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Planning For Smart Structured Settlements In Divorce

By DORI B. HIGHTOWER

Structured settlements in divorce are a tricky business. They require a high level of planning and significant forethought in order to be successful. At their best, structured settlements can provide a continuous source of income, address liquidity issues of the moneyed spouse, and provide financial security over time. At their worst, they can extend conflicts into the future with disastrous consequences for the spouse who is relying on the settlement in order to meet basic needs.

A structured settlement replaces one lump payment with smaller payouts over time — it's a concept frequently used in workers' compensation or tort cases, but more often, these types of settlements are also being used in divorces. It sounds like a positive solution, but I cannot tell you how many times I have observed the many ways that structured settlements have failed because of a lack of penalties and controls built into the final agreement.

Take the case of Jenna, a woman who is self-employed in the high-powered financial services industry and divorced from her ex-spouse Andy, a stay-at-home dad*. While the couple were married, he supported her through business school, helped her start *their* business, and when they decided to have children, he promised her that he would stop working and stay at home.

Shortly after their second child was born, Jenna began an affair with the pool boy and later, the CFO of her (their) company. When Andy discovered her infidelity, she promised to bury him if he divorced her and threatened him with the loss of his lifestyle.

Their structured settlement included a property payout over eight years, alimony with a cost of living increase each year, and a share of the profits from her business. For this stay-at-home dad, however, nothing went according to plan.

Jenna is repeatedly in contempt of court orders and after a year of fighting, Andy can no longer afford an attorney. She refuses to pay for the children's tuition and extracurricular expenses. She is two years behind in their settlement payouts. Meanwhile, Jenna has started another company. She and her CFO are living together on a fancy estate where she can provide a higher standard of living for the children when they visit, including the chauffeur-driven Bentley.

Their house, which Andy received as part of the structured settlement, is in need of major repairs and is in foreclosure because Jenna has not complied with the court order. Every time she is in contempt it costs him money for lawyers. He thought he could make the mortgage payments from the money he received from the property settlement payouts. Eventually, he planned to re-enter the job market. Jenna is also behind in her alimony payments and the town has put a tax lien on the house. Andy has now been out of the job market for years. Just like a perfect storm of financial destruction, these elements have affected Andy's credit rating and, as a result, his ability to get a job.

In hindsight, this structured settlement could and should have been handled differently. The following are some suggested approaches you may want to consider when shaping a structured settlement.

1. Put Safeguards in Place

One common pitfall of structured settlements is simple naiveté. If we take an honest look at this situation — the past and current relationship and the two parties involved — we can see the warning signs. A person who promises to bury his or her ex-spouse will most likely find a way to do it. If affairs and deception have already been an issue in the past, why should we expect a spouse to suddenly play by the rules? This is why safeguards are important.

Without a solid back-up plan or a third party to ensure that the rules are followed, a spouse can easily fall back into his or her old games and find a way around the system. When a person has proven to be untrustworthy in the past, always include a means to verify the information they are giving you.

- **Get Certified Tax Returns**. You may be given a return that was never filed or has been altered or amended.
- **Audit!** Request the right to audit income information and returns.
- **Have a Look Back Period.** Income tax returns can be amended and instances do arise when income is not reported accurately and numbers change significantly.
- **If Employed, Obtain Authorization to Get Paystubs Directly from an Employer.**
- **Acquire Investment Information Directly from the Company.** Don't rely on information from the ex-spouse, go directly to the source.
- **Consider Invoking a "Springing Lien."** J. Allen Kosowsky, P.C., CPA a noted forensic accountant, coined the term

"Springing Lien" for a lien that is put in place in advance and is triggered in the event of a default. This could be a lien on any valuable that is secure, adequate, and readily available to be invoked when there is a breach.

2. Be Thorough

The more thorough and detailed the structured settlement, the more difficult it will be for one spouse to go off course. Also consider having a third party administer the structured settlement agreement. Try to negotiate for payouts to be made to your client over shorter periods of time than offered.

Instead of simply designating a portion of business profits, an alimony payment may be set at approximately 30% of a spouse's income up to a certain amount, but also specify a minimum payment. By putting a minimum payment in place, there is an added level of protection.

If these controls had been in place at the time of the structured settlement, Jenna would not have been able to use her new business as a way to decrease her own income. She was able to start a new business and avoid her alimony obligations because she is now compensated in a different form that was not considered when the original settlement was agreed to. By shifting the income to a third party-her lover/CFO, she was able to avoid the payment and claim financial hardship.

Additional safeguards could also have been put in place to protect Andy and Jenna's children. They could have worked with an accountant to set up a tax-free annuity with a trust for the benefit of the children. An annuity with a reputable company could provide a continuous stream of income without relying on Jenna to keep up on payments or disclose accurate information.

It may be helpful to have a CPA and a Certified Financial Planner review a proposed structured settlement in order to consider the tax ramifications and how it fits into one's long term financial strategy.

3. Don't Delay

Encourage your client never to sleep on his or her rights. Some ex-spouses let a breach go unchecked for years. They don't do this intentionally, often it is too difficult psychologically to handle. The problem with this behavior, however, is that when the terms of the agreement are not enforced, the financial arrearages build up and make it more difficult to collect when they try to finally enforce the terms of the settlement.

4. Include Consequences

Consider adding financial penalties for bad behavior and late payments into a divorce structured settlement. This could come in the form of a clause that gives your client the right to consider mediation rather than going to court when there is a breach. Structure the settlement so there is collateral to cover the debt and potential forfeiture of the collateral if the party breaches the terms of the structured settlement. Collateral may be a letter of credit, life insurance policy, or an annuity (third party payer).

If you know you are dealing with a deceptive ex-spouse, the best solution may be to avoid a structured settlement entirely and instead opt for a smaller immediate payout. This trade-off could have avoided future conflicts and would have allowed Andy to continue to pay the mortgage and carrying charges for the house and provide him with a more stable transition back to the workplace.

*The case of Jenna and Andy is purely fictitious. Names, characters and incidents either are the product of the author's imagination or are used fictitiously. Any resemblance to actual persons, living or dead is entirely coincidental.

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