

MINUTES OF COMMISSION MEETING
September 14, 2000

Present at the meeting of the New Jersey Law Revision Commission held at 153 Halsey Street, 7th Floor, Newark, New Jersey were Commissioners Albert Burstein, Hugo Pfaltz, Jr., Peter Buchsbaum and Vito Gagliardi, Jr. Grace Bertone attended on behalf of Commissioner Rayman Solomon.

Also attending were: Craig Ulman, Hogan & Hartson, Washington, D.C., National Structured Settlement Trade Association; James Maxeiner, Dun & Bradstreet; Arthur Herrmann, Prudential Insurance Co.; Henry Gottlieb, *New Jersey Law Journal*; Francis Manning, Stradley Ronon Stevens & Young; Maureen Davin, Verizon; Riva Kinstlick, Prudential Insurance Co.; Charles Centinaro, New Jersey Governor's Counsel Office; Robin Shapiro, Singer Asset Finance, New York, NY; Mark Melodia, Reed Smith; Craig Lessner, Peachtree; Shirley Foley, Foley & Foley, NJ; Marjorie Crawford, Rutgers Law Library; and Kris Ann Cappeluti, Riker Danzig, NJ.

Minutes

The Commission asked staff to make the following corrections: page 3, second to last paragraph, second line, "like wit" to read "live with" and on page 4, second paragraph, first line "Section 3-2(a)" to read "Section 2-39(a)." The Commission approved the Minutes of July 20, 2000 as corrected.

Structured Settlements

John Burke explained that the issue under consideration as the sale of structured settlement agreements to third party purchasers. Judge Kestin of the Appellate Division had asked the Commission to investigate the matter after filing his dissenting opinion in Owen v. CNA Insurance Co., certified for review by the New Jersey Supreme Court. In Owen, the Appellate Division invalidated the sale and assignment of the structured settlement. In addition, two bills are pending in the Legislature that would require court approval prior to the sale and assignment of any structured settlement. At the request of the Commission, several guests appeared to present their views on the subject and to answer Commission questions.

Craig Ulman, representing the National Structured Settlements Trade Association, provided the Commission with the proposed Model State Structured Settlement Protection Act. That Act sets forth the judicial procedures to be followed for the lawful sale of a structured settlement. Shirley Foley,

counsel for the plaintiff in the Owen case, submitted her Supreme Court brief outlining her argument for the free assignability of structured settlements.

Ms. Foley stated that she represented Carol Owen, 53 years old, who, as a result of an accident several years ago, entered into a structured settlement with the tortfeasor's insurance company. Under the agreement, she was paid an initial lump sum and was to be paid subsequent periodic payments every five years. Ms. Owen wanted to sell the remaining periodic payments of her structured settlement for cash due to the costs of an unrelated medical condition. The insurance company objected to the sale and that dispute led to litigation. Ms. Foley stated that New Jersey law favors the free assignment of assets provided the assignor is a competent adult. Ms. Foley stated that she did not oppose judicial approval of an assignment provided the process was easy and fast. However, Ms. Foley emphasized, since a person may transfer almost every other asset without court permission, there was no reason to single out structured settlements. In particular, Ms. Foley opposed the "best interest" standard of the Model Act. She also stressed that there should be an obligation upon the insurance company to respond quickly to a request to sell a structured settlement.

Commissioner Pfaltz expressed his disagreement with Ms. Foley's position. Structured settlements, he said, are the produce of serious thought, and guard against the dissipation of large tort awards often leading to tort victims becoming wards of the state. Mr. Pfaltz questioned whether Ms. Owen now had the financial acumen to make a sound decision regarding her right to future payments under her structured settlement agreement. Ms. Foley stated that Ms. Owen was offered only a structured settlement deal. She also stated that the five-year interval payments could not support her normal living expenses; the reason for the settlement was not to provide financial support. She also argued that for Ms. Owen, what was good in 1983 when the structure was put in place was not good now due to changed circumstances.

Commissioner Buchsbaum noted that there were many reasons for structured settlements other than those identified by Commissioner Pfaltz, notable the appearance of having settled the case on the plaintiff's financial terms. The ability to delay payment reduces the actual cost of paying claims. Commissioner Buchsbaum also asked why structured settlement assignments were singled out from other assets for court approval. He asked why customary consumer protection laws were inadequate.

Craig Ulman stated that the policy underlying structured settlements and surrounding law justify treating structured settlements differently from other assets. The policy issue is providing ample compensation to severely disabled tort victims. In addition, there are tax and extrinsic legal considerations that often impede the transfer of structured settlement contracts. Structured settlements often are used to resolve worker's compensation claims, but state law uniformly prohibits the assignment of worker's compensation. Court process is needed to make sure that the transfer is lawful under state law and under the particular contract involved.

Commissioner Buchsbaum asked what distinguished the class of people receiving structured settlements, other than worker's compensation awards, from other classes of persons to force them to go to court to transfer an asset. Mr. Ulman answered that since the payments were tax favored, the transfer affected the tax effects for all parties concerned. Every structured settlement included an anti-assignment clause. Each dollar that is paid - the premium and interest - is tax-free. A transfer jeopardizes the tax status of the transaction. The IRS tax treatment of structured settlements is unclear. However, IRS rulings indicate that at least in part, the favored tax treatment of structured settlements turns on the inclusion of anti-assignment language in the contract. If the payee is at liberty to assign away the payments, the payee may have tax liability up front on the value of the annuity.

To avoid uncertainty about the status of transfers, NSSTA and the National Association of Settlement Purchasers have agreed on a package of proposed federal and state legislation. Consequently, there are two model acts: the NCCOIL model and the NSSTA/NASP model. The latter provides for court approval, the "best interest" standard and streamlined procedures.

Commissioner Buchsbaum asked Mr. Ulman to elaborate the definition of "best interest" and the term "interested parties," parties entitled to notice of a transfer including the right to object. Commissioner Burstein asked whether that would lead to a cumbersome process. Mr. Ulman stated that state legislators favor the best interest standard; and that state judges are comfortable with that measure. Both model acts provide a right of interested parties to object. Mr. Ulman felt that this was required by due process and that it would keep transactions honest and lawful. Mr. Ulman also stated that many disagreements are resolved quickly by email communication.

Mr. Singer stated that his company, one of the first to purchase cash flows under structured settlement agreements, has been involved with working out a legislative solution to the legal problems encountered in assignments. The joint model act, he believes, strikes an appropriate balance among interests. Some people do depend upon the structured payment to pay living costs which others are competent adults who should be allowed to freely dispose of their assets. The law must protect against unscrupulous and unregulated factoring companies and must take into account the tax consequences of the transaction. In private rulings, the IRS has stated that if you get a court order, there is no adverse tax consequence to the claimant following an assignment of a structured settlement agreement. If the purchase is not free of legal risk, his company must charge the seller more money for the transactions and the claimant gets less cash. If the court order eliminates the risk, then the company can make the cost of money cheaper to claimants. The model law creates certainty.

Commissioner Buchsbaum asked how the court process provides certainty since the IRS will not issue a ruling clarifying that the court order protects the annuity provider's tax status. Mr. Singer stated that it was his company's belief as well as that of the insurance company, that with the court ordered process there will be tax status assurance. His company and the insurance companies are also working for legislation at the federal level to resolve the uncertainty. In Mr. Singer's view, the tax risks to the insurance company are theoretical. Insurers now may take an immediate deduction for buying the annuity. If the factoring transaction is deemed an acceleration of the payment, the insurer may lost favored tax treatment. This risk has not been tested. Commissioner Burstein asked what has happened in situations where the factor has purchased structured settlements in an unregulated environment. Mr. Singer answered that his company attempts to make sure that the claimant can support himself without future payments, but many companies do not follow this policy.

Commissioner Gagliardi asked if other than the tax issue, there was another factor motivating the factors and insurance companies to seek court orders. Mr. Ulman stated that breach of contract was another matter. A claimant who has assigned may simply revoke his promise and keep the payments without forwarding them to the factor. This leads to litigation with the insurer and claimant. Mr. Manning stated that there are hundreds of cases where the claimant has not turned over the payment to the factor after selling the payment stream. Rates charged in the unregulated environment reflect that level of risk.

Mr. Lessner stated that because insurance companies resist the sale of structured settlements, purchasers have to take steps to collect the payments. Mr. Lessner said that even if the New Jersey Supreme Court decides Owen, it might not resolve all problems surrounding factoring transactions. Mr. Manning stated that the Supreme Court decision would not resolve the issue because it will resolve only the common law question, not the policy/legislative question. There will be a clamor to put consumer protections around such transactions.

Commissioner Buchsbaum stated that the court ordered procedure appeared to be delegating to the court the role of regulator of the factoring industry. Mr. Manning stated that this is not unusual since structured settlements are more like deferred compensation schemes. The best way to make money available is to follow the approach of the model acts. Mr. Burke asked why Revised Article 9 would not provide certainty since it states specifically that proceeds of tort claims are assignable. Mr. Lessner stated that the court in Owen did not find that Revised Article 9 was clear on the issue.

Commissioner Burstein asked why the issue of transfer is not addressed at the time the litigation is settled and the agreement filed with the court. Mr. Lessner stated that many agreements do not contain the anti-assignment clause. In New Jersey, lottery payments can be assigned; that law has led to lowered interest rates. In states without such laws, the interest rates are in the double digits. The lottery court process occurs quickly. Commissioner Burstein stated that he did not think the structured settlement court procedure could work as fast. Mr. Ulman stated that there are economic incentives to expedite proceedings.

The Commission referred the September 11, 2000 proposed model act, asked staff to examine the law on assignment of lottery winnings and asked the guests to provide typical IRS rulings.

Uniform Computer Information Transactions Act

§103 Scope. With regard to scope, Ms. Garde stated that software in the form of goods or embedded in goods should be under Article 2. Other data is under UCITA. In addition, the scope excludes libraries.

“Embedded in goods” means, for example, software contained in a microchip that regulates the brakes on your car. The information is fully incorporated into the goods. Commissioner Buchsbaum asked how that

definition differed from a CD-ROM containing information. The Commission liked the approach but asked staff to refine the definition. Mr. Cannel proposed a "predominance" standard. Ms. Garde asked whether shrink-wrapped software should be under Article 2 because it looks like a goods transaction. Referring to the discussion during the last meeting concerning the analogy to the sale of a book, Ms. Garde stated that if transactions look the same to the consumer they should be treated the same: that is, as sales.

The Commission found that consumers believe that they own something if they hold it in their hands; they do not have the same feeling if they download the equivalent product electronically. Commissioner Gagliardi stated that this approach fit with the Commission's design to draft a consumer protection statute. The draft allocates transactions between Article 2 and UCITA by operation of law; it cannot be varied. They asked staff to refine the definition of "embedded goods."

Mr. Maxeiner of Dun & Bradstreet stated that UCITA is based on recognizing a fundamental difference between goods and information. The difference is the license right, what you do with the product. For example, with regard to a videotape, it is critical whether they buyer can show the tape on national television one time or a hundred times or can only show it in his home. The license rights are the value. Thus there is no difference between a book and other information. Copyright law provides protection for copyrightable work but not for non-protected information. UCITA is attempting to regulate not the product but the rights with respect to the product. The value is in the breadth of use.

The Commission decided to apply the altered scope provision to mass-market transactions only. In other goods-like transactions, the presumptive rule would be to cover them under Article 2 but the parties would have the power to vary that rule by agreement. The Commission also asked Ms. Garde to clarify the definition of mass-market transactions.

Ms. Kinstlick of Prudential stated that the insurance services exemption was not sought after or supported by the insurance industry. Ms. Kinstlick wanted to change the definition of insurance services transactions. Ms. Garde and Ms. Kinstlick arranged to speak about the change later.

The Commission reconfirmed its previous recommendation that libraries should be excluded from UCITA. Recent amendments to UCITA exclude utility companies.

§105. Amended §105(c) contained the New Jersey definition of “consumer” based on the Consumer Fraud Act; that definition is broader than that contained in the Official Text. In addition, §105(d) was deleted because it would operate to remove New Jersey consumer protection provisions governing the term “conspicuous” and the concept of “consent.” Mr. Maxeiner remarked that §105(d) merely provided a safe harbor rule; the purpose of which was to deal with the non-print world of clicking to acknowledge assent and the use of fonts to achieve conspicuousness. However, Mr. Cannel and Ms. Garde affirmed that the deletion of (d) would allow New Jersey consumer law rather than UCITA to determine these issues.

Title to copy. The amended provision modifies UCITA. The Official Text provides that the vendor determines whether title is transferred as a result of a purchase of information. Ms. Garde maintained that UCITA undermines the “first sale” doctrine of the federal copyright law, though in mass-market transactions, it requires disclosure of terms. The problem with that disclosure requirement is that the term can be contained in the box. As redrafted, in a mass-market transaction for a single payment, title is transferred as a matter of law unless conspicuous language restricts the transfer of title.

Mr. Maxeiner noted that UCITA provides for return of products where the consumer objects to terms which are available for review only after the product is purchased and opened. Mr. Cannel stated that the return provisions were effective only in expensive transactions because a person who bought an inexpensive program at a retail store would not take advantage of his UCITA return right by driving back to the store and returning the program. In addition, the retail store might not know how to handle the return. The Commission asked staff to review the specific language of the provision.

With respect to the following items, the Commission preliminarily approved their retention in the draft report, subject to further discussion.

New Subsection. A new subsection was added at the request of an organization interested in maintaining the interoperability of computer systems. This organization wanted to make certain that reverse engineering could be used to achieve interoperability of program and to conduct academic research. The

requesting organization believed that under UCITA a contract restriction could override copyright law that provides for reverse engineering for these purposes.

§107. Section 107 dealing with legal recognition of electronic record and authentication was deleted because of a parallel provision in UETA.

Choice of law. The UCITA provision was replaced with one taken from a recent draft of Revised Article 1 of the UCC. That article gives greater deference to the parties' agreement as to choice of law whether or not the designated jurisdiction has a relation to the transaction. However, the Article 1 provision set limits to choice of law terms in mass-market transactions; in addition, parties could not choose the law of a country other than the U.S. unless there is a relationship between the jurisdiction and the transaction.

§110 Choice of forum. As amended, a term in a mass-market contract designating a specific forum would not be enforceable in New Jersey. In other transactions, the term would be enforceable.

Formal Requirements. The draft strikes out this section. UCITA's statute of frauds provision is inconsistent with the Commission's views on the subject and with New Jersey law. It does not have much consumer protection because the UCITA provision requires a writing only if the cost of the information is greater than \$5,000.

Determining reasonableness of attribution procedure. The New Jersey Constitution requires factual disputes related to the attribution procedure to be decided by trial by jury, not by a court determination. As amended, if the question is a matter of law it goes to the court. If it is a matter of fact, it goes to the jury.

§§213 214 and 215. These provisions were deleted because they duplicate provisions in UETA.

Submission of idea. This provision was added on to UCITA at the NCCUSL 2000 annual meeting. The movie industry wanted this provision because they should not have to pay for obvious ideas. The intention was to limit lawsuits based on claims that movie studios misappropriated an idea. Ms. Garde stated that this provision does not belong in UCITA.

§816 Electronic Self-help. This section is recommended for deletion. Removal does not bar self-help. Note that §605 must be amended because it also deals with electronic self-help.

Introduction. Ms. Garde explained that her approach in drafting the introductory statement was to review the history of UCITA as a UCC project. She expressed the view that the history would enable the Legislature to better understand the differing views regarding the merits of UCITA. In particular, the introduction notes that the American Law Institute objected to the inclusion of Article 2B (now UCITA) into the Uniform Commercial Code and that NCCUSL took the unprecedented step of spinning off UCITA as a stand-alone uniform act. This background clarifies why the Commission examined UCITA in unusual detail given the fact that it is a uniform law.

Miscellaneous

The next meeting was scheduled for October 12, 2000.