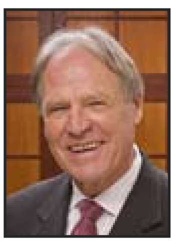
Annuity costs don't equal damages

Caution: Calculating the present value of future damages by using the cost of an annuity can be injurious to your client's financial health.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If you have not seen it yet, it might be just around the corner with your next case. The defense expert economist, who not only applies a net discount rate that seems to defy logic and reality, states that she/he has obtained quotes for annuities that she/he intends to present as evidence of present value for the future economic damages in your case. The defense economist asserts that the use of annuity quotes is an alternative to the "prudent investment method," traditionally used by every economist in every personal injury case.

This attempt to offer evidence and testimony on the cost of annuities related to the payment of future damages that may be awarded in a case should not be permitted. As soon as this becomes an issue in your case, you should immediately file a motion to preclude the expert, testimony and evidence. At the very least, you should have a motion in limine prepared.

This is an improper effort to try to confuse the fact finder and artificially reduce the award against the defendant. Defendants will try to argue that an annuity can be evidence of present value for damages in a personal injury action (most common in a medical malpractice action) in order to get a reduction in the amount to be paid should plaintiff prevail. However, there is no California law that authorizes a change in how present value is calculated – the prudent investment method; nor is there case law that directly addresses the use of an annuity as a present value damage determination. The following is the legal analysis that I have successfully used in a number of medical malpractice cases where defense counsel has attempted to insert annuity quotes as a means of determining present value for future damages.

Evidence of present value of damages

The Prudent Investment Method

Both plaintiff and defendants will have retained expert economists who will testify on the issue of damages, including future medical and lost wages or earning capacity. Both economists will be providing testimony as to what these future annual amounts are and what the present value is of the future annual costs based on the "prudent investment method" consistent with California law and the approved CACI instruction 3904.

In order to determine the present value of plaintiff's future damages, plaintiff's expert and defendant's expert both do a calculation using the "prudent investment method" that is the standard methodology for determining present value under California statutory and case law. Both experts will calculate the amount that would need to be invested now (at predicted rates of interest, and accounting for inflation) for a net rate as to each year of future loss. Each then aggregates these figures for a present value. The goal is to determine the sum of money if ***prudently invested*** which would equal the future amount of damages that the plaintiff will suffer as a result of the injuries caused by the defendant. The offer of expert economic testimony on present value using the "prudent investment method" is in accordance with California law, done in virtually every personal injury case, and is the general practice of

California courts. It is relevant and instructive to the fact finder regarding the task of determining present value.

In a medical malpractice case where damages may be subject to periodic payments under Code of Civil Procedure section 667.7, the trier of fact is required to make certain factual determinations: life expectancy, gross damages for each remaining year of life, and a reduction to present value for each year that the plaintiff will suffer damages in the future.

Annuity quote

An annuity is not a calculation of present value; rather it is an insurance company's risk assessment as to plaintiff's life expectancy and its own projection of possible return on investment. The insurance company is not bound by prudent investment strategies. In the past, annuity companies have gone into bankruptcy as a result of bad investments. There is no guarantee, especially in this economic climate, that any particular insurance company will be around in the future to guarantee that payments are made consistent with their projections.

An annuity quote cannot have a proper foundation to be admissible evidence. The evidence of the cost of the annuity is based on a quote that may not be valid and cannot be guaranteed. The broker testifying provides the testimony based on hearsay statements provided by an insurance company's employee who is not subject to cross-examination. There is no way to determine what factual information that the insurance company is ultimately relying on when making their determinations, so there is no way to know if the risk assessment is proper or not.

The risk assessment is based on limited medical records provided by defendants to an insurance company employee who makes their own determination of life expectancy before the case has been heard and evidence has been presented. One of the specific tasks of the fact finder in any case will be to determine the life expectancy of the plaintiff. To allow evidence of an annuity would be to turn over the responsibility of this fact-finding obligation to an unknown person at an insurance company who cannot be cross-examined and where the parties have no information as to what evidence is being relied upon for the determination.

California law expressly states that the fact finder must make the determination of present value, based on its own assessment of plaintiff's medical condition and disabilities, life expectancy, future costs and rates of return. These are not decisions that are to be made by a person or entity different from the fact finder. Simply put, annuity evidence is not evidence of present value, but rather evidence of a gamble that an insurance company may be willing to make based on factors and evidence that is inadmissible, not subject to cross-examination, and will contradict determinations that the fact finder must make. Therefore, evidence and testimony offered on annuity quotes is misleading and confusing, since it will be based on an incomplete record of the evidence and contradicted by the evidence offered by the economists.

Future damages under CACI 3904

Only relevant evidence, "having . . . tendency in reason to prove or disprove a disputed fact," is admissible evidence. (Evid. Code, §§ 210, 350, & 352.) Relevancy is determined by the relationship of the proffered evidence to the matters in controversy. Evidence, including expert testimony, will be excluded if it is irrelevant or speculative, or if its limited relevance is outweighed by the danger of prejudice or confusion. (Evid. Code, § 352.)

In a personal injury case, the finder of fact has a duty to make a determination of both the gross amount of the plaintiff's future damages and the present value of those damages. The relevant Judicial Council jury instruction on present value, CACI 3904, states in pertinent part:

> If you decide that [name of plaintiff]'s harm includes future [economic] damages for [loss of earnings/future medical expenses/lost profits/[insert other damages]], then the amount of those future damages must be **reduced to their present cash value**. This is necessary because money received now will, through investment, grow to a larger amount in the future.
>
> To find present cash value, you must **determine the amount of money that, if reasonably invested today, will provide [name of plaintiff] with the amount of [his/her/its] future damages.**

(CACI 3904 (emphasis added); see also *Holt v. Regents of U.C.* (1999) 73 Cal.App.4th 871, 878 [affirming use of "investment method," that is, the present value is "that sum of money **prudently invested** at the time of judgment which will return, over the period the future damages are incurred, the gross amount of the award" (emphasis added)].) This instruction and the former BAJI 14.70 instruction on present value have been used repeatedly and with approval by the courts of this state. (See, e.g., *Salgado, supra,* 19 Cal.4th at p. 636 (discussed *infra*); *Hrimnak v. Watkins* (1995) 38 Cal.App.4th 964, 979 [referring to the BAJI 14.70 approach as the "traditional manner"]; *Atkins v. Strayhorn* (1990) 223 Cal.App.3d 1380, 1398-99; *Canavin v. Pacific Southwest Airlines* (1983) 148 Cal.App.3d 512, 521.)

The California Supreme Court has approved the use of the "prudent investment method" to calculate present value in the context of a medical malpractice case. In *Salgado*, the court stated in connection with future non-economic damages:

> To avoid confusion regarding the jury's task in future cases, we conclude that when future noneconomic dam-

> ages are sought, the jury should be instructed expressly that they are to assume that an award of future damages is a present value sum, i.e., they are to determine the amount **in current dollars paid at the time of judgment** that will compensate a plaintiff for future pain and suffering.

(*Salgado, supra,* 19 Cal.4th at pp. 646-647 (emphasis in original).)

Similarly, future *economic* damages are reduced to *present cash value* by the fact finder. The Comment to former BAJI No. 16.01 (the verdict form for medical malpractice), citing the Supreme Court's ruling in *Salgado,* is instructive:

> [T]he *Salgado* court concluded that when an award for future economic damages is made by the jury is a present value sum, the plaintiff is entitled (if the payments are made over time) to a schedule based upon the present value determined by the jury. In other words, **even if defendant can obtain an annuity which over time matches the total economic damages determined by the jury, at a lesser cost, the plaintiff is entitled to the benefit of the jury's determination of the present value**, and what that amount will produce as an annuity.

Comment, BAJI No. 16.01 ¶ 4 (emphasis added); see also *Salgado*, *supra,* 19 Cal.4th at pp. 649 & 651; *Hrimnak v. Watkins* (1995) 38 Cal.App.4th 964, 979 [referring to "prudent investment" approach as the "traditional manner" of calculating present value, and rejecting the use of annuity evidence before judgment is entered].)

California statutory and case law requires the fact finder to calculate present value in the manner stated in CACI 3904, that is, as "the amount of money that, if reasonably invested today, will provide [name of plaintiff] with the amount of [his/her/its] future damages."

The California Supreme Court

California courts, including the California Supreme Court, have criticized the use of annuities as a present value calculation in the pre-judgment context. In *Salgado*, cited above, after the jury had determined present value by the investment method, the trial court re-calculated the present value, using the cost of an annuity, thus lowering the award to the plaintiff. The Court of Appeal affirmed the trial court's award using the lowered annuity-based valuation. The Supreme Court expressly rejected the argument that cost of an annuity can be used to replace the accepted "investment" method of calculating present value:

> The Court of Appeal thus **erred** in concluding that its concededly "harsh" result was compelled by *American Bank & Trust Co. v. Community Hospital, supra,* 36 Cal.3d 359, which it understood to authorize "insurers to purchase annuities to fund periodic payments at a smaller cost than would be required to make a lump sum payment." **Not so.** *American Bank & Trust Co.* makes no mention whatever of annuities; **nor does it otherwise permit the defendant who requests periodic payments to *drastically reduce the total value* of a capped award of future noneconomic damages by making periodic payments without any adjustment to account for what the award would have yielded if invested prudently at the time of judgment**.

(*Salgado, supra,* 19 Cal.4th at p. 644 (emphasis added).) Such a "drastic reduction in value," sharply criticized by the Supreme Court, is exactly the danger with defendant's attempt to introduce annuities. The Supreme Court noted that this would usurp the fact finder's role in determining present value:

> **[O]nce that present cash value was decided by the jury, it could not be disregarded** in favor of a determination by the superior court of the present value of the jury's award of future damages, **based on the cost of an annuity** to fund future payments, without **usurping the jury's established constitutional role** and prerogative as the sole judge of the facts.

(*Salgado, supra,* 19 Cal.4th at p. 649 (quotation marks omitted) (emphasis added).)

When California courts consider the use of annuities, it is as a means of satisfying judgments, it is not used in the trial or pre-judgment context. In *Hrimnak v. Watkins*, a medical negligence case cited with approval by the Supreme Court in the *Salgado* case (*supra,* 19 Cal.4th at pp. 643-644), the Court of Appeals specifically disapproved the use of an annuity before a judgment has been entered:

> [I]t is **premature to consider satisfaction of judgment before a valid judgment has been entered** . . . [I]f plaintiff wishes to accept an annuity as satisfaction of the judgment, she may do so, but the law does not require her to do that. Defendant's obligation is to pay the money, in the amounts and at the times that will be specified. (citation omitted).

(*Hrimnak, supra,* 38 Cal.App.4th at pp. 981-982.)

Defendant should not be permitted to abrogate California law by introducing irrelevant, prejudicial and confusing evidence on annuity cost as a substitute for the present value calculations mandated by CACI 3904 and case law.

Plaintiff cannot be forced to accept an annuity

Any consideration of the use of annuities in the pre-judgment context is premature and violates plaintiff's rights. California law does not impose an obligation on the plaintiff to accept an annuity as payment or satisfaction of a judgment that requires future payments. Any calculation using an annuity during trial necessarily forces the plaintiff to accept an annuity valuation before the judgment has been entered and before

the plaintiff has the opportunity to respond regarding the use of an annuity.

In *Hrimnak v. Watkins*, a medical negligence case cited with approval on this point by the Supreme Court in the *Salgado* case, the Court of Appeals specifically disapproved the use of an annuity before a judgment has been entered:

> [I]t is **premature to consider satisfaction of judgment before a valid judgment has been entered** . . . [I]f plaintiff wishes to accept an annuity as satisfaction of the judgment, she may do so, but **the law does not require her to do that.** Defendant's obligation is to pay the money, in the amounts and at the times that will be specified.

(citation omitted).
(*Hrimnak, supra,* 38 Cal.App.4th at pp. 981-982; see also, *Salgado, supra,* 19 Cal.4th at 643-644 [noting plaintiff is not required to accept an annuity].)

While plaintiffs in other cases may have agreed to allow this evidence, plaintiff does not in this case. Plaintiff should not be required to give up her rights to approve the method of payment, before the judgment has even been rendered. Moreover, plaintiff should not be forced to accept a valuation that contradicts the traditional investment approach, and that may contradict the fact-finder's specific findings regarding the life expectancy and discount rate.

Use of annuities on present value in California

When California courts consider the use of annuities in medical malpractice cases, it is as a means of satisfying judgments or making post-verdict calculations. Annuities have not been used in the pre-judgment context unless the plaintiff has agreed in advance. This is consistent with the general policy that annuities are used to pay judgments and not for determining the amount of damages. Further, in the pre-judgment phase, the cost of an annuity is not yet established.

In *Schneider v. Kaiser Foundation Hospitals* (1989) 215 Cal.App.3d 1311, annuities were utilized because the parties agreed to the evidence during the arbitration. *Schneider* involved a fee dispute between an attorney and his clients in a Kaiser arbitration that arose at the time the arbitrator was deciding the case and after the presentation of the evidence. During that arbitration the parties agreed to the use of an annuity for payment of future periodic payments under Code of Civil Procedure section 667.7 to satisfy the judgment. (*Id.* at 1315) A decision was rendered in favor of the plaintiff that did not initially include a determination of present value of the gross award and attorney's fees for the attorney. The attorney moved to establish the value of the award for the purpose of computing his fees. The *Schneider* Court held that, since the parties had agreed to an annuity and "because the cost of the annuity is established beyond dispute on this record," the cost of the annuity was appropriate for the post-verdict determination of the attorney's fees. (*Id.* at 1320.) (The court in *Hrimnak* specifically commented on *Schneider's* use of annuities for determining present value, and emphasized that *Schneider* did not mandate replacing the traditional investment method with annuities. (*Hrimnak, supra,* 38 Cal.App.4th at 980.))

Similarly, *Nguyen v. Los Angeles County Harbor* (1996) 40 Cal.App.4th 1433, involved a post-verdict attorney fee dispute in a medical malpractice case. The jury had calculated future damages and the future inflation rate, as the foundations of a present value calculation. (*Id.* at 1440) The parties agreed to use an annuity to fund the judgment. The plaintiff's attorney complained that the lump sum payment would not cover the total attorney's fees, and attempted to set aside the judgment. In that situation where the jury had not made a final determination of present value and the parties had agreed an annuity would satisfy the judgment, the court held that the cost of an annuity may (not must) be used as the present value to calculate attorney's fees. (*Id.* at 1454)

Thus, there is no legal justification for the use of annuities during the pre-judgment phase of a medical malpractice action to determine present value.

Expert testimony

As noted previously, expert testimony on irrelevant or ancillary topics is improper. (Evid. Code, §§350, 352; 801; 803) It is therefore irrelevant and inadmissible. (Evid. Code, § 350; see *People v. Son* (2000) 79 Cal.App.4th 224, 240-41 [proper to exclude testimony that is irrelevant to the issues].) Additionally, expert testimony on ancillary issues wastes the court's time and should be excluded. (Evid. Code, § 352; see *People v. Quartermain* (1997) 16 Cal.4th 600, 625 [proper to exclude expert testimony on collateral issues].)

Defense counsel has indicated that he intends to offer annuity quotes as evidence of the present value of plaintiff's future damages, and will offer the testimony of an annuitist, Robert Bell. Such testimony should be deemed inadmissible because it does not address the issue to be decided by the fact finder – the present cash value of any future economic damages to be suffered by plaintiff, and the plaintiff's life expectancy based on evidence presented. As the present cash value is determined by the investment method, any testimony regarding the cost of an annuity is not relevant to that determination. It would waste time at the hearing to include expert testimony on this ancillary topic.

Additionally, any expert opinion testimony regarding annuities would be improper under Evidence Code sections 801 and 803. Section 801 requires expert opinion testimony to be "based on

matter . . . personally known to the witness . . . of a type that **reasonably may be relied upon** by an expert in forming an opinion upon the subject to which his testimony relates . . . " (emphasis added). (See, *Stephen v. Ford Motor Co.* (2005) 134 Cal.App.4th 1363 [proper to exclude expert testimony on causation that lacked foundation and was not shown to be reasonably relied on by professionals in the field].)

As set forth above, an estimate of the cost of an annuity, with its lack of relevance, speculative nature, and many attendant issues, is not the kind of fact that is "reasonably relied upon" to determine present value of plaintiff's future damages. Therefore, any opinion by defendant's economist or other expert as to the cost of an annuity, if offered to show present value, would be an unreliable basis for that expert's opinion on present value.

Annuities – or rather a time-limited quote as to an insurance company's likely valuation of an annuity – are inherently different from the investments used to calculate present value under California law. Annuities take into account irrelevant factors that are not part of the present value calculation required by CACI 3904. For example, an annuitist bases his cost estimate in part on a determination of the plaintiff's lifespan prior to the fact finder in the case making this determination. **This lifespan estimate is always different than the estimate testified to by the medical experts in the case and determined by the jury and is not subject to cross-examination.** With this artificial reduction of the plaintiff's life expectancy, the future stream of payments to plaintiff is estimated to stop sooner, thus reducing the gross award and therefore the present value. Therefore, if this evidence is permitted, the fact finder would be prohibited from making the determinations it is required to make regarding life expectancy when determining the total of future economic damages. In this way, defendant can offer an artificially lowered price for the annuity and thereby offer alleged present value testimony that "drastically reduces" the present value calculation that the jury must determine. Such a usurpation of the fact finder's role was prohibited by the Supreme Court in *Salgado*.

Further, there are inherent uncertainties with annuities that make them speculative and unsuitable as evidence of present value. An annuity estimate is not an offer to pay; it is only an **estimate** of an amount needed to purchase a **promise** to pay in the future. No expert can represent that any insurance company will make a firm offer to pay a certain amount. Further speculation is introduced by the uncertainty of the future existence of the annuity company, since annuity companies have become bankrupt, creating uncertainty in the future stream of income to the plaintiff. The use of an annuity violates the rights of the plaintiff to accept or reject an annuity as a form of payment, and gives the jury the false impression that the plaintiff is obliged to accept an annuity.

Annuity quotes are also time sensitive. The quotes offered by defense experts will be good for a limited number of days. Defendant will not be able to produce reliable quotes that will be valid through the end of trial. Further, any quotes are based on the assumption that plaintiff would be willing to accept the risks associated with the investments chosen and the financial strength of the entity. Finally, the defense expert's own opinions on present value using the traditional "prudent investment method" will **contradict the use of annuities.**

The multiple problems with annuities, and their sharp distinction from the investments used to calculate present value pursuant to CACI 3904, make them irrelevant to a determination of present value. Any quotes testimony or opinions would be misleading and highly prejudicial to plaintiff, and should be excluded under Evidence Code sections 350, 352, 801, and 803.

Conclusion

The following is a list of reasons annuities are speculative and likely to cause confusion in your trial:

- Costs of annuities change with the economy and with the health status of the plaintiff. There is no assurance that a quote for today only will have any relevance to the future.
- Annuity cost estimates are a promise to pay, and are not binding until the defendant's insurer agrees to pay. The annuity company can rescind the offer at any time.
- The annuity calculations relied upon by defendant expire soon after they are made, and will not be valid following the trial.
- Annuities are based on insurance companies' risk assessments and life expectancy calculations. These are not admissible evidence, and the trier of fact has no way to evaluate the reasonableness of these foundational assessments.
- The annuity cost is based on a life expectancy calculation (a "rated age") that will be different from the fact finder's determination; this either contradicts an express finding of the fact finder or supplants the fact finder's determination with the insurance company's assessment.
- Unlike "prudent investments" in U.S. Treasury bills recommended by economists to calculate present value, annuities are risky, as annuity companies may go bankrupt and become unable to pay.

Defense counsel's efforts to introduce this evidence, testimony and opinions should be uniformly resisted by the plaintiff's bar.

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