoring transactions should not be banned because they provide liquidity to those in dire situations.[54] Rather, in response to the issues surrounding the N.Y. SSPA, this Note proposes practical methods to resolving the problems caused by the factoring industry.

Part II of this Note briefly describes the history of structured settlements. Next, Part III explains the rise of the factoring industry and the contemporary problems created by this enterprise. Part IV then introduces the federal and state efforts that have been made to better protect structured settlement recipients from the perils of factoring transactions. Part IV also focuses specifically on New York State legislative initiatives made thus far and points out the problematic aspects of the N.Y. SSPA. Part V then concludes with practical solutions that New York State should adopt in order to better effectuate the N.Y. SSPA. Part V also suggests alternatives to factoring transactions and what structured settlement recipients can do to better safeguard their financial security.

II. THE EMERGENCE OF THE PERFECT SOLUTION: STRUCTURED SETTLEMENTS

Prior to the emergence of structured settlements, tort victims were only awarded on a lump-sum basis. Section A details the birth of

48. Hindert & Ulman, *supra* note 28, at 20.

49. N.Y. GEN. OBLIG. LAW §§ 5-1701 to 5-1709 (McKinney 2010).

50. *See, e.g.*, *supra* text accompanying notes 17-27.

51. *See In re* J.G. Wentworth Originations, L.L.C., No. 21636 2011, 2011 WL 6224568, at *4 (N.Y. Sup. Ct. Dec. 14, 2011).

52. *Id.*

53. *See, e.g.*, *Senator Warns on Selling Structured Settlement Payments*, NAT'L STRUCTURED SETTLEMENTS TRADE ASS'N, http://www.nssta.com/news/senator-warns-selling-structured-settlement-payments (last visited Apr. 20, 2012).

54. *See* Mannix, *supra* note 1, at 62.

structured settlements. Section B then explains how to create a structured settlement. Lastly, Section C explains why structured settlements are preferred over lump-sum payments.

A. Settlements: The Preferred Alternative to the Trial Ordeal

Settlements are common and a reality of litigation today.[55] Studies indicate that most civil cases never make it to trial.[56] In fact, less than six percent of cases actually survive the trial ordeal.[57] Moreover, both scholars and judges regard public trials as a wasteful exercise.[58] Trials are time-consuming and often require large monetary commitments from both the plaintiff and defendant.[59]

Traditionally, tort settlements "have been awarded on a lump-sum basis."[60] In the past, plaintiffs often exhibited serious problems with the handling of large sums of money.[61] Approximately thirty percent of structured settlements paid in lump sums were squandered within two months, and ninety percent were exhausted within five years.[62] Fortunately, in the late 1960s, the concept of structured settlements was introduced.[63] Prior to the arrival of structured settlements, plaintiffs had

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55. EVALUATING AND SETTLING PERSONAL INJURY CLAIMS 32 (George M. Gold ed., 1991); Blanca Fromm, Comment, *Bringing Settlement Out of the Shadows: Information About Settlement in an Age of Confidentiality*, 48 UCLA L. REV. 663, 666 (2001) (explaining that approximately sixty percent of all cases settle).

56. Marc Galanter & Mia Cahill, *"Most Cases Settle": Judicial Promotion and Regulation of Settlements*, 46 STAN. L. REV. 1339, 1344 (1994). Judges actively promote the use of settlement and often intervene to assure that the dispute is resolved before the jury trial. *Id.* at 1342, 1344.

57. Theodore Eisenberg et al., *Litigation Outcomes in State and Federal Courts: A Statistical Portrait*, 19 SEATTLE U. L. REV. 433, 442 (1996) (explaining that the completed state trial rate is 2.9%, and the completed federal rate, excluding asbestos cases, is five percent). Quality settlements result in party satisfaction, cost savings, and judicial efficiency. Galanter & Cahill, *supra* note 56, at 1350-51. These benefits make it highly probable that the number of disputes resulting in settlement will remain high. *See id.* at 1387.

58. *See* Scales, *supra* note 31, at 894. Trials can be analogized to surgeries: "painful last resorts . . . likely to place the patient in a weakened condition . . . and almost certain to leave lasting scars." David Luban, Essay, *Settlements and the Erosion of the Public Realm*, 83 GEO. L.J. 2619, 2621 (1995). Following this metaphor, settlements are better than surgery, because if successful they provide "noninvasive alternate therapy." *Id.*

59. JOHN G. FLEMING, THE AMERICAN TORT PROCESS 175 (1988) ("[N]egative features of the American adjudicative process . . . [include] calamitous delay in getting to trial, the procedural complexity and chicanery open to litigants, and the uncertainty of legal outcome implicit in the jury system."); Luban, *supra* note 58, at 2621.

60. Scales, *supra* note 31, at 862.

61. Andrada, *supra* note 29, at 468.

62. *Id.*

63. Jeremy Babener, *Structured Settlements and Single-Claimant Qualified Settlement Funds: Regulating in Accordance with Structured Settlement History*, 13 N.Y.U. J. LEGIS. & PUB. POL'Y 1, 16 (2010); Richard B. Risk, Jr., *A Case for the Urgent Need to Clarify Tax Treatment of a Qualified*

no other option than to accept a lump sum as a method of compensation.[64] The structured settlement, in comparison to the lump-sum method, provides victims with periodic payments over a period of time that generally cannot be spent until the payments are made to the plaintiff.[65]

B. How to Create a Structured Settlement

Structured settlements are relatively simply to create.[66] Typically, the plaintiff and defendant agree to a structured settlement before the judge gets deeply involved in the case.[67] A structured settlement can be understood as a compensation vehicle comprised of three main parts: (1) an initial amount paid in a lump sum at the time that the parties agree to a settlement; (2) future periodic payments; and (3) annuities.[68] The first component, which consists of cash paid at the time of settlement, usually covers outstanding expenses that may be related to the injury.[69] Second,

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Settlement Fund Created for a Single Claimant, 23 VA. TAX REV. 639, 641-42 (2004); *see also* Brian Brown & Lisa Chalidze, *Structured Settlements: An Overview*, VT. B.J. & L. DIG., Feb. 1996, at 14, 14 (explaining that the use of structured settlements to make periodic payments to plaintiffs increased in the 1960s following the large litigation triggered by thalidomide, a drug linked with causing birth defects amongst infants).

64. Andrada, *supra* note 29, at 467. Today, plaintiffs have the option of selecting a lump sum or a structured settlement award. Ciecka, *supra* note 32, at 450.

65. Andrada, *supra* note 29, at 468. *See also* Ciecka, *supra* note 32, at 450 ("Although part of a structured settlement may involve an immediate cash payout, the nature of such a settlement is that the plaintiff will receive periodic payments in the future."); Hindert & Ulman, *supra* note 28, at 19.

66. *See* Anthony Riccardi & Thomas Ireland, *A Primer on Annuity Contracts, Structured Settlements, and Periodic-Payment Judgments*, J. LEGAL ECON., Winter 2002–2003, at 1, 7 (explaining how parties properly establish a structured settlement). In order to qualify as a structured settlement, the arrangement must be established by:

> (A) (i) suit or arrangement for the periodic payment of damages . . . or
> (ii) agreement for the periodic payment of compensation under any workers' compensation law . . . and
> (B) . . . [where] periodic payments are—
> (i) of the character described in subparagraphs (A) and (B) of section 130(c)(2), and
> (ii) payable by a person who is a party to the suit or agreement or to the workers' compensation claim or by a person who has assumed the liability for such periodic payments under a qualified assignment in accordance with section 130.

I.R.C. § 5891(c)(1) (2006). The referenced Section, 130(c)(2), provides that "if—(A) such periodic payments are fixed and determinable as to amount and time of payment, (B) such periodic payments cannot be accelerated, deferred, increased, or decreased by the recipient of such payments." *Id.* § 130(c)(2)(A)–(B).

67. Babener, *supra* note 63, at 9.

68. JAMES R. ECK & JEFFREY L. UNGERER, STRUCTURING SETTLEMENTS 29 (1987).

69. *Id.* These outstanding expenses can include "medical expenses due the hospital, physician, pharmacy, technician, and other health care providers." *Id.* Additionally, there can be "expenses for travel by family members to and from the place of confinement of the injured party, meals, lodging, clothing, telephone expenses, and like costs not covered by any hospital or major medical insurance policy." *Id.*

the calculation for future periodic payments may include compensation for "[f]uture [m]edical and [s]urgical [e]xpenses," "[f]uture [e]nvironmental [m]odifications and [m]edical [e]quipment," an "[e]ducation [f]und," or any other needs that are likely to arise.[70] The third part, an annuity, is the means used to pay out the second part, the future payments.[71] An annuity is defined as a stream of fixed payments over a specified period of time.[72] Therefore, the defendant purchases a single-premium annuity contract from a life insurance company in order to fund the plaintiff's future payments.[73] Through the annuity contract, a stream of future payments is produced in accordance with the schedule set out in the settlement agreement.[74] The annuity contract ensures that the future periodic payments are made to the plaintiff on schedule.[75] The result is a "structured" method of guaranteed income over the victim's lifetime, as opposed to lump-sum compensation in the form of cash.[76]

C. Structured Settlements: Not Just the Popular Choice, but the Right Choice

There are many reasons as to why a plaintiff should consider using a structured settlement over a lump-sum compensation award.[77] One of the most compelling reasons is that structured settlements provide spendthrift protection.[78] Plaintiffs are often unable to properly manage large sums of money themselves.[79] Thus, the periodic payments prevent

70. *Id.* at 31-32.

71. *See* Hindert & Ulman, *supra* note 28, at 19; Riccardi & Ireland, *supra* note 66, at 7.

72. Ciecka, *supra* note 32, at 452 ("A structured settlement can entail fixed periodic payments or payments that increase at a fixed percentage per year."). *See also* Mangelsdorf, *supra* note 29, at 560 (remarking that structured settlements are flexible in that for a family with children, the settlement agreement can stipulate that payments should increase to meet the children's future educational needs and decrease upon reaching adulthood). The fixed payments may be made on a monthly or annual basis. ECK & UNGERER, *supra* note 68, at 29.

73. Ciecka, *supra* note 32, at 450 ("In a structured settlement, the defendant makes a lump-sum payout to an insurance company which, in turn, guarantees that periodic payments will be made to the plaintiff."); Hindert & Ulman, *supra* note 28, at 19; Mangelsdorf, *supra* note 29, at 561; Riccardi & Ireland, *supra* note 66, at 7; Koenig, *supra* note 28, at 812.

74. Riccardi & Ireland, *supra* note 66, at 7.

75. *See id.*

76. Scales, *supra* note 31, at 865 (internal quotation marks omitted).

77. *See* Andrada, *supra* note 29, at 468.

78. *See* ECK & UNGERER, *supra* note 68, at 42.

79. Scales, *supra* note 31, at 869; Andrada, *supra* note 29, at 468. Plaintiffs are typically unable to handle large sums of money and are left with no source of income once the funds run out. Mangelsdorf, *supra* note 29, at 560. Many experienced attorneys lamented that plaintiffs typically dissolve their settlement awards rather quickly because they cannot say "no" to friends and relatives or sometimes fail to make wise investments. Randee Karen Carson & David J. Tong, Commentary, *Structured Settlements: Customized Compensation for Personal Injury Plaintiffs*, 13 STETSON L. REV. 309, 313 (1984) (internal quotation marks omitted).

the plaintiff from "[s]quandering" his or her damage award.[80] In the event that the plaintiff falls prey to bad judgment, delinquent habits, bad advice, or bad luck, the structured settlement's spendthrift measures, mainly spreading the payments over time, protect the plaintiff.[81]

Additionally, premature dissipation can pose a serious problem when the plaintiff is relying on his or her future income as compensation for lost wages, or future medical or living expenses.[82] When a plaintiff with a diminished earnings capacity exhausts a settlement award too quickly, which is typically the case when the plaintiff receives a lump-sum award, the plaintiff may be unable to afford his or her future medical and living expenses.[83] Consequently, the plaintiff may become a burden to society because he or she no longer possesses the ability to support him- or herself financially.[84] Once the plaintiff squanders the lump-sum cash payment, he or she typically looks to public assistance as a source of income.[85] Without a doubt, the victims are "revictimized."[86] The plaintiff is typically still unable to provide for him- or herself and thus is back in the very predicament that the structured settlement agreement sought to prevent.[87]

A second reason that structured settlements are the "right choice" is because they are protected from bankruptcy petitions.[88] Bankruptcy courts have held that the public policy supporting structured settlements mandates that the courts protect structured settlement recipients from creditors.[89] In the event that the victim defaults on his or her debt and files for bankruptcy, the future payments are immune from creditor claims.[90]

Third, structured settlements benefit both the "unsophisticated" and "sophisticated investor."[91] For instance, the more experienced investor

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80. *See* Scales, *supra* note 31, at 869 (noting that commentators unanimously agree that the plaintiffs are known for mismanaging large sums of money); *see also* ECK & UNGERER, *supra* note 68, at 42.

81. Richard B. Risk, Jr., Comment, *Structured Settlements: The Ongoing Evolution from a Liability Insurer's Ploy to an Injury Victim's Boon*, 36 TULSA L.J. 865, 867 (2001).

82. Andrada, *supra* note 29, at 468-69.

83. *Id.*; Carson & Tong, *supra* note 79, at 312-13.

84. Carson & Tong, *supra* note 79, at 313.

85. *Id.* (rationalizing that squandering the lump sum may lead tort victims to become dependent on public assistance programs such as welfare or Medicaid).

86. Corboy, *supra* note 1, at 116.

87. *Id.*; *see* Carson & Tong, *supra* note 79, at 313.

88. Risk, *supra* note 81, at 867.

89. At least two federal bankruptcy courts ruled that the debtors' structured settlement payments are beyond creditors' reach. *Id.*; *see, e.g.*, *In re* Belue, 238 B.R. 218, 223 (Bankr. S.D. Fla. 1999); *In re* Alexander, 227 B.R. 658, 661 (Bankr. N.D. Tex. 1998).

90. Risk, *supra* note 81, at 867.

91. *Id.* at 868.

can take advantage of "dollar cost averaging" as an investment strategy to beat market returns.[92] In the event that an experienced investor makes a poor investment decision with one or more of his or her payments, the investor can use future payments as a financial cushion.[93] Meanwhile, under a lump-sum payment, one poor financial decision could potentially force even an experienced investor to turn to the federal government for assistance.[94]

Arguably, since work-related injuries are typically rewarded the largest amount of money, the majority of structured settlement recipients are unsophisticated investors.[95] For the inexperienced investor, a structured settlement requires little to no managerial effort.[96] On the other hand, if the investor were to receive a lump-sum payment, he or she would have to make critical decisions in order to make the lump sum last a lifetime.[97] Fortunately, the structured settlement method of spreading the payments relieves the burden imposed by the financial decision making process.[98] Thus, the owner of a structured settlement, unlike a typical investor, does not have to worry about market fluctuations or bad investments.[99] The recipient's future income stream is guaranteed, regardless of market performance.[100]

The final reason that structured settlements are preferred over lump-sum payments is due to congressional efforts to safeguard the payees' rights to compensation.[101] Congress amended the Internal Revenue Code ("I.R.C.") to allow for federal tax exemption of all periodic damage payments and accrued interest on structured settlement payments.[102]

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92. *Id.* (internal quotation marks omitted). This concept requires the investor to invest his or her tax-free periodic payments in a given security at regular intervals rather than second-guessing what might occur in the market, essentially attempting to beat the market. *See id.*

93. *See id.* at 867.

94. *See* Carson & Tong, *supra* note 79, at 313.

95. *See* Scales, *supra* note 31, at 869 (noting that in work-related claims, the victim is typically the average worker). Since corporate financial officers, who would likely be more sophisticated investors, spend most of their time behind a desk or in a boardroom, it is unlikely that they will be structured settlement recipients. *See id.* The recipient may also be a minor, who is likely an unsophisticated investor as well. Andrada, *supra* note 29, at 469.

96. Risk, *supra* note 81, at 866. The unsophisticated investor does not have to worry about the investment portfolio because the annuity or insurance company manages the investments. ECK & UNGERER, *supra* note 68, at 42; Ciecka, *supra* note 32, at 450.

97. Ciecka, *supra* note 32, at 450; Risk, *supra* note 81, at 868; *see* ECK & UNGERER, *supra* note 68, at 42 (clarifying that for larger investments, an investor must be able to diversify his or her portfolio).

98. *See* Risk, *supra* note 81, at 868.

99. *See id.*

100. *Id.*

101. *See* Riccardi & Ireland, *supra* note 66, at 7-8; *infra* Part IV.B.

102. *See* Hindert & Ulman, *supra* note 28, at 19; Riccardi & Ireland, *supra* note 66, at 7-8; Andrada, *supra* note 29, at 470. *See also* Risk, *supra* note 81, at 872 (stating that the tax exclusion

Further, Congress endorses the use of structured settlements over lump-sum payments by taxing the investment gains made on lump-sum awards.[103]

On the other hand, proponents of lump-sum awards argue that a major disadvantage of structured settlements is the "inflexibility" of the awards, such that the recipients are barred from having unlimited access to their funds.[104] However, it is the inflexibility behind the fixed payments that affords the plaintiff with future economic protection.[105] Additionally, a few critics question the statistic that ninety percent of lump-sum settlements are depleted within five years.[106] Although some critics question this statistic because of the broad scope of the study, the study is at least indicative of the structured settlement recipient's "propensity" to spend lump-sum awards.[107] The main reason for this result is the "apparent inability" of many plaintiffs to make prudent investments with the large awards.[108] The personal injury tort victims are

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by Congress is an incentive to the award recipient to choose a structured settlement rather than a lump sum, which if dissipated, can cause the recipient to become an outcast in society).

103. *See* Hindert & Ulman, *supra* note 28, at 19; Andrada, *supra* note 29, at 470. Andrada states:

> Generally speaking, personal injury settlement awards are not taxed, regardless of whether they are received as a lump sum or as payments over time. On the other hand, investment gains are generally taxed, even if those gains are made with money received in a personal injury settlement. Thus, with a lump sum award, the plaintiff pays no taxes for receiving the award but will usually begin to pay taxes on the award once it is received. For example, a plaintiff may decide upon receiving an award to invest in the stock market, purchase a mutual fund, or simply deposit the money in the bank. In each of these cases, the plaintiff will generally pay federal income tax on any profits or interest. The structured settlement, on the other hand, allows those portions of the award that have not yet been disbursed to accrue interest which is exempt from the federal income tax.

Andrada, *supra* note 29, at 470 (footnotes omitted).

104. *See* Risk, *supra* note 81, at 868; Press Release, J.G. Wentworth, The #1 Reason Consumers Sell Their Structured Settlements Is to Pay Bills, According to Survey by J.G. Wentworth (Nov. 4, 2008), *available at* http://www.jgwentworth.com/about/news/press/detail.aspx?i=46. Proponents of the lump-sum method argue that with unlimited access to the award, a plaintiff could possibly beat the annuity's guaranteed interest rate by investing in the right mix of securities. Risk, *supra* note 81, at 868. However, this is very difficult because one bad investment could deplete a plaintiff's entire award. ECK & UNGERER, *supra* note 68, at 41. There is no guarantee that a plaintiff can invest in the market and do better than the guaranteed income stream provided by the annuity. *See id.*

105. *See* ECK & UNGERER, *supra* note 68, at 41 (emphasizing the high risk associated with investing in securities); Risk, *supra* note 81, at 868 ("But, for those payees . . . who might otherwise be inclined to dissipate a large settlement, inflexibility also means indestructibility.").

106. Scales, *supra* note 31, at 870-71; Jeremy Babener, Note, *Justifying the Structured Settlement Tax Subsidy: The Use of Lump Sum Settlement Monies*, 6 N.Y.U. J. L. & BUS. 127, 137-38 (2009).

107. Carson & Tong, *supra* note 79, at 312.

108. *Id.*

typically in more need of protection because the injury may have left them physically or mentally disabled and unable to make wise monetary decisions with the lump-sum award.[109] Thus, the structured settlement is a valuable tool for tort victims.[110]

III. THE FACTORING INDUSTRY: THE RISE OF A PREDATORY INDUSTRY

Factoring industries made their debut appearance in the 1990s. Section A follows their career path from their early beginnings of buying lottery winnings to ultimately making it big in the structured settlement payment market. Section B demystifies the factoring transaction by explaining how they work. Finally, Section C details what issues are created when structured settlement payees sell their future payments to factoring companies.

A. The Rise of the Factoring Industry and the Demise of the Economic Protection Provided by Structured Settlements

The 1990s introduced a private market composed of "a new breed of aggressive hucksters," otherwise known as structured settlement factoring companies.[111] Factoring companies use aggressive advertising to persuade structured settlement recipients, or payees, to sell their future rights to payment for a lump-sum cash payment.[112] These companies acquire the payees' rights to future income in exchange for steeply discounted cash.[113] Essentially, the factoring company makes a large net profit by providing the recipient with cash at a value worth much less than the future payment.[114]

Factoring companies originally started in the lottery industry, purchasing future payments at a discount rate from lottery winners.[115] These companies soon realized that more money could be made through the purchase of structured settlements.[116] Currently, the largest purchaser of structured settlements is J.G. Wentworth & Co., ("Wentworth") which handles approximately half of all the transactions in the factoring

109. *Id.*

110. *Id.*

111. Babener, *supra* note 63, at 31-32; Corboy, *supra* note 1, at 116; Hindert & Ulman, *supra* note 28, at 19.

112. Babener, *supra* note 63, at 31-32; Hindert & Ulman, *supra* note 28, at 19.

113. Corboy, *supra* note 1, at 116; Hindert & Ulman, *supra* note 28, at 20.

114. Babener, *supra* note 63, at 32 ("By offering a cash amount to a structured settlement recipient sufficiently below the present value of the future income stream, a factoring company can net a profit." (footnote omitted)).

115. Risk, *supra* note 81, at 883.

116. *See* Mannix, *supra* note 1, at 62.

market.[117] Wentworth is a Philadelphia, Pennsylvania firm that started out as a financer to nursing homes and long-term care facilities.[118] However, in 1992, Wentworth discovered that more money could be made in the structured settlement market.[119] That year, Wentworth began to purchase structured settlements from vehicular accident victims in New Jersey.[120] Since the transition into the structured settlement market in 1992, Wentworth has participated in more than 15,000 structured settlement transactions, totaling over $370 million.[121] In 2007 and 2008, Wentworth reportedly purchased structured settlements with aggregate payments of $728 million for each of those years.[122]

Factoring companies like Wentworth use aggressive marketing strategies to induce structured settlement recipients to sell their structured settlement rights.[123] These companies produce commercials that flood television sets and the Internet.[124] For instance, Wentworth, whose commercials are played numerous times throughout the day, boasts that they specialize in providing structured settlement holders with "cash now."[125] However, these commercials fail to explain to the structured settlement recipient that what he or she is really trading is his or her financial well-being.[126]

B. How Factoring Transactions Work

Factoring transactions are difficult to understand because the financial concepts involved are complex. These concepts include: the time value of money, present value, and discount rate.[127] For example, a

117. *Id.*

118. *Id.*

119. *See id.* at 62-63.

120. *Id.*

121. *Id.* at 63.

122. Babener, *supra* note 63, at 33.

123. Hindert & Ulman, *supra* note 28, at 19.

124. Between 1996 and 1998, Wentworth aired more than 90,000 thirty-second television commercials. Vanessa O'Connell, *Like It or Lump It: Thriving Industry Buys Insurance Settlements from Injured Plaintiffs*, WALL ST. J., Feb. 25, 1998, at A1.

125. *Id.* (internal quotation marks omitted); *see also Senator Warns on Selling Structured Settlement Payments*, *supra* note 53 (stating that television ads which offer "cash now" to an individual receiving structured settlement payments advocate a practice that should be outlawed (internal quotation marks omitted)).

126. *See* O'Connell, *supra* note 124, at A1 ("Allen Reed, a lawyer for Chicago-based insurer CNA Financial Corp., [said] the whole idea behind structured settlements is to prevent vulnerable or unsophisticated claimants from frittering their settlements away." (internal quotation marks omitted)).

127. *See* Corrie Erickson, *Chapter 593: A Structure for the Transfer of Structured Settlements*, 41 MCGEORGE L. REV. 667, 674 (2010) (explaining that a payee must have "legal sophistication and patience" to understand the factoring transaction); Mannix, *supra* note 1, at 63.

structured settlement recipient who would like to sell a future payment of $75,000 will not sell the payment for $75,000 because money to be paid years from now is worth less in the present day.[128] This concept is known as the time value of money.[129] Basically, money to be paid at a later date is worth less today because of inflation.[130] As a result, because of the time value of money, the factoring company will pay less today for the recipient's future payment.[131] The factoring company uses a complex formula, known as the present value formula, to calculate how much the future payment is worth today.[132] The interest rate used in the present value formula is called the discount rate.[133] The present value formula takes into account certain factors, such as the date to maturity, the interest rate, inflation, and the time value of money.[134]

C. *Problems Caused by the Factoring Industry*

Many legal issues surround the sale of structured settlements to factoring companies. First, since the factoring industry is essentially unregulated, factoring companies often charge exorbitantly high rates.[135] In fact, courts and government officials have reported that factoring companies have charged over seventy percent on a single transaction.[136] The factoring companies argue that these high rates reflect the cost of doing business, which includes the cost of borrowing money to finance the lump-sum payments made to payees and legal costs.[137] Moreover,

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128. ROBERT W. HAMILTON & RICHARD A. BOOTH, ATTORNEY'S GUIDE TO BUSINESS AND FINANCE FUNDAMENTALS § 2.01, at 2-3 (Aspen Publishers 2d ed. 2007) (1989) ("One of the most fundamental financial concepts is that money to be paid or received in the future is not worth as much as money to be paid or received today."); Mannix, *supra* note 1, at 63.

129. HAMILTON & BOOTH, *supra* note 128, § 2.01, at 2-3.

130. Mannix, *supra* note 1, at 63.

131. *See id.*

132. *See id.* Present value is defined as "[t]he sum of money that, with compound interest, would amount to a specified sum at a specified future date; future value discounted to its value today." BLACK'S LAW DICTIONARY 1303-04 (9th ed. 2009).

133. *See* Mannix, *supra* note 1, at 63.

134. *See id.*

135. Corboy, *supra* note 1, at 116 (finding rates in some cases to be as high as seventy-two percent); Hindert & Ulman, *supra* note 28, at 20 (claiming that factoring companies charge rates as high as seventy percent); Vince Tilley, *Damages: Regulate the Transfer of Structured Settlement Payment Rights; Provide That No Such Transfer Shall Be Effective Unless Certain Disclosures Are Made; Provide for a Right of Rescission with Respect to Such Transactions; Provide for Enforcement*, 16 GA. ST. U. L. REV. 277, 278 (1999); *see also* O'Connell, *supra* note 124, at A8 (pointing to an instance where Wentworth charged a consumer twenty-one percent interest on her structured settlement payment).

136. Corboy, *supra* note 1, at 116.

137. Koenig, *supra* note 28, at 814.

factoring company proponents point out that the high rates are "*primarily* a function of competition and capital costs."[138]

However, the factoring companies' argument for high discount rates cannot be substantiated. Unlike credit card companies and banks that loan out unsecured money at much lower rates, factoring companies charge high rates, yet receive a secure asset backed by a guaranteed source of income.[139] Since the future payments are backed by the annuity contract, the factoring company is guaranteed payment and thus the future payments are essentially risk-free.[140] As a result, the high discount rates are not justified because interest rates are associated with risk; the higher the risk, the higher the rate.[141] Both federal and state legislators agree that if factoring transactions were treated as loans, these rates would be deemed "usurious."[142] Thus, if the structured settlement recipient properly understood these rates, he or she would surely find them to be unreasonable and refuse to sell his or her payments.[143]

Second, when a plaintiff exhausts his or her settlement award too quickly, numerous problems may arise. In most cases, settlement awards are expected to pay for future medical, living, or extraordinary expenses.[144] For those victims with serious injuries, the transfer of future income may be detrimental to the payee if he or she is left unemployed and disabled as a result of the injuries.[145] As a result, where the plaintiff's injuries are so serious that he or she can no longer work, the factoring transaction may "have life-threatening consequences."[146] Further, the inflexibility, which allows the payee to spend only a portion of his or her settlement, also means indestructibility.[147] Without the structure that structured settlement payments provide, victims like White and Whitney are left with no security and are thus revictimized.[148]

Third, critics are "unequivocally antagonistic to the enterprise," because they argue that the factoring industry preys on vulnerable

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138. Scales, *supra* note 31, at 930.

139. Babener, *supra* note 63, at 35; *see, e.g.*, Corboy, *supra* note 1, at 116 (finding factoring companies charging rates as high as seventy-two percent); James J. White, *The Usury Trompe L'Oeil*, 51 S.C. L. REV. 445, 449, 467 (2000) (finding the interest rate limit for banks in Minnesota to be no higher than eighteen percent per year).

140. *See* Riccardi & Ireland, *supra* note 66, at 7.

141. *See* HAMILTON & BOOTH, *supra* note 128, § 2.06, at 2-14.

142. Corboy, *supra* note 1, at 116; Mannix, *supra* note 1, at 62.

143. Corboy, *supra* note 1, at 116.

144. Tilley, *supra* note 135, at 277.

145. Andrada, *supra* note 29, at 468-69.

146. *Id.*

147. 144 CONG. REC. 23,343 (1998); Risk, *supra* note 81, at 868.

148. *See* Corboy, *supra* note 1, at 116; *supra* Part I.

consumers.[149] These critics also argue that if structured settlement recipients "did not require protection and were not susceptible and potentially gullible, they would have no need for such settlements."[150] The victims are those who do not have the legal sophistication to understand the true value of their future payments.[151] It is a fact that factoring transactions have a disproportionate impact on African-Americans and low-income individuals.[152]

Factoring companies often charge high discount rates to payees who are not equipped to fully understand the importance of their future payments or the "onerous terms" involved in the factoring transaction.[153] For instance, in 1990, Debra Ann Hayden sold her medical malpractice settlement to a factoring company.[154] Hayden sold her annuity payments in exchange for a lump sum because at the time, she was experiencing financial problems.[155] Although $92,420.63 of the money Hayden received was to pay her outstanding debt, she declared Chapter 13 bankruptcy within two years of selling her structured settlement award.[156]

In contrast, Wentworth and other factoring companies argue that since structured settlements are not flexible assets, factoring companies are necessary to provide the recipients with liquidity.[157] Further, factoring companies contend that structured settlement recipients may need future adjustments, which the fixed monthly payments of structured settlements fail to provide.[158] Rather, these companies argue that they provide an invaluable service: flexibility.[159] While this may be so, the sharp discount rates that factoring companies charge do not seem to suggest that they provide a valid service; rather, the rates suggest exploitation.[160] U.S. Senator Max Baucus lamented that the planning that goes into "structuring" the future payments "can be unraveled in an

149. Corboy, *supra* note 1, at 116.

150. *Id.*

151. Hindert & Ulman, *supra* note 28, at 20. *See, e.g.*, 321 Henderson Receivables, L.P. v. Martinez (*In re* 321 Henderson Receivables, L.P.), 816 N.Y.S.2d 298, 299-302 (Sup. Ct. 2006).

152. *Martinez*, 816 N.Y.S.2d at 298-99.

153. Hindert & Ulman, *supra* note 28, at 20.

154. W. United Life Assurance Co. v. Hayden, 64 F.3d 833, 834-36 (3d Cir. 1995).

155. *Id.* at 835-36.

156. *Id.* at 836.

157. Mannix, *supra* note 1, at 63.

158. *Id.*

159. *See id.*

160. *See* Corboy, *supra* note 1, at 116 (noting that the factoring companies exploit structured settlement recipients by charging "unconscionable rates").

instant by a factoring company offering quick cash at a steep discount."[161]

Several state attorneys general believe that factoring companies run counter to the public policy of protecting structured settlement victims.[162] For instance, Joseph Goldberg, the senior deputy attorney general for Pennsylvania, contended that "[y]ou have got to worry about people who have a debilitating injury . . . . The injury is never going away and they have no real means of income and probably no means of employment. . . . If they give that monthly payment up, it could have serious consequences."[163] Additionally, disability groups, like The National Spinal Cord Injury Association, have voiced similar concerns and refuse to accept factoring companies' advertisements in their magazines.[164] In fact, these groups warn members that they should avoid such quick cash transactions.[165] Factoring transactions violate the very premise that structured settlements are intended to prevent.[166] The simple idea of taking away money from injury victims, including children, for a steep price is clearly contrary to public policy.[167]

IV. CURRENT STATE OF THE LAW

Both state and federal legislators have sought to combat the evils of factoring transactions. Section A explains the federal efforts thus far to protect structured settlement recipients from the perils of factoring. Section B goes through the federal laws that have been passed to encourage the use of structured settlements by plaintiffs, particularly the concept of tax exemptions of future payments. Section B, Subsection 1 begins with the origin of the concept of excluding compensatory damages from taxable income. Subsection 2 deals with two revenue rulings that sought to legitimize the use of structured settlements. Subsection 3 recognizes the codification of the two revenue rulings and the subsequent growth of the factoring industry. Next, Section C identifies New York State legislative efforts to protect structured settlement recipients pursuant to the N.Y. SSPA. Section D lists the preliminary hurdles an applicant faces before he or she can entertain receiving a lump-sum cash payment from a factoring company. Section

161. Mannix, *supra* note 1, at 62 (internal quotation marks omitted).
162. *See id.* at 66.
163. *Id.* (internal quotation marks omitted).
164. *Id.*
165. *Id.*
166. Corboy, *supra* note 1, at 116 ("One official recently suggested that structured settlements are a scam foisted upon tort victims . . . ."); Mannix, *supra* note 1, at 62.
167. *See* Corboy, *supra* note 1, at 116.

E explains the new role played by N.Y. courts in factoring transactions. Finally, Section F explains the many problems surrounding the N.Y. SSPA.

A. Federal Efforts to Protect Structured Settlement Recipients from Factoring Companies

The U.S. Department of the Treasury (the "Treasury") was one of the first to realize that the factoring companies' abusive practice thwarts the congressional intent of protecting structured settlement recipients.[168] In doing so, the Treasury urged Congress to take immediate action for relief against the victimization of claimants.[169] In the federal budget for the 1999 fiscal year, a remedial measure was proposed which intended to reduce the number of factoring transactions.[170]

The proposal recommended that Congress impose a federal excise tax on the factoring transactions that involved the transfer of structured settlement recipient rights without prior court approval.[171] On January 23, 2002, President George W. Bush signed into law the Victims of Terrorism Tax Relief Act of 2001,[172] which successfully adopted the proposition.[173] The proposal was then codified under the I.R.C. as Section 5891.[174] Specifically, the I.R.C. imposes a forty percent federal excise tax on any party that acquires a payee's rights through a factoring transaction without a court order.[175]

B. Federal Efforts to Encourage the Use of Structured Settlements

1. The Origin of the Concept of the Exclusion of Compensatory Damages from Taxable Income

Congressional efforts to help structured settlement payees began far before the Treasury took note of the effects factoring companies had on

168. *See* OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 1999, at 69 (1998), *available at* http://www.gpo access.gov/usbudget/fy99/pdf/spec.pdf; Hindert & Ulman, *supra* note 28, at 20; Mannix, *supra* note 1, at 62.

169. *See* Hindert & Ulman, *supra* note 28, at 20-21.

170. *See* OFFICE OF MGMT. & BUDGET, *supra* note 168, at 69.

171. *Id.*

172. Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, 115 Stat. 2427 (2002) (codified in scattered sections of 26 U.S.C.); *IRS Implements New Tax Relief for Victims of Terrorist Attacks*, IRS (Jan. 23, 2002), http://www.irs.gov/pub/irs-news/ir-02-07.pdf.

173. Victims of Terrorism Tax Relief Act of 2001 § 115(a), 115 Stat. at 2436 (codified at 26 U.S.C. § 5891 (2006)).

174. I.R.C. § 5891 (2006).

175. *Id.* § 5891(a)–(b).

structured settlement claimants.[176] Starting in the 1980s, Congress enacted a variety of tax guidelines to encourage the use of structured settlements over lump-sum payments.[177] As a result, structured settlement payments are now exempt from taxation.[178]

The concept that tort damages should not count towards gross income,[179] and thus should be excluded from taxable income, can be traced back to the back to the early 1900s.[180] The Revenue Act of 1918 (the "Revenue Act") introduced the notion that tort damages should not be taxed.[181] Specifically, Section 213(b)(6) of the Revenue Act excludes from taxation all income received from damages under workmen's compensation.[182] The rationale behind this concept is that Congress did not consider the victim's damage award as a gain but merely as compensation intended to make the victim whole again.[183] Congress reasoned that, since the plaintiff's future payments do not come within the meaning of "income"[184] under the Sixteenth Amendment,[185] the

176. Koenig, *supra* note 28, at 814.

177. *Id.* at 814, 816.

178. I.R.C. § 130(a) ("Any amount received for agreeing to a qualified assignment shall not be included in gross income to the extent that such amount does not exceed the aggregate cost of any qualified funding assets.").

179. Revenue Act of 1918, Pub. L. No. 65-254, § 213(a), 40 Stat. 1057, 1065 (1919) ("[T]he term 'gross income'—(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service . . . .").

180. Risk, *supra* note 81, at 870.

181. *See* Revenue Act of 1918, § 213(b)(6), 40 Stat. at 1065-66. Further:

> [T]he term "gross income" . . . [d]oes not include the following items, which shall be exempt from taxation under this title: . . . [a]mounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness . . . .

Id.

182. *Id.*

183. *See* Risk, *supra* note 81, at 870. The U.S. House Committee on Ways and Means report accompanying the Revenue Bill of 1918 states:

> Under the present law it is doubtful whether amounts received through accident or health insurance, or under workmen's compensation acts, as compensation for personal injury or sickness, and damages received on account of such injuries or sickness, are required to be included in gross income. The proposed bill provides that such amounts shall not be included in gross income.

H.R. REP. NO. 65-767, pt. 2, at 9-10 (1918). In 1927, the Board of Tax Appeals reasoned that tort damages are intended to "make the plaintiff whole," and thus, cannot be said to constitute gain or income. *Id.* at 870-71.

184. In a 1922 tax ruling the IRS affirmed the belief that the damages are not considered income for tax purposes. *See* Eisner v. Macomber, 252 U.S. 189, 207 (1920) (ruling that compensatory damages are not taxable as income because the damage award is not a gain derived from capital, labor, or the growth of an investment); Mark J. Wolff, *Sex, Race, and Age: Double Discrimination in Torts and Taxes*, 78 WASH. U. L.Q. 1341, 1439 (2000); Risk, *supra* note 81, at 870.

185. U.S. CONST. amend. XVI ("The Congress shall have power to lay and collect taxes on

payments are not subject to federal taxation.[186] Subsequently, Congress codified tax enhancements for tort damages in Section 104(a) of the I.R.C.[187]

2. The Two Revenue Rulings that Legitimized the Use of Structured Settlements

The favorable tax treatment of structured settlements did not occur until 1979.[188] That year, the Internal Revenue Service issued two revenue rulings that clarified that Section 104(a)(2)[189] applied to structured settlements,[190] Revenue Ruling 79-220[191] and Revenue Ruling 79-313.[192] Both permitted periodic payments to be excluded from taxation for personal injury settlements.[193]

Revenue Ruling 79-220 allowed a plaintiff to exclude from gross income "the full amount of monthly payments received in settlement of a damage suit[,]" rather than the "discounted present value" of those payments.[194] Additionally, Revenue Ruling 79-313 allowed a plaintiff to exclude from gross income the future periodic payments regardless of whether the payments increased on an annual basis.[195]

3. Thanks, Congress: The Exponential Increase in the Use of Structured Settlements

Although structured settlements were used more frequently after the 1979 rulings, defendants were still unable to take full advantage of the tax exemptions.[196] As a result, when a defendant purchased an annuity to fund the periodic payments, the payments could only be deducted "as business expenses as the money was distributed to the plaintiffs."[197] Senator Baucus advocated for the expansion of the application of tax

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incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.").

186. Risk, *supra* note 81, at 870.

187. *See* I.R.C. § 104(a)(1) (2006) ("[G]ross income does not include . . . amounts received under workmen's compensation acts as compensation for personal injuries or sickness.").

188. Babener, *supra* note 63, at 21.

189. I.R.C. § 104(a)(2) ("[G]ross income does not include . . . the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness.").

190. Babener, *supra* note 63, at 21.

191. Rev. Rul. 79-220, 1979-2 C.B. 74.

192. Rev. Rul. 79-313, 1979-2 C.B. 75.

193. *Id.*; Rev. Rul. 79-220, 1979-2 C.B. 74; Babener, *supra* note 63, at 21.

194. Rev. Rul. 79-220, 1979-2 C.B. 74.

195. Rev. Rul. 79-313, 1979-2 C.B. 75.

196. *See* Babener, *supra* note 63, at 22.

197. *Id.*

benefits to all payments set aside for structured settlements.[198] He reasoned that structured settlements needed further protection because they have become the norm due to the "obvious advantages" over lump-sum payments.[199] Senator Baucus proved to be successful. In 1983, Congress passed the Periodic Payment Settlement Tax Act of 1982,[200] which codified the two 1979 revenue rulings by amending Section 104(a)(2) and adding Section 130 to the I.R.C., which is still in effect today.[201] As a result, all money set aside for structured settlements, including future payments, is not considered taxable income under Section 104(a)(1) and (a)(2) of the I.R.C.[202]

Congressional efforts successfully generated growth in the structured settlement industry.[203] In 1976, the structured settlement market's net worth was approximately $5 million.[204] By the early 1990s, structured settlement annuity sales had grown to approximately $4 billion.[205] As of 2002, more than $6 billion were being paid out annually to fund the purchase of annuity contracts.[206]

Unfortunately, Congress's attempt to protect the financial interests of tort victims spawned the growth of the factoring industry.[207] By 2005, an estimated $250 million of structured settlements were being sold to factoring companies on an annual basis.[208] Today, a number of factoring companies compete for over $5 billion in structured settlement awards paid on an annual basis.[209] As long as structured settlements remain in force, the factoring industry will continue to grow.[210]

The continued growth of the factoring market is evidence that the tax rules were not as detrimental to the factoring industry as Congress had hoped. For instance, although Section 5891 seeks to impose a tax on

198. 127 CONG. REC. 30,462 (1981) (statement of Sen. Baucus). U.S. Representative Daniel Rostenkowski, chairman of the Committee of Ways and Means, also submitted a report supporting the position that "any amount received for agreeing to undertake an assignment of a liability to make periodic payments as personal injury damages is not included in gross income." H.R. REP. NO. 97-832, at 4 (1982).

199. 127 CONG. REC. 30,462.

200. Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, 96 Stat. 2605 (codified as amended in scattered sections of 26 U.S.C.).

201. *Id.* § 101, 96 Stat. at 2605–06; H.R. REP. NO. 97-832, at 1; Babener, *supra* note 63, at 23.

202. I.R.C. § 104(a)(1)–(2) (2006).

203. Babener, *supra* note 63, at 18; Andrada, *supra* note 29, at 467.

204. Babener, *supra* note 63, at 18.

205. *Id.* at 19.

206. *Id.* at 7 & n.15.

207. *See* Koenig, *supra* note 28, at 813-14.

208. Babener, *supra* note 63, at 33.

209. Mannix, *supra* note 1, at 62.

210. Koenig, *supra* note 28, at 813-14 (recognizing that the factoring industry is in a great position to sustain future growth in an "ever-growing" structured settlement market).

factoring companies, it does not stop the factoring companies from charging excessive discount rates in order to make up for the tax.[211] In fact, the factoring market is so strong that it emerged nearly unscathed from the economic crisis in 2008.[212] Although the economic crisis has caused the price of factoring transactions to go up, the economic turmoil caused a direct increase in consumer demand.[213] Unfortunately, the federal government's efforts have been insufficient. Currently, approximately $100 billion in structured settlements are in full force today, and factoring companies have shown that they will relentlessly buy as many structured settlements as possible.[214]

C. *New York State Legislature to the Rescue: The Enactment of the N.Y. SSPA*

State legislators recognized a need to address the social problems caused by an unregulated factoring industry. In September 2000, the National Structured Settlement Trade Association (the "NSSTA") and National Association of Settlement Purchasers drafted the Model Structured Settlement Protection Act (the "Model SSPA").[215] The Model SSPA's main requirement is judicial approval of the transaction as a precondition to the sale of a structured settlement recipient's rights to a third party.[216] The NSSTA believed that the best way to regulate the market would be through court supervision.[217] At least thirty-five states have passed some sort of structured settlement protection statute based on the Model SSPA.[218]

The Legislature's concern regarding the growth of the structured settlement industry precipitated the passage of New York's structured

211. *See* I.R.C. § 5891(a) (2006); Mannix, *supra* note 1, at 62.

212. Babener, *supra* note 63, at 7.

213. *Id.* at 7 n.17, 34.

214. Hindert & Ulman, *supra* note 28, at 19 (estimating that more than $6 billion is paid out to structured settlements recipients on an annual basis); *see also* Babener, *supra* note 63, at 33 ("Currently, it is estimated that approximately 8,000 factoring transactions occur annually, with an average price of $45,000, amounting to $360 million.").

215. MODEL STATE STRUCTURED SETTLEMENT PROT. ACT §§ 1–7 (Language Agreed to by National Structured Settlements Trade Association and National Association of Settlement Purchasers 2000), *available at* http://www.ncoil.org/Docs/2011/StructuredSettlementsModel.pdf (last visited Apr. 20, 2012); *see also* Hindert & Ulman, *supra* note 28, at 20, 28 n.4.

216. *See* MODEL ST. STRUCTURED SETTLEMENT PROT. ACT § 4; Hindert & Ulman, *supra* note 28, at 20.

217. *See* MODEL ST. STRUCTURED SETTLEMENT PROT. ACT § 4; Hindert & Ulman, *supra* note 28, at 20 ("The effectiveness of any transfer of structured settlement payment rights is conditioned on advance court approval of the transfer . . . .").

218. Hindert & Ulman, *supra* note 28, at 20; *see, e.g.*, CAL. INS. CODE § 10136(a)–(b) (West 2005); MASS. GEN. LAWS ANN. ch. 231C, § 2(a) (West Supp. 2011); NEB. REV. STAT. § 25-3104 (2004); N.Y. GEN. OBLIG. LAW § 5-1706 (McKinney 2010).

settlement laws.[219] Recently, New York passed its own structured settlement protection act to safeguard its citizens against the factoring industry.[220] As of July 1, 2002, the Legislature stated that all factoring transactions must meet the conditions set forth in the N.Y. SSPA in order to effectuate the factoring sale.[221] The legislation's main purpose is to protect and maintain the legitimacy of structured settlements for tort victims.[222]

The Legislature contended that the policy concerns surrounding the sale of structured settlement recipients' payments at such sharply discounted prices poses a serious threat to many, including new and old claimants, taxpayers, and the government (which funds the assistance programs that payees are forced to rely on once their future income has been sold).[223] The Legislature was concerned with the aggressive advertisements (which create the allure of easy money, high discount rates used by factoring companies), and the premature dissipation of structured settlement funds tailored to the victim's needs.[224] Moreover, the Legislature understood that factoring companies, when left unregulated, gained at the expense of a victim deprived of long-term financial security.[225]

Accordingly, the Legislature enacted legislation to limit the exploitive practices of the factoring industry.[226] The N.Y. SSPA's main requirement is prior court approval, which is intended to limit the premature dissipation of structured settlement funds with those largely unfamiliar with handling large amounts of money.[227] The Legislature believed that N.Y. courts would put a halt to the "victimization so prevalent in the industry."[228]

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219. Memorandum of Assemblyman Mark Weprin, *reprinted in* 2002 LEGIS. ANN. 304, 304-05 (N.Y. 2002).

220. N.Y. GEN. OBLIG. LAW §§ 5-1701 to 5-1709; Memorandum of Assemblyman Mark Weprin, *reprinted in* 2002 LEGIS. ANN., at 304-05.

221. 2002 N.Y. Sess. Laws 1336-41 (McKinney). Effective January 1, 2011, the Legislature amended Section 5-1705, now requiring an order to show cause, a statement explaining any previous transfers or application for transfers, and that the payee attends the hearing transfer unless excused for good cause. N.Y. GEN. OBLIG. LAW § 5-1705(a), (d)(iv)–(e) (McKinney, Westlaw through 2011 legislation).

222. Memorandum of Assemblyman Mark Weprin, *reprinted in* 2002 LEGIS. ANN., at 304.

223. *Id.*

224. *Id.*

225. *See id.*

226. *See* N.Y. GEN. OBLIG. LAW §§ 5-1701 to 5-1709 (McKinney 2010 & Westlaw); Memorandum of Assemblyman Mark Weprin, *reprinted in* 2002 LEGIS. ANN., at 304-05.

227. *See* N.Y. GEN. OBLIG. LAW § 5-1706(a)–(b); Memorandum of Assemblyman Mark Weprin, *reprinted in* 2002 LEGIS. ANN., at 304-05.

228. 321 Henderson Receivables, L.P. v. Martinez (*In re* 321 Henderson Receivables, L.P.), 816 N.Y.S.2d 298, 300 (Sup. Ct. 2006).

D. Preliminary Hurdles Plaintiffs Face When Entering into a Factoring Transaction in New York

A claimant must pass a few preliminary hurdles before he or she can sell his or her future income to a factoring company.[229] For example, Section 5-1706(c) of the N.Y. SSPA requires that the factoring company advise the payee, in writing, to seek independent counsel regarding the transfer.[230] Additional procedural requirements are laid out in Sections 5-1703 and 5-1705.[231] Specifically, Section 5-1705(d) requires: "(i) a copy of the transfer agreement; (ii) a copy of the disclosure statement and proof of notice of that statement required under Section 5-1703 of this title; and (iii) a listing of each of the payee's dependents, together with dependent's age."[232] Section 5-1703 explains that the disclosure statement must set out, among other things, conspicuously in writing:

(1) "due dates of the structured settlement payments to be transferred";
(2) "the aggregate amount of [the] payments";
(3) "the discounted present value of the [future] payments";
(4) a price quote which reflects the cost of purchasing a comparable annuity for that amount;
(5) "the gross advance amount and the annual discount rate, compounded" on a monthly basis;
(6) a list "of all commissions, fees, costs, expenses, and charges payable by the payee"; the net amount to be received by the payee;
(7) "any penalties or liquidated damages payable by the payee in the event of any breach of the transfer agreement"; and
(8) "a statement that the payee has the right to cancel the transfer agreement," which must be done by the third business day after the payee signs the agreement.[233]

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229. *See* N.Y. GEN. OBLIG. LAW § 5-1706. Although most structured settlement contracts contain an anti-assignment clause, the restrictive language of an anti-assignment clause is typically not upheld in New York. *See In re* Settlement Funding of N.Y., L.L.C. (*Platt*), 774 N.Y.S.2d 635, 640 (Sup. Ct. 2003) (clarifying that if the parties meet all the requirements under the N.Y. SSPA, a claimant may assign his or her structured settlement contract to a third party).

230. N.Y. GEN. OBLIG. LAW § 5-1706(c).

231. *Id.* §§ 5-1703, 5-1705.

232. *Id.* § 5-1705(d).

233. *Id.* § 5-1703. The discounted present value for the purpose of this statute means, "the calculation of current value of the transferred structured settlement payments under federal standards for valuing annuities, and the amount of the applicable federal rate used in calculating such discounted present value." *Id.* § 5-1703(c) (internal quotation marks omitted). The net advance amount means, "[t]he net cash payment you receive in this transaction from the buyer . . . determined by applying the specific discount rate to the amount of future payments received by the buyer, less the total amount of commissions, fees, costs, and expenses and charges

Arguably, many of the procedural requirements set forth under the N.Y. SSPA are very difficult to understand and thus provide a reason why court supervision is necessary. Unless the petitioner truly understands the complex financial terms set forth in the disclosure statement, then the disclosure requirement does not help the claimant further understand the transaction. For instance, the statute requires that the present value and annual discount rate be clearly stated.[234] However, the concepts of present value of money and discount rates are typically foreign terms to the average recipient.[235] Unfortunately, an understanding of the present value of a recipient's future income, mainly how much money is worth today in relation to the future, is the very foundation of the factoring transaction.[236]

E. The Courts' New Role

Since the passage of the N.Y. SSPA, the Legislature has forced N.Y. judges to rule on a high number of factoring transactions.[237] Prior to the passage of the N.Y. SSPA, N.Y. courts were not involved in the factoring process.[238] However, Section 5-1706(b) created a new role for N.Y. courts: determining the "best interest" of settlement recipients.[239] Section 5-1706(b) mandates that the court must ensure that the transaction is truly in the "best interest" of the payee, meaning the court must consider the financial condition and needs of the applicant.[240] Meanwhile a second inquiry is made to see whether the transaction is "fair and reasonable" by looking at the overall market of loans, prevailing interest rates, and alternative financing options, which means that many times the two questions cannot be separated.[241]

The best interest standard appears to be more lax than the standard initially set forth when the statute was first adopted in 2002. Initially, the

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payable." *Id.* § 5-1703(g) (internal quotation marks omitted).

234. *Id.* § 5-1703(c), (e).

235. *See* Erickson, *supra* note 127, at 674 (explaining that the factoring transaction requires "legal sophistication" to understand).

236. *See* Mannix, *supra* note 1, at 63.

237. *See* Memorandum of the Assembly Rules Committee, *reprinted in* 2004 LEGIS. ANN. 327, 328 (N.Y. 2004) (recognizing that prior to the passage of the N.Y. SSPA in 2002, claimants could exchange their future payments for a lump sum without prior court approval).

238. *See id.*

239. The "best interest" criteria set out by the statute includes "the welfare and support of the payee's dependants; and whether the transaction, including the discount rate used to determine the gross advance amount and the fees and expenses used to determine the net advance amount, are fair and reasonable." N.Y. GEN. OBLIG. LAW § 5-1706(b) (footnote omitted).

240. *Id.*; *In re* 321 Henderson Receivables, L.P. (*DeMallie*), 769 N.Y.S.2d 859, 861 (Sup. Ct. 2003).

241. N.Y. GEN. OBLIG. LAW § 5-1706(b); *DeMallie*, 769 N.Y.S.2d at 861.

best interest determination included an "imminent financial hardship" requirement.[242] However, after deliberation, the Legislature removed the "hardship" requirement.[243] The Legislature no longer believes that a showing of hardship is a necessary precondition to approval.[244] Rather, the Legislature believes that since the claimants are adults capable of consent, they are in the best position to determine what is in their best interest without proving hardship.[245] As a result, the transaction can be approved without a court determination of hardship.[246]

F. The Major Problems with the N.Y. SSPA

Although the N.Y. SSPA remains a significant statute, the practical effects of the statute on factoring transactions have not received much attention.[247] For example, despite the requirement for prior court approval, the approval rate for factoring transactions in the United States is currently ninety-five percent or higher.[248] Moreover, even when denied, many applicants merely reapply for a transfer without a waiting period.[249] Although legislatures "did not intend for the courts to be mere rubber stamps" on proposed factoring transactions, the numbers indicate that courts across the country are approving these transactions at an alarmingly high rate, and New York is no exception.[250] Although a review of the cases found on the legal research database Westlaw suggests that most factoring transactions in New York are denied,[251] this is not the case.[252]

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242. Memorandum of the Assembly Rules Committee, *reprinted in* 2004 LEGIS. ANN., at 328 (internal quotation marks omitted).

243. N.Y. GEN. OBLIG. LAW § 5-1706(b); Memorandum of the Assembly Rules Committee, *reprinted in* 2004 LEGIS. ANN., at 328 (internal quotation marks omitted).

244. N.Y. GEN. OBLIG. LAW § 5-1706(b).

245. Memorandum of the Assembly Rules Committee, *reprinted in* 2004 LEGIS. ANN., at 328.

246. N.Y. GEN. OBLIG. LAW § 5-1706(b).

247. 321 Henderson Receivables, L.P. v. Martinez (*In re* 321 Henderson Receivables, L.P.), 816 N.Y.S.2d 298, 298-99 (Sup. Ct. 2006).

248. Babener, *supra* note 63, at 40.

249. *Id.* at 40-41.

250. *In re* Settlement Capital Corp. (*Ballos*), 769 N.Y.S.2d 817, 827 (Sup. Ct. 2003); Babener, *supra* note 63, at 40.

251. As of February 22, 2012, Westlaw cites approximately one hundred New York cases that reference the best interest standard and in nearly all the cases listed, the courts did not approve the factoring transactions. *See, e.g.*, *Martinez*, 816 N.Y.S.2d at 300, 302; *In re* 321 Henderson Receivables, L.P. (*DeMallie*), 769 N.Y.S.2d 859, 862-63 (Sup. Ct. 2003); *Ballos*, 769 N.Y.S.2d at 829.

252. Many cases do not appear in a legal database. There is evidence that many factoring transactions are approved but cannot be found on a legal database. *See, e.g.*, *supra* notes 17-27 and accompanying text (demonstrating that there was no record on Westlaw of the first three times the court approved Whitney's transaction until an unpublished opinion was issued after her fourth

Additionally, the best interest standard is not concrete enough to create uniformity amongst the treatment of claimants, and thus courts merely rubber stamp the cases with approval.[253] In New York, scant interest has been devoted to actually creating a real standard for the best interest test.[254] Rather, different judges continue to scrutinize each claimant's situation with a different focus. For instance, in *In re 321 Henderson Receivables, L.P. (DeMallie)*,[255] the court likened the best interest test to the test applied in applications for the modification of child support payments.[256] The court stated that unless the appellate court establishes otherwise, structured settlement agreements are presumed negotiated in the best interest of the payee and in order to overcome this presumption, "there must be a showing, by clear and convincing evidence, of an unforeseeable change in circumstances that would justify the sale of rights to future payments."[257] The court acknowledged that the standard could not be defined precisely.[258] It held that DeMallie's desire to trade in his future payments for cash to use towards the purchase of a new home is not an unforeseeable change in circumstances, and thus, his transaction was denied.[259] However, since there is no clear standard another court could have come out the other way. For instance, in Charlotte Whitney's scenario, the courts must have applied a different standard because she was approved for three different factoring transactions within three years despite her lack of proof for a concrete plan for the use of funds, and her track record of misusing the funds that she received from the factoring transaction.[260] Thus, since the Legislature has not yet devised a more precise rule, courts are likely to continue to apply different standards to all future factoring transactions.

Additionally, although courts have ruled on hundreds of applications since the passage of the N.Y. SSPA, there are no bright-line rules for prohibitions against using high discount rates; thus, it appears in many cases that "the transaction rates currently being used (along with other factors) are inherently not fair and reasonable, nor in the payees' best interests."[261] Factoring companies typically charge structured

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appearance before the court).

253. *Martinez*, 816 N.Y.S.2d at 300; *see supra* notes 17-27 and accompanying text.

254. *Martinez*, 816 N.Y.S.2d at 298-300.

255. 769 N.Y.S.2d 859 (Sup. Ct. 2003).

256. *DeMallie*, 769 N.Y.S.2d at 863.

257. *Id.*

258. *Id.* at 862.

259. *Id.* at 863.

260. *See* Whitney v. LM Prop. & Cas. Ins. Co., No. 3375/2011, 2011 WL 2654028, at *2 (N.Y. Sup. Ct. June 24, 2011).

261. *In re* J.G. Wentworth Originations, L.L.C., No. 21636 2011, 2011 WL 6224568, at *4

settlement payees a "punishingly high effective rate of interest."[262] When the claimant seems to be in desperate need of cash, the money comes at a steeper price, which translates into a steeper discount rate.[263] The Legislature has not proposed any parameters as to whether factoring transactions are "in fact, fair and reasonable."[264] Nevertheless, the court will likely find that the discount rate is acceptable as long as it is "within the range of the marketplace."[265] This is a major problem because the range of rates charged may be as high as seventy-two percent.[266] Thus, under the fair and reasonable test, a largely unregulated market governs the range of rates acceptable in N.Y. courts. The question must be posed then: how can a transaction be in the best interest of the payee when the rates are "punishingly high"?[267]

Further, the high interest rates charged by factoring companies pose a possible ethical dilemma. Attorneys have an ethical and fiduciary duty to obtain a reasonable amount for their client; however, the rates factoring companies charge certainly makes this nearly impossible.[268] Another ethical dilemma posed by the N.Y. SSPA is that there is no requirement that independent council must represent the payee when the payee appears before the court.[269] An attorney working for Wentworth, for example, may very well represent the payee before the court.[270] The N.Y. SSPA does not limit the number of times an applicant can appear before the court regarding the factoring of his or her payments, nor is there a waiting period.[271] Thus, if a claimant is denied on the first payment, he or she can potentially reappear before the court to factor the second, third, and even fourth payment.[272]

(N.Y. Sup. Ct. Dec. 14, 2011).

262. *DeMallie*, 769 N.Y.S.2d at 861.

263. *Id.*

264. *In re J.G. Wentworth Originations, L.L.C.*, 2011 WL 6224568, at *4.

265. *See In re* 321 Henderson Receivables, L.P. (*Lemanski*), 819 N.Y.S.2d 826, 832 (Sup. Ct. 2006).

266. Corboy, *supra* note 1, at 116.

267. *DeMallie*, 769 N.Y.S.2d at 861.

268. *See* Corboy, *supra* note 1, at 116.

269. *See* N.Y. GEN. OBLIG. LAW § 5-1706(c) (McKinney 2010) (indicating that the applicant must be advised in writing to seek independent professional advice and has received that advice or knowingly has waived such advice).

270. *See id.*

271. *See id.* §§ 5-1701 to 5-1709.

272. *See id.* (failing to state in the statutory language that anything prevents a claimant from appearing in court in an attempt to factor his or her payment(s), even if he or she fails on a prior attempt).

V. FIXING THE N.Y. SSPA: PROPOSALS

The Legislature should provide clearer guidelines for the judges to follow in order to better effectuate the N.Y. SSPA. Section A provides four legislative solutions to resolve the problems with the N.Y. SSPA. Meanwhile, Section B provides feasible approaches that plaintiffs can utilize to better equip themselves against the false sense of security that factoring transactions provide.

A. Necessary Legislative Action

The N.Y. SSPA, when applied, does little to protect claimants. Rather, structured settlement recipients are left at the mercy of the factoring industry because the standards that courts are instructed to follow are not clearly defined.[273] As a result, since courts have been unable to achieve a clear standard, the Legislature should revise the statute to create a more uniform standard in New York so that the initial intent of protecting payees from aggressive factoring can truly be effectuated.

Critics have suggested that the factoring industry should be banned.[274] These critics have often compared structured settlements and the factoring industry to *The Odyssey*'s Ulysses who bound himself to the mast of his ship to prevent from swimming towards the Sirens' deadly shores.[275] One author even noted that "[t]he difference between Ulysses and the plaintiff in the structured settlement is that, so far as we know, Ulysses did not get a tax break to encourage being bound."[276] The key difference between the factoring industry and Ulysses, however, is that Ulysses could not simply untie himself for a small price.[277] Despite public policy concerns, banning the factoring industry is not justified. Since the recipient's future is unpredictable, the liquidity that factoring companies provide is valuable.[278]

The Legislature should not ban the factoring industry. Rather, the Legislature should revise the N.Y. SSPA in order to better regulate the

273. *See supra* Part IV.F.

274. *Senator Warns on Selling Structured Settlement Payments*, *supra* note 53.

275. Babener, *supra* note 63, at 41; Henry E. Smith, Essay, *Structured Settlements as Structures of Rights*, 88 VA. L. REV. 1953, 1969-70 (2002).

276. Smith, *supra* note 275, at 1970.

277. Babener, *supra* note 63, at 42.

278. *Id.* In 1995, Douglas Winsor, jobless and hard-pressed for cash, sought the help of Wentworth after watching Wentworth's "cash now" ads on television. O'Connell, *supra* note 124, at A1. He turned his $106,385.50 into $31,711 in order to catch up on his late mortgage payments. *Id.*

factoring industry and limit the number of factoring transactions. There are four main revisions that the Legislature should make.

First, a maximum discount rate should be introduced so that factoring companies cannot charge steep discount rates on non-risky assets.[279] These rates are surprisingly high for a "secured investment."[280] Even credit cards, which are unsecured assets, do not charge nearly as much as some factoring companies.[281] If credit card companies do not charge excessively high rates for unsecured assets,[282] why should factoring companies be able to do so for secured assets?

Comparatively, the Legislature has effectively created a similar limitation on the discount rate with respect to the assignment of lottery winnings.[283] Pursuant to the N.Y. Tax Law, a court will allow for the assignment if the court finds that "[t]he purchase price being paid for the payments being assigned represents a present value of the payments being assigned, discounted at an annual rate that does not exceed ten percentage points over the Wall Street Journal prime rate."[284] The Legislature should apply a similar provision under the N.Y. SSPA given the following factors:

> (1) the unequal bargaining power of these payees as compared to the transferees is palpable; (2) it appears that persons in financial distress may be disproportionately targeted by transferees simply because of their financial position, thereby forcing the former to accept pennies on the dollar on AAA-rated annuities; and (3) there is little, if any, risk on the part of transferees yet payees nevertheless receive a small portion of what their annuities are presently worth."[285]

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279. *See In re* 321 Henderson Receivables, L.P. (*DeMallie*), 769 N.Y.S.2d 859, 861 (Sup. Ct. 2003) ("[Structured settlement payments are] as secure as any commercial instrument can possibly be, and there is no obvious justification for treating it as equivalent to a consumer's unsecured promise to keep a revolving credit account current."). A trial court judge has asked that the Legislature consider adding a cap discount rate to the N.Y. SSPA. Peter Vodola, *New York Judge Rejects Structured Settlement Factoring Transaction, Calls for Legislature to Consider Rate Cap*, SECONDARY INS. MARKET BLOG (Dec. 28, 2011, 11:59 PM), http://www.secondaryinsurancemarketblog.com/weblog/2011/12/new-york-judge-rejects-structured-settlement-factoring-transaction-calls-for-legislature-to-consider.html.

280. *DeMallie*, 769 N.Y.S.2d at 861 (finding that eighteen percent is a very high rate for a "secured investment").

281. *See, e.g.*, Corboy, *supra* note 1, at 116 (noting factoring company rates as high as seventy-two percent); White, *supra* note 139, at 449, 467 (noting that the interest rate limit for banks in Minnesota to be no higher than eighteen percent per year).

282. *See* White, *supra* note 139, at 449, 467.

283. N.Y. TAX LAW § 1613(d)(1)(ii) (McKinney Supp. 2011).

284. *Id.* (specifying that the rate applied would be the one "published on the business day prior to the date of execution of the contract").

285. Vodola, *supra* note 279.

Thus, it would be appropriate for the Legislature to create a similar discount rate scheme.

Second, claimants should not be allowed to sell their structured settlements to any factoring company within a small time frame.[286] A maximum ratio should be set to make sure that only a portion of the structured settlement is sold to a factoring company over the course of the victim's lifetime.[287] Since every factoring transaction differs on a case-by-case basis, the statute should not adopt a standard percentage.[288] Rather, a maximum ratio, which incorporates how much of the structured settlement a claimant has left and the present value of the future payments, would make more sense.[289]

For instance, if a maximum ratio were set at fifty percent, once that ratio is met, a claimant would be precluded from appearing before the court to sell off the remaining payments.[290] In support of this proposition, when the applicant argues that he or she is in dire need of immediate cash in order to avoid a situation such as foreclosure, once the claimant receives the cash, the problem should be resolved.[291] However, because there is no maximum ratio, claimants are not using the funds for their intended purpose and are appearing before the courts numerous times and selling off, one by one, their entire future income stream.[292] The maximum ratio approach would be judicially efficient and force the claimant to be cognizant of the fact that he or she must make better use of the cash received from previous factoring transactions, otherwise the claimant will have to wait for the future payment to mature.[293] Thus, the combination of a maximum ratio and a maximum discount rate will

286. *But cf. supra* text accompanying notes 17-27 (demonstrating that the court allowed Whitney to sell half of the payments due to her for the next sixty-six years within three years).

287. A maximum ratio would ensure that Whitney could not sell half of her payments within a mere three years. *See supra* text accompanying notes 17-27.

288. *Compare supra* text accompanying notes 1-16 (discussing how White factored away so many payments that he eventually required public assistance), *with supra* text accompanying notes 17-27 (discussing how Whitney factored away half of her guaranteed payments, while failing to provide the court with different reasons for the multiple factoring transactions).

289. *Cf. supra* text accompanying notes 1-27 (noting that without a maximum ratio, claimants can factor away an exorbitant portion of their structured settlement).

290. *See, e.g., supra* text accompanying notes 17-27 (demonstrating that since Whitney sold half of her payments, the maximum ratio would be met, and she would be precluded from selling off the rest of her payments).

291. *See* O'Connell, *supra* note 124, at A1 (explaining that Winsor received cash for his future payments and used the money to pay off his mortgage as intended).

292. *See supra* text accompanying notes 17-27.

293. *But cf. supra* text accompanying notes 17-27 (demonstrating that without a maximum ratio, Whitney was free to use the funds however she desired and did not need to wait for future payments to mature if she wanted more money).

ensure that the sharp discount rates, which legislators and attorneys general have referenced as being "usurious," will be avoided.[294]

Third, the Legislature should amend the N.Y. SSPA prohibiting factoring companies and any of its affiliates from providing advice regarding the transfer. A major issue the N.Y. SSPA fails to sufficiently address is the issue of representation.[295] Currently, the N.Y. SSPA does not require the payee to actually speak to an independently qualified professional.[296] Rather, the factoring company merely has to *advise* the transferee to seek independent professional advice and the payee has the option to "knowingly" waive such advice in writing.[297] A situation may arise where the payee may very well consult an attorney affiliated with the factoring company and waive the independent advice requirement. Hence, a provision should be added to explicitly bar the payee from receiving legal advice from factoring companies and their affiliates.[298]

Moreover, in order to give this proposed provision more bite, the provision should require written proof that the payee has sought truly independent advice and understands the consequences and alternatives of factoring transactions.[299] A viable solution would be to allow law students to represent the payees free of charge through law school clinic programs.[300] Thus, a requirement that claimants actually speak to independent professionals, particularly attorneys who will ensure that factoring companies are truly independent of the transaction, ensures that the payees are not lured into transactions through a false sense of security.[301]

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294. *See* Mannix, *supra* note 1, at 62.

295. *See* N.Y. GEN. OBLIG. LAW § 5-1706(c) (McKinney 2010).

296. *Id.*

297. *Id.*

298. A victim that falls for the allure of a factoring company's advertisements, such as Bobbie Jean Sweeney, is not likely to speak to independent counsel and knowingly waive her rights. *See* O'Connell, *supra* note 124, at A8 (discussing how Sweeney fell for a factoring company advertisement that left her unable to make ends meet but never sought help beyond calling the factoring company itself).

299. *Cf.* Mannix, *supra* note 1, at 62 (recognizing that many of the applicants are vulnerable individuals who do not truly understand the value of their payments).

300. *Cf.* Margaret Martin Barry, *Accessing Justice: Are Pro Se Clinics a Reasonable Response to the Lack of Pro Bono Legal Services and Should Law School Clinics Conduct Them?*, 67 FORDHAM L. REV. 1879, 1903-04 (1999) (explaining that the University of Maryland law school clinics initially staffed the Pro Se Divorce Project and helped clients by explaining legal issues the clients were facing, subsequently making the program into a success).

301. *See* Memorandum of Assemblyman Mark Weprin, *reprinted in* 2002 LEGIS. ANN. 304, 304 (N.Y. 2002) (stating that factoring companies use advertisements and promises of instant cash to lure payees into selling off their settlements); *see also* Mannix, *supra* note 1, at 62 (providing a reminder that the public policy behind structured settlements is to "prevent accident victims from frittering away large sums intended to provide for them over their lifetimes").

Fourth, the statute should adopt a preclusive subsection. For instance, under the N.Y. SSPA, a claimant can try to sell the same payment without any limits as to the number of times he or she can appear before the court.[302] Further, there are no limits to the number of times a plaintiff can be denied the sale of a future payment.[303] Since nothing in the N.Y. SSPA stops recipients from renewing a petition for transfer until the payment is actually paid out, a petitioner initially denied benefits could return days later to seek approval.[304]

Effective January 1, 2011, New York enacted a few amendments that address but do not completely resolve the preclusion issues on a factoring transaction already denied by a N.Y. court.[305] The enactment of the New York proposals demonstrates that the Legislature recognized that there were problems associated with the N.Y. SSPA.[306] However, the recent amendments are not enough. For instance, under the amendment, the petitioner must include "a statement setting forth whether there have been any previous transfers or applications for transfer of the structured settlement payment rights and giving details of all such transfers or applications for transfer."[307] Although this proposal does not rise to the level of claim preclusion, it would allow the court to take into account the number of times a petitioner has filed for court approval on any given future payment.[308] This is also important because prior to this amendment, N.Y. courts had no record of prior transfers.[309] A payee could bring forth a petition for the last of his or her payments, after having transferred all but one of his or her future payments, and the judge would be unaware that this was the last of the recipient's payments.[310] Additionally, prior to this amendment, the petitioner could

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302. *See, e.g.*, *In re* 321 Henderson Receivables, L.P. (*Lemanski*), 819 N.Y.S.2d 826, 827-28 (Sup. Ct. 2006) (explaining that Lemanski was denied on June 8, 2006, yet on July 13, 2006, he reappeared before the court to reargue that the very same payments that were initially denied by the courts should be approved for transfer).

303. *See* N.Y. GEN. OBLIG. LAW §§ 5-1701 to 5-1709 (McKinney 2010).

304. *See id.*; Babener, *supra* note 63, at 40-41.

305. The Legislature has made an effort to ensure that a claimant does not take advantage of the lack of a preclusive effect on a denied claim. *See* N.Y. GEN. OBLIG. LAW § 5-1705(a), (d)(iv), (e) (McKinney, Westlaw through 2011 legislation).

306. These amendments, when taken as a whole, were intended to better safeguard the payee. *New Consumer Protections Take Effect with New York's Structured Settlement Protection Act*, NAT'L STRUCTURED SETTLEMENTS TRADE ASS'N (Jan. 3, 2011), http://www.nssta.com/content/new-consumer-protections-take-effect-new-york's-structured-settlement-protection-act.

307. N.Y. GEN. OBLIG. LAW § 5-1705(d)(iv) (Westlaw).

308. *See id.*

309. *New Consumer Protections Take Effect with New York's Structured Settlement Protection Act*, *supra* note 306.

310. *See id.* According to Peter Vodola of the NSSTA Legal Committee:

> Courts have repeatedly said that they should be made aware of prior transfers and also

have been denied in another state without the court ever knowing that the transaction was denied by another court.[311]

Moreover, the federal government should step in to ensure that there is uniformity in structured settlement protection acts in the United States. For instance, there are a few states that do not have a structured settlement protection act in place, and even fewer states have one that requires the court to receive information about prior transfers.[312] Thus, the lack of uniformity undercuts the progress that many states have made because a claimant who is denied a transfer in New York could travel to one of those non-protectionist states and likely get the factoring transaction approved.

B. What Else Can Be Done? More Feasible Approaches

Structured settlement recipients must become more educated on the available alternatives to the factoring industry. American International Group ("AIG") conducted its own study on structured settlements and found that that fifty-seven percent of structured settlement recipients who chose lump-sum payments squandered the entire settlement prematurely.[313] Although the study does not indicate how long the recipients took to deplete their settlements, the study nevertheless demonstrates the need to educate Americans on structured settlements. AIG contends that "[w]ithout awareness, the majority of those impacted by personal injury or accidental death cases run the risk of making ill-informed choices that may jeopardize long-term financial health."[314]

> about unsuccessful transfer attempts—and that they may need these details to make informed judicial decisions. Judges say that the information about such factoring attempts can impact the issue of the payee's best interests, and can be critically important, especially if a judge denied a transfer for some reason that continues to be relevant. The New York SSPA now spells it out that factoring companies must provide judges with that prior transfer information.

Id.

311. *See id.*

312. *See* Hindert & Ulman, *supra note* 28, at 20; Peter Vodola, *New York Amends Structured Settlement Protection Act So That Courts Get More Information About Prior Transfers*, SECONDARY INS. MARKET BLOG (Oct. 11, 2010, 5:16 AM), http://www.secondaryinsurancemarketblog.com/weblog/2010/10/new-york-amends-structured-settlemetn-protection-act-so-that-courts-get-more-information-about-prior.html. New York is now the second state to include in its structured settlement protection act a requirement that the court making a determination on the factoring transaction receive information about any prior transfers. Vodola, *supra*.

313. AM. INT'L GRP., STRUCTURED SETTLEMENTS SURVEY REPORT (2008), *available at* https://www.aigag.com/life/life.nsf/Lookup/AIGSSsurvey_press/$file/AIGSSsurvey_report.pdf.

314. *Id.* Many Wentworth customers claim that they might have realized the repercussions of their transactions had they understood the long-term effects of factoring transactions. Mannix, *supra* note 1, at 64.

Taking into account the structured settlement recipient's lack of financial sophistication, if claimants were more educated on factoring transactions and alternatives available to them, they would be less likely to fall prey to factoring transactions.[315] For instance, investment alternatives, such as trusts, are vehicles that could help the plaintiff better manage his or her money.[316] A trust is very similar to a structured settlement, except that the defendant gives the funds to a trustee, typically a bank, to hold for the beneficiary, who is the tort victim.[317] The trustee then makes the investment decisions by investing those funds in the trust.[318] Subsequently, payments are made in accordance with the trust agreement.[319] Trusts can prove to be quite flexible because the terms of the payments frequently vary.[320] Moreover, the trust payments can be designed at the outset to allow the tort victim to access the funds as necessary, but it is dependent upon the victim's predisposition to dissipate funds prematurely.[321] Thus, those who understand how a trust works may very well benefit from the flexibility and protection that a trust provides.

VI. CONCLUSION

The Legislature should revise the N.Y. SSPA in order to better safeguard the rights of structured settlement recipients from the destructive practices of the factoring industry. A structured settlement is a better option over lump-sum payments because it offers a claimant many advantages over lump-sum payments.[322] These benefits include tax breaks, spendthrift protection, a guaranteed source of income, and lifetime financial support.[323] Further, the guaranteed source of income greatly diminishes the risk that a claimant will become a burden to society and depend on the government for assistance.[324] Disability advocates, economists, and many others all share the belief that structured settlements provide victims with "model benefit[s]."[325]

315. *See* AM. INT'L GRP., *supra* note 313.
316. Andrada, *supra* note 29, at 494-95.
317. *Id.* at 495.
318. *Id.*
319. *Id.*
320. *Id.*
321. *Id.*
322. *See supra* Part II.C.
323. *See supra* Part II.C.
324. Carson & Tong, *supra* note 79, at 313.
325. *See* Babener, *supra* note 63, at 8.

However, factoring transactions inhibit a claimant's ability to fully realize these advantages.[326] For instance, the factoring transaction transfers to the factoring company a claimant's guaranteed source of income and lifetime financial support for a steep price.[327] Thus, factoring practices undermine the legislative intent of protecting structured settlement recipients from prematurely dissipating their structured settlements.[328]

Unfortunately, the N.Y. SSPA does little to limit the high rates charged by factoring companies.[329] The Legislature should do more to ensure that unsophisticated claimants are not charged excessively high rates—which, if charged by the loan industry, would be unacceptable.[330] Thus, a maximum discount rate and maximum ratio should be adopted in order to minimize the exploitation of claimants, a provision should be included in the N.Y. SSPA that clearly states that factoring companies cannot represent payees in court, and claimants should not be allowed to sell their structured settlement payments to any factoring company within a specific time frame.[331] Finally, educating claimants cannot be overemphasized.[332] Perhaps if claimants knew more about factoring transactions, they would make wiser financial decisions regarding their future payments.[333] Thus, the adoption of these proposals by the Legislature would be a significant step towards curing the modern day Esau problem caused by the factoring industry.

*Michelle M. Marcellus**

326. *See* Corboy, *supra* note 1, at 116.

327. *Id.*

328. Mannix, *supra* note 1, at 62.

329. *See supra* text accompanying notes 261-67. "Despite the improvements to the New York SSPA, NSSTA remains profoundly concerned about actions of companies outside the structured settlement industry that encourage accident survivors to sell their future structure payment rights." *New Consumer Protections Take Effect with New York's Structured Settlement Protection Act*, *supra* note 306.

330. *See* Corboy, *supra* note 1, at 116.

331. *See supra* Part V.A.

332. *See* AM. INT'L GRP., *supra* note 313.

333. *See id.*

* J.D. candidate, 2012; Hofstra University School of Law. This Note is dedicated to my parents, Martha and Jean Marcellus, my brother Kiani Marcellus, my extended family, and friends. Thank you all for your endless love and support. Many thanks to the Honorable Marguerite A. Grays and her staff for introducing and assisting me on the development of my Note topic. I am forever indebted to my mentor and faculty advisor, Professor Akilah N. Folami, for her patience, guidance, and unconditional support throughout my law school tenure. Finally, my gratitude goes out to the *Hofstra Law Review* editors for their dedication and support to the Note writing process. Special thanks to Emily Harper, Henry Shapiro, and Rebecca Sklar for their effort and time spent improving the quality of this Note.