A Comment on "One More Time: New York's Structured Settlement Statutes, Rent Seeking and the Pro-Plaintiff Bias" Draft date: 3/23/04

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Lawrence Spizman and Elizabeth Dunn Schmitt, this time accompanied by Frederick Floss (henceforth SSF), have responded in this journal (2002) to a comment by my frequent co-author, Anthony M. Riccardi (2001) about the earlier Spizman-Schmitt paper (2000; henceforth SS). The SSF response contains a number of factual errors that this comment will point out. Very recently, New York has changed the way 50 A&B calculations are to take place, but this comment will respond as if the system in place when SS, Riccardi and SSF were all written was still in place. Primarily, this refers to the requirement of a 4 percent annual upward adjustment in periodic payments. Juries are now free to set that rate at values other than 4 percent. Riccardi has provided an index for this comment that discusses those changes. Riccardi has also reviewed the text of this response and is in agreement with the points that were made. This comment consists of a series of individual comments, which are numbered, followed by a general comment about the meaning of overcompensation, which pulls the individual comments together.

(1) SSF claim that SS demonstrated mathematically that the structured judgment provisions of New York's 50-A and 50-B provisions "overcompensate plaintiffs in the vast majority of cases" (p. 304). This sounds as if the original SS paper contained statistical evidence of the number of times plaintiffs were overcompensated versus the number of times plaintiffs were not overcompensated. No empirical evidence of any sort was provided in the original SS paper, so this claim is patently false. SS did not attempt to determine the percent of cases in which 50-A and 50-B resulted in overcompensation of a plaintiff. Further, neither SSF or SS provide a definition of what would constitute overcompensation of a plaintiff. The term

"overcompensation" implies a value judgment, which at least requires that the value judgment be clearly stated. Whether "overcompensation" can be said to exist will be discussed below.

(2) SSF state that the annuity premium is "still" a function of the present value of the present value of the actual future loss stream. Riccardi had correctly pointed out that calculations under 50 A & B are not based on present value. SSF are here asserting that those calculations are a function of the present value of the actual future loss stream. New York law mandates that juries award undiscounted damages. Those damages are then converted by 50 A&B formulas into structured periodic payments (if the parties to not agree to alternative arrangements). Nothing in that process has anything to do with present value except the determination of the attorney's fee. . This SSF statement, therefore, is flatly incorrect. The required structured judgement payments are determined by a process that does not involve reducing any financial value to present value, either at the trial level or at the level of the post trial hearing mandated under the rules of 50 A&B. Only the determination of the attorney's fee involves a present value calculation, as Riccardi pointed out.

(3) SSF repeat the argument made by SS that inflation is double counted under 50 A&B (p. 304). This is a misunderstanding of the 4 percent requirement. SS and now SSF have assumed that the intent of the 4 percent increase that was previously mandated under 50 A&B was to offset inflation. If that was the purpose and an economist had already factored inflation into a projection of total damages, the argument that inflation has been double counted would be correct. In fact, however, there was no indication in law that the purpose of the 4 percent increase was to offset inflation and there were specific case rulings that the 4 percent increase was not for that purpose. This is clear in cases already cited by SSF and Riccardi. The addition of the 4

percent factor was apparently a list minute "sweetener" that was added into the legislation at the last minute to offset apparent defense bias. There is no indication that the New York legislature believed then or at any subsequent time that inflation would continue at a 4 percent annual rate. Neither SS or SSF attempt to justify the notion that the 4 percent annual increase is intended to offset inflation. They simply assume that it was for that purpose and make the claim that this results in double counting on the basis of this incorrect assumption.

(4) SSF and SF both repeatedly assume that 50 A&B overcompensate plaintiffs. Riccardi pointed out that New York's provisions can result in smaller awards for all categories other than lost earnings than in other states because they are made life contingent. Because payments for replacement of lost earnings are not life contingent, however, Riccardi did not make that argument regarding lost earnings. If only lost earnings are involved, New York's 50 A&B provisions will *sometimes* result in larger awards than in other states, depending on collateral source issues to be discussed in the next section. That reality is apparently the central guiding thrust of SSF and SS. Neither Riccardi nor this author would contest the fact that New York's 50 A&B can result in larger awards for lost earnings than methods for determining damages in other states. However, whether this results in "overcompensation" in those cases is a different matter. In other states, an injured plaintiff suing for damages in a personal injury will almost certainly pay a contingency fee in the range of 30 percent. For "overcompensation" to occur by any reasonable definition, it must follow that the plaintiff will receive a stream of replacements for earnings payments that are larger in present value than the stream of earnings payments that the injured plaintiff lost because of the injury. No such argument is made in either SSF or SF. The simply assert that New York's provisions "overcompensate" injured plaintiffs. The true

circumstance could be that New York comes closer to fully compensating injured plaintiffs for their earnings losses than other states. This, however, is an empirical question that should be resolved by empirical methods.

(5) In making their "overcompensation" argument, SS ignored and SSF continued to ignore the collateral source provisions of New York's 50 A&B legislation. Riccardi did not discuss this issue in his response, but the periodic payment provisions of 50 A&B were part of a general tort reform effort on the part of legislators supporting the defense bar in New York. Unlike most other states, New York's collateral source rules allow offsets for almost all private sources of earnings replacement. All disability income payments, whether from government sources or from private insurance, are treated as offsets to lost earnings. What a jury awards for lost earnings, therefore, is not final story. That award is reduced by all collateral payments for disability that are being received by the injured plaintiff. If the injured plaintiff is receiving substantial insurance payments to replace lost earnings, the result can be much a much smaller award than in other states even though the damages award before such collateral reductions was larger than in the other states. It is not clear whether SSF would prefer to argue that those other states "overcompensate" injured plaintiffs even more than New York in such instances, or that SSF simply failed to take this difference in treatment of collateral offsets into account. Of most importance, they failed to mention this aspect of 50 A&B, which is critical to both their "overcompensation" argument and any allegation that the plaintiff bar has been engaged in "rent seeking."

(6) SSF claim that "Riccardi has chosen to dwell on the exceptional case of no economic damages and severely limited life expectancy (2001, p. 292) to argue a pro-defense bias."

Riccardi did not argue that 50 A&B had a pro-defense bias, but that those provisions did not have an obvious pro-plaintiff bias. As was appropriate to his argument, Riccardi was demonstrating circumstances in which 50 A&B would result in outcomes more favorable to defendants in other states. Those circumstances are most easily demonstrated when there are no lost earnings and the plaintiff has a severely limited life expectancy. Given the intended purpose of Riccardi's analysis, his choice of examples was appropriate, not "dwelling" on a particular type of case. The outcome of 50 A& B is that plaintiffs whose damages are limited to lost earnings will receive larger compensations than in other states if collateral offsets do not exist. If other kinds of damages are claimed, the results will frequently be smaller than other states. This is all that Riccardi said and his analysis was correct. Riccardi did not attempt to determine whether the larger awards for lost earnings in New York were greater than the payment stream actually lost because that is not ordinarily the sort of question that an economist is asked to address.

(7) SSF claim that Riccardi "is suggesting that the discount rate should be based on the market for annuities thus taking into consideration mortality adjustments" (p. 307). That is flatly incorrect. Riccardi made no such argument. Instead, Riccardi argued that complex underwriting and marketing considerations are involved in the determination of premiums to be charged for annuity contracts that defendants are required to purchase under 50 A&B requirements. Riccardi correctly points out that SS confused the annuity contract premium with a narrow measure of present value. To the extent that economists are called upon to determine the present value of payment streams, Riccardi does not use and did not argue for using a mortality adjusted discount rate. He argued for using mortality adjustments with a market discount rate of the same sort that forensic economists use in all other calculations.

(8) SSF claim that: "In his relentless focus on the cost of an annuity and the incompetence of SS, Riccardi misses the basic point about what good law should accomplish" (p.309). Riccardi's paper is not "relentless" about anything. Riccardi wrote about what the law is, not what the law ought to be. Spizman and Schmitt tried to argue that 50 A&B resulted in "overcompensation" and that this alleged "overcompensation" implied that 50 A&B were bad law. Riccardi did not address the "goodness" or "badness" of 50 A&B, but explained how those provisions actually work. He also explained why, under some circumstances, 50 A&B favor defendants rather than plaintiffs. This is the appropriate focus of forensic economists, particularly in light of the fact that neither SS nor SSF defined what they meant by "overcompensation." They argued for "badness" by ipse dixit, an exercise of very limited value.

(9) SS made a major claim that New York's 50 A&B provisions involved "rent seeking." "Rent seeking" is a term of art in economic analysis that refers to seeking legislation because that legislation will generate quasi-rents to the "rent-seeker." Riccardi correctly pointed out that there is no evidence that plaintiff attorneys were "rent-seekers" by that definition. In historical context, 50 A&B were part of a tort-reform movement by the defense side of the bar. The requirement of a 4 percent annual increase in 50 A&B was apparently added into the litigation at the last minute to offset the perception that the provisions were otherwise too defense oriented. If there was rent seeking going on, it was rent seeking by the defense bar that was significantly offset at the last moment by a 4 percent annual increase that was included to offset the general defense orientation of the legislation.

(10) SSF say that, "Riccard's diversion about the use of rent seeking behavior is also perplexing," and then proceed to give standard text citations about the meaning of rent seeking

behavior (p. 309). Since SS had made "Rent Seeking in New York State's Structured Settlement Statutes" the second half of the title of their paper, Riccardi correctly stated the meaning of rent seeking in his response to indicate why he felt that there was no rent seeking by the plaintiff bar associated with New York's 50 A&B legislation. As such, Riccardi made no "diversion" into this topic. He considered it because it was a part of the title of the SS paper and pointed out that there was no indication of rent seeking if one used the meaning of that term in the economics literature. There is nothing "perplexing" about dealing with what was advanced by SS as a major theme of their paper.

(11) This author had not read Riccardi's response until the publication of SSF. SSF are derogatory on a personal level toward Riccardi. Terms like "relentless" are both incorrect and inappropriate for a professional journal. Unless there is an accusation of ethical impropriety, there is no good reasons to attribute motives to another author. Regardless of the correctness or incorrectness of one's interpretation of 50 A&B, the intellectual argument should be based on the ideas put forth, not snide remarks about personal motives of the author being criticized. Riccardi did not write his response to SS in a personal way, but limited his remarks to specific claims made by SS about the nature of forensic practice under 50 A&B. Riccardi even included the text of the statute in his response. After reading SSF, this author felt that a response from someone else who took the trouble to understand 50 A&B was very much in order because personal comments of the sort in SSF about Riccardi do not belong in a professional publication. Nothing would be gained by having Riccardi defend his personal motives. Riccardi was given the opportunity to review an earlier draft of this comment and make suggestions, which were followed. Riccardi also wrote note that follows, which is a stand alone explanation of recent

changes in the formulas for how damages calculations are to be made in New York.

A General Comment on Overcompensation in both SS and SSF

Much of the problem with both the SS and SSF papers is that they do not define the meaning of the term "overcompensation" as used in both papers. The term "over compensation" implies that there is a standard for what constitutes "compensation" and that the procedures used in the state of New York result in payment of damages in excess of that amount. To make this claim "compensation" must be defined quantitatively, with "overcompensation" implying compensation in a greater amount than "compensation." When reference was made to the need for an "empirical" answer, this was the standard being applied. It would be possible under some circumstances for a given procedure to result in "overcompensation" without requiring empirical evidence that "overcompensation" has occurred. For a simple example, if a state had damage award procedures such that a plaintiff always received 10 percent more than the amount defined as "compensation," one could argue on theoretical grounds that "overcompensation" occurs under those procedures without needing empirical demonstration.

That is not what happened in the SSF paper, nor did it happen in the SS paper before it. No clear definition is provided for what is meant by "compensation" and thus the reader was left to guess what constituted "overcompensation." This writer understood both SS and SSF as trying to make a basic argument that began with New York's calculation of damages as the total value of lost earnings without reduction to present value. This is what economists are asked to do for trial testimony in New York, along with specifying the number of years over which the loss will occur. Assume further that the jury awards total damages and determines the loss period based on the calculations of an economist whose projections would be regarded as fair and reasonable by

most other economists. Total damages are now measured as an undiscounted sum that is assumed to be equal to the amount of earnings loss of the plaintiff over the period specified. At this point, the judge divides the number of years into total damages to determine a starting point for the projection of payments for lost earnings to be received by the plaintiff. Since earnings would be projected to increase over the loss period, starting from the average amount would mean that the amounts paid would be larger in the first year than would be the case with projected damages in other states. Empirical evidence is not needed to establish that fact.

The old rules in New York required that payments in the starting year must be increased each year by 4 percent on the anniversary of the start of payments. Since the calculations started at a higher level than would be the case in other states and would then also be increased at 4 percent per year, it follows that this process would result in greater payments than in other states. That is the core of the argument made by both SS and SSF. If nothing else was involved, the argument could be made that payments in New York would be greater than in other states using procedures that are allow an economist to project lost earnings in terms of present value in the ordinary fashion. Whether that would constitute "overcompensation," however, is a different matter. Without considering other adjustments, one must first define "compensation." Although SS and SSF did not do so, it would be this writer's guess that they had in mind the "make whole" standard for compensation. That definition would call for the injured plaintiff to receive future flows of payments sufficiently large to cause the injured plaintiff to be no worse off financially than if the injury had not occurred.

If that definition is used and all other issues are ignored, the question would be whether New York's procedures produced a larger cash flow than would be required to replace financial

losses due to lost earnings by the injured plaintiff. Since the injured plaintiff will typically have to pay 30 percent in attorney fees, the question becomes whether NewYork's procedures would result in cash payments sufficiently large that the 30 percent paid to attorneys is fully compensated by payments under the New York system. If the payment stream resulted in payments that were more than 30 percent larger than a similar projection in another typical state, one could argue that the plaintiff's lost earnings had been "overcompensated" under a "make whole" standard for "compensation." It is an empirical question whether New York's procedures, ignoring other elements in the compensation system, would produce results that averaged more than 30 percent larger than compensation systems in other states. That question is not answered in SS or SSF.

However, New York's 50 A&B were adopted as part of a general tort reform effort primarily to benefit defendants. The 4 percent increase in payments under 50 A&B was added at the last minute as an offset to other provisions that favored the defense bar. Arguably, if there was any "rent seeking" going on, it was "rent seeking" by the defense bar, not the plaintiff bar as assumed in the original SS paper. Defendants benefit significantly from other aspects of that reform process. Payments for life care, pain and suffering and household services are all life contingent in New York. Similarly defendants are not put into the position of having to argue that since plaintiffs may die sooner because of their injuries to contain costs. Cost containment is taken care of by the provision of structured payments though life expectancy. For those reasons, costs to the defendant that are typically lower for those elements than would be the case in other states. Further, New York protects almost no payments a plaintiff receives from disability insurance under its collateral source rules. Such collateral sources are often protected in other

states. One can argue that not taking collateral sources into account "overcompensates" plaintiffs in other states, but the question would then be whether the rate of "overcompensation" in New York was greater than in those other states. Clearly, this is also an empirical question that cannot be resolved by theoretical considerations. This question was also not addressed by either SS or SSF.

What one can say is that New York's procedures are more complex than in other states. One can also say that in some circumstances awards for lost earnings are larger than in other states, while in other circumstances New York's treatment of other damage elements and collateral sources results in lower payments than in other states. However, one cannot reach the sweeping conclusion reached by SS and SSF that New York's system results in "overcompensation" or that the plaintiff bar is somehow engaged in rent seeking in New York under New York's damage award procedures. One can also reach the conclusion that Riccardi's paper was correct in its conclusions that New York's system is much more complex than envisioned by SS and that there is no indication that rent seeking by plaintiff attorneys.

References

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