10 PRE-TRIAL TASKS AND ISSUES

10.1 Introduction
10.2 General considerations on the plaintiff's side
A. Expected outcomes
B. Updates of economic analysis
C. Additions to economic analysis
D. Coordination with related experts
10.3 General considerations on the defense side
10.4 Economic report in settlement proposals
10.5 Structured settlements and settlement negotiations
A. The nature of structured settlements
B. Taxes
C. Other considerations
D. Valuation of a structured settlement
E. Sample valuations
10.6 Discovery depositions
A. Defense
B. Plaintiff
10.7 Preparation for trial: plaintiff
A. Resources of economist
i. The case file
ii. Back-up data
iii. Demonstrative evidence
iv. Attorney/economist conference
v. Scheduling
10.8 Preparation for testimony: defense
10.9 Stipulations
A. Plaintiff
B. Defense
10.10 Summary

10.1 Introduction

The period between the completion of an economic loss analysis and economic testimony at trial is marked by two distinct processes which involve the economic expert. One is the process of pursuing an economic settlement of the case. The other is the process of preparing for testimony on economic damages, if the case

is not settled. It is in this period of time that settlement packages are prepared, structured settlements may be considered, and discovery depositions may occur. These processes and topics are the subjects of this chapter.

Two preliminary comments may be appropriate before examining specific pre-trial issues from plaintiff and defense perspectives. First, plaintiff and defense economists should not become involved in settlement negotiations *per se,* even though they may advise their attorney clients on the economics of various settlement options. The veil of neutrality clearly falls when an expert witness economist becomes involved in negotiation strategy and tactics on either side of the case.

Second, a National Academy of Economic Arbitrators began operations in Washington, D.C. early in 1990. This new organization sends out three-person lists from a handful of experienced forensic economists. The parties to lawsuits now have the option of jointly choosing an economic arbitrator from such a list. They may then proceed with advisory or binding arbitration on issues of economic damages before trial. This may occur whether or not the parties enter such an arbitration with an economist, and an economic analysis, of their own.

10.2 General Considerations on the Plaintiff's Side

A. *Expected Outcomes*

The manner in which the plaintiff's attorney uses his economist and his economic analysis may be influenced by his evaluation of the probabilities of settlement versus trial. If the attorney perceives a reasonable likelihood of settlement, he may want a prompt report from the economic expert to be forwarded to the defense early-on as part of a settlement package. He would lean toward a report which clearly states the assumptions and does not obscure the techniques of analysis. Finally, he might welcome a discovery deposition of his economic expert, especially if this expert has a solid reputation, hoping that the defense will understand the economic analysis, perceive it to be at least reasonably fair, and worry about the prospect of very effective trial testimony by the forensic economist if no settlement occurs.

A disadvantage of such a stance is that, if a settlement does not occur, the defense will be well prepared to counter any weaknesses in the economic analysis at trial. Thus, some plaintiff's attorneys, expecting little chance of settlement, will lean toward some degree of obscurity in the economic report. They will desire to save everything possible for trial, consistent with the rules of discovery. The forensic economist, of course, may have his own consistent position on the level of detail provided in written reports. From our experience in reviewing the reports of other economists, a wide variation exists in the degree of clarity and specificity achieved in written reports by alternative economists.

B. *Updates of Economic Analysis*

Months and even years can elapse between the original production of economic loss estimates and the prospect of an imminent trial. The plaintiff's attorney and his or her economist must therefore consider the need for an updated economic analysis for serious settlement negotiations and/or testimony at trial.

When a report is more than 6 months old, much of the data upon which the report is based begins to lose its "freshness," and the plaintiff's economist

becomes increasingly vulnerable. Another year of data, or more may have become available on inflation rates, productivity rates, interest rates, life expectancies, participation rates, employment rates, average employer contributions to fringe benefits, etc. If a multi-year union contract has been signed, the years of wage and fringe benefit data can be added. An update generally will not substantially affect the bottom line, although this is possible, especially considering inflation. The updated estimate may be either higher or lower than previously, but the single change of moving the present value date to a more current date can only increase a lump sum estimate of economic loss.

A major advantage of an update is that the economist needs to appear "state of the art" in using the latest in techniques and economic data. A particular problem may exist when the other side can show that the economist ignored new data which would have lowered his original estimates.

On the other hand, an updated analysis can produce disadvantages at trial. Every new analysis adds to the complexity of the economist's explanation of what he did, and a defense tactic is to make economic estimates seem so complex that they should be ignored. Furthermore, every update will result in a new bottom line, and the defense may ridicule the fact that the estimates change, perhaps significantly, depending on the day that the economist chooses to perform an analysis. So what is the jury to believe as a prediction of the future? Given these pros and cons, our feeling is that the net advantage of an update increases as an original report becomes more than six months old. We typically insist upon an update after a written analysis under discussion is more than one year old.

Both the plaintiff's attorney and the economist must also recheck the status of the law applying to economic damages in the relevant jurisdiction as the date of trial approaches. Legal parameters affecting how economic damages are calculated may have changed, and this could require a recalculation of, or addition to, the original economic analysis.

Some examples from our recent experience may be instructive. In one state, deductions from earnings for personal consumption in wrongful death cases were not allowed. Before several of our testimonies in that state, the state supreme court ruled that at least a deduction for subsistence personal consumption must occur. Each economic analysis was recalculated. In another state, language in a court of appeals decision seemed to indicate that circuit court judges *could* require an economist to employ a total offset technique. Thus, a back-up analysis using a total offset technique was performed in every case coming to trial. Finally, changing legal parameters regarding testimony on hedonic damages have been an important concern in many states. A review of jurisdiction-by-jurisdiction legal parameters affecting economic damages calculations is a focus of Chapter 12.

C. *Additions to Economic Analysis*

Generally, it is a good idea to decide upon all desirable versions and iterations of an economic loss report when the report is initially produced. If a specific iteration, based upon a certain set of assumptions, is worth doing, it usually is worth doing from the beginning. In our experience, however, plaintiff's attorneys may only begin to ask the economist for additions to a basic report when a trial is approaching and/or settlement discussions are becoming more intense. This may be because

information on the liability portion of the case makes the defense attorney wish to be ultraconservative, because the attorney feels that a range of loss estimates may be more credible than a single estimate, or for a variety of other reasons.

Several examples may be cited. Where a deceased worker had only a few years of earning history, the economist might be asked to add a very conservative projection of a zero rate of future wage growth (actually a rate of annual real wage decline) to the projection based upon an all-U.S.-worker wage growth rate. Again with sparse data, economists have been asked to use only legally-required fringe benefits as an addition to estimates with average fringe benefits. Life, participation, and employment rate variations from work-life calculations of "average" persons have been added, as have been alternative calculations of personal consumption deductions. An advantage of these types of calculations is that they provide a range for settlement negotiations or a range with which a jury may feel more comfortable. Disadvantages include the need to comply with discovery rules; the possibility that the credibility of the initial analysis (and perhaps of all versions) will be eroded, and the increasing complexity of testimony as any version is added.

D. *Coordination With Related Experts*

Coordination of the work of related experts on economic damages has often fallen upon the forensic economist. This remains, of course, a primary responsibility of the economist's attorney client, but economists may serve a useful role in this area. It is the economist who brings any chain of testimony on damages to a "bottom line," and experienced forensic economists may have significant knowledge regarding related experts.

Such coordination is not covered here in more detail because it is a major focus in other chapters of this book. Examples include medical care experts and economists (Chapter Six), vocational experts and economists (Chapter Eight), and Certified Public Accountants (CPA's) and economists in commercial damages cases (Chapter Thirteen). An emerging area of coordination is the psychologist and the forensic economist in hedonic damages calculations for personal injury cases.

The forensic economist should not dictate either methods or conclusions to other types of experts. However, he may contribute very effectively regarding the *format* of conclusions by related experts who precede him in a chain of testimony. The necessary linkages toward a bottom line are interdisciplinary and involve experts who speak different "languages." The forensic economist who can help in tightening these linkages may be a great asset. The work of related experts should have been a primary concern as the experts were hired, and this continues as an important area as the attorney prepares for trial on issues of damages.

10.3 General Considerations on the Defense Side

In Chapter Two, the issue of whether an economist should be hired by the defense attorney was discussed. If a defense economist has been hired, his role includes a careful study of the economic analysis of the plaintiff economist and of past evaluations by that economist. He will look for questionable assumptions and techniques and for outright mistakes. He will aid the defense in preparing for discovery depositions, settlement discussions, and cross examination. More specific

routes of attack will be discussed in the next chapter. Of course, absent an economist, the defense attorney is nevertheless pursuing weaknesses in the economic projection(s) of the other side. This preparation process is a major consideration for the defense as trial and/or serious settlement negotiations approach.

Another issue is whether and how to depose the plaintiff's economist. In a case with damages which are potentially significant, this is usually a good idea when the thrust is to purely explore what will be said at trial. The defense economist, if one has been retained, will want more background than is normally exposed in an economic report. On the other hand, discovery depositions may tip your hand; these pros and cons will be further discussed.

Finally, assuming that an economist has been retained by the defense, this economic expert may be asked to perform an independent economic estimate. Such an analysis may be a great help in dealing with the client insurance company, for example, to establish an initial and a final position on a settlement offer. It may be a basis for testimony, especially when the "bottom line" loss estimate is significantly below that of the plaintiff's economist.

A danger of asking the defense economist to make a projection is that he may be forced to testify to this projection. Even if the defense does not plan to use him in testimony, he can potentially be subpoenaed by the plaintiff. His estimate may become a concrete "bottom line."

10.4 Economic Report in Settlement Proposals

Subject to many of the considerations cited above, the plaintiff's attorney who offers a settlement package to the defense will generally want the report of the economic expert as an important component. The report should be professionally produced and attractive in format. The credentials of the expert(s) preparing the report may also be included. If the report is preliminary, with additions or other versions forthcoming, this may or may not be mentioned. Finally, the economic portion of the settlement package should address amounts demanded for other elements of damage not covered by the report of the economist, such as loss of consortium and pain and suffering. Estimates of hedonic damages, of course, are increasingly a part of the economist's report. A total demand is developed, which is the sum of the component parts developed in the package.

10.5 Structured Settlements and Settlement Negotiations

Defense and plaintiffs' attorneys seek to reach equitable resolution of their cases. Most of the time, this pursuit leads to settlement rather than trial. The majority of settlements are reached even before suit is filed, and the majority of the remaining cases are settled before trial. For both plaintiffs and defendants, there are two principal advantages to settling. First, the earlier the settlement is reached, the lower the expenses of litigation, both in monetary terms and in terms of the stress of litigation. Second, both sides eliminate the risk of an undesirable verdict.

Settlement depends upon a successful meeting of the minds on a compromise amount. Reaching that compromise depends upon an analysis of many complex factors and successful negotiations. The important factors include liability issues,

the personalities of the parties, the demonstrable nature of the injury, various damage elements, aggravating circumstances, the quality and reputation of the attorneys, jury verdicts in the jurisdiction, the time remaining before trial, etc. The interplay of these many factors is complex and thus makes the comparison of settlement offers with possible litigation alternatives difficult to assess in purely quantitative terms. However, the costs of litigating through to a verdict and the risk of an undesirable verdict are such powerful considerations for both sides that, despite the complexity of analysis, settlements are almost invariably reached. It is beyond the scope of this section to discuss case evaluation procedures and negotiation strategies. While much has been written on these topics, the clients ultimately rely upon the wisdom of their attorneys for this analysis. This wisdom is gained from litigating and settling many cases and from the extensive writings, seminars, and formal legal training in these areas. The evaluation of a prospective trial result can sometimes be simplified into an outcome matrix showing the weighted average or expected result:

TRIAL OUTCOME MATRIX

Possible Award	Probability of Award	Weighted Value
$2,000,000	20%	$ 400,000
1,500,000	40%	600,000
750,000	20%	150,000
250,000	10%	25,000
0	10%	0
	Expected Result:	$1,175,000

According to this matrix, a litigant should be willing to settle for $1,175,000, but this analysis is, at best, a simple approximation. It does not take into account litigation costs and emotional stresses. Perhaps most importantly, the undesirability of a poor outcome, which can be different for each side, is not considered. An institutional defendant may be willing and able to suffer a poor outcome. A plaintiff may have only one chance in a lifetime to achieve financial security and may be unwilling or unable to take substantial extra risk, particularly if a reasonable settlement offer is proposed. Depending upon the parties, the converse may be true in a given case. Each side will give different weight to these factors, set targets, set first demands and responses, and negotiate.

While estimating an outcome matrix of litigation is complex, the present value of settlement amounts can be successfully analyzed in purely quantitative terms. When settlement negotiations are based on a lump sum amount, the analysis of the settlement value is rather simple. Both sides are discussing offers and counteroffers in terms of a single figure, in present day dollars.

The analysis of the present value of the periodic payments under a structured settlement, while fairly mechanical, is more complex than the evaluation of a single lump sum. Yet in recent years, the percentage of settlements that involve a structure has increased dramatically and, in fact, such structures lead to more settlements. This paradox, that a more complicated and difficult-to-value offer facilitates more settlements, is explained by the fact that plaintiffs will place a financial value on

the generally tax-free structured payments at an amount greater than the cost to the defendant—a key reason for their increase in popularity. The original lack of common ground that may have existed in negotiations over a single lump sum can narrow significantly or disappear. There are other sizeable advantages, to both the plaintiff and defendant, for structuring a settlement instead of settling upon a lump sum. There are also disadvantages, and these must be weighed carefully before agreeing to a structure.

The actual cost to the defendant of funding the structure is usually not revealed to the plaintiff; instead, a present value figure is given. Usually the defendant claims that this preserves the plaintiff's tax advantage by precluding constructive receipt of the annuity, but this claim is groundless and incorrect. The principal advantage of not revealing the cost is preservation of the possibility that the plaintiff will value the payments at an amount higher than the cost. While the present value of the payments should be evaluated by the plaintiff independent of the cost, knowing the cost is an important factor in negotiations. Persevering plaintiffs' attorneys should seek to determine the exact cost as well as any non-standard assumptions about life expectancy. Defense attorneys, by withholding cost information, may strengthen their position, but they run the risk of being perceived as acting in bad faith. In some states, the cost must be disclosed. Defense attorneys should always obtain several quotes for the annuity prices since, as for any product, prices can vary substantially.

Based on total dollars paid over time, the value of the payments can appear to be much higher than the highest settlement figure sought by the plaintiff. However, these periodic payment amounts must be discounted to present value, which is a fairly straightforward process. Plaintiffs' attorneys can then "reality test" their value estimate by seeking to obtain a quote for the annuity from an issuer. The analysis process, while straightforward, is complex and typically requires the expertise of an economist. While plaintiffs and defendants may not be able to agree on a compromise lump sum payment, the difference in the perceived value of the structured settlement, due primarily to the tax-free status of such payments, is one major reason it serves well to form the common ground in settlement negotiations, even when the costs are known to both sides. There are other reasons for which structured settlements are more advantageous than the alternative of an identical lump sum award. These are discussed below.

A. *The Nature of Structured Settlements*

A structured settlement is one in which payment of part of the settlement amount is deferred beyond settlement day. Hence the settlement calls for periodic, or structured, payments. The variety of structures is virtually infinite since payments are usually geared to take into account the particular cash flow needs of the recipient. In most structures, a significant portion of the total funds is paid on the settlement day, and periodic amounts (usually monthly or annually) are paid throughout the balance of the life of the recipient. The periodic payments are usually constant but may grow over time. However, actual indexing for inflation is rare. Additional lump sums are often scheduled at certain intervals in future years. The periodic payments are typically guaranteed for a minimum number of years, at little incremental expense given the relevant life expectancy tables. While this section

discusses periodic payments principally in the context of personal injury litigation, structured settlements can be used in a variety of settings that seek to obtain the advantage of deferral of payments, including the buyout of business partners, the dissolution of a marriage, contributions to charities, etc.

B. *Taxes*

Allocation of lump sum awards and structured payments can significantly affect the taxes paid by the plaintiff, defendant, insurers, and the plaintiff's attorney. The governing tax laws are complex and subject to change and various interpretations. The following is only a commentary on certain possible tax considerations. It is NOT a substitute for tax counsel from experts in taxation. Given the complexity of the tax code, it is IMPERATIVE to seek advice and interpretation from such experts to assure proper conformity to applicable laws, regulations, and revenue rulings, and to obtain the best possible tax advantage.

Payments for personal injuries or sickness and certain other claims for workers' compensation and other statutory matters are generally free from federal taxes under Internal Revenue Code Section 104(a) (26 U.S.C. §104[a]). This exclusion does not require the filing of a lawsuit. Payments for contractual injuries, injuries to business reputation and certain other types of claims, however, are generally taxed. Awards are also generally taxable to the extent of reimbursement for deducted medical expenses in the past. Future medical expenses incurred may be deductible only to the extent that they exceed the award for such expenses. In the past, the IRS distinguished between compensatory and punitive damages, holding punitive damages taxable, although Section 104 does not distinguish between the two types of damages. The tax-exempt status and future deductibility of punitive damages is, at the moment, uncertain. In general and within reason, it is desirable for tax purposes to allocate as little as possible to medical expenses, punitive damages, and injury to business reputation. Conversely, it is desirable to allocate as much of the award as possible to lost income, pain and suffering, emotional harm, and to business property with sufficient remaining eligible basis to offset the award. Plaintiffs and their expert tax counsel should also examine state laws when deciding upon such allocations. While these allocations are not binding on the Internal Revenue Service (IRS), courts will look to the reasonable nature of such allocations in determining whether they are fair and proper.

Regarding future periodic payments arising from structured settlements, Revenue Ruling 79-220, 1979-2 C.B. 74, authorizes plaintiffs to exclude from their reported income on federal tax returns receipt of payments that are prefunded with an annuity, so long as the transaction is properly configured. This can represent a distinct advantage since the interest earned on a single lump sum award may otherwise be taxable to the plaintiff unless most of the payments were later offset by tax-deductible future medical expenses, for example. The existence of tax-free, high grade securities reduces the size of the tax advantage to some degree, depending upon the actual future tax bracket of the plaintiff and the rate of return on the bonds, but the advantage still remains significant. The tax-free advantage of structured settlements, as opposed to the taxable nature of the interest earned on a lump sum award, is a principal reason this vehicle is desired by plaintiffs and their attorneys. Plaintiffs can frequently achieve their own tax-free status without a structure, although

generally at a sacrifice of investment returns over those that accrue from tax-free, structured settlement annuities.

In determining the allocation of taxable and non-taxable portions of periodic payments, it is desirable to allocate as much as possible to the nontaxable claims and to allocate the awards for taxable claims to more distant future payments. Spreading reimbursements for previously deducted medical expenses over the years can also reduce the effective tax rate. Financial planning in this regard can bring about substantial tax savings and should be sought. Of course, the allocations are subject to IRS challenge.

The deductibility of the award by the defendant is not set forth in any specific code provision. The general test for deductibility is whether the expense and obligation arose out of conducting an income producing activity. The desire to reduce publicity or to protect certain assets from claims does not support deductibility. Rather, it is the actions which gave rise to the claim, the nature of the claim, and whether the claim resulted from ordinary operations. There are further limitations in the 1986 Tax Reform Act which limit immediate tax deductions. Punitive damages may not be ordinarily deductible, but might be deductible if the facts support the deductibility of the compensatory elements of the award. Thus, there appear to be opportunities in drafting the settlement to provide maximum tax advantage to defendants, also.

In general, when the liability for damages falls upon the insurer, all payments may be deducted, since these obligations arise out of the insurer's ordinary operations. When the defendant or its insurer purchases an annuity, it can deduct the obligation currently if certain rules are followed. The 1986 Tax Reform Act qualified Internal Revenue Code Section 130, which now essentially provides for favorable tax treatment of the income the annuity issuer receives from the sale of annuities to fund periodic payments for physical injuries, sickness, and wrongful death by allowing for the deductibility of the cost of acquiring the funding assets (again, provided certain statutory requirements are met).

The plaintiff's attorney's fees are frequently based on the present value of the structure. Courts may hold that such fees must be based on the cost of the structure rather than on some other valuation method. Attorneys' fees are often paid from the initial payment, but payments may be deferred in any satisfactory way. For an attorney who is a cash-basis taxpayer, an advantage of deferring fees is that, depending on the marginal tax rate, for deferral may lower the attorney's tax payments by spreading income and deferring taxes paid on the earnings of such income to future years. This does not apply to an accrual-basis taxpayer. However, an increase in future tax brackets and the uncertainty of the financial status of the obligor could eliminate this possible tax advantage. Last, deductibility is not available if under the fee arrangement the attorney is deemed to have constructive receipt of the fee.

Typically, the defendant (or his insurer) fulfills the periodic payment requirements by purchasing an annuity issued by an annuity company, although other methods of providing for secure future payments are available.[1] Proper transaction configuration of a structured settlement requires that the defendant or the insurer (*not* the plaintiff)

---

[1] Alternatives include various types of trusts, private investment annuities, and court administered funds.

own the annuity and that the purchase *per se* not relieve the annuity issuer from responsibility for payments in the event of default. The Technical and Miscellaneous Revenue Act of 1988 Amendment to Section 130 of the Internal Revenue Code permits the plaintiff to be a secured creditor of the issuer, secured by the annuity. This provides additional financial security to the plaintiff. Proper transaction configuration is critical to assure conformity with, and to take maximum advantage of, the governing tax rules. Thus specialized tax expertise in drafting the structured settlement is important and should definitely be sought.

C. Other Considerations

The settlement, whether simple or structured, is often the most significant financial event of the life of the recipient. Investment of a simple lump sum in risky but high return securities is attractive because it can possibly increase the plaintiff's wealth over time. But there is always the risk of considerable loss. To avoid this risk and to assure proper financial management of settlement funds, plaintiffs' attorneys frequently think it is important that their client be provided periodic payments over the course of many years. A structure serves as a safeguard against the client's own lack of investment expertise, imprudent or fraudulent financial management, the appearance of a "sudden suitor," and other possibilities of premature dissipation, not only for incompetent or underage plaintiffs, but for many people. Defined benefit pension plans follow this same logic and provide structured rather than lump sum payments upon retirement.

The safeguarding of a plaintiff's wealth through periodic payments is seen as one of the principal advantages of a structured settlement. While the plaintiff can always purchase his own annuity with a lump sum settlement amount, it probably cannot confer the same degree of tax advantage. Moreover, institutional defendants are often able to purchase the annuity at a substantial wholesale discount and obtain further reductions if the life expectancy of the recipient is impaired. These advantages may be shared with the plaintiff, who can usually only purchase annuities at full retail value.

While plaintiffs would ordinarily wish to invest a lump sum settlement in lower yielding, risk free securities, insurers can more easily diversify their risks, obtain higher returns in riskier securities, and offer more to plaintiffs. Thus, the discount rate used by plaintiffs to value the structured cash flows will be lower than that used by defendants, especially when after-tax returns are properly determined. Hence the plaintiff's valuation will be higher than the defendant's cost assessment before taking the tax advantage into account, and even more so after tax effects are considered. Herein lies another principal advantage that structured settlements provide: insurance companies can take on more risk, and thus can expect to earn more, on average, than individual investors. A portion of this incremental return can be shared with the plaintiff in the form of larger payments. Future payments are infrequently geared to rise with inflation. If inflation decreases over time, the plaintiff "wins," but if inflation becomes higher than expected, the actual value of the payments falls and the plaintiff "loses." The annuity issuer may have the opposite experience, depending upon the types of securities in which investments are made. The plaintiff can hedge against unanticipated inflation through the purchase of out-of-the-money options on interest rate futures, but this requires complex financial management which vitiates one of the principal features of structured settlements.

The insurer usually has more financial expertise and is more able to invest to hedge against inflation. The *Model Periodic Payment of Judgements Act*[2] recommends inflation-indexed payments. Growth in payments can certainly be arranged, but only at some sacrifice to the initial payment level.

To the disadvantage of plaintiffs, a structure is inflexible; once entered into, it cannot be "cashed out" easily to take care of the emergencies that life sometimes serves up. This inflexibility is the result of the inherent advantage of a structure providing safeguards against premature dissipation. It cannot be avoided without jeopardizing the tax advantages from the lack of constructive receipt of the entire present value of the payments.

Also, while the structure payments may be secured by the annuity and, in general, by the assets of the issuer, the payments are not completely risk free, as is a lump sum payment. Frequently, the liability of the defendant or its issuer is assigned to a third party which may have a stronger balance sheet than the defendant. Yet, the analysis of the financial ability of an insurance or an annuity company is a complicated endeavor. A.M. Best and Company and the National Association of Insurance Commissioners provide information regarding the expected financial future of an insurance company. Highly secure insurance companies have not failed in recent decades, but as private entities, they are as subject to market forces as any other business. Examining the future financial viability of the issuer is of critical importance to the plaintiff.

In summary, the advantage to both sides in seeking a structured, versus a simple lump sum, award can be shared so that everyone benefits. The defendant typically views a structured settlement in terms of its cost, and the plaintiff may be willing to accept a structured settlement which costs less than a negotiated lump sum award due to the possible tax savings, the safeguarding of wealth, the sharing of higher returns from riskier securities with no management costs, and the sharing of the spread between the wholesale and retail cost of an annuity. The disadvantages of the inflexibility of cash flows, the lack of sensitivity to inflation, and the risk of default by the insurers must be weighed against the advantages.

D. *Valuation of a Structured Settlement*

Even though the cost of an annuity may be known, the value to the plaintiff may be higher than the cost. It is important to compare the value *to the plaintiff* and weigh this against the alternative of a lump sum payment. The principal elements in valuing a structure to the plaintiff are the timing and the amount of the cash flows, the interest rates assumed for discounting, and the probability of the recipient surviving through each successive year through age 100. Any deviations from normal life expectancy assumptions must be taken into account. Sometimes the defense agrees to make future payments for required future medical expenses that cannot be known with certainty at the time of settlement. The estimated future payments at the time of the settlement can be used, but this adds some uncertainty to the settlement value. Beyond this uncertainty, the valuation process is fairly straightforward.

While the process may be mechanical, it is all but impossible to accurately value a structured settlement in present value terms without formal mathematical

---

[2] Uniform Law Commissioner's Model Periodic Payment of Judgements Act (St. Paul, Minnesota: West Publishing Company, 1974 Supplement) ULA Vol. 14.

analysis. Our minds are not geared toward mentally calculating to present value a series of periodic and uneven cash flows further affected by mortality statistics, using a yield curve. Few people easily grasp that, at 12 percent interest, the present value of $10,000 to be received 24 years hence by a 40-year-old black male plaintiff, if alive at that time, is less than $825.

Computers greatly simplify the valuation process. Each future payment must be discounted to present value using a compound interest (discount) rate. Each payment must be further modified by the probability of payment, which is 1.00 if guaranteed and less than 1.00 if dependent upon the recipient's being alive at the time of payment. Once the present value of each of the payments has been determined, these are simply added together to arrive at a total present value. Many economists take the shortcut of not using year-by-year probability of survival statistics through age 100, but only a single life expectancy statistic. They estimate the value of all payments through life expectancy, as if they were guaranteed. This overvalues payments received after the guarantee period expires but prior to the end of life expectancy. Further, it ignores the value of payments that may be received when life expectancy is exceeded. The net effect of this shortcut has the general effect of *overestimating* the value of a structure; the greater the age of the plaintiff, the greater the overestimation.[3]

E. *Sample Valuations*

For the purposes of illustration, we assume the following example of payments to Mrs. Doe (wife of Jack Doe, a white female born August 13, 1955) starting August 13, 1990:

$100,000 Cash August 13, 1990
$24,000 per year starting August 13, 1991 for 5 years guaranteed;
$30,000 per year starting August 13, 1996 for 10 years guaranteed;
$36,000 per year starting August 13, 2006 for 25 years guaranteed;
$40,000 per year starting August 13, 2031 through life expectancy but no guaranteed payments if not alive;
$100,000 August 13, 1996 guaranteed
$150,000 August 13, 2006 guaranteed
$200,000 August 13, 2016, 2021 and 2026 guaranteed.

Table 1 shows payments and other statistics regarding the structured settlement analysis as of August 13, 1990. We assume an 8 percent nominal return on risk free securities. For simplicity's sake, we assume a flat yield curve, i.e., interest rates for all government securities are at 8 percent regardless of maturity. If the yield curve (a graph of the interest rates versus maturity) were not flat, then a separate discount rate for each future year might be used. Yield curves are commonly available from many financial publications. Assuming a 28 percent marginal tax bracket, the after-tax return for discounting is 8 percent × (100 percent − 28 percent) = 5.76 percent. Further, we assume that Mrs. Doe's probability of survival is normal for a white female of her age.

---

[3] For a more thorough discussion of this, see STRUCTURING SETTLEMENTS, by Eck and Ungerer, Shepard's/McGraw-Hill, 1987, p. 26.

TABLE 1

EVALUATION OF STRUCTURED SETTLEMENT PAYMENTS TO MRS. JACK DOE

A PERIOD	B YEAR	C AGE	D PAYMENT	E GUARANTY	F SURVIVAL	G LIFE EXP	H INTEREST	I PRES VAL	J PV GTY	K PV LE	L PV TX
1	1990	35	$100,000	$100,000	1.0000	1.00	1.0000	$100,000	$100,000	$100,000	$100,000
2	1991	36	24,000	24,000	1.0000	1.00	0.9259	22,222	22,222	22,222	22,727
3	1992	37	24,000	24,000	1.0000	1.00	0.8573	20,576	20,576	20,576	21,522
4	1993	38	24,000	24,000	1.0000	1.00	0.7938	19,052	19,052	19,052	20,381
5	1994	39	24,000	24,000	1.0000	1.00	0.7350	17,641	17,641	17,641	19,300
6	1995	40	24,000	24,000	1.0000	1.00	0.6806	16,334	16,334	16,334	18,276
7	1996	41	130,000	130,000	1.0000	1.00	0.6302	81,922	81,922	81,922	93,748
8	1997	42	30,000	30,000	1.0000	1.00	0.5835	17,505	17,505	17,505	20,487
9	1998	43	30,000	30,000	1.0000	1.00	0.5403	16,208	16,208	16,208	19,400
10	1999	44	30,000	30,000	1.0000	1.00	0.5002	15,007	15,007	15,007	18,372
11	2000	45	30,000	30,000	1.0000	1.00	0.4632	13,896	13,896	13,896	17,397
12	2001	46	30,000	30,000	1.0000	1.00	0.4289	12,866	12,866	12,866	16,475
13	2002	47	30,000	30,000	1.0000	1.00	0.3971	11,913	11,913	11,913	15,601
14	2003	48	30,000	30,000	1.0000	1.00	0.3677	11,031	11,031	11,031	14,774
15	2004	49	30,000	30,000	1.0000	1.00	0.3405	10,214	10,214	10,214	13,990
16	2005	50	30,000	30,000	1.0000	1.00	0.3152	9,457	9,457	9,457	13,248
17	2006	51	186,000	186,000	1.0000	1.00	0.2919	54,292	54,292	54,292	77,784
18	2007	52	36,000	36,000	1.0000	1.00	0.2703	9,730	9,730	9,730	14,257
19	2008	53	36,000	36,000	1.0000	1.00	0.2502	9,009	9,009	9,009	13,501
20	2009	54	36,000	36,000	1.0000	1.00	0.2317	8,342	8,342	8,342	12,785
21	2010	55	36,000	36,000	1.0000	1.00	0.2145	7,724	7,724	7,724	12,107
22	2011	56	36,000	36,000	1.0000	1.00	0.1987	7,152	7,152	7,152	11,465
23	2012	57	36,000	36,000	1.0000	1.00	0.1839	6,622	6,622	6,622	10,857
24	2013	58	36,000	36,000	1.0000	1.00	0.1703	6,131	6,131	6,131	10,281
25	2014	59	36,000	36,000	1.0000	1.00	0.1577	5,677	5,677	5,677	9,736
26	2015	60	36,000	36,000	1.0000	1.00	0.1460	5,257	5,257	5,257	9,219
27	2016	61	236,000	236,000	1.0000	1.00	0.1352	31,908	31,908	31,908	57,233
28	2017	62	36,000	36,000	1.0000	1.00	0.1252	4,507	4,507	4,507	8,268
29	2018	63	36,000	36,000	1.0000	1.00	0.1159	4,173	4,173	4,173	7,829
30	2019	64	36,000	36,000	1.0000	1.00	0.1073	3,864	3,864	3,864	7,414
31	2020	65	36,000	36,000	1.0000	1.00	0.0994	3,578	3,578	3,578	7,021
32	2021	66	236,000	236,000	1.0000	1.00	0.0920	21,716	21,716	21,716	43,584
33	2022	67	36,000	36,000	1.0000	1.00	0.0852	3,067	3,067	3,067	6,296
34	2023	68	36,000	36,000	1.0000	1.00	0.0789	2,840	2,840	2,840	5,962
35	2024	69	36,000	36,000	1.0000	1.00	0.0730	2,630	2,630	2,630	5,646
36	2025	70	36,000	36,000	1.0000	1.00	0.0676	2,435	2,435	2,435	5,346
37	2026	71	236,000	236,000	1.0000	1.00	0.0626	14,779	14,779	14,779	33,190
38	2027	72	36,000	36,000	1.0000	1.00	0.0580	2,087	2,087	2,087	4,794
39	2028	73	36,000	36,000	1.0000	1.00	0.0537	1,933	1,933	1,933	4,540
40	2029	74	36,000	36,000	1.0000	1.00	0.0497	1,790	1,790	1,790	4,299
41	2030	75	36,000	36,000	1.0000	1.00	0.0460	1,657	1,657	1,657	4,071
42	2031	76	40,000	0	0.6868	1.00	0.0426	1,171	0	1,705	2,942
43	2032	77	40,000	0	0.6623	1.00	0.0395	1,045	0	1,579	2,687
44	2033	78	40,000	0	0.6362	1.00	0.0365	930	0	1,462	2,444
45	2034	79	40,000	0	0.6087	1.00	0.0338	824	0	1,353	2,214
46	2035	80	40,000	0	0.5796	0.33	0.0313	726	0	414	1,997
47	2036	81	40,000	0	0.5492		0.0290	637	0	0	1,792
48	2037	82	40,000	0	0.5155		0.0269	554	0	0	1,593
49	2038	83	40,000	0	0.4785		0.0249	476	0	0	1,400
50	2039	84	40,000	0	0.4385		0.0230	404	0	0	1,215
51	2040	85	40,000	0	0.3957		0.0213	337	0	0	1,038
52	2041	86	40,000	0	0.3505		0.0197	277	0	0	871
53	2042	87	40,000	0	0.3038		0.0183	222	0	0	715
54	2043	88	40,000	0	0.2566		0.0169	174	0	0	572
55	2044	89	40,000	0	0.2100		0.0157	132	0	0	443
56	2045	90	40,000	0	0.1654		0.0145	96	0	0	330
57	2046	91	40,000	0	0.1245		0.0134	67	0	0	236
58	2047	92	40,000	0	0.0885		0.0124	44	0	0	159
59	2048	93	40,000	0	0.0586		0.0115	27	0	0	99
60	2049	94	40,000	0	0.0355		0.0107	15	0	0	57
61	2050	95	40,000	0	0.0192		0.0099	8	0	0	29
62	2051	96	40,000	0	0.0089		0.0091	3	0	0	13
63	2052	97	40,000	0	0.0033		0.0085	1	0	0	5
64	2053	98	40,000	0	0.0009		0.0078	0	0	0	1
65	2054	99	40,000	0	0.0001		0.0073	0	0	0	0
66	2055	100	40,000	0	0.0000		0.0067	0	0	0	0
				$2,270,000				$626,912	$618,742	$625,254	$856,033

Column Headings in Table 1 are Defined as Follows:

Column A, PERIOD	is the period number.
Column B, YEAR	is the calendar year.
Column C, AGE	is the age at the time of payment.
Column D, PAYMENT	is the proposed payment amount in all future years.
Column E, GUARANTY	is the guaranteed payment stream.
Column F, SURVIVAL	is set at one for guaranteed years and at the probability of living through each year thereafter to age 100.
Column G, LIFE EXP	indicates the full or partial year of life expectancy.
Column H, INTEREST	shows the discount factor for each future year at 8 percent compounded annually.
Column I, PRES VAL	shows the true present value of all payments, affected by the probability of survival to age 100.
Column J, PV GTY	shows the present value of the guaranteed payments.
Column K, PV LE	shows the present value of payments if Mrs. Doe lived through life expectancy.
Column L, PV TX	shows the true present value taking the tax-free nature of the payments into account.

The total cash guaranteed (E) is shown to be $2,270,000. While this appears to be a great deal of money, it has a present value at 8 percent discount, affected by guarantees and mortality (I), of only $626,912. The present value of only the guaranteed payments (J) is $618,742, which is only slightly less than the total present value (I). If only the guaranteed portion were valued, the structure would be undervalued. In the sample case, the shortcut of valuing all payments assuming Mrs. Doe lives only to life expectancy (K) also slightly undervalues the true present value. Usually, the shortcut leads to overvaluation.

Any errors resulting in undervaluation increase the probability that the plaintiff may turn down a satisfactory offer. Errors producing an overvaluation increase the probability that the plaintiff will accept an offer which is financially inadequate. The present value (I) of $626,912 may be somewhat higher than the defendant's cost, particularly if the annuity company expects to earn more than an 8 percent return on the investment. However, the perceived value to the plaintiff is a most important consideration since plaintiffs cannot typically earn the same returns without management costs.

When the tax-free nature of the payments is taken into account, the perceived present value of the annuity (L) is shown to be $856,033. This figure would be less at lower marginal tax rates. But at the current rate, the value of the annuity is worth almost $230,000 more than a lump sum with interest earnings that are fully taxable. Here, the plaintiff would value the annuity at some $230,000 more than the comparable lump sum award costing the defendant $626,912.

Once the perceived value to the plaintiff is determined, the other factors such as the costs of litigation, the stress of conflict, and the risk of a poor trial result must be weighed to determine the proper course of action: settlement versus trial. Complex forces are at play in negotiating and evaluating the offer of a settlement,

but the important factors described here can be decisive in successfully negotiating a settlement, whether as a simple lump sum or a series of periodic payments.

10.6 Discovery Depositions

A. *Defense*

If the defense attorney decides to proceed with a discovery deposition of the plaintiff's economist, he must decide upon his primary reason for requesting the deposition. One reason is to better understand how the economist has performed his calculations. This aids in the evaluation of settlement proposals, in preparation for cross-examination, and perhaps in the decision to counter with another economist at trial. Another rationale, which may assume primary importance in a discovery deposition, is to intimidate the plaintiff's economist and belittle his estimates. This may be sensible if, by lessening the credibility of the expert in the eyes of the plaintiff's attorney, the defense might obtain a more satisfactory settlement before trial.

Obviously, the nature of the deposition will be affected by the reason for the deposition. If simple understanding is the central theme, the defense gains the advantage of not tipping its hand on lines of attack at trial. Where a more aggressive approach is utilized, the plaintiff's economist may learn more than the defense attorney about how to prepare for cross-examination.

Whatever the thrust of the defense, we recommend that the plaintiff's economist be asked to state all major assumptions and make clear how these assumptions are converted into calculations and then loss estimates. Ask the economist if he agrees with, and supports, all of his assumptions. Ask him about related publications and related testimony in the past year or so. These types of questions provide data needed by the defense attorney and economist in preparing for cross-examination and may yield a bonanza. For example, the economist may say that he has problems with a certain assumption given to him by the plaintiff's attorney. Or, after research, you may find that he repudiated the offset technique in recent testimony but is using this technique in your case.

Lines of inquiry are addressed in more detail in the next chapter. One overriding concern in both deposition and cross-examination at trial, however, is the defense attorney's level of sophistication in both formulating questions and understanding the responses. Even before the discovery deposition, the defense attorney may need the assistance of more experienced attorneys, the Defense Research Institute and its publications, and his own economic expert.

B. *Plaintiff*

The plaintiff's attorney, to comply with discovery rules, will usually have his expert bring his entire file and perhaps trial exhibits to the deposition. The economist should assume that the defense attorney will take his file and review it, page by page, as part of the deposition.

One tactical issue for the plaintiff's attorney and economist is whether the economist should be glib and concise in his answers at deposition or be more forceful in responses as he might be at trial. Such "forcefulness" at trial might include pointing out that the defense has made a very minor point, or elaborating all counterpoints to a line of argument, or showing countervailing reasons in response

to contentions that his economic estimate is too speculative or too high. An advantage of saying a minimum in deposition is that one volunteers the least information possible to help the defense prepare for cross-examination. The disadvantage is that the economist may not boost the settlement position of the plaintiff's attorney. This pro and this con are reversed as the plaintiff's economist becomes more forceful in responding to questions by the defense.

Most experienced economic experts feel that they gain more than they lose in discovery depositions, unless their assumptions are questionable or they have made outright mistakes. Even when the defense economist asks straightforward questions to understand the economic report, the economist will pick up indications of lines of inquiry at trial.

Let us now assume that the defense attorney has listed his own economic expert, who is subject to discovery. Assuming that the case is worth the expense, the plaintiff's attorney is usually well advised to depose this potential witness. He should be asked about his own past articles and testimony, and these should be researched. He should be asked to detail every criticism which he has of the assumptions, techniques, and estimates of the plaintiff's economist. If possible, he should be forced into the posture of making his own estimate of economic loss, and he should be asked if he has made his own calculations.

A defense economist will probably not be used to testify at trial, but his deposition will greatly aid preparation by the plaintiff's attorney and economist. If the defense economist does testify, the deposition, and follow-up research, may well show him criticizing assumptions and techniques which he has used before. Finally, discovery depositions have led to the defense economist being subpoenaed by the plaintiff's attorney for testimony that reinforces the estimates of the plaintiff's economist.

10.7 Preparation for Trial: Plaintiff

A. *Resources of Economist*

The forensic economist for the plaintiff will have three primary resources on the witness stand, above and beyond his brain, experience, personality, etc. These are:

1. His specific case file.
2. His file or notebook of back-up economic or related data.
3. His exhibits.

As trial approaches, the economist must ensure that he is prepared to effectively utilize these resources.

(i) *The Case File*

A disadvantage of utilizing experienced economic experts is that they are very busy. They may be testifying in your John Brown case today after an Adam Smith testimony yesterday. Yet, on your day, they must be well prepared for, and thinking of, John Brown. The ability to do this accrues from advanced preparation.

The file itself must contain all information, but only that information necessary for testimony. The economic report, itself, may be first in the file with a cover sheet that contains the input program. The economist can ascertain from this one sheet most or all of the inputs which produced the output. Next in the file should be

the package of detailed calculations which led to the economic report. Next will be back-up data such as income tax returns, W-2's, completed Information Guide Sheets, specific employer contributions to fringe benefits, etc.

The point is that the plaintiff's economist should have a specific protocol for the organization of his file, so that he knows what is where. Moreover, he must have taken the time to ensure that he is very familiar with the specific contents of this file. Nothing is worse than the expert who continually shuffles or fumbles through his file, or the expert who forgets the name of the injured or deceased party.

(ii) *Back-up Data*

In addition to the specific file, the economic expert may have a file, or a Trial Notebook, containing general economic data about which he may be asked. No economist, or any other person, can memorize all of the economic data which could be the subject of a random question. However, a practical rule is to have handily available the answers which, if not known, would embarrass one in the eyes of a lay juror. Horror stories abound about the economist who did not know the current minimum wage, or inflation rate, or the unemployment rate in the relevant state. Yet, there is a defined range of statistics beyond these which relate to economic loss cases and which the economist may choose to have available at trial.

(iii) *Demonstrative Evidence*

It is very true that one picture is worth a thousand words. A basic rule which we recommend on the plaintiff's side is to blow-up the "bottom line" summary chart on a large cardboard poster. This can be introduced as evidence and sit in the jury room. Other tables which have been prepared in the economic analysis to lead to the "bottom line" may also be blown up, so that the economist, at trial, may explain these in front of the jury. The use of demonstrative evidence is further discussed, and a complete sample testimony is provided, in the following chapter on testimony.

(iv) *Attorney/Economist Conference*

Before testimony, the plaintiff's attorney should provide for at least 2 to 3 hours of preparation time with his economist if this is their first work together. For subsequent cases, 1 to 2 hours of specific preparation is still needed. Lawyers are not economists, and they need to be refreshed. Every case may involve different economic applications, and legal parameters on economic testimony change.

The experienced economic expert will probably have an order of questions and answers to suggest. He or she is not an attorney but does have experience in explaining economic principles. In the interplay of backgrounds and skills of attorney and economist, a specific plan of questions should emerge, as well as some discussion of re-direct examination.

(v) *Scheduling*

Another problem with economic experts is that they may have a conflict with your desired time of testimony. This may be because of other cases or a teaching conflict, as many forensic economists are also college professors.

This is the reason that the attorney must carefully coordinate the available time of his expert with his preferred order of testimony. Advance notice of specific

times to an expert is critical. The experienced expert understands the time management problems associated with trials, but he or she also has inescapable commitments. If testimony is rendered impossible, a videotape testimony can be arranged.

10.8 Preparation for Testimony: Defense

Much of the preparation process has been discussed above, in regard to discovery depositions and hiring a defense economist, for example. Specifics of cross-examination tactics, for which one should prepare, are discussed in the next chapter.

However, in preparing for an attack on the plaintiff's economist, the defense attorney can produce several exhibits in conjunction with his advisors. For example, if the plaintiff's economist has projected wages without inflation, perform the same projection with inflation and be prepared to show the jury the very high wage earnings in future years. Or, take the "bottom line" lump sum analysis of the plaintiff's economist and show the annual income in the first year, at current interest rates, compared to what the injured or deceased party might have earned in that year. Many such exhibits can be prepared, especially with the aid of your economist.

10.9 Stipulations

A. *Plaintiff*

As a rule, stipulations in the area of economic damages are more important in state than in federal courts. In the former, rules of evidence are more likely to restrict what the economist can talk about, unless the basis of his comments is in the record. In the latter, he has wide latitude in basing his comments on information which he can reasonably rely upon as an expert in his field. Thus, the groundwork for the economist's testimony must be carefully laid in many state courts, and stipulations are obviously an easy manner of laying this groundwork.

The consensus of plaintiffs' attorneys seems to be, nevertheless, to attempt to stipulate as much as possible. A minority prefers to introduce many facts and underlying assumptions through testimony, especially in federal courts. The checklist below provides information relevant to economic damages in a personal injury or wrongful death case, which the plaintiff attorney may wish to stipulate. A caveat is that in attempting to stipulate a particular fact or assumption, the plaintiff attorney may call attention to a weakness or problem which he perceives.

CHECKLIST
INFORMATION PLAINTIFF'S ATTORNEY MAY DESIRE TO HAVE STIPULATED

1. Demographic information about injured or deceased and family—dates of birth and injury (or death), race, sex, birthdates of wife and children.
2. Education, training, work history, and job titles.
3. Past wage and salary earnings history from W-2's or income tax returns.
4. Amount of employer contributions to each category of fringe benefits.
5. Life expectancy and work-life expectancy of the deceased or injured person.
6. Qualifications of economist as an expert witness.

B. *Defense*

The defense will carefully scrutinize everything which the plaintiff wishes to stipulate regarding the damages portion of the case. Some defense attorneys seem to fight every stipulation, while others will not object to the stipulation of obvious facts, such as demographic data on the deceased, W-2 statements, and income tax returns. In areas such as fringe benefits, work-life expectancy, household services loss, and personal consumption deductions, stipulation is less likely. Depending upon the particular case, a basis may exist to attack the assumptions and/or methods employed by the economic expert in these areas.

10.10 Summary

The process of securing a settlement without trial is most important to both plaintiffs' and defense attorneys. The economic expert, on either or both sides, may be extremely important in this process. At the same time, the opposing attorneys and their economic experts should be pursuing useful strategies and guidelines which will maximize their effectiveness, if necessary, at trial.