Response to the Letter to the Editor Published in Trusts and Estates January 2005

By Mark Merric & Douglas Stein
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Douglas Stein, a member of the Michigan UTC Committee, and Mark Merric are the authors of *The Uniform Trust Code a Threat to Special Needs Trusts*, and wish to thank Richard E. Davis for his comments in the December issue of Trusts and Estates Magazine. Unfortunately his letter to the editor provides almost no legal support for his positions, for the most part are contradicted by the Restatement Third, and appear to be inconsistent with Mr. Davis's own actions as a member of the Ohio Uniform Trust Code review committee.

After consultation with Mark Merric, Richard Davis led the Ohio elder law committee to unanimously vote against adoption of the proposed Ohio UTC until the concept of a "wholly discretionary trust" was incorporated into the Ohio UTC. For a very limited number of trusts, the wholly discretionary trust retains the discretionary-support distinction. However, Mr. Davis's article implies that he has changed his professional opinion. Mr. Davis asserts that the discretionary-support distinction is "artificial" and "arbitrary" therefore the statutory amendment he pioneered maintaining the "wholly discretionary trust" should be unnecessary. However, according to an e-mail dated December 16, 2004 from estate planning attorney Dennis Williams to the chair of the Ohio UTC, Robert Brucken, the concept of the "wholly discretionary trust" must remain intact if the bar was to seek passage for the Ohio UTC.

Both the North Carolina and South Carolina UTC review committees have expressed similar concerns and have made efforts to deal with the issue. While the authors agree the proposed solutions by Ohio, North Carolina, and South Carolina are a step in the right direction, these solutions fall far short from approaching the benefits available under most states common law.

We do not wish to belabor our points made in prior articles, however, Mr. Davis inaccurately describes the law and our article. For example, Mr. Davis alleges that UTC § 504 does not abolish the common law principles of discretionary trusts. While only partially true this misstates the authors' positions and inaccurately describes the interplay of the UTC and the Third Restatement of Trusts ("Restatement Third"). The preamble to the UTC acknowledges the close coordination it has with the Restatement Third. The Restatement Third states that a discretionary standard is subject to court review for reasonableness.[1] In essence the Restatement Third requires that a trustee be reasonable even if the distribution standard is in the trustee's absolute and sole discretion. In sum, by reducing the standard of review traditionally afforded discretionary trusts, the

Restatement Third reduces a discretionary trust to a mere support trust because the trustee must act reasonably when making distributions.[2]

Mr. Davis, complains about our reliance on a hand full of cases that have interpreting the "good faith" standard with the standard of reasonableness. Yet, neither he nor NCUSSL provides authority for another interpretation. Richard Covey and Dan Hastings have also addressed several problems with UTC § 814(a) definition when they stated:

> "Section 814(a) illustrates the uncertainty that codifying the trust law may create. What do the words "and in accordance with the terms and purposes of the trust and the interests of the beneficiaries" mean? Do they create a stricter limit on the discretion that may be conferred upon a trustee than the common law test set forth in the above quotation from Scott? It seems likely that courts will use them to do so in particular cases, yet their application to particular facts remains as hard to predict as that of the common law. Has anything been gained by codification?"[3]

Unfortunately, the "good faith" standard only needs to be interpreted as something slightly less than the high discretionary common law threshold for judicial review of (1) improper motive, (2) dishonestly, or (3) failure to act, and this results in the beneficiary having a right to force a distribution. If so, the trust assets should constitute an available resource, and most likely disqualify the SNT beneficiary from governmental benefits. The *Kreitzer* line of cases[4], as well as an Iowa line of cases[5], a similar line of cases in Pennsylvania [6], and possibly a recent case in Connecticut hold that whenever a discretionary trust is coupled with any standard a beneficiary has an enforceable right to a minimal distribution that constitutes an available resource.

Mr. Davis misstates our position regarding the *Kreitzer* line of cases. There are two issues (1) is there an available resource and (2) whether a creditor may force a distribution. The UTC codifies the first issue creating an available resource due to the good faith standard of UTC § 814(a) and the right of a beneficiary to enforce a standard or remedy. Mr. Davis ignores this issue of what happens if a beneficiary has an available resource and is disqualified from receiving Medicaid.

Mr. Davis errors when he claims that the Restatement Third dispenses with the standard of reasonableness. The Restatement Third provides that "judicial intervention is not warranted merely because the court would have differently exercised its discretion."[7] The Comment further provides that "a court will not interfere with a trustee's exercise of a discretionary power when that exercise is reasonable and not based on an improper interpretation of the terms of the trust."[8] The comment continues, "[a] court **will also intervene if it finds the payments made, or not made, to be unreasonable as a means of carrying out the trust provisions.**" Although the UTC does not modify the Restatement Third it is to be read in conjunction with the Restatement Third.

Wishful thinking that SNTs containing no standard should be safe from the newly created continuum of discretionary trusts is hardly comfort to the medical needy whose life literally depends on certainty in legal interpretations. Unfortunately, the Restatement

Third may well support the opposite of Mr. Davis's position. Section 50, comment d of the Restatement Third provides if a standard is omitted, the court will still apply a reasonableness or good-faith judgment "based on the extent of the trustee's discretion, the various beneficial interests created, the beneficiaries' circumstances and the relationships to the settlor, and the general purposes of the trust."[9]

Again we must disagree with Mr. Davis's statement that Medicaid is not a creditor of an SNT beneficiary. Medicaid is the creditor of any person receiving medicaid benefits ("MA"). The state agency administering Medicaid ("State") has the right to adopt recovery statutes against the estate of the MA[10] and is required to adopt estate recovery laws.[11] The estate recovery rules allow the State, under certain federally mandated circumstances, to place a lien against the MA's home.[12] In fact, in some states the Medicaid agency need not file a claim outside the normal deadline for claims against the estate.[13]

Although federal law initially failed to define the term estate recovery resulting in cases like Citizens Action League v. Kitzer[14] this was rectified in OBRA-93.[15] Under OBRA-93 estate includes, at the State's option, any property in which the MA had an interest.[16] Under the UTC and Restatement Third the MA has an interest in a purely discretionary trust because they can force a distribution from the trust under reasonableness standard. Since a discretionary trust is converted into a support trust under the UTC and Restatement Third those assets should be considered an "available resource" to the MA and thus render them ineligible for Medicaid.[17] For example, in California, a discretionary trust set up for support was treated as a mandatory support trust.[18] Since Medicaid steps into the shoes of the MA not only at death but also during life the entire value of a discretionary trust is potentially at risk. If a court imputes income to the MA from a trust the State must seek recovery of any amounts improperly paid by the state under OBRA-93.

The estate recovery rules allow the State, under certain federally mandated circumstances, to place a lien against the MA's home.[19] In fact, in some states the Medicaid agency need not file a claim within the normal deadline for claims against the estate.[20] It is beyond question that, under federal law, the State is a creditor of a MA both during life and after death. On the other hand, Mr. Davis introduces an interesting issue of whether the UTC also threatens SSI benefits. This may be better addressed in an article.

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Interestingly, since criticism of the UTC became more vocal UTC reviewing committees are beginning to address the many problems with the UTC and its interplay with the Restatement Third. In fact, in the August 2004 NCCUSL convention, NCCUSL finally addressed whether a creditor could attach a sole trustee's beneficial interest in a trust. The need for a well reasoned clear trust law which provides certainty is beyond dispute. We hope that a scholarly dialogue bringing to light the many issues posed by the UTC results in a well reasoned clear trust law, including citations supporting the authors' positions.

[1] Section 50, comment c.

[2] *See* Dwight v. Dwight, 761 N.E.2d 964 (Mass. 2001). For an example in Mr. Davis's home state, Ohio, and others see Bureau of Support in the Department of Mental Hygiene and Correction v. Kreitzer, 243 N.E.2d 83 (Ohio 1968); Matter of Gantz, 1986 WL 12960; Samson v. Bertok, 1986 WL 14819 (the creditor did not recover because it was not a governmental claim); Matter of Trust of Stum, 1987 WL 26246; Schierer v. Ostafin, 1999 WL 493940; In re: Carol Miller, 432 Mich 426 (1989) holding property in a wholly discretionary trust is not considered a countable asset because beneficiary has no ascertainable interest in the trust and cannot force a distribution.

[3] Richard Covey and Dan Hastings, Practical Drafting, October 2003.

[4] *Bureau of Support in the Department of Mental Hygiene and Correction v. Kreitzer,* 243 N.E.2d 83 (Ohio 1968); *Matter of Gantz,* 1986 WL 12960; *Samson v. Bertok,* 1986 WL 14819 (the creditor did not recover because it was not a governmental claim); *Matter of Trust of Stum,* 1987 WL 26246; *Schierer v. Ostafin,* 1999 WL 493940 (the creditor did not recover because it was not a governmental claim). In *Metz v. Ohio Dept. of Human Services,* 762 N.E. 2d 1032 (OH App. 2001).

[5] *Strojek v. Hardin County Board of Supervisors,* 602 N.W. 2d 566 (Iowa App. 1999) also see the follow up unpublished opinion where the Iowa Appellate Court expanded the definition of the distribution language as much broader than "basic needs." *Strojek v Hardin County Board of Supervisors,* 2002 WL 180377 (Iowa App. 2002); Also see the unpublished opinion of *McCabe v. McKinnon,* 2002 WL 31757533 (Iowa App. 2002).

[6] *Estate of Taylor v. Department of Public Welfare,* 825 A.2d 763 (Penn. 2003); *Shaak v. Pennsylvania Department of Public Welfare,* 747 A.2d 883 (Penn. 2000); *Estate of Rosenberg v. Department of Public Welfare,* 679 A.2d 767 (Penn. 1996); *Commonwealth Bank and Trust Co.,* 598 A.2d 1279 (Penn. 1991)

[7] Section 50, comment b.

[8] *Restatement (Third) of Trusts,* Section 60, comment a.

[9] *Restatement (Third) of Trusts,* Section 50, comment d.

[10] 42 U.S.C. 1396p(b)(1); West Virginia v. U.S. Dept. of Health and Human Services, 289 F3d 281 (4th Cir. 2002).

[11] 42 U.S.C. 1396p(b)(1).

[12] 42 U.S.C. 1396p(a)(1).

[13] In re: Cahill, 131 S.W.2d 859 (Mo. Ct. App. 2004).

[14] 887 F.2d 1003 (9th Cir. 1989) holding that assets held in a joint tenancy escape estate recovery because common law did not include joint tenancy property as part of a decedents estate.

[15] Omnibus Reconciliation Act of 1993.

[16] 42 U.S.C. 1396p(b)(4).

[17] *See* Brenda J. Rediess-Hoosein, *Disabled Beneficiaries Present Unique Estate Planning Problems*, Taxation for Accountants, Jan 1995.

[18] Lackman v. Dept. of Mental Hygiene, 156 Cal. App. 2d 674; Estate of Hinkly v. Blackstock, 195 Cal. App. 2d 164 .

[19] 42 U.S.C. 1396p(a)(1).

[20] In re: Cahill,131 S.W.2d 859 (Mo. Ct. App. 2004) (holding that the Medicaid agency is a "taxing authority" therefore exempt from the one year claims period.