SOUTH DAKOTA DEPARTMENT OF LABOR

DIVISION OF LABOR AND MANAGEMENT

NU LU **HF 110, 2005/06**

Claimant/Payee,

v.

SETTLEMENT FUNDING, LLC dba PEACHTREE SETTLEMENT FUNDING, **DECISION**

Transferee, and

FARMERS NEW WORLD LIFE INSURANCE COMPANY, and MID-CENTURY INSURANCE COMPANY,

Annuity Issuer.

This action involves Transferee's SDCL 21-3B-5 application to approve Lu's transfer of certain structured settlement payments to Transferee. Claimant Lu appears pro se.[1] Glen L. Roth and Jason Sutherland represent Transferee Settlement Funding, LLC, dba Peachtree Settlement Funding. Michael M. Hickey, of Bangs, McCullen, Butler, Foye & Simmons, L.L.P., and Peter J. Vodola represent Annuity Issuer Farmers New World Life Insurance Company, and the structured settlement obligor Mid-Century Insurance Company.

FACTUAL BACKGROUND:

The structured settlement payments at issue derive from Lu's workers' compensation claim, Department's hearing file number HF 94, 2000/01. To resolve that claim, the parties to that action, Lu, his employer Corner Construction Company, dba The Oaks Restaurant, and his employer's insurer Mid-Century Insurance Company, entered into a compromise settlement agreement which was approved by the Department on June 14, 2001.[2]

Although the settlement agreement termed the settlement amount a "lump sum", Lu did not receive a lump sum distribution of the total settlement amount at that time. Paragraph 9 of the settlement agreement provided for a partial lump sum distribution to pay Lu's attorney fees, and provided for payment of the balance of the settlement amount in annual payments:

[1] Claimant was represented by counsel in the workers' compensation action. He appears pro se in the current action.

[2] The settlement agreement incorrectly sets out "Farmers Insurance Group" as the Insurer in its caption. By prior written stipulation the parties agreed that the correct Insurer was "Mid-Century Insurance Company."

> The present value of the settlement is $190,000. . . . Insurer agrees to pay Claimant a lump sum settlement award of $190,000 representing $6,713.78 per year or $559.48 per month for his life expectancy of 28.3 years. This lump sum settlement of benefits is intended to provide benefits of $559.48 per month to Claimant over the balance of his lifetime. The sum of $190,000 includes Claimant's attorney fees, costs and sales tax of $53,756.72.
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> Employer/Insurer shall satisfy its obligations under this paragraph by paying to Claimant and his attorney of record, Margo Tschetter Julius, by one check, $63,000. With the balance of the lump sum, Employer/Insurer shall, at Claimant's option and request, purchase an annuity paying one annual benefit of $9,561.10 to Claimant every year for life, with 20 years of payments guaranteed as reflected in Exhibit A.

The settlement agreement concluded with the following paragraph:

> 14. The parties hereto specifically stipulate and agree that the foregoing paragraphs constitute an agreement as to compensation within the context of the South Dakota compensation laws in satisfaction of all rights, all of which is agreeable to each party hereto.

Pursuant to paragraph 9 of the settlement agreement, Mid-Century purchased a Life Certain Annuity from Farmers New World Life Insurance Co., documented by Periodic Payment Reinsurance Agreement #S00082906. Pursuant to the reinsurance agreement, Lu is to receive "$9,561.10 for life, payable annually, guaranteed for 20 years, beginning on 12/01/2001, with the last guaranteed payment on 12/01/2020."

Transferee has now filed the application which is the subject of this action, seeking Department approval of a proposed transfer of rights to the periodic payments under the annuity whereby Lu would assign to Transferee his right to receive ten annual payments, each in the amount of $9,561.10, beginning with the December 1, 2006, payment, through and including the December 1, 2015, payment.

According to Transferee's required disclosure to Lu:

1. The aggregate amount of the annuity payments to be transferred is $95,611.10.
2. The discounted present value of the annuity payments to be transferred is $73,284.15.
3. The gross amount to be paid to Lu is $39,115,13.
4. However, the net amount to be received by Lu is $36,915.13, after deducting a $200.00 "Processing Fee", and $2,000.00 "Legal Fees".

Pursuant to the South Dakota Structured Settlement Protection Act, SDCL Chapter 21-3B, Farmers New World Life Insurance Company, the "annuity issuer" and Mid-Century Insurance Company, the "structured settlement obligor", respectively under the Act, have objected to the proposed transfer on various grounds.

Lu and his wife Sheryl Lu, each testified at the hearing. Lu is 54 years old and married. He has 7 children, 4 of whom still live at home. He has a high school education, followed by some vocational education as a welder. He last worked as a restaurant cook, part-time, being paid $9 per hour, for approximately 20 hours per week. His current physical condition prevents full time work.

Sheryl is also unemployed and disabled by agoraphobia[3]. She testified there were still 5 of the 7 boys at home. She prepared handwritten lists of income, expenses, assets and liabilities, which were received as hearing exhibits.

Nu and Sheryl have the following income in addition to the annual annuity payments: Lu social security $1175, Sheryl Lu social security $579, the children's social security $489, Lu part-time work $600. This total annual income, approximately $34,000, together with Lu's annual annuity payment, in the amount of $9,561.10, gives the two and their dependents, approximately $43,500 annual income. This computes to $3,625 per month.

The only asset identified by Lu is his house, valued at $110,000, which is encumbered by a mortgage in the approximate amount of $85,000.

The two identified a number of other loans, including "check loans", credit card debt, private loans and a pawn shop loan, in the total approximate amount of $29,700.

Lu's monthly expenses, according to the list compiled by Sheryl, show that the two pay an $885 monthly house payment, and approximately $467 in monthly utilities. They claim they spend $1,100 per month on food, and $100 per month on clothing. Although they do not own a car, they list a $400 per month "gas" bill for a car they borrow from one of their sons. Assuming these figure to be correct, the total is approximately $3,000. The balance of the expenses listed appear to be nearly $1,000 monthly payments on interest or debt reduction, including $600 to "Chek Loan" and $130, "interest only" to a pawn shop.

The parties have covered their financial needs by using "payday" or "check loan" services charging 25% to 30%. They carry large credit card balances at interest rates of 18% or more. Because of this cycle of high-interest debt, they were both asked if they would consider bankruptcy as a means to pay these debts. Lu "does not believe in it". Sheryl testified that she does not want to get "stressed out" and does not want to lose the house. She testified that her father told her not to file bankruptcy.

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[3] According to the American Psychiatric Association, the essential feature of Agoraphobia is anxiety about being in places or situations from which escape might be difficult (or embarrassing) or in which help may not be available in the event of having a Panic Attack or panic-like symptoms.

In Lu’s December 2005 supplemental affidavit in support of the transfer, he stated that if the transfer was approved he would use the proceeds to pay his past due mortgage payments and back taxes. His home loan has been refinanced to include these amounts, so he is now current and these are no longer a concern. He also said he would use $15,900 to repair his deck and garage. The remainder would be used for payment of debts and home improvements. $6000 would pay off his credit card and $4000 would get utility bills current. At the hearing, Lu testified that if assignment of his annuity is approved he would use the proceeds to pay bills and buy a car.

Lu admitted he has not talked to an accountant or attorney to get advice on this proposed assignment.

Lu has presented no plan on how he would replace the annual annuity payment, or how he would use the proceeds of the assignment to create or preserve a stream of future income. Lu and his wife were each asked how they currently use the annual annuity payment. They each testified that they use it to catch up and pay bills. Lu argues that he was not able to make it on his current income, yet has no plan for how he will support himself or his dependents when the $9,500 annual annuity is taken away.

When pressed on redirect, Lu testified that he would replace the lost annual annuity income with the income from a family business that he would start “if we have money left.” Lu’s wife testified that she would go back to school and would then open her own business, a restaurant on the reservation. She also testified they would receive more income from their sons, who would help them.

In addition to the hearing testimony, the following exhibits were received at the hearing. The court reporter lost all original exhibits. The exhibits in the file have been reconstructed by agreement of the parties.

Exhibits received at the hearing:

1. Copy of Supplemental Affidavit of Nu Lu, dated December 7, 2005;
2. Copy of Affidavit, signed by Nu Lu, dated November 17, 2005;
3. Lu’s listing of expenses and income;
4. Lu’s listing of assets and liabilities;
5. The November 17, 2005, Absolute Assignment and UCC Article 9 Security Agreement;
6. South Dakota Transfer Disclosure;
7. The application to transfer payment, with attachments;
8. Affidavit of Heather E. Covey. This was offered, but not received.

Other facts will be developed as necessary to the analysis and decision.

ISSUE:

Whether Lu's proposed assignment of structured settlement payments to Transferee should be approved pursuant to South Dakota Structured Settlement Protection Act.

ANALYSIS AND DECISION

Transferee has the burden to show compliance with the requirements of SDCL Chapter 21-3B-3.

SDCL 21-3B-3 provides:

> No direct or indirect transfer of structured settlement payment rights is effective and no structured settlement obligor or annuity issuer is required to make any payment directly or indirectly to any transferee of structured settlement payment rights unless the transfer has been approved in advance in a final court order or order of a responsible administrative authority based on the following express findings by such court or responsible administrative authority:
>
> (1) The transfer is in the best interest of the payee, taking into account the welfare and support of the payee's dependents;
> (2) The payee has been advised in writing by the transferee to seek independent professional advice regarding the transfer and has either received such advice or knowingly waived such advice in writing; and
> (3) The transfer does not contravene any applicable statute or the order of any court or other government authority.

"Nothing contained in this chapter authorizes any transfer of structured settlement payment rights in contravention of any law[.]" SDCL 21-3B-10.

Contrary to SDCL 21-3B-3(3) and SDCL 21-3B-10, Lu's transfer of the structured settlement payments would be in contravention of SDCL 62-4-42, the South Dakota Workers' Compensation Law's prohibition on assignment of benefits.

SDCL 62-4-42 provides that "[n]o claim for compensation under this title is assignable, and all compensation and claims therefor are exempt from all claims of creditors except those for child and spousal support obligations."

The structured settlement payments at issue derive from Lu's workers' compensation claim. Despite being referred to in the workers' compensation settlement agreement as a "lump sum settlement of benefits", the workers' compensation settlement was, by the language of the agreement, "intended to provide benefits of $559.48 per month to Claimant over the balance of his lifetime." The workers' compensation Employer/Insurer maintained control over the funds and met its obligations under the agreement by purchasing an annuity intended to provide periodic payments: "one annual benefit of $9,561.10 to Claimant every year for life, with 20 years of payments guaranteed[.]"

The settlement agreement, and the annuity provided by that agreement, was approved by the Department because its periodic payments act to fulfill the overall purpose of workers' compensation law:

> The overall purpose of the worker's compensation act is to compensate an employee and dependents for the loss of income-earning ability where the loss is caused by injury, disability or death due to an employment-related accident, casualty or disease. When compensation is made in lieu of a pay check, such payment on an installment basis allows less chance that the funds could be lost through unwise investments or squandering of the money.

Thomas v. Custer State Hospital, 94 SD 60, 511 NW2d 576 (SD 1994).

> Since compensation is a segment of a total income insurance system, it ordinarily does its share of the job only if it can be depended on to supply periodic income benefits replacing a portion of lost earnings. If a . . . totally disabled worker gives up these reliable periodic payments in exchange for a large sum of cash immediately in hand, experience has shown that in many cases the lump sum is soon dissipated and the workman is right back where he would have been if workmen's compensation had never existed.

Enger v. FMC, 2000 SD 48, ¶11, 609 NW2d 132.

Transferee argues that, despite the prohibition against the transfer of claims for compensation contained in SDCL 62-4-42, Lu may assign his right to annual payments provided by the annuity purchased to fund those periodic payments. Transferee relies on First Colony Life Insurance Company v. Berube, 130 F3d 827, 829 (8^{th} Cir 1997) in support of its position.

In First Colony, Berube received a lump sum distribution in settlement of his 1988 South Dakota workers' compensation claim. Part of the lump sum went to the purchase of an annuity. Thereafter, Berube assigned his right to 240 monthly annuity payments to another. Some four years after this assignment, Berube demanded the insurer reinstate the monthly annuity payments, arguing that his assignment of his workers' compensation benefits was prohibited by SDCL 62-4-42.

The United States District Court for the District of South Dakota, in granting summary judgment for the insurer, concluded that SDCL 62-4-42 does not prohibit assignment of annuity benefits "purchased with the proceeds of a lump sum workers' compensation award[.]" (emphasis added).

The Eighth Circuit Court of Appeals stated: "In the absence of controlling state law, we must predict how the state's highest court would decide the issue." The court held:

> We agree with the district court that the South Dakota Supreme Court would conclude that the assignment here is not prohibited by section 62-4-42. The anti-assignment provision of that statute is limited to “claims for compensation”, and thus is not applicable, because Berube received his lump sum distribution and he could use the proceeds for whatever purpose he saw fit. (emphasis added).

Although federal cases may be persuasive, they are not controlling. State v. Neville, 346 NW2d 425 (SD 1984) (citations omitted).

First Colony is not persuasive and can be distinguished on its facts.

Unlike Berube, Lu did not “receive his lump sum distribution.” Unlike Berube, Lu did not purchase an annuity with the proceeds of his workers’ compensation award. Lu’s workers’ compensation funds were controlled by Insurer. Insurer bought and owned the annuity for the express purpose of meeting its obligation to provide periodic payments toward Lu’s workers’ compensation award. Lu has the right merely to receive annual payments under an annuity provided by and owned by the workers’ compensation insurer for that purpose. He can not use these undistributed proceeds for whatever purpose he sees fit until he receives each annual payment of those proceeds.

Lu’s assignment to Transferee would contravene SDCL 62-4-42 in violation of SDCL 21-3B-3(3) and SDCL 21-3B-10.

Contrary to SDCL 21-3B-3(3) and SDCL 21-3B-10, Lu’s transfer of the structured settlement payments would be in contravention of SDCL 62-7-6, the South Dakota Workers’ Compensation Law’s requirement that any payment of a lump sum be in the claimant’s “best interests”, as that term is defined in the context of workers’ compensation.

SDCL 62-7-6 requires that any payment of compensation in a lump sum must be “in the best interests of the employee[.]”

Lu has the burden to prove that the proposed transfer of his undistributed workers’ compensation benefits, which would amount to a lump sum distribution as that term is used in SDCL 62-7-6, would be in his best interests.

The South Dakota Supreme Court has identified four factors for defining “best interests:”

1. Age, education, mental and physical condition, and actual life expectancy
2. Family circumstances, living arrangements, and responsibilities to dependants
3. Financial condition, including all sources of income, debts and living expenses.
4. Reasonableness of plan for investing the lump sum proceeds and ability to manage invested funds or arrangement for management by others.

Enger at ¶ 13 (citations omitted).

Considering the first factor, Lu is 54 years of age, is relatively uneducated, has suffered several work injuries, and has a number of physical conditions, which adversely affect his ability to work and earn an income. He is currently restricted to only part-time employment.

Considering the second factor, Lu has a wife who is disabled and on social security, as well as four dependent children to support.

Lu's obligations to his dependants support the argument that it would be in his best interest to maintain periodic income by way of the current annuity payments.

Considering the third factor, his financial condition, Lu established nothing more than the fact that he needs more money. Lu and his wife and children receive social security. There is no evidence what affect the proposed assignment would have on these amounts, if any. Lu has stated it is his intention to use some of the proceeds of the assignment to pay off debts. It is not clear what debts would be paid or whether he would then be able to maintain a stream of income over the next ten years to stay current with his living expenses and other bills.

Finally, the fourth factor is his plan for investing. Lu's plan for the payment addresses only current or short term needs and contains no plan to provide or maintain a stream of income. He would temporarily solve some of his current problems, but would have less ability to address future money needs.

Lu has presented a plan for his use of the one-time assignment proceeds that appears to address primarily immediate needs. Once this money is gone, he will have significantly reduced income left to cover living expenses. He provided no evidence relating to investments which would provide a future stream of income. This is particularly important because he will be using ten years of periodic income if his assignment is approved. It is doubtful that Lu could live on a reduced income, especially in light of the fact that he and his wife both testified that they are unable to live on their current income, including the annual payments.

While reducing current debt may provide some future savings, it is only a temporary fix. The proposed one-time payment would be contrary to the purpose of workers' compensation, that is to provide the steady stream of income now provided by the annual annuity payments.

Examination of the required four factors supports the conclusion that the continued focus of Lu's best interests must be on wage replacement. The annual annuity payment works to provide just that. Approval of the assignment of these annual annuity payments would not be in accordance with the goal of replacing his future wage replacement benefits. Neither Transferee, who has the burden, nor Lu have proven that approval of the assignment would be in Lu's best interests.

Lu's assignment to Transferee would contravene SDCL 62-7-6 in violation of SDCL 21-3B-3(3) and SDCL 21-3B-10.

Transferee failed to prove that the proposed assignment would be in Lu's best interest, as required by SDCL 21-3B(1).

SDCL 21-3B-3(1) requires that the transfer be "in the best interest of the payee, taking into account the welfare and support of the payee's dependents[.]"

Lu has an obligation to support his wife and four dependent children. He has accrued debt and unpaid bills while receiving the annual annuity payments. To further reduce his annual income by the amount of the annual annuity payment would compound the problems he has with managing his money.

The proposed assignment is on its face unconscionable. The aggregate amount of the annuity payments he seeks to transfer is $95,611.10. The discounted present value of the annuity payments to be transferred is $73,284.15. Of this discounted amount, Lu would receive only $36,915.13, after paying Transferee's attorney fees and processing fees, totaling $2200.

If this same transaction were to be arranged as a loan, rather than the proposed assignment, Lu would be paying Transferee an effective annual interest rate of 21.68%. Transferee argues "[a] rate of 19.99% is fair and reasonable when one considers the nature of this industry." Transferee's argument is not persuasive, it is an indictment.

SDCL 21-3B-3(1) requires an express finding by the Department that the proposed assignment is in Lu's best interest. That is simply not the case. The proposed transfer does is not in Lu's best interests as required by SDCL 21-3B-3(1).

The anti-assignment provision in the Periodic Payment Reinsurance Agreement prohibits the proposed assignment.

Paragraph 7 of the Periodic Payment Reinsurance Agreement between Mid-Century and Farmers New World Life Insurance Company prohibits assignment by Lu:

> 7. Neither Claimant, Payee, nor Recipient of any guaranteed payments remaining after the death of Claimant[,] have any right to modify the Periodic Payments, nor accelerate, defer, increase, decrease, anticipate, sell, assign, or encumber any payment under the Agreement.

SDCL 58-12-10 provides:

> If an annuity contract so provides, the benefits, rights, privileges or options accruing under such contract to a beneficiary or assignee shall not be transferable nor subject to commutation[.]

Lu has no right to assign the periodic payments provided under the Agreement. Nothing in the South Dakota Structured Settlement Protection Act abrogates either the anti-assignment provision of the Agreement or SDCL 58-12-10.

Conclusion

The proposed transfer of the structured settlement payments by Lu to Transferee would be contrary to SDCL 21-3B-3(3) and SDCL 21-3B-10, because the transfer would violate SDCL 62-4-42, the South Dakota Workers' Compensation Law's prohibition on assignment of benefits and SDCL 62-7-6, the South Dakota Workers' Compensation Law's requirement that any payment of a lump sum be in the claimant's "best interests." Further, the proposed transfer is not in Lu's best interest, as required by SDCL 21-3B(1). Finally, the anti-assignment provision in the Periodic Payment Reinsurance Agreement prohibits the proposed assignment.

Counsel for Annuity Issuer shall submit proposed Findings of Fact and Conclusions of Law, and an Order, consistent with this Decision, within 10 days of the receipt of this Decision. Lu and counsel for Transferee, shall each have an additional 10 days from the date of receipt of Annuity Issuer's proposed Findings of Fact and Conclusions of Law to submit objections. The parties may stipulate to a waiver of formal Findings of Fact and Conclusions of Law. If they do so, counsel for Annuity Issuer shall submit such stipulation together with an Order consistent with this Decision.

Dated: October 26, 2006.

SOUTH DAKOTA DEPARTMENT OF LABOR
DIVISION OF LABOR AND MANAGEMENT

Randy S. Bingner
Administrative Law Judge