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One More Time: New York's Structured Settlement Statutes,  
Rent-Seeking, and the Pro-Plaintiff Bias

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Abstract

In "Unintended Consequences of Tort Reform: Rent Seeking in New York State's Structured Settlements Statutes" Spizman and Schmitt (2000) demonstrate mathematically that the structured judgment provisions for future periodic payments, under New York State's *Civil Practice Law & Rules Article 50-A and 50-B*, overcompensate plaintiffs in the vast majority of cases. This pro-plaintiff bias is relative to the present value of the true stream of damages and independent of the discount rate. Anthony Riccardi's (2001) critique of Spizman and Schmitt centers around the representation of the structured settlement process, the usefulness of present value calculations as a benchmark in evaluating plaintiff compensation and the misunderstanding surrounding New York State structured settlement statutes. This reply to Riccardi reviews the simple mathematical principles associated with the overestimation aspect of the legislation, refutes the use of mortality-based adjustments, and further illustrates the substantial misunderstandings and inefficiencies that surround this legislation.

## One More Time: New York's Structured Settlement Statutes, Rent-Seeking, and the Pro-Plaintiff Bias

In "Unintended Consequences of Tort Reform: Rent Seeking in New York State's Structured Settlements Statutes" Spizman and Schmitt (2000) demonstrate mathematically that the structured judgment provisions for future periodic payments, under New York State's *Civil Practice Law & Rules Article 50-A and 50-B*, overcompensate plaintiffs in the vast majority of cases. This pro-plaintiff bias is relative to the present value of the true stream of damages and is independent of the discount rate. Spizman and Schmitt (hereafter SS) also argue that the complexity of the statute itself complicates settlement negotiations and encourages rent-seeking behavior.

Anthony Riccardi's (2001) critique of SS centers around the representation of the structured settlement process, the usefulness of present value calculations as a benchmark in evaluating plaintiff compensation, and the misunderstanding surrounding New York State structured settlements statutes (hereafter 50-B). Riccardi claims that SS have no understanding of the statute, relevant case law or actual negotiations between plaintiff and defendant in structured settlement cases.

Given SS's fundamental premise that the complexity of New York State structured settlement law gives rise to widespread misunderstanding and inefficiencies, we can hardly fault Mr. Riccardi's misunderstanding of the simple mathematical principles associated with the overestimation aspect of the legislation. However, we would offer that lack of civility in commentary is a deliberate choice. In responding to Riccardi, we contend that:

- The original calculations of the structured settlement are correct, and do result in a pro-plaintiff bias in the vast majority of cases. While the actual annuity premium will determine the final cost to the defendant, the issue in SS is that a law that mandates a structure for periodic payments that overstates the present value of the actual damage stream is not good law.<sup>1</sup>
- The present value of future economic and non-economic damages is important as a benchmark in what constitutes correct compensation to the plaintiff. While the annuity premium may be lower, in part due to mortality adjustments, it is still a function of the damage award, and still is a function of the present value of the actual future loss stream.
- The original discussion of annuities, negotiation, and inefficiency by SS is based on experience in structured settlement negotiation. While Riccardi is correct in suggesting that anecdotal evidence is never the ideal, we are confused as to why his anecdotes are superior. Furthermore, SS agree with Riccardi's comment that data on settlements would

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<sup>1</sup> The New York State legislature evidently agreed, since they radically changed CPLR Article 50-A for all medical malpractice actions commenced on or after July 25, 2003. The new legislation amended CPLR 4111[d] and CPLR 5031. These changes only apply to medical malpractice cases. The legislature as of yet did not change Article 50-B, which applies to all personal injury and wrongful death other than medical, dental or podiatric malpractice.

be helpful, but point out that negotiations are always private, so such data are unlikely to be available.

- The misunderstandings surrounding the structured settlement statutes of New York State are self-evident in the relevant case law, which is heavily cited in SS's original paper. Riccardi's comments about this only bolster our case.

### **50-B Structure, Present Value, and Bias**

It is important to stress that we agree with Riccardi on the determination of the claimant's recovery and attorney's fee, and SS refer to the very methodology described by Riccardi (SS p.32). However, the claimant's recovery and attorney's fees are based on a gross recovery figure that distorts the true present value of the future loss stream. SS deal with that distortion. This distortion is a mathematical certainty because of the structure itself and is independent of the discount rate. This is a fact that Riccardi does not understand or chooses to ignore.

There are four reasons why structured settlements in New York State over compensate the plaintiff relative to the present value of the actual future loss stream. The reasons are: (1) The \$250,000 lump sum payment, (2) smoothing the future loss stream over the expected work-life, (3) double adjustment for inflation, and (4) averaging the pain and suffering award over a maximum ten-year period.

Initially the jury's verdict is based on testimony of nominal damages (not the present value of future damages). The jury must itemize damages among different categories such as lost income, pain and suffering, household services, future medical care, etc. They must specify past and future damages, and set the number of years future damages are to be awarded. The jury is instructed to award the nominal amount of future damages. All past damages and the first \$250,000 of future damages are paid as a lump sum with the attorney receiving one third of this amount.<sup>2</sup> Each element of damages should be removed proportionally from the first \$250,000 of future damages. The remaining future damages are divided by the number of years specified by the jury for each category (smoothing the future loss stream) except for pain and suffering.<sup>3</sup> The pain and suffering award is averaged over a maximum ten-year period.<sup>4</sup> The first year's loss

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<sup>2</sup> This amount can be up to \$500,000 of future losses if both spouses are parties to the suit with one having a derivative claim, *Rodgers and Flynn*. Thus up to \$500,000 of future losses are paid as a lump sum regardless of how many years the jury awarded future losses for. Riccardi does not seem to understand how this over compensates the plaintiff and has nothing to do with the discount rate or the mortality adjustments he proposes (which the law does not allow) because the entire sum is paid today when the plaintiff is alive.

<sup>3</sup> For example, if the jury awarded \$10,000 in year one, \$20,000 in year two and \$30,000 in year three for a total of \$60,000, the first year annuity payment under 50-B would be \$20,000 ( $\$60,000/3$ ) and not the \$10,000 the jury actually awarded. This is an obvious over compensation to the plaintiff. This smoothing occurs independent of any interest rate.

<sup>4</sup> Riccardi's entire paper assumes that pain and suffering (or some other non-economic loss) will be the only loss and is awarded for only 10 years and the plaintiff dies prior to 10 years. Yet he fails to understand the arithmetic that is the basis for the initial payment of the structure. Additionally, putting a maximum of 10 years on pain and suffering is an attempt to adjust for the mortality problem that Riccardi suggests is a bias. If the 10 years adjustment is approximately correct then the annuity rate quoted will double count this adjustment. According to the law if the plaintiff dies prior the 10-year payout (pain and suffering is a non-economic loss and thus stops upon the death of the plaintiff) then the defendant does not have to continue the payment to the estate. There is no argument here that this will happen. It is important to note that ceasing payments for pain and suffering upon death is not necessarily a

would be this average loss stream and each future year (starting with year two) would grow by four percent.<sup>5</sup> This is the “gross recovery” as shown by Riccardi in his diagram of the damage award structure (Riccardi, 2002, p. 276). The attorney fees on these future damages (including the annual four percent increase as mandated by the law) would be a percentage of the present value of the periodic payment schedule and is paid as a lump sum to the attorney. What Riccardi’s simplistic figure does not show is how the periodic payment schedule is developed by law. SS demonstrate the mandated structure of the periodic payment schedule is larger than the present value of the actual future loss stream in the vast majority of cases.

However, the purpose of the SS paper was not to determine which type of structure or discount rate should be used, but instead to prove that independent of the discount rate or the computation of attorney fees,<sup>6</sup> the provisions for the nominal periodic payments of New York’s 50-B statute overcompensate the plaintiff relative to the present value of the nominal economic and non-economic damages. In his concern over annuity costs to the defendant and mortality adjustments Riccardi fails to understand this point: The attorney fees, plaintiff recovery, and eventual annuity premium are all derived from a periodic payment structure that is a distortion of the actual future loss stream.

This overcompensation was upheld most recently in *Desiderio v Ochs and New York Hospital*. This is the fourth case where the Court of Appeals has extensively examined the structured judgment provisions of CPLR articles 50-A and 50-B.<sup>7</sup> In this case the defendant wanted the lower court overruled because the literal application of the 50-A statute had a structure that was greater than the jury’s future damage award. That is, the structure overcompensated the plaintiff. The highest court rejected the defendant’s argument and affirmed the Appellate Division order upholding the Supreme Court’s judgment, which allowed the overcompensation to occur.

In his example of a damage award, Riccardi has chosen to dwell on the exceptional case of no economic damages and severely limited life expectancy (2002, p. 292) in order to argue a pro-defense bias. We have no argument with this exceptional case and in fact Riccardi (1996) stated this already in another reply. His article concludes “The most significant impact is on verdicts with large amounts of non-earnings-related future damages, paid to an elderly claimant, over a long period of time. Verdicts with future damages which are only earnings-related would not be affected.” (p. 996) SS and others (Wolkoff and Hanushek, 1995; Bryant, 1999) have acknowledged this exception, but contend that its occurrence is unlikely (SS, p. 32).

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bias for the defense as Riccardi suggest. The law stops payments for pain and suffering upon death because once you die you are no longer feeling any pain nor are you suffering. Since your estate no longer has any loss due to pain and suffering that portion of the award ceases upon the plaintiff’s death.

<sup>5</sup> Since the economist already included an inflation factor while testifying at trial, the additional four percent mandated increase can be looked at as a double adjustment for inflation. Romans and Floss (1999) and *Desiderio (2003)* recognized this may be an adjustment for the risk of taking the annuity and not for inflation.

<sup>6</sup> The 50-B provision is nothing more than a method to calculate legal fees as a present value lump sum and has no effect on the stream of annuity payments to the plaintiff. If legal fees were zero, one could calculate the first year’s payment without using discounting at all. That is discounting is only important to the calculation of the payment to the lawyer.

<sup>7</sup> The other three cases are: *Bryant v New York City Health & Hosps. Corp*, *Schultz v Harrison Radiator and Rohring v City of Niagara Falls*.

While the outcome in Riccardi's example is superficially correct it is deceptive. He assumes no economic damages, that the non-economic damages are only awarded for ten years and that the plaintiff will die within these ten years. We are confused why he would make this repeated point about a small technical adjustment of life-contingent annuity payments and why he would put forward a case with no economic damages as one that is generally applicable. If he could offer any evidence that this scenario is usual or even likely then his example might be more persuasive, but Riccardi presents no evidence on the number of times a plaintiff's death terminates annuity payments for non-economic damages.

### **The Role of Annuities and Mortality Adjustments**

Riccardi devotes a significant portion of his response to the annuity contract, in particular lamenting an alleged lack of understanding of annuities on the part of SS:

...the authors make mention of the purchase of an annuity contract, conjecturing that during post-trial settlement negotiations: 'The plaintiff attorney wants [an annuity contract] . . . costing the defendant the maximum amount.' (SS p. 33)  
This is simply incorrect.

It is certainly confusing, as the original quote attributed to SS is taken completely out of context. Revisiting this discussion by SS in its full context will give the reader a better understanding of this issue:

Any cost savings realized by the defendant in the annuity market are not shared with the plaintiff, so the plaintiff wants these savings put back into purchasing a larger annuity. . . . The plaintiff attorney wants to make sure that the structure is favorable to the client while costing the defendant the maximum amount. (SS p. 33)

SS recognize annuity cost to be important, but they also recognize that it is not a random number. Despite Riccardi's assertions to the contrary (2002, p. 280) at no time do SS hold that the annuity contract premium cost is identical to the present value of the periodic payments mandated under 50-B. They assume them to be directly related, i.e. the cost of an annuity contract is most certainly a function of the size and timing of the payments specified in such a contract.

Riccardi's entire argument revolves around the annuity company using a mortality-adjusted discount rate to determine the attorney fees and the cost of the actual annuity to satisfy the judgement. However, the courts do not agree with this practice. In his example (2002, p. 292) he uses mortality-adjusted present values when calculating the attorney fees. In essence he is suggesting that the discount rate should be based on the market for annuities thus taking into consideration mortality adjustments. While annuity carriers will certainly make these adjustments before quoting a price for an annuity, New York law does not have any adjustments for expected mortality either in economic or non-economic damages, and courts have upheld the

law. In *Rodgers v 72nd Street Associates*, Judge Solomon did not allow the annuity market discount rate to be used:

Plaintiffs suggested that the court look to an alleged market for annuities in selecting the discount rate for the 10-year award. Doing so, as defendant argued, would ignore that subdivision (e) looks to “generally accepted actuarial practices” in respect of a discount rate, and no representation was, nor likely could be, made that an “annuities market” or its rates are commonly accepted in making or valuing investments.

The *Desiderio* court agrees with *Rodgers*, ruling that an economist involved in a 50-B hearing should not make the same mortality adjustments that the annuity company makes in trying to sell the annuity. The Court of Appeals was rather clear that the types of economic mortality adjustments prescribed by Riccardi are not permissible by law even if economically sound:

The Attorney General, as intervenor and amicus, contends that the phrase ‘determined in accordance with generally accepted actuarial practices’ in CPLR 3031 (e) creates an ambiguity in that the structured judgment arrived at under this section does not appear to comport with settled economic rules concerning the time value of money. However, it is clear from a reading of the statute that the phrase ‘generally accepted actuarial practices’ refers to selection of the discount rate used to reduce the structured judgment to present value. A fair reading of that phrase in its context does not give the court the power to review and rewrite the entirety of a structured judgment to conform to economic doctrines.

Riccardi fails to understand the distinction between the legal meaning of generally accepted actuarial practices versus the economic meaning.

The 50-B statute does not tell us what the appropriate discount rate is, thus the court must determine what discount rate to use.<sup>8</sup> Different courts have applied different discount rates based on different factors.<sup>9</sup> Most courts understand that determining the appropriate discount rates presents a conflict of interest between the plaintiff’s attorney and the plaintiff. That conflict arises since a lower discount rate results in higher fees to the plaintiff’s attorney but smaller future periodic payments to the plaintiff.<sup>10</sup> Goldberg and Mauro (1999) point out that the 1999 Law Revision Commission recognized this conflict between attorney and client.

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<sup>8</sup> The amended law, effective July 25, 2003, for Article 50-A solves this problem by specifying that the discount rate should be 10-year U.S. Treasury bonds on the date of the verdict for awards under 20 years and a variation of this rate for awards over 20 years.

<sup>9</sup> For a discussion of using different discount rates see *Binghamton Masonic Temple*.

<sup>10</sup> Mauro, Staller and Sullivan (1994) point out that the annuity for pain and suffering is limited to 10 years and thus is likely to be higher than other damage items. The conflict arises because the plaintiff’s attorney fee which is based on the present value of future damages will earn more on each dollar of pain and suffering (if the jury awards it for more than 10 years) than they would earn on other damage awards. The statute itself can cause the plaintiff’s attorney to stress the pain and suffering aspect of the loss to the jury over other types of damages.

Not only are there negotiations as to the proper discount rate and the nature of the structure, but also the court will often direct the parties to submit how the judgment should be structured and recommend that both sides suggest discount rates. (*Reliant Airlines*) The court in *Blythe v Lonero Transit*, said the parties “shall work together to prepare a structured judgement package that shall be submitted to the court for approval.” The court said that if both parties agree to skip the 50-B hearing that would be permissible. *Rodgers v 72<sup>nd</sup> Street Associates*. *Rodgers* also asks both sides to submit a structure and if both parties agree to disregard the provisions of 50-B they could. The appellate division in *Bermeo v Yucel* suggested that the lower court should ask the parties to the dispute what discount rate they each think will be appropriate and then the court can choose upon hearing the different rates.

If all of this does not lead to bargaining then what does? Given that there have been so many interpretations of the proper structure and no clear mandate as to the discount rate, it is simple to see that both sides to the dispute negotiate along many dimensions and may not have symmetric information. While defendants, as Riccardi suggests, are often insurance carriers that employ actuaries “supported by state-of-the-art technology,” (Riccardi, 2002, p. 281) we have found some of these experts to simply be sales associates with a computer program but little first hand knowledge of present value, much less a more complicated structure.

Clearly, all things equal, the defendant will shop the annuity structure around to get it at the lowest cost possible. Riccardi suggests that the cost of the annuity is the only issue. However, independent of the discount rate used or the cost of the annuity, the 50-B bias exists because of the way the law mandates the structuring of the nominal losses. Even with mortality adjustments, the annuity to be purchased is based on the smoothed future loss stream, increasing 4 percent annually, instead of the actual future loss stream.

### **Inefficiencies, Misunderstanding, and Rent-Seeking Behavior**

Given the complexity of the structure presented here, along with curious and conflicting court interpretations that have followed the passage of 50-B, we affirm our contention that parties are unlikely to come to the table with a symmetric and correct understanding of the value of damage awards under the 50-B structure. This is in addition to uncertainties about how the court will interpret 50-B. While post-verdict negotiations are not unique to jurisdictions with structured settlement statutes, the uncertainty over the correct imposition of a 50-B structure does increase the cost and complexity of negotiation and thus litigation.

In his relentless focus on the cost of an annuity and the incompetence of SS, Riccardi misses that basic point about what good law should accomplish. If the fundamental purpose of a damage award is to, as best possible, make an injured plaintiff “whole” again, then this award should be structured to mirror the actual future loss stream as closely as possible. 50-B fails miserably in this regard, imposing a structure for periodic payments that distorts the actual loss in each period. This distortion is inefficient, as it distorts incentives for the disputants both pre- and post-trial, and it uses resources better used elsewhere.

Riccardi’s diversion about the use of rent-seeking behavior strategy in a legal setting is also perplexing. One widely-used Principles of Microeconomics textbook defines rent-seeking



behavior as “The actions by persons, firms, or unions to gain special benefits from government at the taxpayers’ or someone else’s expense.” (McConnell and Brue, 2002, Glossary G-18) If Mr. Riccardi or others would like to investigate rent seeking in the litigation process the following articles are a good starting point: Osborne (2002), Farmer and Pecorino (1999), Rubin, Curran and Curran (2001) and Parisi (2002).

Riccardi accuses SS of misunderstanding the 50-B provisions and process, of a lack of familiarity with the controlling case law, and of offering no case illustrations. While confident of our presentation of 50-B structure and its consequences, we must admit our struggle to understand how Riccardi could have missed the references to the relevant case law in thirteen footnotes, as well as those in the body of the original paper.

### **Concluding Remarks: The True Irony**

In this response to Riccardi we continue to hold that structured settlements under 50-B do result in a pro-plaintiff bias in the vast majority of cases. Riccardi’s exceptional case of pro-defense bias with no economic damages and severely limited life expectancy is true, but hardly representative or generally applicable.

While the actual annuity premium, with a mortality adjustment, will determine the final cost to the defendant, the issue in the SS paper is that a law that mandates a structure for periodic payments that overstates the present value of the actual damage stream is not good law, regardless of the annuity premium. The misunderstandings surrounding the structured settlement statutes of New York State are self-evident in the relevant case law, which is heavily cited in the original SS paper. Riccardi’s comments about this only bolster their case.

Riccardi finds the use of quotes from the Bryant ruling by SS to be ironic. We suggest the real irony is that he concludes his critique by essentially agreeing with SS about the complexity of 50-B, about the courts’ recognition that 50-B is problematic, and about the importance of comprehensive and reliable data from closed structured judgement cases.

With respect to ongoing efforts to understand the consequences of structured settlements Riccardi notes, “Data is [sic] the key. Systematically gathering data from closed structured judgement cases is not a simple matter.” (Riccardi, 2002, p. 283)

We could not agree more, and SS said as much in their original paper, noting that “such research would require data on pre- and post-trial settlements. Much of that data is [sic] proprietary and thus unavailable, and any subset of available data may not be representative.” (SS, 2000, p. 43)

We note, again, that, “a better understanding of [structured settlements] among plaintiffs, defendants, and judges may result in more efficient settlement negotiations . . .” (SS, 2000, p. 43)

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