December 6, 2015

MEMORANDUM
FOR
THE NATONAL STRUCTURED SETTLEMENTS TRADE ASSOCIATION

Re: Possible Contingent Liability of Settling Defendants/Liability Insurers Who Have Made Qualified Assignments

If a settling defendant or its liability insurer has made a qualified assignment of periodic payment obligations under a structured settlement and the annuity issuer later fails to make the payments, can the defendant and/or its insurer be held liable for the missed payments? Since August 2013, when Executive Life Insurance Company of New York ("ELNY") was liquidated and benefits under some of ELNY's structured settlement annuities were reduced, defendants, liability insurers and their counsel have been asking whether qualified assignments can shield assignors from contingent liability for periodic payments that are not made by an annuity issuer. NSSTA has received unsubstantiated reports that defendants and/or liability insurers that made qualified assignments in structured settlements funded by ELNY annuities have been compelled to make up payment shortfalls. Should those reports be given credence? This memo will respond to the foregoing questions.

Executive Summary: Whether a defendant or liability insurer that makes a qualified assignment of periodic payment obligations under a structured settlement is relieved of contingent liability for the periodic payments depends on the effectiveness of the

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release of the periodic payments obligations given by the settling claimant(s) as part of the settlement. Although qualified assignments have been in widespread use for over 30 years, we are not aware of any case in which a settling defendant or liability insurer that has made a qualified assignment and has received a clear release of periodic payment obligations has been held liable for payment shortfalls. In two cases in which payees have sought to hold defendants and liability insurers liable – one arising from the liquidation of Executive Life Insurance Company of California ("ELIC") and the other arising from the liquidation of ELIC's affiliate ELNY – the courts have found that clear, unambiguous releases relieved the assignors from any contingent liability for periodic payments. (In both the ELIC liquidation and the ELNY liquidation NSSTA and its member have worked to minimize benefit shortfalls and to reduce hardships for payees facing shortfalls, while recognizing that settling defendants and liability insurers that have bargained for and received clear releases cannot be expected to assume responsibility for obligations from which they have been released.)

Release of Periodic Payment Obligations. When a settling defendant or liability insurer (a "Settlement Obligor") makes a qualified assignment of its periodic payment obligations under a structured settlement, it generally expects to be released from those obligations and thus to have no contingent liability if future payments are not made by the annuity issuer (or the assignee).1/ Sometimes, however, Settlement Obligors make qualified assignments without being released, and without expecting to be released, from liability for periodic payments. For example, workers' compensation insurers sometimes make qualified assignments of periodic payment obligations under workers' compensation settlements in jurisdictions in which the

1/ As the assignee that accepts a qualified assignment usually is an affiliate of the issuer of the annuity that funds the assigned periodic payments (often a limited purpose affiliate with few assets other than annuities funding assigned settlements), the assignee seldom, if ever, will be in a position to make payments if the annuity issuer fails to do so. Accordingly, the remainder of this memo generally will refer only to an annuity issuer's failure to make payments and will not mention the hypothetical possibility that an affiliated assignment company could compensate for that failure.

workers' compensation authorities require that an employer and/or its workers' compensation insurer remain liable for all settlement payments. 2/

Whether a Settlement Obligor that seeks to be relieved of contingent liability for assigned periodic payment obligations actually is relieved of that liability depends on the effectiveness of the release of the periodic payment obligations contained in the structured settlement documents. In order for a release of periodic payment obligations to be effective:

i. The release must be enforceable under the applicable State law, generally the governing law specified in the agreement that contains the release. If a release is clear and unambiguous it normally will be enforceable under State law, as illustrated in the two cases discussed below.

ii. The release must be binding on the settling claimant or other party designated to receive the periodic payments, i.e., the structured settlement payee. If the release appears only in a document that is not signed by or on behalf of the payee, the payee is not likely to be bound, and the Settlement Obligor may remain contingently liable (if not primarily liable) for the periodic payments. A binding release typically is incorporated in one of two documents signed (or intended to be signed) by or on behalf of the payee: a qualified assignment and release agreement or a settlement agreement that expressly authorizes the Settlement Obligor to make a qualified assignment and releases the Settlement Obligor from the periodic payment obligations if a qualified assignment is made. If neither the payee nor a party authorized to sign on behalf of the payee signs a document providing for release of the periodic payment obligation, the payee may be in a position to disregard the release, and the Settlement Obligor may remain contingently (or primarily) liable.

2/ Nothing in Internal Revenue Code § 130, which establishes the essential attributes of a qualified assignment for federal income tax purposes, requires that a Settlement Obligor that makes a qualified assignment of periodic payment obligations be released from liability for the assigned obligations.

iii. If a payee claims that a Settlement Obligor is liable for periodic payments, the Settlement Obligor must be able to produce and authenticate a copy of the release – even if the payee's claim is made long after the settlement is agreed upon and implemented. A binding release contained in a settlement document that cannot be located and authenticated obviously is of little use to the Settlement Obligor. 3/

Have Settlement Obligors that Have Made Qualified Assignments and Have Received Releases from Assigned Periodic Payment Obligations Later Been Held Liable for the Payments? The payee under a structured settlement normally receives payments directly from the issuer of the annuity that funds the settlement. Unless the annuity issuer fails to make scheduled payments when they are due, the payee has no occasion to seek payment from the Settlement Obligor.

Since 1983, when Internal Revenue Code § 130 became effective and qualified assignments began to be commonly used, there have been only two known cases in which issuers of structured settlement annuities have been liquidated and annuity payments have been reduced: the ELIC liquidation in 1992 and the ELNY liquidation in 2013. In each of those cases many of the structured settlement annuities funded settlements under which the periodic payment obligations were assigned to First Executive Corp. ("FEC"), the parent of ELIC and ELNY. FEC was reorganized under Chapter 11 of the Bankruptcy Code and effectively was immunized against any liability for settlement payments not made by ELIC or ELNY.

Following the ELIC liquidation and the ELNY liquidation, payees receiving reduced periodic payments under settlements assigned to FEC have attempted to hold Settlement Obligors responsible for shortfalls in periodic payments, notwithstanding the releases contained in their settlement documents. In each case the courts have given effect to the releases and have recognized that the Settlement Obligors are not contingently liable for the payments:

3/ In August 2013, when ELNY was liquidated, all of the structured settlements funded by ELNY annuities had been in place for 25 years or more. Locating copies of critical settlement documents has in some cases proven very challenging for the Settlement Obligors.

In Thornton v. Hubill, Inc., 571 N.W.2d 30 (Iowa App. 1997), the payee under a settlement funded by an ELIC annuity and assigned to FEC sued the liability insurers who had settled the payee's underlying tort claim and assigned the periodic payment obligations to FEC. The settlement agreement provided –

> Plaintiff [Thornton] agrees that by reason of such assumption and assignment, . . . Hubill, Inc., Economy Fire & Casualty Company and United States Fidelity & Guaranty Company are fully and completely released and forever discharged from their liability to make all periodic payments set forth in paragraph 2(b) of this Agreement herein, and are completely released and forever discharged from liability to fulfill any and all other obligations under this Agreement. [571 N.W.2d at 32.]

In addition to signing the settlement agreement, the plaintiff and his attorney joined FEC in signing an "acceptance of annuity contract and assignee," stating that they –

> hereby accept the assignment by the released parties in the Settlement Agreement and release executed October 31, 1984, of the obligations under paragraph 2(b) thereof to the Executive Life Insurance Company of California; acknowledge that any liability for the obligations under paragraph 2(b) on the part of the released parties is extinguished . . . ; and hereby accept the First Executive Corporation, a California corporation, as the "ASSIGNEE" acceptable to the Plaintiff. [Id.]

Following reduction of ELIC annuity payments the payee filed a breach of contract action against the liability insurers and their insured. The defendants moved for summary judgment based on the release provisions of the settlement documents, and the trial court granted the motion. The Court of Appeals affirmed, explaining:

> We conclude, based on our review, the terms of the settlement agreement are clear and unambiguous. Therefore, the contract will be enforced as written. . . . The terms of the agreement clearly express the parties' intent to release Economy Fire of all liability and legal obligations to Thornton. Hubill, USF&G and First Executive are entitled to summary judgment as a matter of law. [571 N.W.2d at 33.]

Yerkes v. Cessna Aircraft Co., No. 14-05925, 2015 WL 3903569 (U.S. Dist. Ct., D.N.J. June 25, 2015) closely resembles Thornton v. Hubill, except that the annuity issuer was ELNY rather than ELIC. Following the ELNY liquidation structured settlement payee Eric Yerkes sued

Cessna Aircraft and its liability insurers (as Settlement Obligors) for breach of contract, notwithstanding the release provisions of the Release and Indemnity Agreement and Assignment Agreement governing Yerkes' settlement. The Release and Indemnity Agreement provided:

> It is also understood and agreed that [Cessna] and [Lloyd's] will assign their obligations for these periodic payments to First Executive Corporation as set forth in the Assignment Agreement. This assignment is accepted by [plaintiff] **. . . [in full release of Cessna and Lloyd's]** with respect to these periodic payments. [Plaintiff] acknowledges that once this assignment is made Cessna and [Lloyd's] are released from the obligation to make such payments. [2015 WL 3903569,*1. Emphasis and brackets in opinion.]

The corresponding provision of the Assignment Agreement stated:

> In consideration of payment of a premium payment by [Cessna's insurers], ("Assignor") to [FEC], a California Corporation ("Assignee"), assignee assumes, and assignor assigns to assignee, the liability of Assignor to make periodic payments in the amounts and at the times set forth in the Schedule of Payments attached as Exhibit A, to [plaintiff] . . . . [Plaintiff] agrees that, by reason of such assumption and assignment, [Cessna's insurers are] fully released from [their] liability to make periodic payments. [Id., *2. Brackets in original.]

Cessna Aircraft and Lloyd's moved to dismiss the complaint, and the District Court granted the motion. The Court concluded:

> In sum, the terms of the settlement agreement, as embodied in the [Release and Indemnity Agreement] and Assignment Agreement . . . clearly and unambiguously demonstrate that Defendants fulfilled their contractual obligations by making a lump sum payment, purchasing an annuity from ELNY, and assigning it to FEC. Under the terms of the settlement agreement, therefore, Plaintiff fully released Defendants from liability. [2015 WL 3903569,*7.] 4/

Yerkes remains pending. The plaintiff has moved to file an amended complaint alleging that the Settlement Obligors were negligent and breached obligations of good faith and fair dealing in "selecting ELNY to fund Plaintiff's annuity and selecting ELNY's parent, FEC, as the assignee" and in failing to disclose information about ELNY's deteriorating financial condition.

4/ The Court also dismissed an unjust enrichment claim against the Settlement Obligors.

Yerkes v. Cessna Aircraft Co., No. 14-05925 (U.S. Dist. Ct., D.N.J.), proposed Third Am. Complaint (Doc. 39-3, filed 7/27/15) ¶¶ 26, 44. The motion – which presupposes that Cessna and Lloyd's undertook obligations to Yerkes that would have been highly unusual for a tort defendant and its liability carrier – remains pending. Even if it is granted, however, and Yerkes has an opportunity to attempt to prove the tenuous tort-based claims alleged in his proposed Third Amended Complaint, the Yerkes Court's dismissal of the breach of contract claims, like the rulings of the Iowa courts in Thornton v. Hubill, confirms that clear release provisions, signed by or on behalf of a structured settlement payee, releasing a Settlement Obligor from liability for assigned periodic payment obligations, can and will shield the Settlement Obligor from contingent liability for the periodic payments. We are not aware of any contrary case authority. 5/

5/ The courts' conclusions in Thornton v. Hubill and Yerkes v. Cessna find indirect support in In re Monarch Capital Corp., 130 B.R. 368 (Bankr. D. Mass. 1991), in which structured settlement payees sought protection following the bankruptcy of an assignee that had assumed the periodic payment obligations under the payees' structured settlement. The Bankruptcy Court explained:

> In the present case, the Tort Defendants and their liability insurance companies wishes to relieve themselves of all future liability, even liability contingent upon failure of the insurance company issuing the annuity to make the payments. [130 B.R. at 370.]

The settlement agreement at issue contained the following authorization for a qualified assignment:

> The parties hereto acknowledge and agree that RELEASEES [i.e., the settling defendants] may make a "qualified assignment" within the meaning of Section 130(c) of the Internal Revenue Code of 1954, as amended, of RELEASEES' liability to make the periodic payments required herein. Any such assignment, if made, shall be accepted by RELEASORS without right of rejection and shall completely release and discharge RELEASEES from such obligations hereunder as are assigned to the assignee. RELEASORS realize that, in the event of such assignment, the assignee shall be their sole obligor with respect to the obligations assigned, and that all other releases that pertain to the liability of RELEASEES shall thereupon become final, irrevocable and absolute. [Id. at 371.]

Owners of more than 350 ELNY annuities have chosen to become parties to the ELNY "Facilitation Plan" for Settlement Obligors that are making up payment shortfalls under settlements funded by those annuities. Most of those owners are parties to "buy-and-hold" settlements, in which they made no qualified assignments and remained contingently liable for the periodic payments. Some owners participating in the Facilitation Plan have said that they made qualified assignments but did not receive clear releases from periodic payment obligations and thus have chosen to make up payment shortfalls.

Having been extensively involved in the ELNY insolvency beginning in 2007, we are not aware of any case (whether or not it has led to any published court decision) in which a Settlement Obligor has been compelled to cover shortfalls in payments under an assigned structured settlement funded by an ELNY annuity in which the Settlement Obligor received a clear release of the periodic payment obligation and the release was signed by or on behalf of the payee. 6/ Reports of such cases appear to be apocryphal. Any NSSTA member who reads this memo and knows of or learns of any such case is urged to report the particulars as soon as possible, so that we can investigate and, if appropriate, supplement this memo.

− Craig H. Ulman

The Bankruptcy Court later observed: "The parties accomplished exactly what they intended to accomplish – novation of the Tort Defendants' settlement obligations . . . ." Id. at 377. As a novation necessarily entails a substitution of obligations, with a new obligor assuming obligations from which the prior obligor is released, the Bankruptcy Court effectively recognized (albeit in a discussion that was not necessary to its decision) that the settling defendants had been fully released from any contingent liability.

6/ We are aware of two cases in which payees have sought to hold the U.S. Government responsible for payments under Federal Tort Claims Act settlements funded by ELNY annuities under which benefits were reduced; but neither case involved any qualified assignment (or release) of the periodic payment obligations. See Hendrickson v. United States, No. 82-621T, 2014 WL 1224715 (U.S. Dist. Ct., W.D. N.Y., March 25, 2014), vacated and remanded, 791 F.3d 354 (2d. Cir. 2015); Nutt v. United States, 121 Fed. Cl. 579 (Ct. Fed. Cl. 2015).