Unusual Illinois Decision May Impact Structured Purchasing Industry

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The Illinois legislature appears poised to amend the state's "Structured Settlement Protection Act", in part to address the anomalous decision in *Settlement Funding, LLC v. Cathy Brenston*, Nos. 4-12-0869, 4-12-0870, 4-12–0944, 2013 Ill. App. LEXIS 573 (Ill. Ct. App. Aug. 26, 2013). In *Brenston*, the Illinois Court of Appeals (Fourth District) decided that the trial court was without authority to approve structured settlement transfers because the Illinois Structured Settlement Protection Act did not apply when the settlement agreement contained an enforceable anti-assignment clause. The Court further held that, because the factoring company knew or should have known about the anti-assignment clause, and failed to inform the trial court, it committed a fraud upon the court and therefore the orders approving the transfers were invalid. Settlement Funding (a/k/a "Peachtree") filed a petition for review to the Illinois Supreme Court, which denied the petition on November 30, 2013.

The Fourth District court held that the trial court had a duty to enforce the anti-assignment provisions and stated that the transfer court had no authority under the Act to approve the transfers, even though the relevant parties had waived the anti-assignment provisions. The court stated "Settlement Funding knew or should have known that the structured settlement contained an anti-assignment clause, and knew or should or should have known that if the settlement did contain such a clause, the payments could not be assigned. In abandoning or ignoring this non-delegable obligation, Settlement Funding fraudulently concealed this issue from the trial court and affirmatively alleged that its petitions for approval of the transfers was in compliance with the law."

The Fourth District's decision theoretically impacts every transfer in Illinois (and possibly other states), since nearly every structured settlement contains boilerplate language purporting to limit or restrict assignability. The decision seems at odds with the Structured Settlement Protection Acts ("SSPA's") passed in 48 states, as well as the "Victims of Terrorism Relief Act", 26 U.S.C. § 5891, wherein Congress expressly contemplated that structured settlement transfers would contravene anti-assignment language, and provided for the continued favorable tax treatment of Insurers under Section 130 of the Tax Code.

Contractual Anti-assignment provisions

The secondary market, in which structured settlement "factoring" companies purchase from settlement recipients their rights to receive future payments, has experienced varying degrees of success. Although the effectiveness of anti-assignment provisions was extensively litigated between factoring companies and insurers in transactions that predated SSPAs, the industry continues to face challenges, including misapprehension of the law in this area.

Settlement documents typically prohibit any assignment of the right to receive future settlement payments. However, in light of the protections available under the SSPAs and Section 5891, insurers generally do not insist on enforcement of anti-assignment provisions. Thus, if anti-assignment provisions are purely contractual, rather than statutory or court-ordered, they are effectively waived in most cases.

Contrary to popular misconception, structured settlements typically result from the *voluntary* settlement of an underlying tort claim. Simply put, structured settlements are a cost-effective way for insurance carriers to settle personal injury claims on favorable terms and are often used for garden variety cases. In the vast majority of cases, they are simply the result of a negotiated settlement between plaintiff and defendant, with no substantive court involvement. More often than not, the only difference between an adult Plaintiff with a structured settlement and one who settled for a cash payment is that the latter enjoys the immediate use of his settlement, while the former is constrained to either await periodic payments or convert the annuitized payments to immediate cash pursuant to a state SSPA.

Anti-assignment provisions are often included in structured settlement agreements under the mistaken belief that they are required to prevent the application of the "constructive receipt" tax doctrine. These anti-assignment provisions are not intended as a form of spendthrift trust, nor are they intended as a restriction on alienation of the right to receive structured settlement payments. Rather, they result from an overly cautious reading of several private letter rulings from the early 1980's and a misunderstanding of the constructive receipt tax doctrine. Any lingering doubts as to whether an anti-assignment provision is required to prevent constructive receipt were dispelled in 2002, with the passage of 26 U.S.C. Section 5891, *et seq*., which made it clear - by way of a clarification of existing law - that a sale or transfer of structured settlement payment rights would *not* alter the tax treatment applicable to the annuitant or annuity issuers. Notwithstanding this background, anti-assignment clauses remain as a lingering vestige of common practice and are hence present in many settlement agreements.

Brenston Court Rationale

In *Brenston*, the underlying settlement was obtained when Cathy Brenston resolved a claim for medical negligence against the University of Illinois. Following her settlement, Ms. Brenston completed multiple factoring transactions with Peachtree, all of which were approved by the Illinois Circuit courts in accordance with the Illinois SSPA. The transactions were funded and closed, and Brenston was paid, pursuant to the final court orders. Brenston then filed lawsuits in Cook County, nearly three years later, seeking to void her transactions, arguing that anti-assignment clauses in the settlement agreement and the qualified assignment agreements prevented the transfer courts from exercising jurisdiction, and also that the transfers were obtained by fraud and were therefore void *ab initio* and subject to challenge at any time.

In one of Brenston's transfers, she sold monthly payments (from an Allstate annuity) of $4,251.37 for a five-year period from March 1, 2008 through February 1, 2013, in exchange for an up-front lump sum payment of $146,782.35. The present value of the payments she sold was $222,405.52 A second similar transaction involved payments from an annuity issued by Genworth.

In all respects the transfer petitions in Brenston were straightforward, and in line with the pleading standards of hundreds of other transfer petitions filed in Illinois, and numerous other states. Nonetheless, the Illinois appellate court found that "[Peachtree] failed to acknowledge the anti-assignment provision in the body of its petition… the anti-assignment provision states that Brenston has no power to sell, mortgage, or encumber the periodic payments or any portion

of them… Peachtree… suppressed the existence of this provision in its pleadings before the court". 2013 IL App (4th) 120869 at 16. The court further stated "Settlement Funding knew or should have known that the structured settlement contained an anti-assignment clause, and … that if the settlement did contain such a clause, the payments could not be assigned….the misrepresentations were common threads throughout each petition and they were tightly woven to create a cloak of fraud upon the court". Id at 19. The court then ordered that three of Brenston's transfer orders were void *ab initio*, and ordered the trial court to conduct a hearing to restore Brenston to the economic position she held prior to the legally ineffective transfer of her annuity payments.

Impact of Brenston

In its amicus brief, NASP ("National Association of Settlement Purchasers") suggests that the Illinois appellate decision will render the Illinois transfer statute a "practical nullity". "Without the certainty and finality of a court order, there is no viable secondary market", NASP argued. "Because every structured settlement contains boilerplate language that purports to limit or restrict assignability, every Illinois court approved transfer would be subject to challenge at any time".

The Illinois appellate court overlooked the very purpose and fundamental intent of the state SSPAs, including the Illinois statute. It appears anecdotally that this appellate decision has been ignored by other Illinois trial courts. Transfer petitions continue to be filed, hearings are going forward and transactions are being approved, funded and closed in accordance with the applicable final court orders. No insurance companies thus far have affirmatively tried to "undo" already completed transactions. Further, there appear to be no instances of other state courts citing the *Brenston* rationale, seeking to disrupt the industry, or seeking guidance as to anti-assignment issues – perhaps acknowledging the very purpose of the state SSPAs – as a framework in which anti-assignment language must be over-ridden if the requirements for approval of the transfer are otherwise met.

In enacting the SSPAs including the Illinois statute, state legislatures recognized that transfers completed pursuant to the Act would often times be in conflict with the terms of the settlement agreement. The SSPAs *expressly contemplate* situations where the transfer of structured settlement payment rights contravenes the terms of the structured settlement, and requires certain interested parties' (insurance companies) approval in those scenarios. In taking the drastic step of voiding Ms. Brenston's closed and funded transactions based merely on anti-assignment language, the Court of Appeals misinterpreted the law and ignored key provisions of the Illinois statute. In fact, the fundamental purpose of the SSPAs is to permit transfers to go forward, even if anti-assignment language is present.

Potential Impact on Industry

The *Brenston* decision raised significant concerns across the structured purchasing industry. However, in now appears that the Illinois legislature will address some of these concerns, and, in practice, the decision will have little precedential value in Illinois or across the industry. Recently, the Illinois legislature proposed an amendment to the Illinois SSPA, Senate Bill 1268, seeking to clarify the requirements for court approval of factoring transactions. Among other

things, SB 1268 requires that: the "effective interest rate" be disclosed to the Payee; an Application for approval must be brought in the circuit court in which the Payee is domiciled (thus addressing one of the issues in *Brenston*, in which applications had been approved in more than one county prior to the Fourth District's review); requiring the Payee to disclose previous transfers in the application for approval; and providing that "a court shall not be precluded from hearing an application for approval of a transfer of payment rights under a structured settlement where the terms of the structured settlement prohibit sale, assignment, or encumbrance of such payment rights…." SB 1268, Section 30 "General Provisions". SB 1268 has passed in both the Illinois Senate and House of Representatives, and is awaiting signature by the Governor.

Although the ramifications of the *Brenston* decision might have been far-reaching, it now appears that the decision will be of minimal impact to the industry, and that individuals such as Ms. Brenston will continue to have the option of some flexibility and necessary liquidity relative to their structured settlement payment rights.

If you have any questions or would like more information on the issues described above, please contact

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