SUPPLEMENTAL NEEDS TRUSTS FOR PEOPLE WITH DISABILITIES: THE DEVELOPMENT OF A PRIVATE TRUST IN THE PUBLIC INTEREST

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"The problem is that the Legislature throughout the century has haphazardly enacted a series of statutes, couched in general terms, which were intended to carry out shifting or evolving concepts of social need. Older statutes based on policies dimly stated, unstated or later greatly modified, perhaps even abandoned, have been re-enacted and left to stand beside more recent enactments based on new, and apparently conflicting notions of social justice, some in fact imported from Federal law. Courts seeking a precise solution to a particular problem have been utterly frustrated in their efforts to discover an integrated or workable statutory scheme or a paramount legislative concern which would provide consistent guidance through the maze."[1]

I. INTRODUCTION

In 1924 Martin Escher executed a will for the purpose of distributing his property equally to his five children.[2] He knew that his daughter Marie suffered from severe psychiatric problems, so Escher placed her share of the property in trust until she reached the age of 30.[3] Eight years later, Escher executed an addendum to his will that extended Marie's trust for her entire life. Escher died in 1937; Marie began living at the Rockland Psychiatric Center in 1947, and she was formally adjudicated an "incompetent" on July 24, 1956.[4]

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[1] Baker v. Sterling, 39 N.Y.2d 397, 406, 348 N.E.2d 584, 590-91 (1976).

[2] In re Escher, 407 N.Y.S.2d 106 (Sur. Ct. Bronx Co. 1978), *aff'd*, 426 N.Y.S.2d 1008 (N.Y. App. Div. 1980), *aff'd*, 420 N.E.2d 91 (1981). Escher is the seminal case in New York which established the right of a parent to create a discretionary trust for a disabled adult child without jeopardizing the child's financial eligibility for government benefits which are "means-tested."

[3] *Id.* 407 N.Y.S.2d at 108.

[4] The term "incompetent" is a vestige of an earlier era and modern guardianship statutes replaced the term with "incapacitated" to describe the person for whom a guardian is appointed.

In 1978, 54 years after Martin signed his will, 46 years after the codicil, and 41 years after his death, a court in Bronx County, New York denied the government's demand to be reimbursed for the cost of Marie's care during her institutionalized years. The *Escher* decision is noteworthy because it articulated a public policy based on the following: 1) traditional principles of trust analysis; 2) the socioeconomic reality of the Great Depression; 3) an entitlement theory of government benefits; and 4) society's evolving attitudes about the costs, stigmas, and realities of long-term care.[5] The convergence of these elements created a compelling narrative about society, the law, and a parent's plan for a disabled child.

The court found that Martin Escher did not intend the trust's principal to be used to pay for his daughter's government-provided medical care. The trust directed that the principal only be used in the event of an "[I]llness, accident, or other emergency,"[6] which protected it from the government's claim for reimbursement for the costs of Marie's care. The *Escher* trust was thus a primitive conceptual blueprint for what is now commonly referred to as a "supplemental needs trust" ("SNT").[7]

The gradual acceptance of third-party trusts designed to supplement government benefits resolved a major dilemma faced by parents (and other relatives or friends) who wanted to plan for the future care of a disabled loved one, without jeopardizing that person's eligibility for government benefits. However, these cases did not address the problem that arises when a Medicaid recipient receives a lump sum of money from a personal injury case, an inheritance, or another source.

Jean Williams was born in 1985 with multiple physical and neurological disabilities.[8] Jean is confined to a wheelchair and depends on adults for all activities. Jean's cognitive and intellectual development will be severely limited throughout her lifetime. Jean's parents brought a product liability action against several drug companies that manufactured the drug they believe caused Jean's disabilities while she was in utero. Because of problems in proving the various defendants' liability, the total amount of the individual settlements was $140,000, a relatively small sum in relation to Jean's actual damages and future needs. The settlement order blocked use of the funds until Jean reached age eighteen.

Jean receives Medicaid services through a program designed to prevent the institutionalization of severely disabled children.[9] As part of the Omnibus Budget

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[5] At the time of the decision, Marie Escher was 77 years old, confined to a wheelchair, incontinent, totally dependent, and destined to live out the remainder of her life at the Rockland Psychiatric Center. Escher, 407 N.Y.S.2d at 108.

[6] *Id.* at 108.

[7] This article defines the term "supplemental needs trust" broadly to include trusts designed to provide for a beneficiary without jeopardizing the beneficiary's eligibility for government benefits. These trusts are also referred to as "special needs trusts," State Medicaid Manual, Part 3-Eligibility, MCFA Transmittal No. 64 § 3259.7(A) (Nov. 1994), or "supplemental care trusts" Clifton B. Kruse, Jr., Third-Party and Self-Created Trusts 24 (2d ed. 1998).

[8] Jean Williams is a pseudonym. The facts and circumstances of her unreported case have been modified to protect confidentiality.

[9] This program provides Medicaid coverage to disabled minors in order to furnish home

Reconciliation Act of 1993 ("OBRA '93"),[10] Congress passed legislation allowing people in Jean's situation to protect their "excess" assets in a trust that would not be considered in determining Medicaid eligibility.[11] Thus, when Jean turns eighteen, the cost of her care will not rapidly deplete the settlement proceeds. The funds could be placed in an OBRA '93 supplemental needs trust and used for Jean's benefit during the course of her lifetime.[12]

Unfortunately, the hope of protecting Jean's settlement proved to be short-lived. Subsequent to the OBRA '93 legislation, a number of cases in a variety of jurisdictions held that a Medicaid agency has the right to satisfy an existing Medicaid lien against the proceeds of a personal injury lawsuit before the money is transferred into a supplemental needs trust.[13] As a result, when Jean turns eighteen in 2003, the settlement money will be subject to a Medicaid lien that will probably exceed the amount of the settlement. Jean will receive no benefit from the lawsuit, and the money intended to compensate her personal injuries will disappear into the state's budget. Despite progress in the law governing trusts for people with disabilities, Jean's case demonstrates that the struggle is not over.

The primary purpose of an SNT in both *Escher* and Jean Williams-type circumstances is to prevent costs and expenses related to health care and daily living that would otherwise be covered by means-tested government benefit programs from consuming assets. [14] An SNT benefits a person with a disability[15] who usually re-

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care. Eligibility is based on the child's disability, without regard to the income and assets of the parents. In Jean Williams' case, the program pays for a variety of goods and services, including respite child care, modifications to her home to allow wheelchair access, a special stroller, medical treatment, dental treatment, physical therapy, and orthotics.

[10] Omnibus Budget Reconciliation Act of 1993, Pub. L. 103-66, 107 Stat. 312 (1993) *et seq.*

[11] The provisions authorizing trusts for people with disabilities are codified at 42 U.S.C. § 1396p(d)(4)(A) & (C) (1993). *See infra* Part III C.

[12] *See infra* Part III C.

[13] *See infra* Part IV B.

[14] In this context, the term "government benefits" refers primarily to Supplemental Security Income (SSI) and Medicaid, both of which have financial eligibility requirements. The SSI program is Title XVI of the Social Security Act and became effective on January 1, 1974. *See* 42 U.S.C. § 1381 (1972) *et seq.* SSI replaced a cluster of grant-in-aid federal and state joint programs that provided income support for the aged, blind, and disabled who were not eligible for Social Security Retirement or Disability Insurance Benefits. JOHN J. REGAN ET AL., TAX, ESTATE, AND FINANCIAL PLANNING FOR THE ELDERLY § 8.02[1], at 8-6 & n.1 (2000). These programs included Old Age Assistance (OAA), Aid to the Blind (AB), and Aid to the Permanently and Totally Disabled (APTD). *Id.*

Medicaid is Title XIX of the Social Security Act. *See* 42 U.S.C. § 1396 *et seq.* Medicaid is a medical assistance program for certain categories of financially eligible people, including individuals and families who receive cash public assistance, the disabled, and the elderly. REGAN, *supra* § 10.02, at 10-9. People with disabilities and the elderly may also or otherwise be eligible for benefits under the Old Age Survivors and Disability Insurance (OASDI) and Medicare programs administered by the Social Security Administration. The OASDI programs are Title II of the Social Security Act. *See* 42 U.S.C. § 401 *et seq.* The Medicare

lies on Supplemental Security Income ("SSI") for basic income support and Medicaid for a significant amount of health care coverage. The SNT is an emerging tool that mitigates the inadequacies of government benefit programs for people with disabilities.[16] The SNT is designed to enhance the beneficiary's quality of life

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program is Title XVIII of the Social Security Act and is codified at 42 U.S.C. § 1395 *et seq.* These social insurance benefit programs do not have financial criteria for eligibility, but determine eligibility based on the insured's earnings record, age, and disability. In contrast, means-tested government benefits carefully scrutinize the finances of an applicant and any excess income or assets will render the person ineligible. Every Western industrial democracy provides medical insurance universally on a social insurance model, except the United States, which only extends public health insurance to the poor, elderly, disabled, and veterans. THEODORE R. MARMOR ET AL., AMERICA'S MISUNDERSTOOD WELFARE STATE 45 (1990). Medicare provides health insurance to 39 million people who are either elderly or disabled. *See* www.Medicare.gov. Medicare is extremely limited in the scope of its coverage for home care, nursing home care, services related to the treatment and rehabilitation of chronic medical conditions; also, Medicare does not cover prescription drugs. *See, generally,* 42 U.S.C. §§ 1395-1395ccc; 42 C.F.R. Parts 405489; REGAN, *supra*, §§ 9.09– 9.16. Medicaid is the only government program that provides coverage for long term care and related services. *See* http//www.hcfa.gov/Medicaid. However, Medicaid requires a person to become impoverished in order to access the program's services that are not available elsewhere. For a discussion of the development of this structure of social welfare see Peter B. Edelman, *Toward A Comprehensive Antipoverty Strategy: Getting Beyond the Silver Bullet*, 81 GEO. L.J. 1697 (1993). Professor Edelman discusses how various groups have taken their place among the "deserving" poor, including the blind, deaf, and insane in the nineteenth century, the elderly after the passage of the Social Security Act in 1935, disabled workers in 1956, and the working poor with the passage of the Earned Income Tax Credit in 1975.

[15] The term disability generally includes a continuum of conditions that include, but are not limited to, physical disabilities, developmental disabilities, mental retardation, traumatic brain injuries and neurological impairments associated with age, such as Alzheimer's Disease. The precise definition of disability varies according to the context. With respect to supplemental needs trusts, if the trust is a third-party trust established and funded by a parent (or other person), the controlling definition will be found either in the particular state's statute authorizing the trust or in the eligibility criteria for the government benefit program. *See, e.g.,* WIS. STAT. § 701.06(5m) (1999)(defining a disabled individual as a person "who has a disability which has continued or can be expected to continue indefinitely, substantially impairs the individual from adequately providing for his or her own care or custody, and constitutes a substantial handicap to the afflicted individual. . . ."). If the trust is funded by the disabled beneficiary and established pursuant to OBRA '93, the beneficiary must meet the rather strict definition of disability under the Social Security Act. "[A]n individual shall be considered to be disabled for purposes of this title if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve months." 42 U.S.C. § 1382c(a)(3)(A).

[16] Our system of care does not adequately meet the needs of people with disabilities and the elderly because it is premised almost exclusively on a medical model oriented toward acute care. Problems with the medical model of health care include its failure to recognize the importance of, and provide coverage for, preventive care, "nontraditional" forms of health care, and a broader array of delivery models (i.e., home based care, day care, visiting

through the purchase of additional goods and services that are not covered or adequately provided by SSI and Medicaid. Periodic budget cutbacks, rationing of services, pre-set levels of provider reimbursement, and prior approval requirements have increased the need for supplemental goods and services that may be vital for the well-being of a person with a disability. An SNT is used primarily in two circumstances: 1) as part of a parent'sestate planning for a child with a disability;[17] and 2) when a disabled person receives a "lump sum" of money from a lawsuit, inheritance, or other source.

There have been significant differences in the law's treatment of "third-party trusts" (funded by a parent or another "third party") in comparison to "self-settled" trusts (funded with assets owned by the beneficiary).[18] Prior to court and government agency acceptance of third-party SNTs, a parent had to exclude a disabled child from an estate plan in order to avoid disqualifying the child from Medicaid eligibility.[19] Until OBRA '93 authorized trusts funded with a disabled Medicaid recipient's assets, the receipt of a "lump sum" of money would render the person financially ineligible for Medicaid due to "excess resources."[20]

An SNT gives a person with a disability increased economic power to purchase goods and services that enhance his or her quality of life. For example, a disabled person can use an SNT to provide additional health care services and equipment,[21]

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nurses, and physical therapy).

[17] This kind of SNT can be established by a parent, other relative, friend, or any other "third party" who is not legally responsible for the beneficiary under the relevant state law. In this context, the third party is not legally responsible for the support, including medical care, of the beneficiary of the trust. Federal Medicaid law defines a third party as one who is legally responsible for paying the medical expenses of the Medicaid recipient. 42 C.F.R. § 433.136 (1985). *See also* 42 U.S.C. § 1396a(a)(25)(B) (mandating that States seek reimbursement from responsible third parties). For a discussion of Medicaid liens and responsible third parties see infra Part IV.

[18] *See infra,* Part II.

[19] Although supplemental needs trusts are used to transfer wealth "down" from one generation to another, they can also be used in most states to provide for an elderly parent, relative, or friend who is receiving government benefits.

[20] The federal Medicaid statute and regulations establish the criteria and methodology for a state's resource standard. 42 U.S.C. § 1396a(a)(10)(C)(I); 42 C.F.R. § 435.840. The precise resource limit varies among the states. For example, in 2000, an individual Medicaid recipient in New York State is permitted to have $3,660 in liquid assets. N.Y. SOC. SERV. § 366(2)(a)(4)(West 2000). Some assets are exempt from being counted for eligibility purposes, including a burial account and primary residence.

[21] The most sophisticated assistive technology is usually not available under the Medicare or Medicaid programs. *See* BRUCE C. VLADEK ET AL., *Confronting the Ambivalence of Disability Policy: Has Push Come to Shove?, in* DISABILITY: CHALLENGES FOR SOCIAL INSURANCE, HEALTH CARE FINANCING & LABOR MARKET POLICY 83, 94 (Virginia P. Reno et al. eds., 1997). *See also, e.g.,* Warder v. Shalala, 149 F.3d 73 (1st Cir. 1998) (bracing systems for severe musculoskeletal problems classified under Medicare as braces rather than durable medical equipment, and thus not reimbursable in hospital and institutional settings); DeSario v. Thomas, 139 F.3d 80 (2d Cir. 1998) (Medicaid limitations on coverage of "dura-

specialized or unique therapy,[22] private health insurance,[23] educational and vocational training, computers and software,[24] case management services, and recreational activities.[25] Moreover, the SNT may facilitate independent living in the community by subsidizing the rental or purchase of a residence.[26]

This Article examines the development of supplemental needs trusts and their role in meeting those needs of people with disabilities which are not adequately met by government benefit programs. SNTs create a complementary partnership be-

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ble medical equipment" upheld based on distinction between equipment primarily medical in nature and devices employed for nonmedical purposes which might incidentally benefit someone with a particular condition). This is a prime example of an area where an SNT can fill in the gaps in Medicare and Medicaid coverage.

[22] The limits of the medical model of treatment and services have created the push for outcomes that focus on functionality and an assessment of what services and goods are necessary to treat the whole person, rather than the narrowly defined medical condition. Notably there is often a more subjective functional benefit from assistive technology rather than a medical benefit. VLADEK ET AL., *supra* Note, 21 at 95-96.

[23] *Id.* For a discussion of how the structures of health care plans operate to exclude the chronically ill, see STANLEY B. JONES, *Why Not the Best for the Chronically Ill?*, *in* DISABILITY: CHALLENGES FOR SOCIAL INSURANCE, HEALTH CARE FINANCING & LABOR MARKET POLICY 101, 101-112 (Virginia P. Reno et al. eds., 1997).

[24] Assistive equipment such as computer keyboards, screens, and other devices that maintain health or prevent disease, improve a person's functional limitations, or serve a vocational purpose are generally not covered by either private insurance, Medicaid, or Medicare. VLADEK ET AL, *supra* note 21.

[25] These examples do not exhaust the potential uses of an SNT. The SNT enables a beneficiary to utilize health care providers who do not accept Medicaid or whose services are not covered by Medicaid. The potential therefore exists for SNTs to reduce the utilization of Medicaid providers by beneficiaries who pay for their health related services through the SNT.

[26] The SNT can be a powerful tool for creating alternative living arrangements for people with disabilities by subsidizing rent, providing a down payment to purchase a house and assisting with mortgage payments. People with disabilities who are unable to live independently, particularly those with mental illness or developmental disabilities, may otherwise face a long waiting list for individual community residence "group homes." Often the person with a disability either lives in an institution that is inappropriate or at home with parents who are aging and increasingly unable to provide the necessary care. *See* Betty Booker, *Aging Parents Worry About Fate of Disabled Middle-Aged Children*, RICHMOND TIMES-DISPATCH (Sept. 25, 2000), *available at* www.timesdispatch.com; Juliana Gittler, *For Your Children, It's a Matter of Trust: Couple Wanted to Provide a Safe, Financially Secure Environment for Their Disabled Son*, THE POST-STANDARD, Syracuse, NY, May 29, 2000, at 5, *available at* 2000 WL 5838476; Susan Garland, *When Your Kids Will Always Be Dependent: How to Assure Care for Disabled Children*, BUSINESS WEEK, April 10, 2000, at 233, *available at* WL 7825654; Sue McDonald, *Plan for Disabled Adults*, THE CINCINNATI ENQUIRER, April 21, 1999, at EO1, *available at* 1999 WL 9432807; Andree Brooks, *Special Fund for Disabled Kids*, NEW ORLEANS TIMES-PICAYUNE, Dec. 14, 1993, at D2, *available at* 1993 WL 7787207.

tween government benefits and private wealth.[27] They promote a higher level of support and care to the beneficiary of the trust than is available from government benefits alone. An aging society, the prevalence of functional disabilities, and the structure and limitations of the health insurance system in the United States have made the supplemental needs trust an important tool.

People with disabilities are diverse in the nature and origins of their disabilities, their unique special needs, and even the extent to which they rely on government benefits.[28] The social construct of disability is changing, and there are greater numbers of people with a wider variety of disabilities.[29] "[D]isability is a socially

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[27] Supplemental needs trusts are usually funded with relatively modest amounts of money and are probably most often in the range of $10,000-$150,000. *See, e.g.*, Santiago v. Craigbrand Realty Corp., 706 N.Y.S.2d 87 (1st Dept. 2000) ($140,000 personal injury settlement less $12,857.06 Medicaid lien); *In re* Patrick BB, 700 N.Y.S.2d 301 (3d Dept. 1999) ($14,899.37 from inheritance after funding of Medicaid burial fund and resource allowance); S.S. v. Utah, 972 P.2d 439 (1998) ($130,545.42 after payment of $44,454.58 Medicaid lien); Wallace v. Estate of Jackson, 972 P.2d 446, (1998) ($42,000 after payment of $43,000 Medicaid lien); Norwest Bank of North Dakota, N.A. v. Doth, 159 F.3d 328 (8th Cir. 1998) (in companion cases, $38,000 after payment of $72,000 Medicaid lien and $84,000 after payment of $56,000 Medicaid lien); Guardianship and Conservatorship of Watkins, 947 P.2d 45 (Kan. App. 1997) ($28,000 inheritance); Hecker v. Stark County Social Service Bd., 527 N.W.2d 226 (N.D. 1994) ($81,000 in trust created by parent of person with developmental disability); Zeoli v. Commissioner of Social Services, 179 Conn. 83, 425 A.2d 553 (Conn. 1979) ($9,515 in trust created by parent of disabled daughters); *cf.* Department of Social Services v. Saunders, 724 A.2d 1093 (Conn. 1999) ($579,824.02 net settlement).

[28] People with very severe disabilities are often wholly dependent on Medicaid, which covers the cost of care and services in residential facilities. However, many people with disabilities reside in the community, are covered by private insurance and/or Medicare and do not incur substantial Medicaid bills. The community of people with disabilities is not monolithic and the need for an SNT depends on the extent to which a person may need Medicaid coverage or the extent of any cognitive impairment. If Medicaid is a part of the person's health insurance, the SNT is essential to protect what would otherwise be considered "excess" assets. Even if the person is not currently eligible for Medicaid, it is probably beneficial to utilize an SNT "just in case." If the person with a disability has a cognitive impairment that affects her ability to manage property, the use of an SNT is prudent unless there are enough funds to pay the costs of any foreseeable health care needs.

[29] Social Security Administration actuaries predicted an 88% increase in disabled workers receiving Disability Insurance Benefits from 1995-2010. *See* R. ALEXANDER VACHON, *Disability Policy in an Age of Reform*, *in* CHALLENGES FOR SOCIAL INSURANCE, HEALTH CARE FINANCING & LABOR MARKET POLICY, *supra* note 21, at 118, 119. People with disabilities can be grouped into the following broad categories: 1) adults with severe, often life-threatening, medical conditions such as cancer, HIV, respiratory, lupus, emphysema, multiple sclerosis, and heart disease; 2) adults with musculoskeletal impairments, typically back problems, and chronic pain; 3) adults with mental disorders, including cognitive impairments and mental illness (e.g., clinical depression and schizophrenia); 4) young adults age 18-25 with mental retardation, head and other injuries from accidents; and 5) children with developmental disabilities, physical disabilities, and learning disabilities. *See* JERRY MASHAW, *Findings of the Disability Policy Panel*, in CHALLENGES FOR SOCIAL INSURANCE, HEALTH

and economically crosscutting phenomenon" in which income support and medical care are only components of a larger picture that also includes housing, personal assistance, educational and vocational services, and rehabilitation.[30] The SNT plays a crucial role in this "larger picture" that is part of a "future care plan" developed with and for the person with a disability.

Throughout its history, the trust has furthered social justice by providing for the needs of people who are subject to the harsh dictates of the law. The supplemental needs trust emerged from a mix of judicial and legislative developments and broader societal changes. The intermingling of trust law and eligibility criteria for means-tested government benefit programs created the concept of supplemental needs trusts.

Public policy toward people with disabilities has moved away from an institutional model and has moved toward community-based living and support services that emphasize independent living and maximizing employment potential. The demographics of an aging society created a sense of urgency to address the needs of two groups: 1) a generation of aging parents facing their own mortality, who cared for their disabled child through adulthood; and 2) an increasing number of adults with disabilities who are integrated into the community.

Part I of this Article discusses the historical antecedents of the supplemental needs trust in feudal England and the United States. In feudal England the "use" emerged as a tool for social justice by evading the harsh dictates of feudal law that disadvantaged women, daughters, younger sons, and religious orders. In American jurisprudence, centuries-long interplay among innovations in the form of trusts, legislation designed to regulate trusts, and judicial interpretation of trusts within the context of law and public policy shaped the trust.

Part II discusses three significant stages of SNT development in the United States: 1) the common-law treatment of third-party trusts; 2) the enactment of SNT statutes by state legislatures; and 3) the groundbreaking provisions of the federal Omnibus Budget Reconciliation Act of 1993, which authorized the use of individual and pooled trusts funded with "lump sums" received by a person with a disability.

Part III analyzes and critiques cases decided after the enactment of trust provisions of OBRA '93 holding that a Medicaid agency has the right to satisfy a lien against the proceeds of a personal injury lawsuit prior to the funding of a supple-

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CARE FINANCING & LABOR MARKET POLICY, *supra*, at 22-23. From 1989 to 1995 the number of children receiving SSI more than tripled to 927,000, and the cost increased from 1.1 billion to $5 billion. VACHON, *supra* at 122. *See also*, Sullivan v. Zebley, 493 U.S. 521 (1990) (holding that Social Security regulations violated Social Security Act in that children with disabilities of comparable severity to adults were denied benefits under Supplemental Security Income Program). The Zebley decision resulted in reassessments of eligibility and numerous retroactive awards of benefits. To accommodate these lump sums without jeopardizing the recipient's eligibility for SSI, the Social Security Administration approved the use of supplemental needs trusts. These so-called "Zebley trusts" foreshadowed the trust provisions in the OBRA '93 legislation.

[30] VLADEK, *supra* note 21, at 89.

mental needs trust. If the size of the Medicaid lien is significant in relation to the settlement or award, and the lien can be satisfied prior to the funding of the trust, the protections created by OBRA '93 are sabotaged. This Article argues that these decisions misinterpret the federal statutes governing Medicaid liens and undermine a primary purpose of the OBRA '93 legislation.

Part IV explores the rationale of public policy toward supplemental needs trusts by responding to a critique that SNTs merely waste scarce resources by providing SSI and Medicaid to people who are not truly indigent. This Article then suggests a number of proposals for reforming the law governing SNTs and also proposes using the SNT model to expand the trend toward enhanced resource allowances, trusts, and earmarked funds. These proposals aim to do the following: 1) make SNTs more accessible and efficient; 2) eliminate the continued existence of variation and uncertainty in judicial analysis of third-party trusts for a beneficiary who is disabled and who receives government benefits; 3) strengthen the disability trust provisions under OBRA '93; and 4) use the SNT model to narrow the differences between means-tested government benefits and social insurance programs.

I. HISTORICAL ORIGINS OF THE SUPPLEMENTAL NEEDS TRUST

A. *A Snapshot of Trusts in Feudal England*

For centuries, the trust has proven to be a durable, flexible, and effective structure for managing property in England and the United States.[31] The development of the trust has been extolled as the "most distinctive achievement of English lawyers."[32] The dominant theory underlying the concept of a trust is grounded in property law. Its defining feature is a bifurcated ownership structure in which property is transferred to a trustee who manages it for a beneficiary.[33] A trust differs from the "outright" ownership of property in that the trustee, the recipient of the transfer, is considered the "legal" owner and the beneficiary has an "equitable" interest. The trustee controls the property, but the beneficiary can enforce the terms of the trust instrument, which provide directions to the trustee as to how the trust should be administered.

The triangular relationship among creator, trustee, and beneficiary has also been explained as an essentially contractual relationship based on the "trust deal."[34] Re-

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[31] The trust is most prevalent in common law legal systems based on the English model, and is generally not found in European civil law countries. *See* Henry Hansmann & Ugo Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. REV. 434 (1998). *Compare* Avisheh Avini, *The Origins of the Modern Trust Revistsed*, 70 TUL. L. REV. 1139 (1996) (proposing that the Islamic "waqf" was the primary model for the original development of the trust in England).

[32] F.W. MAITLAND, EQUITY ALSO THE FORMS OF ACTION AT COMMON LAW 23 (A.H. Chaytor & W.J. Whittaker eds., Cambridge Univ. Press 1984).

[33] *Id.* at 44.

[34] *See, e.g.*, John Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J.

gardless of whether one categorizes the trust under the rubric of property law or contract law, its form, function, and substance are adaptable and flexible. The trust's distinctive structure has forged new paths between existing legal doctrine across the span of centuries in England and the United States.

The trust began as a tool to transfer land, which was the primary form of wealth in feudal England. The "use"[35] was the original term that described an arrangement whereby a landowner conveyed his land to his friends (the trustees[36]) "for the use" of the landowner's children. The use proved to be a powerful force that subverted the burdens imposed by the King on landowners in a feudal system. [37]

The earliest instance of the use occurred in the first half of the thirteenth century when landowners employed the use for the benefit of the Franciscan friars.[38] The rules of their order required the friars to take complete vows of poverty so that they would be dependent on the people whom they served.[39] Friars could not own any property, either individually or collectively.[40] In order to provide housing for the friars in the towns to which they traveled as missionaries, a landowner would convey it to the "borough" for the friars' use.[41] Thus, the friars were able to enjoy the benefits of using land without violating their vows of poverty.[42]

The modern trust developed as a result of the "more or less accidental circum-

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625, 632-33 (1995) (identifying three particularly resented landholding rules: 1) the feudal landholding rules mandating that land pass by descent and prohibiting land from being conveyed by will; 2) the shares of primogeniture and dower; and 3) financial penalties on transfers of land to minors called "wardship and marriage.").

[35] According to Professor Maitland, "use" derives from the vulgar Latin "ad opus" meaning "on his behalf". MAITLAND, *supra* note 32, at 24. "In Old French [ad opus] became 'al oes, ues'. In English mouths this becomes confused with 'use'." *Id.*

[36] In feudal England, the trustee was referred to as a "feofee"—for ease of reference I use the term trustee throughout.

[37] *See* Austin Wakeman Scott, *The Trust as an Instrument of Law Reform,* XXXI YALE L.J.1 457 (Mar. 1922).

[38] *See* AUSTIN WAKEMAN SCOTT, ABRIDGMENT OF THE LAW OF TRUSTS 9 (1960); MAITLAND, *supra* note 32, at 25.

[39] MAITLAND, *supra* note 32, at 25.

[40] *Id.*

[41] *Id.*

[42] Although different in significant ways, the use's application for the benefit of the friars loosely foreshadowed the modern day supplemental needs trust. In order to qualify for means-tested government benefits, a person who is deemed deserving (i.e., categorically eligible) must take a "vow of poverty." If a deserving person is eligible for government benefits, but owns even a modest amount of assets, the government requires that the property be relinquished in order for the owner to qualify. To avoid the harshness of these rules, the SNT provides some of the benefits of private wealth to people who are forced into poverty because they are unable to cure it through employment due to disability or age. Perhaps the use as it was applied for the friars has a more direct relationship with the modern day charitable trust, but the role of the use in alleviating the Franciscans' vow of poverty invites the comparison with a supplemental needs trust. The comparison also reminds us that, despite their vulnerability, people with disabilities often help us re-frame our perspective on life and inspire us through their struggles.

stance that beginning in fifteenth-century England, there were separate courts of law and equity."[43] Until the fifteenth century, the use was not legally enforceable, but was treated as a "gentleman's agreement." The rigid application of the law by the common law courts created injustice, and petitioners looked to the King's Court and Council. These cases were referred to the chancellor and the Court of Chancery was established around 1422.[44] From the fifteenth century onward, the use became subject to the exclusive jurisdiction of the courts of equity, which employed procedures and remedies that were better suited to enforcing the use than the rigid approach of the King's Court or common law courts.[45]

Although the Chancellor initially enforced the personal duties of the trustee through an appeal to conscience, over time a "system of equitable ownership" was created.[46] In the eyes of the Chancellor, the trust did not violate public policy. In contrast, the common law judges were preoccupied with categories of property ownership that caused them to rule that the purposes of the use violated "the policy of the law."[47]

The use became extremely popular as an effective way to avoid the burdens of an increasingly obsolete feudal system.[48] A fundamental pillar of feudal policy was the prohibition against devising land by will on the theory that the eldest son was best suited to take over from the tenant upon his father's death.[49] Because the formal legal rules that governed estates did not bind equity, land could be transferred for the benefit of younger sons and daughters despite feudal decrees and restrictions.[50] During this time, the use enabled tenants to defeat the multiple and burden-

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[43] The Judicare Acts of 1873 and 1875 reunited the courts under the "High Court of Justice." MAITLAND, *supra* note 32, at 15.

[44] SCOTT, *supra* note 38, at 8. Originally Parliament and the King's Council were the only available alternatives. The Council referred these cases to the chancellor, who in the early years was an ecclesiastic and not a lawyer. Their domain was conscience, not law. Beginning in 1529, lawyers have reigned in the Court of Chancery and shaped it into a system of law. *Id.*

[45] The equity courts could enforce specific performance by the trustee, which enabled the beneficiary to receive the "ancestral land," rather than mere money damages. In addition, the Chancery court obtained testimony under oath, unlike the common law courts. *See* Langbein, *supra* note 34, at 634-35.

[46] MAITLAND, *supra* note 32, at 5. The chancellor was concerned with equity to remedy the injustice of the law. For a discussion of the origins of equity and the role of the chancellor, *see* PETER CHARLES HOFFER, THE LAW'S CONSCIENCE 7-29 (1990). The new form of property ownership represented by the trust evolved under the guise of an appeal to the trustee's conscience in order to enforce the trustee's personal duties. *Id.* As it developed, the beneficiary's equitable interest shared some characteristics with a legal interest. For example, if the beneficiary of the trust died without a will, his interest in the trust passed to heirs.

[47] SCOTT, *supra* note 38, at 11.

[48] MAITLAND, *supra* note 32, at 7.

[49] This was the system of primogeniture, the English system of passing property to heirs.

[50] SCOTT, *supra* note 38, at 11. Athough a landowner could not dispose of land in a will, he could request that the trustees deal with land in a particular way. *See* MAITLAND, *supra* note 32, at 27.

some claims of the "overlords."[51]

Married women utilized the trust to improve their economic positions by preventing their husbands from controlling property inherited by them. On the other hand, the trust could also prevent a wife from claiming "dower," her share of a deceased husband's estate.[52]

If a landowner wanted to allow a religious order to benefit from land, he could employ a use and avoid the *mortmain* laws, which required forfeiture of land conveyed to religious or other corporations.[53]

Despite the role of the use in distributing land to achieve these positive social purposes, those who sought to avoid the claims of creditors sometimes abused the use.[54] A creditor seeking to enforce a judgment could not seize land that the landowner transferred to multiple trustees for the use of the landowner. In 1376, Parliament struck down the use as a "spendthrift" device to avoid creditors of the transferor.[55]

In 1536, the Statute of Uses was enacted by Parliament, allegedly as a response to what was perceived to be the fraud and injustices perpetuated by the use. In reality, the architect of the statute was Henry VIII, "the one man in the kingdom who had everything to gain and nothing to lose by abolishing uses."[56] Although the Statute of Uses abolished the "passive" landholding use, it did not apply to the "active" use that evolved into the modern-day trust.[57] The distinction between a passive use and an active use is often subtle. If the trust merely instructed the trustee that the beneficiary was to enjoy the use of the land, the trust was converted to a legal estate owned by the beneficiary and could not be transferred by will.[58] How-

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[51] Land would revert to the overlord if the tenant didn't have any natural heirs. If an heir was an infant, the overlord was entitled to rents and profits until the infant became an adult. The overlord also had the right to sell the privilege of marrying the heir, and was entitled to "aids" when the tenant's eldest son was knighted and the eldest daughter married. Although the "feofees" (trustees) had to pay their "dues" to the overlord, the use of multiple feofees as joint tenants avoided the feudal incidents. *See* SCOTT, *supra* note 38, at 11. A use could also evade the law of forfeiture for treason and escheat for felony. *See* MAITLAND, *supra* note 32, at 27.

[52] SCOTT, *supra* note 38, at 12.

[53] MAITLAND, *supra* note 32, at 7. In 1391, the mortmain forfeiture rules, which mandated that land transferred to religious organizations or corporations be forfeited to the overlord, were expanded to cover land conveyed to individuals for the use of those organizations or corporations. *Id.*

[54] SCOTT, *supra* note 38, at 10.

[55] *Id.* During this time, there was enormous discontent in England among laborers, and the poll tax, renewed by the Parliament of 1380, ignited revolt among peasants. *See* JOHN RICHARD GREEN, A SHORT HISTORY OF THE ENGLISH PEOPLE 251 (1911). Lawyers did not fare well at the hands of the peasants. In Blackheath, they killed every lawyer they could lay their hands on, shouting "[n]ot till all these were killed would the land enjoy its old freedom again." *Id.* at 252.

[56] MAITLAND, *supra* note 32, at 7.

[57] *See generally, id.* at 34-39.

[58] *Id.* at 38.

ever, if the trust directed the trustee to collect rents and profits and pay them to the beneficiary during his life, the trustee had active duties and the Statute of Uses did not apply.[59]

Together, these developments revolutionized the law of conveyancing in England.[60] As the feudal system dissolved in England, the trust changed from a land-holding device to a means for actively managing financial assets.[61] This evolution continued in colonial America through the present time.[62] Three aspects of the trust's development in feudal England foreshadowed the modern evolution of the supplemental needs trust in the United States: 1) it avoided rigid application of legal doctrine; 2) it was used to alleviate the economic position of a beneficiary who would otherwise be impoverished; and 3) the Court of Chancery used equitable principles to go beyond technical legal rules that were no longer required by public policy.

B. *Origins and Development of Trusts in the United States*

Some of the earliest known trust arrangements in colonial America appeared in the seventeenth century. A physician in Maryland created a trust for his wife and children to avoid liability for potential damages in a lawsuit.[63] In a less formal arrangement, a woman in Massachusetts entered into a verbal trust-like arrangement with her future husband to provide for her children and prevent her husband from controlling her property.[64]

At the end of the eighteenth century and into the mid-nineteenth century, southern slave owners created trusts in their wills as a way to emancipate slaves.[65] These trusts challenged chancellors in courts of equity to decide whether the intent of the testator to free his slaves should be honored against the claims of descendants and in violation of statutes that prohibited a person to manumit slaves.[66] These "slave suits" attracted national attention and embroiled public policy in turmoil.[67] Typically, the trust directed the trustee to free the beneficiaries when the law permitted.[68] Thereafter, when the law was amended to allow manumission, the "next

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[59] *Id.* at 39.

[60] *See* SCOTT, *supra* note 38, at 4.

[61] Langbein, *supra* note 34, at 636.

[62] *Id.*

[63] LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 63-64 (2d ed. 1985).

[64] *Id.*

[65] PETER CHARLES HOFFER, THE LAW'S CONSCIENCE 112-19 (1990). These trusts were in the form of express trusts in which the testator clearly stated his intent, implicit trusts that required the chancellor to discern intent a bit, and so-called "secret trusts" in states that prohibited testamentary trusts. *Id.* In addition, the equitable remedy of the constructive trust was used to prevent the unjust enrichment of a person who attempted to appropriate the land of freed slaves. *Id.* at 115 (*citing* Shaw v. Brown, 35 Miss. 246 (1858)).

[66] *Id.* at 112.

[67] *Id.* Among the public policy issues Chancellors had to decide was the question of whether slaves had standing to petition and obtain relief.

[68] *Id.* at 113 (describing the case of Pleasants v. Pleasants, 2 Call 319 (1799)). The Chan-

friends" of the slaves could petition the chancellor.[69] A favorable ruling in this kind of case would order the beneficiaries' release from bondage and perhaps also order that they be paid wages for the time they were not free.[70] Despite significant opposition and restrictions on the scope of the chancellor's discretion, "trusteeship was a still, small voice for equality and testators heard it."[71] Unfortunately, decrees that refused to uphold equality far outnumbered the cases that recognized and enforced trusts established to free slaves.[72]

In the nineteenth century, the spendthrift trust continued as a way to provide for vulnerable family members (including "married women, minors, incompetents"), while preventing the beneficiaries and their creditors from reaching the trust assets.[73] It was not unusual for a parent to place property in trust for the benefit of a daughter whose husband was "insolvent."[74] If a son was a debtor, a parent could give property to him as trustee, for the purpose of managing it for the benefit of his children, with the right to be paid a reasonable income from the trust.[75]

Trusts were also established for the benefit of wealthy families, corporations, and religious institutions. Families perpetuated their "dynasties" by utilizing trusts to preserve wealth and hold land for generations.[76] The populace viewed dynastic

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cellor who decided Pleasants was George Wythe, Thomas Jefferson's mentor.

[69] *Id.*

[70] This was the result in Pleasants, *supra* note 68. Hoffer describes how testators in North Carolina and South Carolina used "secret trusts" after statutes were enacted prohibiting testamentary slave trusts. HOFFER, *supra* note 65, at 113.

[71] *Id.* at 114. In South Carolina, Judge John Belton O'Neall permitted secret trusts and exercised great lengths (and apparently tortured logic) to serve freedom, even after the legislature eliminated the court on which he sat and passed statutes that extinguished any gifts to slaves that "[a]nticipated their manumission." *Id.* at 115. Unfortunately, Judge O'Neall rationalized his decisions by stating that the institution of slavery could only survive with a "kindly spirit." *Id.* at 116.

[72] *Id.* at 115-19.

[73] *Id.* at 251-55. *See generally* Gregory S. Alexander, *The Dead Hand and the Law of Trusts in the Nineteenth Century*, 37 STAN. L. REV. 1189 (1985).

[74] HOFFER, *supra* note 65, at 251-52 (describing the arrangement Thomas Jefferson made for his daughter).

[75] *Id.* at 252. The purpose of giving the property to the son in his capacity as trustee, and not outright to him individually, was to prevent his creditors from reaching the assets.

[76] *Id.* at 240, 252-55. Friedman makes the point that wealthy individuals and families have used the trust to preserve "dynastic" wealth despite the Rule Against Perpetuities, which limits the duration of trusts that are not charitable to a period of approximately 100 years. A dynastic trust prevented the sale of land by current beneficiaries and prevented the land's use as an article of commerce. The general rule purports to limit the length of time property interests can be suspended without vesting in an individual to 21 years after the death of a life in being upon the creation of the interest. In simple terms, if a person creates a trust, and the measuring lives are the creator's children, the trust must vest full ownership in a beneficiary within 21 years after the death of the last surviving child. The Rule Against Perpetuities is infamous for its complexity and has been the subject of much scholarly analysis. *See, e.g.*, JOHN CHIPMAN GRAY, THE RULE AGAINST PERPETUITIES (4th ed. 1942); Jesse Dukeminier, *A Modern Guide to Perpetuities*, 74 CAL. L. REV. 1867 (1986).

family trusts negatively because they supported the upper class and, by keeping land out of commerce, clashed with emerging values of the market place.[77] Another form of dynastic trust was the charitable trust, which held land and chattels for the benefit of religious groups.[78] Not surprisingly, the religious charitable trust was also unpopular because it was "associated with privilege, with the dead hand, with established churches, with massive wealth held in perpetuity."[79] At the end of the nineteenth century, the trust was used to purchase the stock of competing corporations in order to create monopolies that choked competition. The Sherman Act outlawed these types of trusts. The association of the trust with these dynastic and monopolistic purposes tarnished the trust's image.

In twentieth-century America, use of the trust for an expanding variety of purposes continued and, at the beginning of the twenty-first century, trusts will be practically ubiquitous.[80] In the private sphere they are used as estate planning devices to minimize estate taxes,[81] as perpetuators of dynastic wealth,[82] and as a way to preserve assets against the improvidence of a beneficiary and his creditors.[83] The largest growth of the trust has been in the area of commercial trusts, which have become the dominant structure for the management of mutual funds, pensions, and other assets that constitute a significant portion of personal and national wealth.[84]

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[77] FRIEDMAN, *supra* note 63, at 253.

[78] HOFFER, *supra*, note 65, at 128. Spendthrift and charitable trusts maintained the status quo and conflicted with the rise of the entrepeneurship that began in the 1830s. In 1865, President Johnson ordered the Freedman's Bureau to return land over which it had acted as trustee for the benefit of slaves to the former owners. Hoffer analogizes the return of the white landowners to a "repudiation of the trust." *Id.* At this historical juncture, Hoffer points out that President Johnson argued the case for those who wanted to liberalize trust law while the Radicals supported a more traditional view of trusts. *Id.*

[79] *Id.* at 254.

[80] *See, e.g.*, Joel C. Dobris, *Changes In The Role And The Form Of The Trust At The New Millennium, Or, We Don't Have To Think Of England Anymore*, 62 ALB. L. REV. 543 (1998).

[81] The marital trust and credit shelter trusts are familiar terms of art for trusts that provide for beneficiaries of trusts and minimize estate and gift taxes. The credit shelter trust effectively doubles the size of an estate that is exempt from estate tax without depriving the intended beneficiary (typically the surviving spouse) of the use of the property.

[82] *See generally,* Lawrence M. Friedman, *The Dynastic Trust*, 73 YALE L.J. 547 (1964).

[83] This is commonly known as the "spendthrift trust," a source of much controversy and commentary. *See, e.g.*, JOHN CHIPMAN GRAY, RESTRAINTS ON ALIENATION 1x (2d ed. 1895); ERWIN N. GRISWOLD, SPENDTHRIFT TRUSTS (2d ed. 1947); Adam J. Hirsch, *Spendthrift Trusts and Public Policy: Economic and Cognitive Perspectives*, 73 WASH. U. L. Q. 1 (1995); Anne S. Emanuel, *Spendthrift Trusts: It's Time to Codify the Compromise*, 72 NEB. L. REV. 179 (1993). The spendthrift trust has been called a "close relative" of the supplemental needs trust. *See* Hirsch, *supra* at 82-83.

[84] Within the 20th century United States, charitable trusts and private trusts have been dwarfed by the rise of the commercial trust. For a discussion of commercial trusts (e.g., pension trusts, investment trusts, and other forms of trust that are contractual exchanges in contrast to personal trusts which are funded by gratuitous transfers) and why, despite holding 90% of trust assets in the United States, they have been largely ignored by scholars and

In the public domain, the role of the charitable trust[85] has increased with the emergence of philanthropies as a positive force in American culture. The rise of the charitable trust is also due in no small measure to the unlimited tax deductions and exemptions which provide incentives for the wealthy to give to charities in order to reduce their taxable income and avoid estate taxes.

II. A BRIEF COMPARISON OF THE SUPPLEMENTAL NEEDSTRUST WITH ITS CLOSEST TRUST "RELATIVES"

The rise of the modern welfare state shaped the structure and role of trusts for people with disabilities who qualified for government benefits. The name "supplemental needs trust" refers to a form of private trust for the benefit of a disabled beneficiary who receives means-tested government benefits. The trust is designed so that it will not be considered an available resource under the eligibility rules for Supplemental Security Income and Medicaid, the major means-tested benefit programs. Although a trustee is usually given a fair amount of discretion regarding distributions, if the intent to supplement the beneficiary's government benefits is explicit, the trust will not affect the beneficiary's eligibility for benefits.[86]

The SNT is part of a broader "family" of trusts that includes spendthrift trusts, support trusts, and discretionary trusts. Although each form of trust is discussed separately, their distinctive elements are often combined in a hybrid form of trust.

A. *Spendthrift Trusts: Protecting Trust Assets from the Beneficiary and Creditors*

A "classic" spendthrift trust is a "third-party" trust that provides income to (or for the benefit of) a beneficiary.[87] If the trustee of a spendthrift trust is authorized to distribute principal, a "disabling restraint" may prevent the beneficiary from assigning her right to principal.[88] A "self-settled"[89] trust that attempts to avoid the claims of the creator's creditors, including government agencies, is void as a matter of public policy in most states.[90] Most jurisdictions, however, allow a property do-

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trusts and estates attorneys, see John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 YALE L.J. 165 (1997).

[85] Charitable trusts are governed by I.R.C. § 501(c)(3)(West 2000).

[86] *See infra* Part III.A.3.

[87] The leading case recognizing a spendthrift provision restricting the alienation of a beneficiary's income is Broadway National Bank v. Adams, 133 Mass. 170 (1882). This is the case that provoked Professor John Chipman Gray's suggestion that judges who upheld spendthrift provisions were motivated by paternalism, which Gray called the "[t]he fundamental essence alike of spendthrift trusts and of socialism." WILLIAM F. FRATCHER, SCOTT ON TRUSTS, 4th Ed. § 152 at 90 (quoting Gray, Restraints on Alienation 1x (2d ed. 1895)).

[88] FRATCHER, *supra* note 87 § 153, at 130.

[89] A self-settled trust is a trust created and funded by a person for his own benefit.

[90] FRATCHER, *supra*, note 87, § 156 at 164. *See, e.g.*, N.Y. Est. Powers & Trusts 7-3.1(a): "A disposition in trust for the use of the creator is void as against the existing or subsequent creditors of the creator." Alaska and Delaware are unique in that they have enacted "asset protection" statutes that enable a person to create a self-settled trust that is insulated from

nor to create a "third-party" trust for the benefit of another person who will not be subject to claims of the beneficiary's creditors.[91]

A spendthrift trust prevents an irresponsible, indebted, or incapacitated beneficiary[92] from assigning or alienating her right to the income.[93] Creditors of the beneficiary are not able to attach the income of the trust. [94] The spendthrift trust has been criticized for enabling a beneficiary to enjoy the benefits of personal wealth with no accountability to creditors and dependents.[95] To remedy this potential inequity, some courts and legislatures have recognized exceptions for certain classes of creditors and dependents: government agencies to collect taxes[96] or reimbursement for necessaries,[97] tort plaintiffs,[98] and dependent children.[99] Statutes may also allow the principal of a spendthrift trust to be invaded if the income is not sufficient to provide for the basic support of the beneficiary.[100]

The question of fairness arises with regard to the third-party spendthrift trust, but despite a variety of practical and theoretical critiques,[101] it has endured and gained acceptance in virtually all jurisdictions in the United States.[102] Spendthrift provisions are often incorporated into support and discretionary trusts as "extra protection." However, the structure of each of these trusts offers its own protection against alienation by the beneficiary and the claims of creditors.

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creditors. *See* ALASKA STAT. § 34.40.110 (Michie. 1998); DEL. CODE. ANN. TIT. 12 §§ 3570-76 (1998).

[91] *See, e.g.,* Broadway National Bank v. Adams, 133 Mass. 170 (1882) (upholding restraint on alienation and reasoning that creditors are not defrauded because it is possible for them to discover the restraint on alienation and also their position is no worse than if the trust terminated the beneficiary's interest upon alienation); *see also* Nichols v. Eaton, 91 U.S. 716 (1875) (recognizing the right of a person to establish a discretionary trust that will be immune from the beneficiary's creditors, and rejecting the position of the English Chancery Court that a trust is available to satisfy a beneficiary's creditors regardless of the donor's intent). A third-party trust is created and funded by a person for the benefit of another. The English courts have not recognized spendthrift trusts, except if the beneficiary is a married woman. FRATCHER, *supra* note 87 § 152, at 85.

[92] These are the archetypal kinds of beneficiaries of spendthrift trusts.

[93] For a complete discussion of restraints on voluntary and involuntary alienation of a beneficiary's interest see FRATCHER, *supra* note 87 §§ 149-162, at 74-240.

[94] *Id.*

[95] John Chipman Gray argued vociferously against the spendthrift trust on the basis that it was shocking to allow a person to enjoy wealth without responsibility by receiving income without paying debts. *Id.*

[96] *Id.* § 157.4, at 210.

[97] *See, e.g., In re* Lackmann's Estate, 320 P.2d 186 (Cal. Ct. App. 1958).

[98] *Id.*

[99] *See* GEORGE T. BOGERT, TRUSTS at 156 (6th ed. 1987).

[100] *See, e.g.,* N.Y. EST. POWERS & TRUSTS §7-1.6 (West 2000).

[101] *See supra* note 83.

[102] In contrast, the spendthrift trust has never been allowed in England. FRATCHER, *supra* note 87 § 152, at 85-92.

B. *Support Trusts: A Basic Standard of Living (At Least)*

A support trust typically directs the trustee to distribute the amount of income and principal necessary to provide for the education and maintenance of the beneficiary.[103] Because the trustee has a duty to use the trust for its intended purposes, the beneficiary of a support trust does not have the power to assign his interest and it is protected against creditors.[104]

However, a trust that authorizes the general support of the beneficiary will generally result in a partial or total loss of eligibility for means-tested government benefits because the income and principal will be considered available to the beneficiary.[105]

C. *Discretionary Trusts: It's All Up to the Trustee*

A "pure" discretionary trust gives the trustee complete discretion to decide when and how to distribute income and principal or to withhold distributions completely.[106] The beneficiary of a discretionary trust does not have an enforceable interest in the trust because the trustee is not required to distribute income or principal.[107] Creditors of the beneficiary also cannot force the trustee to make a distribution.[108] However, a person cannot create a discretionary trust for his own benefit in order to avoid the claims of creditors.[109]A pure discretionary trust will generally not be considered "available" to the beneficiary, unless the creator of the trust intended to provide support to the beneficiary.[110] The trustee's refusal to make any distributions may be considered an abuse of discretion.[111]

D. *Supplemental Needs Trusts: A Hybrid Form of Trust Intertwined with Government Benefits*

The supplemental needs trust is essentially a hybrid form of trust that contains elements of a spendthrift, support, and discretionary trust. As a form of third-party spendthrift trust, the beneficiary cannot assign his or her interest in the income or principal and the trust is insulated from the claims of most of the beneficiary's

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[103] RESTATEMENT (SECOND) OF TRUSTS § 154 (1959); BOGERT, *supra* note 99, at 162.

[104] BOGERT, *supra* note 99, at 162.

[105] *See, e.g.*, Bennett v. Sawyer County, 357 N.W.2d 7 (Wis. Ct. App. 1984) (compelling trustee to make payments of principal for beneficiary's health care because trust authorized support); McNiff v. Olmsted County Welfare Dep't, 176 N.W.2d 888 (Minn. 1970) (finding trust intended to provide general, not supplemental, support).

[106] BOGERT, *supra* note 99, at 160. *See also* Edward C. Halbach, Jr., *Problems of Discretion in Discretionary Trusts*, 61 COLUM. L. REV. 1425 (1961).

[107] BOGERT, *supra* note 99, at 160.

[108] *Id.* at 161.

[109] *Id.* at 162.

[110] *Id.* at 161 n.4.

[111] *Id.* at 161. For a discussion of discretionary support trusts for beneficiaries receiving government benefits see infra Part III A.1.

creditors.[112]

The underlying theory of the supplemental needs trust, and the circumstances of the disabled beneficiary, are qualitatively different from a typical spendthrift trust. A classic depiction of the beneficiary of a spendthrift trust is one who is an irresponsible and lazy heir of a wealthy family who gets enough income from the trust to prevent destitution.[113] The assets of the spendthrift trust are protected from the beneficiary's profligate spending and from the trail of creditors created by the beneficiary's irresponsible ways.[114]

In contrast, the beneficiary of a supplemental needs trust has a severe, often permanent, disability that prevents her from supporting herself adequately through employment. The beneficiary of an SNT is usually one who is struggling through life despite daunting odds, considerable physical and/or cognitive limitations, and insufficient public support. The SNT is structured so that the beneficiary qualifies for the widest array of government benefits including basic income support, medical care, and other basic needs.

The supplemental nature of the SNT distinguishes it from the kind of general support that is most commonly associated with a support trust. Similarly, it is different from a pure discretionary trust. Although the trustee of the SNT has a large area of discretion, the purposes of the trust are sufficiently specific to give the beneficiary an arguable claim for a certain level of distributions.

III DEVELOPMENTAL STAGES OF THE SUPPLEMENTAL NEEDS TRUST

The modern supplemental needs trust emerged out of a synthesis of trust jurisprudence, the financial eligibility criteria of means-tested government benefits for people with disabilities, and the evolution of public policy. Three significant developmental stages mark the law's response to this new situation: 1) case law interpreting third-party trusts established for a beneficiary receiving government benefits;[115] 2) state legislative action authorizing the use of third-party trusts as a

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[112] *See infra* Part III.A.

[113] Hirsch, *supra* note 83; Mary Louise Fellows, *Spendthrift Trusts: Roots and Relevance for Twenty-First Century Planning*, 50 THE RECORD 140 (Association of the Bar of the City of New York 1995).

[114] Although support and discretionary trusts are alternatives to a spendthrift trust in that the scope of the beneficiary's enforceable interest is restricted, spendthrift provisions are frequently incorporated into support and discretionary trusts. See Hirsch, *supra* note 84, for a criticism of this practice. However, the analysis of third party SNT's frequently includes an inquiry whether the trust is spendthrift. *See infra* Part III.A.

[115] This discussion is limited to third-party trusts (i.e., a trust created by a person other than the beneficiary), because in almost every state it is against public policy for a person to establish a "self-settled" trust, fund it with her own assets, name herself as a beneficiary, and protect those assets from creditors. A notable exception was created in the Omnibus Budget Reconciliation Act of 1993, which authorized trusts funded with assets received by a disabled Medicaid recipient provided the trust complied with the requirements of the statute. *See infra* Part III.C. Public policy toward self-settled trusts is reflected in RESTATEMENT (SECOND) OF TRUSTS § 156:

supplement to government benefits; and 3) the passage of the federal Omnibus Budget Reconciliation Act of 1993, which authorized a disabled person to transfer assets into a trust without jeopardizing his or her eligibility for Medicaid.

A. *Courts Analyze Trust Language, Statutes, and Public Policy to Determine the Availability of Third-Party Trusts*

The validity of third-party trusts established and funded by parents (and other third parties) to protect disabled beneficiaries depends, to a large extent, on the law in a particular state. The context of these cases usually involves a government agency's claim that the trust assets should be considered available, either to reimburse the agency for benefits already paid to the beneficiary, or as a basis for denying or terminating benefits because the trust constitutes an excess resource.[116] The courts uniformly state that the intent of the creator of the trust is dispositive, and attempt to clarify that intent by examining the following factors: 1) whether the intent of the creator of the trust is clear based on the trust language, or whether it is necessary to examine the circumstances surrounding the creation of the trust; 2) how the particular form of trust is treated under the relevant state trust statutes and the eligibility rules for the government benefits at issue; and 3) whether there are superceding principles of public policy that dictate a particular result.

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(1) Where a person creates for his own benefit a trust with a provision restraining the voluntary or involuntary transfer of his interest, his transferee or creditors can reach his interest.

(2) Where a person creates for his own benefit a trust for support or a discretionary trust, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply to his benefit.

Id. The exceptions are Delaware and Alaska, each of which have enacted "asset protection" statutes that allow individuals to transfer assets into a trust, retain a beneficial interest, and limit the ability of creditors to attach the trust assets. *See* ALASKA STAT. § 34.40.110; DEL. CODE ANN. TIT. 12 §§ 3570-76. *See also,* Amy Lynn Wagenfeld, *Law for Sale: Alaska and Delaware Compete for the Asset Protection Trust Market and the Wealth that Follows*, 32 VAND. J. TRANSNAT'L. L. 831 (May 1999). The availability of trusts under the SSI and Medicaid programs, including these asset protections trusts, will nevertheless depend on the language of the trust document within the framework of the applicable SSI and Medicaid statutes. It is usually easy to distinguish between third-party trusts and self-settled trusts. The trust is considered to be self-settled when it is funded with assets owned by the beneficiary, even if the trust is created by another person or entity. *See, e.g., In re* Estate of Hickey, 635 N.E.2d 853 (Ill. App. Ct. 1st Dist. 1994) (holding that beneficiary is the true settlor of trust created by insurer and funded with settlement of personal injury lawsuit). *Cf.* Trust Company of Oklahoma v. State Department of Social Services, 825 P.2d 1295 (Sup. Ct. Oklahoma 1991), *cert. denied* 506 U.S. 906 (1992). For self-settled trusts established prior to OBRA '93, this meant that the excess assets had to be spent before the beneficiary could qualify for Medicaid.

[116] *See infra* Part III.A.

The following sections are organized by rough categorical groupings: 1) discretionary support trust cases; 2) cases that involve primitive supplemental support language and strong statements of public policy; and 3) cases in which courts determine a trust's availability by relying on federal law, language in the trust that clearly demonstrates an intent to supplement without replacing government benefits, or a combination of these elements. These cases illuminate how elements of language, law, and public policy converge to influence a court's decision. The issue in each case is whether a trust is an available resource for the support of a beneficiary who receives government benefits.

1. Discretionary Support Trusts: Courts Reach Unpredictable Results

A trustee is not permitted to abuse any discretionary powers granted in the trust instrument. If a trustee is granted "discretion" to decide what level of support is appropriate or necessary, a court may apply a reasonableness standard and subject the trustee's decisions to a high level of scrutiny.[117] If the trust grants "absolute" or "sole" discretion, the trustee may be given more deference according to an "arbitrary and capricious" standard.[118] The scope of the trustee's discretion is the primary basis for a court's use of either a "reasonable" or "arbitrary" standard. The difference in these standards reflects a range of what constitutes abuse along the same continuum of discretion.[119]

Cases such as these had to be litigated because the intent of the creator of the trust and the applicable statutes did not clearly resolve the issue of availability.[120] The key issue is whether it is an abuse of discretion for a trustee to decide not to provide basic support for a beneficiary who is eligible for means-tested government benefits. The split in the courts involving cases with similar trust language and factual circumstances suggests that a court's assessment tends to reflect its view of public policy, rather than a predictable application of interpretive principles or statutory law.[121]

a. Resolving the Impasse By Requiring the Trustee to Support the Beneficiary

In *Bureau of Support in Department of Mental Hygiene and Correction v. Kreit-*

[117] *See, e.g.*, RESTATEMENT (THIRD) OF LAW ON Trusts § 187(j).

[118] *Id.* (stating that a trustee may act unreasonably, but may not arbitrarily disregard the purpose of the settlor).

[119] Lang v. Commonwealth Department of Public Welfare, 528 A.2d 1335, 1343 (Pa. 1987) (*citing* Lawrence Frolik, *Estate Planning for Parents of Mentally Disabled Children*, 40 U. PITT. L. REV. 305, 328 (1979)).

[120] The lack of clarity in the trust results from the use of general language that does not specifically address whether the trustee should take into account the beneficiary's eligibility for government benefits in deciding whether the trust should be used for basic support. In addition, there may be state "welfare" statutes that define indigence that conflict with trusts statutes or common law that respect the trustee's exercise of discretion unless it is arbitrary.

[121] *See infra* at 39-58.

zer,[122] the Supreme Court of Ohio stated that a trustee with "sole and absolute" discretion to provide for the "care, comfort, maintenance and general well-being" of the beneficiary could be compelled to provide basic support if the beneficiary was destitute.[123] The court identified an "impasse" that created a Catch-22: if the State fulfilled its obligation to meet the beneficiary's needs, the trustee could reasonably decide that it was not necessary to use the trust to provide for the beneficiary. Therefore, it would never be necessary to provide basic support to a beneficiary who received subsistence government benefits. Relying on a novel (albeit questionable) theory of subrogation to resolve this dilemma, the court held that the State could enforce whatever rights the beneficiary had in order to compel distributions from the trust. In essence, the court disregarded the language of the trust in favor of the right of the government to be reimbursed from the trust property. The court's theory nullified the creator's apparent intent to allow the trustee to exercise "sole and absolute" discretion in deciding whether distributions were necessary. The Court elevated the State to a "super" creditor and created an exception to the general rule that a trustee of a discretionary trust may exercise her discretion without disruption.

In an earlier case decided in 1958, an appellate state court in California similarly held that it was an abuse of discretion when a trustee refused to make payments for the support of a beneficiary residing in a state hospital because of mental illness.[124] The relevant provision of the trust first directed the trustee to pay for the "proper care, support, and maintenance" of the beneficiary, and then gave the trustee "complete and absolute discretion" as to how much should be expended.[125] The state's discretionary trust statute clearly applied to the trust and supported the trustee's decision not to make payments for the beneficiary's basic support.[126] Curiously, the court relied on two California welfare statutes that were not directly applicable,[127] and a New York case that directed reimbursement of the State by the trustee of a discretionary trust.[128] The court held that the public policy of California requires that the assets in a spendthrift trust can be used to support a beneficiary who is a recipient of public benefits.[129] The court stated that it "[w]ould be unreasonable to

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[122] 243 N.E.2d 83 (Ohio 1968).

[123] *Id.* at 85, 86.

[124] *In re* Estate of Lackmann, 320 P.2d 186 (Cal. Dist. Ct. App. 1958).

[125] *Id.* at 188.

[126] The language of the statute was as follows: "[A] discretionary power conferred upon a trustee is presumed not to be left to his arbitrary discretion, but may be controlled by the property Court if not reasonably exercised, unless an absolute discretion is clearly conferred by the declaration of trust." *Id.* at 189.

[127] The statutes in question, Sections 6555 and 6550 of the Welfare and Institutions Code, concerned liability for the support of a mentally ill person by a guardian, certain relatives, and the estate of the mentally ill person. The court explained that "estate" includes the "beneficiary interest." *Id.* However, this analysis was in direct conflict with the controlling statute governing discretionary trusts.

[128] *In re* Gruber's Will, 122 N.Y.S.2d 654 (Sur. Ct. Monroe County 1953).

[129] Estate of Lackman, 320 P.2d at 189.

hold that any discretion given a trustee in the administration of a trust for another's care could enable the trustee to cast his care and maintenance on the state."[130]

In *McNiff v. Department of Public Welfare*,[131] a Minnesota court presumed that the creator's intent was to use the trust assets to provide basic support so the beneficiary would not have to be dependent on government benefits. This analysis focused more on the intent of the creator, rather than the decision of the trustee within the context of the applicable state law. The underlying theme embraced by the court is that public assistance is a charitable benefit that is provided through the largesse of government, rather than because of an entitlement.[132]

In *Button v. Elmhurst National Bank*,[133] a parent established a discretionary trust for the primary benefit of a mentally ill son, as well as for permitting distributions for his other child.[134] Despite discretionary language, the court based its conclusion on prior decisions that a spendthrift trust could be considered part of a beneficiary's estate and on Illinois public policy that seeks payment for the state's costs from those recipients with the means to pay.[135]

After finding that the language of the trust was not clear, the court looked to circumstances surrounding the execution of the trust in order to determine the settlor's intent. The court assumed that the settlor knew that, under Illinois law, he would be required to reimburse the government agency for services provided to his son while residing in a public institution. If the trust did not specifically provide otherwise, that court held that "[I]t is more likely the trust was intended to pay for such

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[130] *Id.* at 187-88.

[131] 176 N.W.2d 888 (Minn. 1970).

[132] *See also, In re* Estate of Dodge, 281 N.W.2d 447, 450 (Iowa 1979) (holding that a third-party spendthrift support trust was available to reimburse the mentally ill beneficiary's sister for "necessaries" she purchased for the beneficiary which consisted mostly of nursing home expenses.)

[133] 522 N.E.2d 1368 (Ill. App. Ct. 2nd Dist. 1988).

[134] *Id.* The relevant language in the trust read as follows:

> My son, KENNETH CHARLES BUTTON, has from time to time been mentally ill, and it is my primary concern that his maintenance and support be adequately provided for. I have one other child, my daughter, BEVERLY BUTTON BERNHARDT. Upon the death of my wife, or upon my death if she predeceases me, the Trustee shall hold all the Residuary Trust, as then constituted, as a single trust so long as my said son, KENNETH CHARLES BUTTON, shall be living. In the meantime, the Trustee shall use or expend and apply so much or all of the income or principal from the Trust as the Trustee deems necessary, in such manner as it deems best, for the medical care, support, education and welfare of either child of mine. The Trustee may use the same entirely for the benefit of one of my children to the exclusion of the other and may completely exhaust the principal of the Residuary Trust for the maintenance and support of either child of mine, rather than preserve the principal for distribution upon the termination of the Trust.

Id. at 1370-71.

[135] *Id.* at 1375 (*citing* Department of Mental Health & Developmental Disabilities v. Philips, 500 N.E.2d 29 (Ill. 1986)).

charges."[136] Perhaps the decisive factor was the amount of assets in the trust, which were large enough to reimburse the government agency and still provide for the beneficiaries.

A recent case decided by the Supreme Court of North Dakota, *Kryzsko v. Ramsey County Social Services*,[137] also illustrates the influence of public policy on a court's analysis. Margaret Kryzscko is described as a "52-year-old mentally disabled woman."[138] Margaret's deceased father created a trust for her in his will, which was funded with $32,000.[139] The local Medicaid agency determined that the assets in the trust were an available resource that made Margaret ineligible for Medicaid benefits.[140] The trust contained the typical "discretionary support" language that has engendered so much litigation:

> I devise Margaret Lee Kryzsko. . .share of my estate to my Trustee to administer said share for the benefit of her by paying to or applying for her benefit *so much of the income and/or principal of such share as the Trustee, in her sole discretion, thinks necessary or advisable to provide for the proper care, maintenance, support, and education of Margaret Lee Kryzsko*. . .provided, that the Trustee must make at least an annual distribution of the Trust income, or more frequent distribution as the Trustee, in its sole discretion deems necessary. . . .[141]

Although the court states that the "key issue" is whether the trust is a support trust or discretionary trust, it acknowledges that the trust contains elements of both.[142] The court states that a preponderance of the evidence supported the Department's finding that "[T]here is no indication the trustor intended the trust should not be used to provide primary support or maintenance for Ms. Kryzsko."[143] The court concludes that the "[p]lain language of the trust demonstrates an intent by the trustor to provide for the future support and care of Ms. Kryzsko."[144]

The dissent in *Kryzsko* argued that the language of the trust clearly expressed the intent to create a discretionary trust, which would not be counted as an available asset.[145] The dissent pointed to the following: 1) the trustee had "sole discretion"

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[136] *Id.* at 1378. At the time, the applicable statute made parents responsible for services provided to individuals in a State hospital without regard to the individual's age. The court failed to mention that this legal responsibility ended upon the death of the parent.

[137] 607 N.W.2d 237 (N.D. 2000).

[138] *Id.* at 238.

[139] *Id.*

[140] *Id.*

[141] *Id.* at 240 (emphasis added).

[142] Under North Dakota law, a support trust is available to a Medicaid applicant or recipient, but a discretionary trust is not. *Id.* at 239 (*citing* N.D. ADMIN. CODE § 75-02-02.1-31(3)(4)). The court distinguished its decision from an earlier case, Hecker v. Stark Cty. Social Serv. Bd., 527 N.W.2d 226 (N.D. 1994). In Hecker, the trust gave the trustee "sole discretion" to determine when it was "necessary or advisable" to provide for the beneficiary's special needs. Kryzsko, at 240 (*citing* Hecker, 527 N.W.2d at 228).

[143] Kryzsko, 607 N.W.2d at 244.

[144] *Id.*

[145] *Id.*

over the trust; 2) the trustee had sole discretion, after making at least one annual distribution of trust income, to decide if more income was "necessary or advisable;" and 3) the trust was only funded with $32,000 which was too small a sum to provide for the beneficiary's support during her lifetime.[146] The crux of the dissent is that giving the trustee discretion makes the trust unavailable, even if the discretion is to be exercised within a standard of support.

The *Kryzsko* case demonstrates that the issue of the trust's availability depends on how a court views the underlying policy behind the rule of law. The trustee had a duty to provide a "proper" level of support and there is no question that the beneficiary had a right to seek redress in court if she believed the trustee was abusing her discretion. However, the trust does not indicate how the beneficiary's eligibility for Medicaid should be factored into the trustee's exercise of discretion. The court professes to find a clear intent that the trustee should provide support, quoting an authoritative treatise which states that if a trustee is "[d]irected to pay as much of the income and principal as is necessary for the support of a beneficiary, he can be compelled to pay at least the minimum amount which in the opinion of a reasonable man would be necessary."[147]

Alas, what is "necessary" in the opinion of a "reasonable man?" Would a "reasonable woman" answer the question differently? Is it necessary to provide basic support to avoid having the beneficiary qualify for government benefits? Does the receipt of government benefits make it unnecessary to provide basic support or medical expenses? The answers to these questions depend on one's attitudes about poverty, the nature of government benefits, disability, donative freedom, and the role of private assets to provide basic support to a needy individual.

The underlying assumption of the courts that have held these trusts to be an available resource is that the creator would not have wanted the beneficiary to receive government benefits before the trust assets were depleted. This assumption is predicated on a view of government benefits as charity, and not as an entitlement. However, an alternative analysis of the synthesis of "discretion" and "support" within the context of public policy informed the decision of other courts faced with similar ambiguities of language and intent.

b. Another Perspective on Reasonable Discretion: An Entitlement Theory of Public Policy

A parallel line of cases holds that a discretionary support trust is not available to the beneficiary receiving government benefits. Some courts use a relatively simple analytical approach: they emphasize the grant of discretion to the trustee as the critical factor, and treat the support language as "[a]n insignificant limitation on the trustee's discretionary powers."[148]

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[146] *Id.*

[147] *Id.* at 241-42 (*citing* WILLIAM F. FRATCHER, SCOTT ON TRUSTS § 187 (1988)).

[148] This was the approach taken in Chenot v. Bordeleau, 561 A.2d 891 (R.I. 1989). In Chenot, the father of a mildly mentally retarded adult created a trust that directed the trustee to pay all or a portion of the income and principal for the son "[a]s the said trustee, in its sole

In *Lang v. Commonwealth Department of Public Welfare*,[149] the beneficiary, William LeViseur, was an adult who had lived in state institutions from the time he was diagnosed with "Idiopathic Epilepsy" and "Mental Deficiency as a thirteen year old in 1946."[150] The trust at issue was created by the beneficiary's father for the benefit of his four children, including William, and was funded with approximately $118,000.[151] The relevant portions of the trust stated that:

> (1) During the lifetime of my son, WILLIAM GEORGE LeVISEUR, if he survives me, the Trustee shall pay the Income periodically to or for the support, maintenance, welfare and benefit of my said son or may, in the Trustee's discretion, add part or all of the Income to principal, to be invested as such.
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> (2) The Trustee may distribute such part of the Income not necessary for the support of my son, in equal shares to my three children. . .
>
> (3) The Trustee shall use so much of the principal as may in her opinion be advisable therefor, for the support, maintenance, welfare, comfort and support of my son, WILLIAM GEORGE LeVISEUR. The Trustee shall have complete discretion as to how much shall be used for such purposes and may pay the sums to any person or institution having the care of my said son, without liability on the part of the Trustee to see to the application thereof, or directly to or for the benefit of my said son. . . .[152]

The court held that the trustee had the power, but not the duty, to support the beneficiary who therefore could not compel the trustee to provide support if adequate public funding was available.[153] The court explicitly disavowed the lower court's "implication" that receiving welfare was not in the beneficiary's interest.[154] Noting that a parent's legal duty of support ended when a child reached the age of 18, the court asserted that the policy of the state's mental health law, "[d]oes not reflect this vision of public assistance as charity and the consequent assumption that a settlor intended to exhaust his family's patrimony before his beneficiary could take advantage of public funds."[155]

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and uncontrolled discretion, shall deem necessary or advisable for his comfort, support and welfare." *Id.* at 892. Apparently the trust also named a daughter as a beneficiary, but expressed the intent that the trustee shall exercise its discretion primarily for the benefit of the disabled child "[b]ecause of his special needs and circumstances." *Id.* at 892-93. The court also noted that the will granted the trustee sole discretion in six different places, which reflected the testator's emphasis on the trustee's discretion powers over his duty to support the beneficiary. *Id.* at 894.

[149] 528 A.2d 1335 (Pa. 1987).

[150] *Id.* at 1339.

[151] *Id.* After the father's death, Pennsylvania amended its laws so that the duty to support a person receiving services under the Mental Health Act ended when the beneficiary reached the age of eighteen. *Id.* at 1340.

[152] *Id.* at 1340-41 (emphasis omitted).

[153] *Id.* at 1341.

[154] *Id.* at 1342.

[155] *Id.* The court also identified the following indicia of the testator's intent to consider

The *Lang* decision rejected the rigid categorization of trusts as either "support" or "discretionary." Each of these two forms of trusts fails to meet the needs of a person with a disability: a support trust risks rapid depletion and a discretionary trust prevents a beneficiary from compelling distributions.[156] The court refused to leave the creator of a trust faced either with the decision to bankrupt his family or to leave a disabled child wholly dependent on an unpredictable, and frequently inadequate, system of government benefits. The court in *Lang* used public policy to support its decision despite decidedly ambiguous language in the trust and evidence of intent that was hardly compelling.[157] The beginning of this public policy can be found in a series of earlier cases.

2. Contextual Analysis, Public Policy, and Intent: Courts Protect Trusts from Government Agencies

In a 1961 case, a Wisconsin court relied on the language in a testamentary trust as well as on public policy, to protect the trust from the claim of a government agency.[158] The testator established a $2,000 trust for the benefit of his "incompetent" son, who resided in a state mental institution. The trust stated that "funds shall be used for such comforts, luxuries, necessities and such other provisions as may not be provided for by said institution, and to place such assets beyond the reach of his creditors."[159] The *Wright* court rejected the government's argument that maintaining the beneficiary in the hospital was a "comfort and necessity" that should be paid by the trust.[160] The court held that no public policy existed "[t]o prohibit a person who is not liable for the support of a charity patient in a public institution to give to the patient extra comforts or luxuries or, at need, necessities which the institution does not furnish nor do we find a public policy to seize such gifts before the patient has received them."[161] The court declined to exercise its discretion to apply the trust for the beneficiary's support.[162] The "sacred" and "constitutional" right of a person to make a will and have it carried out was clearly

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other sources of support and to use the trust as a supplemental resource: the trust permitted income not distributed to be added to principal, indicating a grant of discretion; the words "welfare and benefit" connote a broader standard than merely minimal support; the trustee has the complete discretion to make decisions about principal; the use of one trust rather than separate trusts indicated the desire to provide for all of his children; and during his lifetime the father paid only 37% of the monthly care despite his liability for support. *Id.* at 1343.

[156] *Id.* at 1344-45.

[157] *See also,* Snyder v. Commonwealth Department of Public Welfare, 598 A.2d 1283 (Pa. 1991) (holding that testamentary trust in which trustee had discretion to decide the amount of income and principal "necessary or desirable for the support, maintenance and care of my two children. . ." was not an available asset to her disabled son receiving publicly funded medical assistance).

[158] *In re* Wright's Will, 107 N.W.2d 146 (Wis. 1961).

[159] *Id.* at 377.

[160] *Id.* at 379.

[161] *Id.*

[162] *Id.*

a factor in the court's decision.[163]

The decision foreshadowed the evolution of judicial and societal attitudes toward government benefits and toward people with disabilities. These forces created a different lens through which courts interpreted trust language and extrinsic circumstances surrounding the establishment of the trust, to discern the intent of the creator of the trust.[164]

A Bronx County, New York court articulated this new public policy context in the 1978 case of *In re Escher*.[165] Marie Escher, the beneficiary of the trust, was residing in a state hospital due to mental illness. The issue was whether the principal of the trust was available to reimburse a government agency for the costs it had incurred caring for the beneficiary in a state hospital for over 31 years.[166]

The trust in *Escher* gave the trustee discretion to invade principal to provide for the beneficiary in circumstances limited to "illness, accident, or other emergency." The court began by utilizing the usual analytical approach: it explored the intent of the trust creator by reviewing the language of the trust and then moved on to extrinsic circumstances. The decision became more compelling as the court began to explore the circumstances surrounding the creation of the trust. In addition to the testator's knowledge of the beneficiary's personal circumstances, the court drew on the socioeconomic context of the Great Depression to interpret his intent.

The court held that Martin Escher could not have conceived that the income of the trust would be insufficient to pay for the cost of his daughter's care because of the economic reality that existed during the Depression when he created the trust. The court emphasized the changing nature of government benefits from charity to an entitlement. In particular, the rising costs and diminished stigma attached to the receipt of institutional care buttressed the court's interpretation of Martin Escher's intent.

Although not labeling it as such, the court essentially applied anobjective test to discern the creator's intent. Under this kind of test, it is not the creator's intent *per se*, but the presumable intent of a reasonable person standing in the position of the creator. The *Escher* decision's use of constitutional law and socioeconomic factors was unique, but it was not alone in its articulation of a public policy in favor of

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[163] *Id.* at 380.

[164] The United States Supreme Court decision in Goldberg v. Kelly, 397 U.S. 254 (1970), played an important role in the transformation of government benefits from a charitable benefit to a federal entitlement. This transformation had a profound impact on the way courts analyzed trusts for disabled beneficiaries who received government benefits, even if not expressly made part of the opinion. Unfortunately, the federal entitlement to government benefits for the nation's poorest children was eliminated on August 22, 1996, when the Aid to Families with Dependent Children (AFDC) program was replaced with Temporary Assistance for Needy Families block grants. Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. 104-193, 110 Stat. 2105, codified at 42 U.S.C. §§ 601 *et seq.* (2000).

[165] 407 N.Y.S.2d 106 (1978). *See* text *supra* note 5.

[166] The government benefits at issue were administered solely by New York State and did not include federally funded benefits such as Supplemental Security Income and Medicaid.

protecting trusts from the claims of government agencies. In a number of other jurisdictions, courts agreed that "public policy does not forbid the beneficiary of a private trust from receiving support at public expense."[167]

3. Courts Apply Federal Medicaid Law and Honor the Clear Expression of Intent to Supplement Government Benefits

The foregoing sections demonstrate that a court's interpretation of a trust can turn on a phrase, on the choice to rely on one state statute rather than another, or on the court's view of public policy. In many of these cases, the beneficiary received government benefits administered solely by the state, and not by federal entitlements under the Medicaid or Supplemental Security Income programs.[168]

a. Federal Law Supplies Criteria for Determining if a Trust is an "Available Resource"

Inevitably, courts had to analyze whether a trust was an "available asset" under the financial eligibility criteria that governed the federal SSI and Medicaid programs. *Alabama Medicaid Agency v. Primo* involved a testamentary trust that was established by the sister of a beneficiary who resided in a nursing home and received Medicaid.[169] The sister's will included a trust that directed the trustees to do the following:

> [t]o pay to or use for the benefit of my sister, MAE KLAAS PRIMO, so much of the net income and principal as my Trustees, in their sole discretion, determine to be adequate, reasonable, and appropriate for her support, maintenance, and medical care. The term 'medical care' as used herein shall be broadly construed, and shall include doctors, nurses, hospitals, retirement homes, and nursing homes. Any part of the net income not paid out shall be accumulated and added to and vested and thereafter treated as part of the principal of said trust.[170]

The court did not focus on the language of the trust, or on whether the trust could be categorized as a discretionary or support trust. Instead, the analysis revolved around the issue of whether the trust was an "available resource" to the beneficiary for purposes of her eligibility for Medicaid.[171]

In 1974, Alabama had opted to become an "SSI state" and therefore could not utilize eligibility criteria for Medicaid that was more restrictive than the SSI crite-

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[167] *See, e.g.*, Zeoli v. Commissioner of Social Services, 425 A.2d 553, 559 (1979); Town of Randolph v. Roberts, 195 N.E.2d 72 (Mass. 1964).

[168] Medicaid was created in 1965 and the Supplemental Security Income program was enacted in 1974. Many of the cases were decided prior to these programs. Even after these dates, a beneficiary may receive benefits under a state-administered program that is governed by state law and has no connection to either Medicaid or SSI.

[169] 579 So. 2d 1355 (Ala. Civ. App. 1991).

[170] *Id.* at 1356.

[171] *Id.*

ria.[172] Thus, the court relied on the following provisions of the SSI Program Operations Manual System:[173]

> •the principal of the trust is not a resource if the beneficiary's access is restricted, meaning that only a trustee or court can invade the principal;
>
> •the trust principal is not a resource even if the trust provides a regular payment from the principal to the beneficiary;
>
> •if the beneficiary has unrestricted access, the trust principal is an available resource; and
>
> •even if the trustee has discretion to invade the principal for the beneficiary's support and maintenance, it should not be counted as a resource.

The use of the SSI federal eligibility criteria to determine the availability of a trust made it unnecessary to categorize the trust as a discretionary trust, a support trust, or some form of hybrid trust.[174] This analytical methodology of trusts avoids the semantics and interpretive hair-splitting that often plagued the analysis of discretionary trusts for beneficiaries who received government benefits.[175]

b. Courts Honor the Intent to Provide for a Beneficiary's Supplemental Needs

Although applying federal Medicaid law provided a favorable and more predictable framework in which to analyze trusts for a beneficiary receiving SSI or Medicaid, courts still had to identify and follow the creator's intent. We have seen how the use of general language to guide the trustee's discretion to make distributions for the support of the beneficiary creates uncertainty. Ambiguous language gives a court the opportunity to utilize its own concept of public policy or fairness to achieve a certain result.

In contrast, a trust that clearly expresses the creator's intent to supplement and not to replace government benefits will not be considered an available resource.[176] The use of supplemental language became more common as lawyers and clients

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[172] *Id.* at 1358. In Primo, the availability of a trust under the Alabama statute depended on the terms of the trust instrument. *Id.* at 1356. Although the statute on its face was not more restrictive than the POMS, the court held that the agency's interpretation was arbitrary and unreasonable. *Id.* at 1359.

[173] *Id.* at 1358, (*citing* Social Security Administration, Department of Health & Human Services, Program Operations Manual System, SI 01120.105 A. 2 (October 1981)). Popularly known as "POMS," these are the administrative directions issued by the Social Security Administration.

[174] *Id.* at 1358. *See also, In re* Carlisle Trust, 498 N.W.2d 260 (Minn. App. 1993) (applying POMS guidance for evaluating the availability of trusts under SSI program).

[175] *See supra* Part III.A.1.

[176] *See, e.g., In re* Carlisle Trust, 498 N.W.2d 260 (Minn. App. 1993); Hecker v. Stark City Soc. Serv. Bd., 527 N.W.2d 226 (N.D. 1994).

became aware of the problems caused by trusts that were not explicit regarding their availability for government benefit.

In *Zeoli v. Commissioner of Social Services*,[177] a parent established a spendthrift trust for two "mentally handicapped" sisters who were receiving medical assistance.[178] The issue of eligibility for medical assistance depended on two factors: 1) whether the testator intended the trust to be a supplemental or general source of support; and 2) whether the limitations on the trust prevented it from being considered an available asset under state and federal Medicaid law.[179] The court analyzed whether the trustee abused his discretion based on the language of the entire will "in the light of the circumstances surrounding the testator when the instrument was executed, including the condition of his estate, his relations to his family and beneficiaries and their situation and condition."[180] The court in *Zeoli* held that it is not an abuse of discretion for a trustee of a supplemental needs trust to withhold funds from one or more beneficiaries and to consider other funds that might be available,

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[177] 425 A.2d 553 (Conn. 1979).

[178] The assets in the trust were $9,515.85. The relevant language in the trust directed the trustee as follows:

> To pay or apply so much of the net income or the principal of such trust to or among either one or both of my daughters as shall be living from time to time during the term of such trust, and in such proportions and amounts as my Trustee shall determine in his absolute and uncontrolled discretion. Such amounts of net income or principal may be paid or applied without regard to equality of distribution and regardless of whether any one of my daughters may be totally deprived of any benefit hereunder. My Trustee, in exercising his absolute and uncontrolled discretion shall not be required to consider the amount of income from other sources of any beneficiary or the amount of any beneficiary's independent property or the extent to which any beneficiary may be entitled to support by a parent or any other person. The judgment of my Trustee as to the allocation of the net income or principal of this trust among the beneficiaries shall be final and conclusive upon all interested persons and upon making such payments or application my Trustee shall be full released and discharged from all further liability or accountability therefor. My Trustee shall not be required to distribute any net income of such trust currently and may, in his absolute and uncontrolled discretion, accumulate any part or all of the net income of such trust, which such accumulated net income shall be available for distribution to the beneficiaries as aforesaid.
>
> Without in any way limiting the absolute discretion of my Trustee, it is my fond hope that my trustee pay or apply the net income or principal of the trust for the maintenance, support, education, health and general welfare of those of my daughters who my Trustee believes would benefit most from a share of the income of this trust after considering the income of the beneficiaries from other sources. . . .

Id. at 555. Under Connecticut law, a trust is "spendthrift" and insulated from creditors where the trustee has the power to accumulate or withhold income or the income is intended to support the beneficiary or her family. CONN. GEN. STAT. § 52-321 (2000).

[179] 425 A.2d 553, 554 (1979). The court also had to preliminarily find that the assets were actually part of the testamentary trust.

[180] 425 A.2d 553, 556 (1979).

including public assistance.[181]

James Carlisle was a 58-year-old with cerebral palsy who depended on his mother for his daily care until she could no longer care for him.[182] James subsequently qualified for Medicaid to cover the cost of the home care he needed. His mother created a discretionary trust for the purpose of providing "[e]ntertainment, education, travel, comfort (including home improvement), convenience, and reasonable luxuries as the trustee, in its full discretion, deems advisable."[183] The trustee was prohibited from making payments for basic support provided by a government agency; instead the trustee was required to "[m]ake distributions only to supplement and not to supplant such public assistance. . . ."[184] The court held that the language of the trust clearly demonstrated the creator's intent that the trust be administered so as not to jeopardize the beneficiary's eligibility for government benefits.[185]

The trust at issue in *Hecker v. Stark County Soc. Serv. Bd.*[186] contained an explanation of intent that could not have been more explicit.[187] The trust used exemplary supplemental language and included illustrations of permissible expenditures for special needs, such as "[m]edical and dental expenses, clothing and equipment, programs of training, education, treatment, and essential dietary needs to the extent that such needs are not provided by any government entity."[188] The court held that the trust was not an available asset.

The courts' acceptance of third-party trusts that featured increasingly sophisticated drafting encouraged parents who desperately wanted to include their disabled child in their estate plans, but feared jeopardizing essential government benefits for that child. However, advocacy efforts to enact legislation that authorized the use of supplemental needs trusts were fueled by the variation and unpredictability of the courts.[189]

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[181] 425 A.2d 553, 557 (*citing In re* Hinckley's Estate, 195 Cal. App. 2d 164, 170; Town of Randolph v. Roberts, 195 N.E.2d 72; *In re* Wright's Will, 107 N.W.2d 146).

[182] *In re* Carlisle Trust, 498 N.W.2d 260, 262 (Minn. Ct. App.1993).

[183] *Id.*

[184] *Id.*

[185] *Id.* at 266.

[186] 527 N.W.2d 226 (N.D. 1994).

[187] The language in the trust included the following:

> [I]t is the Grantor's express intent that because the beneficiary is developmentally disabled and unable to support and maintain himself independently, the Trustee shall. . .seek support and maintenance from all available public resources. . . . In making distributions. . .[the] Trustee shall take into consideration the applicable resource limitations of the public assistance programs for which the beneficiary is eligible.

Id. at 230.

[188] *Id.* at 228.

[189] There is also inconsistency in the drafting of these trusts by attorneys. For a proposal to remedy this problem, *see infra* Part V.C.1. Because a third-party beneficiary of a trust does not usually have standing to sue a drafting attorney for malpractice, the beneficiary of a faulty trust may be without recourse. *See* RESTATEMENT (THIRD) OF LAW GOVERNING

B. *States Create Different Statutory Models Authorizing Trusts for People with Disabilities*

The primary benefit of having a statute that specifically authorizes the use of a supplemental needs trust is clarity. The potential risk is that the statute will impose limitations on the use of these trusts (e.g., the amount of money that can be placed in the trust, the age of the beneficiary, etc.) or invalidate trusts that do not conform to the statute. Some states rely on the common law and "generic" trust statutes to guide the interpretation of SNTs.[190] Other states have enacted specific statutes that govern supplemental needs trusts. Although a full survey of these statutes is beyond the scope of this Article, in the following sections I discuss four statutory models that specifically authorize supplemental needs trusts: a comprehensive individual trust statute; a "public-private" pooled family trust statute; statutes that authorize trusts for people with disabilities, with little or no explanation; and statutes that authorize trusts for people with disabilities, but impose restrictions.

1. A Comprehensive Statute: The New York Model

New York has a comprehensive statute that is flexible enough to accommodate a variety of approaches in structuring a trust for a beneficiary who is a "[p]erson with a severe and chronic or persistent disability."[191] The 1993 statute provides a framework for interpreting SNTs and gives the benefit of favorable rules of construction to conforming trusts.[192] The statute is divided into three main sections: 1) a definitional section; 2) rules of construction for conforming trusts; and 3) specimen trust language. The statute explicitly sets forth the elements a trust needs in order to qualify as a "statutory" supplemental needs trust. The statute does not affect the interpretation of trusts that do not conform to the statute. This provision is important to allow for variation in the structure and drafting that is inevitable, and also does not automatically invalidate trusts that are drafted imprecisely and do not fit the statutory criteria.

With respect to third-party trusts, the State has no right of recovery and no right to place a lien as long as the following criteria are met: 1) the SNT was established when the parent (or other third party) no longer had a duty to support the disabled beneficiary; and 2) the trust was *not* funded with any property of the beneficiary against the trust property. Parents can use the SNT to provide a lifetime source of

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LAWYERS §§ 71-73.

[190] These statutes are generic in the sense that they do not directly address a trust established for a disabled beneficiary for the purpose of enabling the beneficiary to maintain eligibility for government benefits. These statutes are often spendthrift statutes that delineate exceptions to protect certain classes of creditors, or authorize a trustee to invade principal to provide for the support of an income beneficiary. *See, e.g.*, N.Y. EST. POWERS & TRUSTS LAW § 7-1.5 (McKinney 2000) (establishing spendthrift presumption as to income but authorizing assignment of income in excess of $10,000 for certain relatives); *Id.* § 7-1.6 (authorizing application of principal to income beneficiary for support and education).

[191] *Id.* § 7-1.12(a)(4).

[192] *Id.* § 7-1.12(b).

supplemental support for a child who has a disability and can direct the distribution of the remaining trust property upon the child's death. The statute originally included a limited exception for self-settled trusts that were funded with retroactive SSI benefits.[193] After the enactment of OBRA '93, it was further amended to allow self-settled trusts that conformed to the requirements of the state statute that implemented OBRA '93.[194]

New York's supplemental needs trust statute permits the creator of the trust to choose among different options for structuring the trust, depending on the goals of the creator and the circumstances of the beneficiary. For example, the trust can be structured to prohibit direct payments to the beneficiary and forbid distributions for food, clothing, shelter, or medical care covered by the relevant government benefit program. This structure is "safe" because it eliminates the possibility that the beneficiary's benefits may be reduced, yet it limits the discretion of the trustee to meet the needs of the beneficiary. In addition, it could be risky if the current safety net of government benefits is weakened or abolished. A court would have to approve the modification of the trust to enable distributions for the beneficiary's basic support.

An alternative is to create a more flexible structure that allows for a broader range of supplemental expenditures.[195] A structure that seeks to strike a balance would give the trustee the limited power to make in-kind payments for food, clothing, shelter, and medical care. Payments made in the form of in-kind distributions for food, clothing or shelter are considered "unearned income" and will generally reduce SSI payments by a maximum of one-third unless there is no actual economic benefit to the beneficiary.[196] Payments for in-kind goods and services other than food, clothing and shelter will not reduce SSI benefits.[197] Medicaid does not have an in-kind income rule, and only income and resources actually available to the Medicaid recipient would be counted for purposes of eligibility. The statute includes specimen trust language that is not required, but will qualify a trust as a "statutory" supplemental needs trust. The inclusion of this sample language provides a normative baseline that attorneys, courts, and government agencies can use as a reference.

The New York statute is an excellent model because it operates on a number of levels that are helpful to lawyers and clients. It addresses virtually all the drafting issues that may arise and includes definitions and specimen language. The statute

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[193] *Id.* § 7-1.12(a)(5)(v).

[194] *Id.*

[195] Generally the trustee is not authorized to make direct payments to the beneficiary. However, if there is a possibility that the beneficiary will become self-supporting and not require government benefits, it may make sense to authorize direct payments under carefully defined circumstances. Any direct payments to a beneficiary receiving SSI or Medicaid will be counted as income and result in a reduction or loss of those benefits.

[196] 42 U.S.C. § 1382a(a)(2)(A)(West 2000); 20 C.F.R. § 416.1130(c)(2000); N.Y. COMP. CODES R. & REGS. tit. 18, § 360-4.3(e)(2000). *See also*, Gordon v. Shalala, 55 F.3d 101 (2d Cir. 1995); Ruppert v. Bowen, 871 F.2d 1172 (2d Cir. 1989).

[197] REGAN ET AL., *supra* note 14, at § 8.10.

serves as a source of information that enables clients and non-legal professionals to better understand the law.

2. A Public-Private Partnership: The Missouri Family Trust

In 1989 the Missouri legislature enacted the Missouri Family Trust, an innovative structure for third-party supplemental needs trusts.[198] Notably, the family trust is intended to cover people with a broad range of physical and mental disabilities, including "[p]ersons with a mental or physical impairment that substantially limits one or more major life activities, whether the impairment is congenital or acquired by accident, injury or disease."[199]

The Family Trust is the only statute in Missouri that authorizes third-party supplemental needs trusts established by a parent. The validity of an individual trust is otherwise based on Missouri case law, which has generally been favorable.[200]

The Missouri Family Trust is an instrumentality of the state under Internal Revenue Code § 115, which allows income from trust assets to be tax-exempt. A separate charitable trust component exists to receive any remainder interests that are donated from the individual trust accounts. The charitable trust also receives tax-deductible donations and uses its assets to provide supplemental support and benefits to disabled people who do not have any immediate family or whose family is indigent. The Governor appoints the nine-member board of trustees. The board must include three members of the immediate family of a person with mental illness, three members of the immediate family of a person with mental illness who is receiving services from the state, and three members with business expertise.

The donor who creates the account designates the beneficiary and a co-trustee (usually the donor or another family member) to advocate for the beneficiary. The co-trustee meets annually with a representative from the Family Trust to decide the amount of distributions and the nature of the services to be provided to the beneficiary. A donor can revoke the trust account during his lifetime.[201] To avoid the

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[198] MO. ANN. STAT. § 402.199-402.217 (West 2000). The Missouri Family Trust currently serves 300 families, has assets of approximately $8 million, and distributes $500,000 annually. August 4, 2000 telephone conversations with Jerry Zafft, Esq. The charitable component has about $1.5 million in assets. *Id.* The average account contains $10,000. *Id.* The trust has a limited exception for "self-settled" trust accounts funded with structured settlements payable for the benefit of a disabled person from a personal injury case.

[199] MO. ANN. STAT. § 402.175 (West 2000) (declaration of policy—purpose of Missouri family trust). *Cf.* FLA. STAT. ANN. § 402.175 (West 2000) (umbrella trust fund limited to beneficiaries who are developmentally disabled or mentally ill).

[200] *See, e.g.*, Tidrow v. Director Division of Family Services, 688 S.W.2d 9 (Mo. Ct. App. 1985) (holding that parent's testamentary trust not available where trustee had discretion to make distributions for beneficiary's "reasonable comfort"). *See also,* Gerald Zafft, *The Missouri Family Trust May Be Better Than Just Relying on a Discretionary Special Needs Trust*, JOURNAL OF THE MISSOURI BAR, 155 (2000).

[201] If an account is revoked, or upon the death of the beneficiary, the charitable trust is entitled to 10% of the remainder if the beneficiary received government benefits for five yeas or less and 25% if the beneficiary received benefits for more than five years.

possibility that a family member who is a remainder beneficiary will revoke the trust account after the death of the donor, a successor trust must be designated to receive the assets in a revoked account after the death of the donor.

3. Simply General: California, Illinois, and Wisconsin

Other states have statutes that are more general and that merely exempt a trust for a disabled individual from being subject to a claim for public support by a government agency.[202] For example, in Wisconsin the disabled individual is defined as a person "[w]ho has a disability which has continued or can be expected to continue indefinitely, substantially impairs the individual from adequately providing for his or her own care or custody, and constitutes a substantial handicap to the afflicted individual. . . ."[203] In Illinois, the statute also defines a discretionary trust (which will not be considered available to the beneficiary) as any trust in which the trustee has discretionary power to determine distributions to be made under the trust.[204] This provision is important because it protects any trust that gives the trustee discretion and avoids interpretive problems that might arise with poorly drafted discretionary trusts.

4. Imposing Limits: Minnesota and Texas

In Texas, the amount that can be held in a trust for a person with mental illness or mental retardation is limited to $50,000 for a person who resides in a state hospital or who is a client of a mental health community center, [205] or $250,000 for a mentally retarded resident of a care facility.[206] Any amounts above those limits will be considered available for the beneficiary's support.

The Minnesota statute sets forth the general purposes of a third-party supplemental needs trust that will not be considered "available" for purposes of government benefits.[207] The trust must expressly prohibit any distributions that will replace or reduce a beneficiary's eligibility for government benefits, or make the beneficiary ineligible for those benefits.[208] This restricts the discretion of the trustee and prevents the trust from being used for, inter alia, shelter payments that can enhance housing options. However, the Minnesota statute excludes beneficiaries over the age of 64 who have resided in nursing homes or other institutions for at

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[202] *See, e.g.*, WIS. STAT. ANN. § 701.06(5m) (West 2000); CAL. PROB. CODE § 15306 (West 2000) (modeled after the Wisconsin statute); 760 ILL. COMP. STAT. § 5/15.1 (2000).

[203] WIS. STAT. ANN. § 701.06(5m)(West 2000).

[204] 760 ILL. COMP. STAT. § 5/15.1 (West 2000).

[205] TEX. HEALTH & SAFETY CODE ANN. § 534.0175 (West 2000) (community centers); TEX. HEALTH & SAFETY CODE ANN. § 552.018 (West 2000) (state hospital).

[206] TEX. HEALTH & SAFETY CODE ANN. § 593.081 (West 2000) (residential care facility for the mentally retarded).

[207] MINN. STAT. § 501B.89(2) (2000). *See also,* Craig P. Goldman, *Render Unto Caesar That Which is Rightfully Caesar's, But Not A Penny More Than You Have To: Supplemental Needs Trusts in Minnesota*, 23 WM. MITCHELL L. REV. 639 (1997).

[208] MINN. STAT. § 501B.89(2)(d) (2000).

least six months and who are not reasonably expected to be discharged. This provision severely limits the use of supplemental needs trusts for elderly people with disabilities.[209]

C. Bridging the Gap: the Omnibus Budget Reconciliation Act of 1993 Resolves (Most of) the Lump Sum Problem

During the federal budget reconciliation process in 1993 it became clear that Congress intended to tighten the eligibility requirements for Medicaid in order to prevent abuse of the program by the affluent elderly.[210] In particular, Congress wanted to prevent the elderly from transferring assets into trusts and also wanted to improve recovery from responsible third parties and the estates of Medicaid recipients.

The community of disability advocates was concerned about the potential loss of protections that prior federal Medicaid law and state law had established for people with disabilities and their parents. Advocates did not want Medicaid to prohibit parents from using trusts to plan for the future of their disabled child.[211] In 1993, in addition to individual trusts established by parents, there existed a number of pooled trust arrangements established by nonprofit organizations and funded by parents. The pooled trusts developed because banks would only act as trustee or custodian if the amount of assets were substantial. The pooled trust typically maintained individual accounts but pooled the money for purposes of investment in order to interest banks in managing the aggregate amount. It enabled parents with modest estates to establish a trust that would be managed by a professional. The individual and pooled trusts that developed varied a great deal from state to state.

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[209] MINN. STAT. § 501B.89(2)(e) (2000).

[210] For a discussion of the OBRA '93 legislative process, see Stewart Weisner, *OBRA '93 and Medicaid: Asset Transfers, Trust Availability and Estate Recovery Statutory Analysis in Context*, 19 NOVA L. REV. 679 (1995). Newspaper articles that appeared around this time may have reinforced Congress' perception that Medicaid was being abused. *See, e.g.*, Arthur Caplan, *Misusing Medicaid for the Wealthy*, BALTIMORE EVENING SUN, Mar. 9, 1993, at 9A, *available in* 1993 WL 7349387.

[211] The discussion about the "advocacy community" refers primarily to the Arc and National Alliance for the Mentally Ill (NAMI) organizations and their local chapters. These groups were instrumental in helping to establish acceptance of trusts by state courts and legislatures. During the budget process in 1993, the Arc, NAMI, and the Bazelon Center were involved in the legislative process. My description of the legislative history of OBRA '93 is based primarily on July 21 and August 4, 2000 telephone conversations with Ms. Marty Ford, Director of Legal Advocacy, Governmental Affairs Office, the Arc of the United States, 1730 K. Street Northwest, Suite 1212, Washington, D.C. 20006. Ms. Ford worked closely with Andrew Schneider, a member of Congressman Waxman's staff and Jane Horvath, a staff member of the Senate Finance Committee which was chaired by Lloyd Bentsen in 1993. The written legislative history of the OBRA '93 trust provisions is sparse. *See* House Comm. on Energy and Commerce, Budget Reconciliation Act of 1993, House Report No. 103-11, *reprinted in* 1993 U.S.C.C.A.N. 511-37. In addition, after the 1994 elections, virtually all of the people involved in the legislative process left the government.

Representatives of several advocacy organizations had discussions with Congressman Waxman's staff about their concerns. However, Medicaid amendments are always among the final parts to be added to the huge budget reconciliation acts. Furthermore, it was not until the last part of the process that advocates worked closely with congressional staffers on the disability trust provisions. After the House approved the Senate-House Conference Bill, there would be no opportunity for advocates to review and discuss the language that dealt with trusts for people with disabilities.

Advocates focused their efforts on four issues: 1) protecting trusts established by a parent of a child with a disability from being considered an available resource to the child; 2) allowing a transfer of assets to a disabled child or to a trust for a disabled child by a parent who might later need Medicaid; 3) authorizing the use of trusts that would be funded by lump sums, e.g., small settlements and inheritances received by a disabled person; and 4) protecting existing pooled trust arrangements.[212] State courts and Medicaid agencies were becoming more receptive to trusts that were created and funded by parents for the benefit of a disabled child.[213] However, if a person with a disability received a "lump sum" in the form of a personal injury settlement or award, an inheritance, or other lump sum of money, should she be able to transfer it into a trust and qualify for Medicaid? The lump sum issue was particularly troubling in circumstances where a person was severely and permanently injured through the negligence or malpractice of a third party. If the injured person had been receiving Medicaid for a number of years, the Medicaid lien on the proceeds of the lawsuit could be substantial. Often, the victim (or a guardian) had little incentive to bring a lawsuit because the proceeds would have to be used to satisfy the lien. Even if there was not a substantial Medicaid lien, the settlement or award would have to be spent on the cost of care before the person could resume eligibility for Medicaid.[214]

Congress had brushed up against the idea of allowing a disabled person to transfer "excess" assets into a trust after the *Sullivan v. Zebley* case.[215] In *Sullivan*, the U.S. Supreme Court ordered the Social Security Administration to revise the SSI eligibility criteria for children to incorporate a broader range of factors in determining disability. As a result, thousands of children received retroactive benefits that were approximately $5,000-$25,000 per class member. Congress specifically authorized notices to *Zebley* class members, informing them that they could place the retroactive benefits into a trust without jeopardizing their eligibility for SSI.

Advocates were also concerned about how the payback to the State would affect pooled trusts. Existing pooled trusts were typically "third-party" trusts that were funded by parents. The nonprofit organization that managed the trust usually received a percentage of the remainder for two purposes: 1) it enabled the trust to help beneficiaries who had outlived their own trust account; and 2) it enabled

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[212] Pooled trusts existing in 1993 included the Arc of Indiana Master Trust and the UJA-Federation of Jewish Philanthropies of New York, Inc. Community Trust.

[213] *See infra* Part III.A.

[214] *See infra* Part IV.

[215] 493 U.S. 521 (1990).

pooled trusts to provide advocacy and services to people who otherwise would not have access to services.

What would happen if pooled trusts were opened up to assets owned by the person with a disability? The congressional staffers agreed to allow the nonprofit to keep a percentage, even the entire remainder, but any amounts that did not stay in the pooled trust had to be used to pay back Medicaid. The pooled trust arrangement was something that was unfamiliar to Capitol Hill, but Congressman Waxman reportedly did not want to interfere with existing arrangements that were benefiting people with disabilities and their families.[216]

The primary concern of Congress was to prevent "gaming" and misuse of the Medicaid program by the elderly. In order to prevent a new loophole for the elderly, the trust provisions were only going to be intended for people with disabilities under the age of 65. Although many Democrats were ardent supporters of disability rights, they were never comfortable with trust funds because they saw them as devices used by rich people.[217] Perhaps ironically, Republicans were perceived as being more receptive to the use of trusts by people with disabilities and their families.

When the lump sum issue was discussed, the Congressional staffers considered a monetary limit to avoid potential misuse or abuse of trust arrangements on the amount of money a disabled person could place into a trust for her own benefit. Advocates were successful in making the case that a monetary limit did not make sense. The needs of people with severe disabilities were quite diverse and while $20,000 can help some people, others may need as much as $200,000 Instead of a monetary limit, it was agreed that a State would be paid back from the assets that remained in the trust when the beneficiary died. There also was agreement that Medicaid would permit anybody (not only family members) to transfer assets to a disabled person or to a trust for a disabled person who was under the age of 65 without imposing a penalty period.

Soon thereafter, the compromise budget bill was passed and included the Medicaid provisions from the House Bill. Upon their first opportunity to review the new law, advocates saw that the legislation divided the individual and pooled trust provisions into two separate sections. Advocates thought that the criteria for individual and pooled trusts would be identical, except that the remainder interest of a pooled trust account could be retained by the trust. However, the legislation included the following differences: 1) the individual trust was limited to a person under the age of 65, but it could only be established by a parent, grandparent, legal guardian or court; and 2) the pooled trust did not include the under-65 age limitation and the person with a disability was authorized to create an individual trust account, in addition to the those listed in the individual trust section.

Advocates believed that these distinctions were technical drafting errors, created when the provision was divided into separate sections to accommodate the retention of the remainder by the pooled trust. The intent was to limit the use of OBRA

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[216] *Id.*

[217] *Id.*

'93 trusts to individuals who were under 65 to avoid creating potential loopholes for the elderly. Congress did not revisit these provisions for technical corrections. Soon after, the majority in Congress shifted, resulting in the departure of many long-time committee staff and the loss of much institutional memory on these issues.

OBRA '93 disability trusts were exceptions to a general prohibition on the use of self-settled trusts to shelter assets in order to qualify for Medicaid.[218] Prior to OBRA '93, if a person wanted to transfer the money into a trust that would not be considered an available resource under Medicaid, the trustee could not be given any discretion to make distributions for the benefit of the creator or her spouse.[219] The law presumed that the trust assets were available to the full extent of the trustee's discretion to distribute those assets.[220] If the trustee could distribute the entire amount of the trust in a particular circumstance, Medicaid would consider the full amount of the trust available to the beneficiary.[221]

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[218] OBRA '93 substantially amended the portions of the Social Security Act that governed Medicaid rules regarding transfers of assets, the use of self-settled trusts, and recovery against responsible third parties and estates of recipients. Congress expanded the "look back" period for a transfer of assets into a trust from 36 months to 60 months. This meant that when a person applied for Medicaid, the agency was entitled to examine all outright transfers of assets for less than fair market value that took place 36 months prior to the Medicaid application, and transfers into trusts that occurred up to 60 months earlier. If a person made a "non-exempt" transfer of assets, the legislation permitted states to impose a penalty period of ineligibility for Medicaid community services as well as institutionalized services. In addition, the statute removed the limit on the length of a penalty period. Congress abolished the use of self-settled trusts except under three circumstances: 1) an individual trust for a disabled person under the age of 65; 2) an income-only trust; and 3) a pooled trust for a person with a disability. Finally, states were required to seek reimbursement for the costs of Medicaid against responsible third parties and were given the option of expanding the scope of property interests that could be recovered from the estate of a Medicaid recipient. *See, e.g.*, Stewart Weisner, *OBRA '93 and Medicaid: Asset Transfers, Trust Availability and Estate Recovery Statutory Analysis in Context*, 19 NOVA L. REV. 679 (1995).

[219] 42 U.S.C. § 1396a(k)(2) *repealed by* Pub. L. No. 103-66, tit. XIII, § 13611(d)(1)(c), 107 Stat. 627(1993).

[220] *Id.*

[221] In 1986, this analytical approach was codified in the provisions of the federal statute entitled "Medicaid Qualifying Trusts,"—surely a misnomer, because the trusts in these categories actually disqualified the Medicaid recipient for benefits. *Id.* A self-settled trust that gave the trustee any discretion would be considered available for purposes of Medicaid eligibility to the maximum extent of the trustee's discretion. *Id.* These provisions severely limited the use of self-settled discretionary trusts by Medicaid applicants or recipients, and the legal landscape is full of cases in which self-settled trusts were categorized as "MQT's" and the trust assets were considered available, which made the beneficiary ineligible for Medicaid. *See, e.g., In re* Kindt, 542 N.W.2d 391 (Minn. Ct. App. 1996) (holding a 1991 discretionary self-settled trust for disabled persons void against public policy because it did not limit distributions to those who would maintain the beneficiary's eligibility for government benefits); Allen v. Wessman, 542 N.W.2d 748 (N.D. 1996)(1991 trust was a Medicaid Qualifying Trust and available where trust assets could revert to creator if trustee exercised

1. The Individual Payback Trust: A Bargain for Life

OBRA '93 created a new form of trust that could be funded with the assets of a person with a disability without impairing her eligibility for Medicaid. An individual OBRA '93 trust is funded with the assets of a disabled beneficiary under the age of 65 and must be established for the benefit of the disabled person by a parent, grandparent, court or legal guardian.[222] The beneficiary must be "disabled" as defined under the Social Security Act.[223] These trusts are exempt from the Medicaid rules, which impose penalty periods on certain transfers of assets.[224] The trust assets are not considered as "available" income or assets for purposes of the beneficiary's Medicaid eligibility.[225]

The bargain is that the State must be "paid back" from the remaining balance upon the death of the beneficiary up to the total value of medical assistance provided to the beneficiary.[226] Implicit in this legislation is the belief that it is sound

discretion to terminate the trust).

[222] 42 U.S.C. §1396p(d)(4)(A) (2000).

[223] An individual shall be considered to be disabled for purposes of this subchapter if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve months. . ..

42 U.S.C. §1382c(a)(3)(A)(2000). Pursuant to the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, the standard for a child under the age of 18 requires a medically determinable physical or mental impairment which results in marked and severe functional limitations and which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve months. The statute created a stricter standard for a child's disability and replaced the "comparable severity to an adult's disability" requirement which came out of the United States Supreme Court decision in Sullivan v. Zebley, 493 U.S. 521 (1990).

[224] 42 U.S.C. §1396p(c)(2)(B)(iv)(2000).

[225] 42 U.S.C. §1396p(d)(4)(A)(2000). The trust provisions of OBRA '93 are structured so that the basic framework is that any trust that is self-settled,i.e., funded directly by the Medicaid applicant or recipient, or on her behalf by a spouse, any other person, or a court,is considered to be an available asset for purposes of Medicaid eligibility. The transfer of assets into the trust will be subject to the rules that impose a penalty period of ineligibility. 42 U.S.C. §1396p(d)(1), (2), (3)(2000). The presumption of availability and the triggering of the penalty period does not apply to a testamentary trust that is established as part of the individual's will. *Id.* A testamentary trust only activates upon the death of the person who made the will and by definition must benefit someone other than the decedent.

[226] 42 U.S.C. §1396p(d)(4)(A)(2000). *See also, In re* Moretti, 606 N.Y.S.2d 543 (Sup. Ct. Kings County 1993). Moretti was the first case in New York to apply OBRA '93. The Conservator of a person who suffered severe brain damage sought to establish a supplemental needs trust that would be funded with the remaining proceeds of the settlement of the personal injury action. The Court held that the proposed supplemental needs trust was explicitly authorized by the new federal law and granted the request to transfer the funds she held as Conservator into the trust with her as trustee. *See also*, Goldfarb & Stone, *Supplemental Needs Trusts for Disabled Persons*, 67 N.Y. St. Bar J. 32 (1995).

public policy to allow a person with a disability to have an additional source of support during her lifetime in exchange for granting the State Medicaid agency the right to be reimbursed upon her death. This represents a departure from the rules governing "available resources," which would otherwise make a person ineligible for Medicaid. [227]

2. Pooled Trusts: From Each According to Their Ability, To Each According to Their Needs

It is rare that Congress passes legislation that redistributes wealth away from the government and toward nonprofit groups that serve indigent individuals with severe disabilities. Yet this is precisely the impact of the pooled trust provisions of OBRA '93.[228] Pooled trusts arrangements were fairly well established in many states as an option for parents and other family members to create and fund a third-party trust account for a person with a disability. To the extent the remaining balance in an individual trust account is retained by the pooled trust after the death of the beneficiary, the State is not entitled to be paid back.[229] However, any amounts

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[227] *See* 42 U.S.C. § 1396a(a)(17). Resources that are exempt for purposes of eligibility for Supplemental Security Income are not counted by Medicaid for people who are elderly or disabled. *Id.* These resource exemptions include a modest resource allowance, a burial account, a primary residence, an automobile, and certain tangible personal property. *See* 42 U.S.C. § 1382b(a).

[228] 42 U.S.C. § 1396p(d)(4)(C)(2000). The exact language is as follows:

> A trust containing the assets of an individual who is disabled (as defined in section 1382c(a)(3) of this title) that meets the following conditions:
>
> (i) The trust is established and managed by a non-profit association.
>
> (ii) A separate account is maintained for each beneficiary of the trust, but, for purposes of investment and management of funds, the trust pools these accounts.
>
> (iii) Accounts in the trust are established solely for the benefit of individuals who are disabled (as defined in section 1382c(a)(3) of this title) by the parent, grandparent, or legal guardian of such individuals, by such individuals, or by a court.
>
> (iv) To the extent that amounts remaining in the beneficiary's account upon the death of the beneficiary are not retained by the trust, the trust pays to the State from such remaining amounts in the account an amount equal to the total amount of medical assistance paid on behalf of the beneficiary under the State plan under this subchapter.

[229] 42 U.S.C. § 1396p(d)(4)(C)(iv)(2000). *See In re* Siegal, 645 N.Y.S.2d 999 (Sup. Ct. Nassau County 1996). There are few reported decisions on pooled supplemental needs trusts, an indication that the legislation is not yet mature, or that it is working so effectively that there are few disputes or problems. Siegal was the first reported decision in New York analyzing an OBRA '93 pooled trust. The case involved a request to transfer assets held in an individual supplemental needs trust to the UJA-Federation Community Trust II. The Court denied the request without prejudice because the charitable remainder beneficiaries of the individual SNT had not provided written consent. However the court held that the trust met the statutory requirements, did not require prior approval by the New York State Department

that are not retained by the pooled trust must be used to reimburse the State for the cost of medical assistance provided to the beneficiary during his or her lifetime.

Nonprofit groups perform caregiving functions that were previously the responsibility of parents and, from a historical perspective, were assumed by the extended family and informal support networks. The pooled trust provisions implicitly recognize this and expand the authority of these groups to assume financial management responsibilities for people with disabilities.

The pooled trust must be "established and managed" by a "nonprofit association."[230] The individual trust account must be created by one of the following: the individual who has a disability; a parent; a grandparent; a legal guardian; or a court. Pooled trusts are required to pool the sub-accounts together for purposes of investment and management, but individual accounts are maintained for each beneficiary.[231] For persons under the age of 65, there is no penalty period for a transfer into a pooled trust.[232] However, the federal Health Care Financing Administration (HCFA) has taken the position that a penalty period applies for transfers made by those over the age of 65.[233]

The following table illustrates the differences between the individual trust and the pooled trust under OBRA '93:

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of Social Services, and was authorized to retain the remainder interest pursuant to the federal statute. *Id.* at 1002.

[230] 42 U.S.C. § 1396p(d)(4)(C) (2000).

[231] *See* 42 U.S.C. § 1396p(d)(4)(C) (2000).

[232] 42 U.S.C. § 1396p(c)(2)(B)(iv) (2000).

[233] *See* HCFA Transmittal No. 64, *supra* note 7, § 3259.7(B).

	Individual Trust	Pooled Trust
1)	Beneficiary must be under 65.	No age limit.
2)	No penalty period for transfer of assets into the trust.	If beneficiary 65 or older, transfer of assets into the pooled trust may create penalty period.
3)	Administered by trustee.	Operated and managed by a non-profit group which either acts as a trustee or selects a trustee.
4)	Assets invested separately.	Assets pooled for investing.
5)	Can only be established by: parent, grandparent, legal guardian, or a court.	Individual trust account can be created by: the disabled person, in addition to parent, grandparent, legal guardian, or a court.
6)	Remainder to the State.	Only amount of remainder not retained by the pooled trust paid back to the State.

The differences between the two forms of OBRA '93 "exception" trusts are significant. The individual trust excludes a person with a disability who is 65 years of age or older. A person under 65 is not permitted to create her own individual trust. In contrast, the beneficiary of a pooled trust account can be any age, provided she fits the definition of disabled under the Social Security Act, and can establish an individual trust account for herself. However, a person 65 or older who transfers assets into a pooled trust triggers a penalty period of ineligibility for Medicaid; a transfer of assets into an OBRA '93 disability trust by a person under the age of 65 is exempt from the penalty period.

One can argue that it makes no sense to impose a penalty period of ineligibility for Medicaid if the person who transfers assets into the pooled trust is over the age of 65. Considering the overall purpose of the OBRA '93 Medicaid amendments—to severely restrict access to Medicaid by elderly people with private wealth—the penalty period is a moderately harsh mechanism that delays an elderly person's eligibility for Medicaid or limits the amount of assets that can be transferred into the pooled trust.[234]

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[234] The length of the penalty period of ineligibility for non-exempt transfers is calculated as follows: the value of the assets transferred for less than fair market value is divided by the monthly cost of a nursing home. 42 U.S.C. § 1396p(c)(1)(E)(I). The impact of the penalty period may be mitigated in that federal law, while requiring a penalty period of ineligibility for Medicaid coverage of institutionalized care, makes it optional for states to impose a penalty period for community medical services. 42 U.S.C. § 1396p(c)(1)(A). Even if a person

a. The Remainder Option: An Opportunity for Nonprofits to Redistribute Wealth and Expand Services

The right to elect to keep the remaining balance in the trust to be used for the benefit of other beneficiaries creates a unique opportunity.[235] The statute does not give any guidance regarding the use of the remainder interest by the pooled trust: it merely states that any amounts not retained by the pooled trust must be paid back to the State. There are several possible interpretations: 1) divide any remainder amounts among existing beneficiaries of the trust; 2) use the additional money to create accounts for new beneficiaries; 3) use the remainder assets to provide services to the beneficiaries of the trust; or 4) use the money for the general purposes of the nonprofit group.

An unduly restrictive interpretation would require that these remainder funds be distributed evenly among the other existing trust accounts in the "pool." However, the statutory language gives the pooled trust far more discretion than this limited reading suggests. A different, more reasonable view, is that remainder funds can be used to create additional trust accounts for new beneficiaries. This would enable the pooled trust to provide supplemental support to people with disabilities who have needs that are not being fully met by government benefits.

A potential conflict of interest arises in the administration of pooled trusts in that the trustee has an interest in the remaining balance of the trust account.[236] The trustee controls distributions, and knows whether the Sponsor has elected to allow the pooled trust to retain any remaining balance upon the death of the beneficiary. The less that is expended on the beneficiary, the more that will remain for the pooled trust. Appropriate disclosures should be made to the Sponsor and the administrator of the trust must be meticulous in assuring that decisions regarding distributions on behalf of beneficiaries are not influenced by the trust's remainder interest.

In many ways, the relationship of nonprofits to their consumers who have disabilities is more like a family relationship than a pure business relationship (e.g.,

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requires Medicaid coverage of institutionalized care (e.g., in a nursing home), she can transfer approximately one-half of her assets, and use the remaining assets to privately pay for the cost of her care during the Medicaid penalty period of ineligibility. However, as of December 13, 1999, non-exempt transfers of resources will result in a penalty period of ineligibility for Supplemental Security Income benefits. *See* 42 U.S.C. § 1382b(b). This applies to a transfer of resources made by a disabled person over the age of 65 into a pooled trust. Although the maximum penalty period is 36 months, a non-exempt transfer of even a relatively small sum will result in a substantial penalty period because the monthly SSI benefit generally does not exceed $600. This acts as a deterrent to the use of pooled trusts for people over the age of 65 who receive both SSI and Medicaid.

[235] 42 U.S.C. § 1396p(d)(4)(C) (2000).

[236] The mandatory remainder interest is perhaps more of an issue with third party pooled trusts in which there is no mandatory payback to the State, and the remaining balance would otherwise be distributed to beneficiaries named by the Sponsor. However, parents and other third parties who may want to utilize these trusts can make an informed decision as to whether the arrangement suits their needs.

between landlords and tenants). The goal is not to completely eliminate conflicts of interest, but we can and should institute safeguards to assure that there is no compromise in the quality and integrity of services provided to each individual beneficiary.

IV. THE TRIUMPH OF THE MEDICAID LIEN OVER THE SUPPLEMENTAL NEEDS TRUST: A MISTAKE IN STATUTORY INTERPRETATION OR A FAILURE TO HARMONIZE COMPETING PUBLIC POLICY OBJECTIVES?

As we have seen, under OBRA '93, a person with a disability who receives a lump sum of money can transfer the funds into an SNT and maintain eligibility for Medicaid. However, the State must be given a priority interest in the remaining balance of the trust upon the death of the beneficiary.[237] This "bargain" strikes a balance between the private interest of the Medicaid recipient in having a supplemental source of support and the public interest in recovering the costs of Medicaid expenditures.

The benefits of OBRA '93 trusts are particularly significant for people who are disabled as a result of personal injuries in an accident. If the injured person obtains a settlement or verdict against the tortfeaser, the proceeds no longer have to be "spent down" before the person can receive Medicaid. The SNT can provide treatment, services, equipment, and therapy that are not available from Medicaid, but extremely necessary for the person's well being. This is perhaps the paradigmatic situation for which the OBRA '93 trust was intended.

As plaintiffs in these cases sought approval to transfer proceeds from the settlement or verdict into an OBRA '93 trust, courts were faced with a dilemma: how should the State's deferred remainder interest be reconciled with the existing federal mandate to recover Medicaid expenditures from responsible third parties?

A. *Seek and Ye Shall Find: The Federal Statutory Mandate to Recover Medicaid Costs From Responsible Third Parties*

The structure and specific language of the Medicaid lien and recovery provisions must be understood in order to analyze the relationship between a Medicaid lien and a supplemental needs trust. As a general proposition, the federal Medicaid statute places few limits on the means and scope of recovery against responsible third parties. In contrast, only under sharply defined circumstances may a State impose a lien or seek recovery directly against the property of a Medicaid recipient.

The federal statutory framework that governs Medicaid liens and recoveries includes three main components: 1) actions a State is required to take; 2) a mandate that a person assign the right to recover against responsible third parties as a condition of receiving Medicaid; and 3) substantive provisions governing liens and re-

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[237] With a pooled trust, the State's remainder interest is subject to the election to retain the remaining balance in the pooled trust. Any amounts not retained by the pooled trust must go to the State. *See* 42 U.S.C. § 1396p(d)(4)(A) (2000).

coveries. In order to comply with the federal statute, a State must do the following: 1) "take all reasonable measures to ascertain the legal liability of third parties to pay for care and services available under the plan;"[238] 2) seek reimbursement from these third parties;[239] and 3) have in effect statutes under which the State is considered to have the rights of the Medicaid recipient to payments from responsible third parties.[240] As a condition of receiving Medicaid, a person has to assign to the state any rights she has to obtain payment for her medical treatment from a third party.[241] When a recovery is made from a responsible third party, the state is permitted to retain the amount necessary to reimburse it for medical payments made to the individual as a result of the injuries and then must give the remainder to the individual.[242] Finally, the statute generally prohibits the imposition of a lien against the property of a living Medicaid recipient and only allows recovery against the estate of a person who received Medicaid from age 55 or older.[243]

Three key aspects of this statutory framework are central to understanding the lien cases: 1) a lien can only be imposed against property that is owned by a responsible party (and not against the property of the Medicaid recipient); 2) the lien must be limited to the amount necessary to reimburse Medicaid for the value of treatment connected to the injuries suffered; and 3) the third party must be "responsible" for the medical expenses of the Medicaid recipient. A State is free to develop mechanisms and procedures that facilitate recovery against responsible third parties, provided they are consistent with the federal requirements. It is within this context that we analyze the Medicaid lien cases.

B. *It's Unanimous: the Medicaid Lien Has Priority*

Federal and state courts unanimously hold that the entire proceeds of a personal injury cause of action prior to funding an OBRA '93 SNT may satisfy a Medicaid lien. However, these decisions overlook key components of the federal statutory framework and in doing so undermine the public policy objectives of OBRA '93 disability trusts. The decisions rely on three propositions to reach their ultimate conclusion that the Medicaid lien trumps the SNT: 1) the proceeds of the settlement

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[238] 42 U.S.C. § 1396a(a)(25)(A) (2000).

[239] 42 U.S.C. § 1396a(a)(25)(B) (2000). The amount of reimbursement is limited to the extent of the third party's liability for the injuries for which Medicaid was provided. 42 U.S.C. § 1396a(a)(25)(B) (2000).

[240] 42 U.S.C. § 1396a(25)(I) (2000).

[241] 42 U.S.C. § 1396k(a)(1)(A) (2000); *In re* Estate of Calhoun, 684 N.E.2d 842 (1997).

[242] 42 U.S.C. § 1396k(b) (2000); *In re* Estate of Calhoun, 684 N.E.2d 842 (1997). The legislative history of OBRA '93 makes it clear that the scope of a responsible third party's legal liability is limited to payment for covered services provided to Medicaid beneficiaries. H.R. Rep. No. 103-11, *supra* note 211 § 5116.

[243] There are two narrow exceptions: 1) if Medicaid was incorrectly paid; and 2) against the real property of a person who resides in a nursing facility, intermediate care facility for the mentally retarded, or other medical institution and who is not reasonably expected to return home. 42 U.S.C. § 1396p(b).

or verdict are not the property of the Medicaid recipient until the lien is satisfied; 2) the OBRA '93 trust provisions relate only to a person's eligibility for Medicaid and do not alter the authority of the Medicaid agency to recover against responsible third parties; and 3) the federal Medicaid statute allows the lien to be enforced against the entire proceeds of the settlement or verdict, not only the portion allocated for past medical expenses.

1. The Initial Cases Set the Stage for the Triumph of the Lien, But Reveal Analytical Flaws

In early 1997, in *Cricchio v. Pennisi* and *Link v. Town of Smithtown*,[244] the New York Court of Appeals held that a Medicaid lien can be enforced against the proceeds of a personal injury lawsuit prior to the funding of an SNT. The plaintiffs in these cases had severe and permanent disabilities and the amount of the settlements greatly exceeded the Medicaid liens. The court found that a Medicaid lien does not become the property of the Medicaid recipient until the Medicaid lien is satisfied pursuant to a legally enforceable settlement or judgment. Because the mandatory assignment of the right to third-party payments is a condition of Medicaid eligibility, the court reasoned that proceeds of the lawsuit are "owed" to the State by the third-party tortfeaser.[245] This reasoning was necessary to overcome the prohibition against placing a lien against the property of a Medicaid recipient.

The Court in *Cricchio* rejected the plaintiffs' argument that the "payback" required in an OBRA '93 trust demonstrates an intent that the State defer recovery against the responsible third party until the death of the beneficiary. The Court stated that the trust provisions relate only to the person's eligibility for Medicaid and are separate from the authority of a State to seek reimbursement from responsible third parties. The Court in *Cricchio* initially held that only the portion of the settlement allocated for past medical expenses may be used to satisfy the lien, and not the amount allocated to pain and suffering. The Court remanded the case for an allocation hearing. However, the Court granted an unusual post-decision motion to modify the language of the decision, and amended it to leave open the question whether only the portion of the settlement allocated to past medical expenses, or whether the entire settlement could be used to satisfy the lien.[246]

The Eighth Circuit Court of Appeals made the next significant decision in *Norwest Bank of North Dakota, N.A. v. Doth*.[247] This case involved two women, each

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[244] 660 N.Y.S.2d 679 (Ct. of App. 1997). The Cricchio and Link cases were decided together.

[245] *Id.* at 305.

[246] *Id.* at 309-10.

[247] 159 F.3d 328 (8th Cir. 1998). Subsequent to Cricchio, appellate courts in North Carolina and Texas each issued a decision directing that the Medicaid lien be enforced prior to funding the trust, with minimum analysis. *See* Payne v. State of North Carolina Department of Human Resources, 486 S.E. 2d 469 (N.C. Ct. App. 1997) (establishing a special needs trust does not bar DMA's right to enforce its lien and DMA was entitled to the entire amount of its lien); Texas Dep't of Health v. Buckner, 950 S.W.2d 216 (Tex. Ct. App. 1997) (hold-

seriously injured while passengers in an automobile accident. Sonya Lotzer suffered "serious and disabling organic brain injuries" and received a settlement of $110,000, subject to a Medicaid lien of $72,000. Bobbi Lerud received "serious and disabling paraplegic injuries" and settled her case for $140,000, subject to a Medicaid lien of $56,000. A court order established an OBRA '93 trust for each woman and funded it with her settlement.

The Eighth Circuit affirmed the decision of the District Court, which held that repayment of the liens should not be deferred. The basis of the District Court's decision was that the OBRA '93 trust provisions related only to a person's eligibility for Medicaid and did not change the State's right to recover against responsible third parties.[248] The Eighth Circuit quoted the portion of the federal assignment statute requiring an individual, as a condition of receiving Medicaid, "[t]o assign the State any rights, of the individual . . . to payment for medical care from any third party."[249] The corresponding Minnesota statute, consistent with federal law, authorized a lien for the "[c]ost of care upon any and all causes of action which accrue to the person to whom the care was furnished . . . as a result of the injuries which necessitated the medical care."[250] The Court stated that deferring the Medicaid lien allows a person to evade an existing lien and to negate the federal statute authorizing the lien.[251]

There are several noteworthy aspects of the *Norwest* decision:1) it explicitly did not decide whether the lien could only be enforced against the portion of the settlement allocated to past medical expenses; 2) it failed to acknowledge that deferring the lien is consistent with the purposes of the assignment, lien, and recovery provisions because it becomes part of a broader "payback" upon the death of the beneficiary; and 3) it acknowledges in a footnote that the district court quoted the wrong legislative history from the *Cricchio* case.

To understand why the "legislative history" footnote is important, one must revisit the *Cricchio* case. The *Cricchio* court justified its holding by reasoning that the settlement was not the property of the Medicaid recipient and that the OBRA '93 trust provisions related only to eligibility, not to reimbursement. To support this analysis, the Court drew on the legislative history of New York's supplemental needs trust statute, which states that its purpose was to "[e]ncourage families to undertake long-term financial planning for loved-ones with family assets that were

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ing the entire cause of action available to satisfy lien, relying on federal assignment statute and state statute that defined third party resources as including payment made to a Medicaid recipient "[f]or injuries requiring Medicaid services including payments for mental anguish, pain and suffering, and future medical expenses when the inury causing the need for Medicaid services was the basis for those claims or payments").

[248] *Id.* at 330.

[249] *Id.* at 332 (citing 42 U.S.C. § 1396k(a)(I)(A) (2000)).

[250] *Id.* at 332 (citing MINN. STAT. ANN. § 256B.0423). Interestingly, the Minnesota statute requires that the Medicaid recipient must receive at least one-third of the net recovery after attorney fees and other costs. *Id.*

[251] *Id.* at 333.

not otherwise earmarked to reimburse government assistance."[252]

Ironically, this legislative history was written prior to OBRA '93 and had nothing to do with OBRA '93. At that time, the statute only authorized third-party supplemental needs trusts established and funded by assets of family members who had no legal duty to support the disabled beneficiary. There was no statute on either the federal or state level that authorized a trust funded with the property of the disabled Medicaid recipient. This would not occur until the passage of OBRA '93 on approximately August 10, 1993.

The Eighth Circuit in *Norwest* dismissed the error, saying the analysis of the district court was "nevertheless sound." However, the failure of these courts to recognize this analytical error suggests a lack of understanding about OBRA '93 trusts and their relationship to Medicaid liens and recoveries. Other courts have since made this mistake.

2. The Cases Continue: The Right to Enforce the Medicaid Lien is Paramount, but Questions Remain

S.S. v. State of Utah,[253] involved a minor who suffered brain damage and was permanently disabled in an accident with a drunk driver. He received a settlement of $175,000 and the amount of the Medicaid lien was $44,454.58. The Utah Supreme Court stated that the distinction between reimbursement (the Medicaid recovery statutes) and eligibility (the OBRA '93 trusts) allowed it to "[c]onclude, without doing violence to either statute, that recoveries from third parties liable for the same expenses covered by Medicaid belong to the State, but any remaining balance not owed to the State may be used to fund a properly structured supplemental needs trust."[254] The court correctly noted that the trust gives the beneficiary the benefit of a greater amount of resources than normally allowed under the Medicaid resource rules.[255] On its face, that conclusion seems reasonable.

However, the court reveals its flawed legal reasoning and failure to truly understand the relationship among the statutes and public policies by its use of a quote from the *Cricchio* case to support its conclusion: "[T]here is no indication that the amendments were designed to alter the legal liability of any responsible third party to reimburse Medicaid for care, which is a cornerstone of the Medicaid program. Rather, the legislative history of the Acts authorizing the creation and favorable treatment of assets held in an SNT reveals that the sole desire to encourage families to undertake long-term financial planning for loved-ones with family assets that were not otherwise earmarked to reimburse government assistance prompted the amendments."[256]

On the same day of the *S.S.* decision, the Utah Supreme Court decided the case

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[252] Cricchio, 660 N.Y.S.2d at 683 (quoting Bill Jacket, L. 1993, c. 433 Mem. In Support).

[253] 972 P.2d 439 (Utah 1998).

[254] *Id.* at 443.

[255] *Id.*

[256] *Id.* (citing Cricchio, 683 N.E.2d at 305).

of *Wallace v. Estate of Jackson*.[257] Sixteen-year-old Daniel McNeil suffered severe and permanent brain injuries resulting in "profound neurological deficits" after an automobile accident. [258] The insurance proceeds could not satisfy the claims of all the injured or deceased parties. As part of the settlement, Daniel received a total of $85,000. The State of Utah made a claim directly against Daniel, but not against the insurer. The lower court ordered that the State be paid $43,000 from Daniel's settlement as reimbursement for the amount of Medicaid expended for Daniel, and the remainder be used to fund a "special needs trust."

The Utah Supreme Court rejected Daniel's claim that a state statute authorizing liens against "proceeds payable to the recipient by a third party" violated a federal statute prohibiting direct liens against the property of a Medicaid recipient.[259] Associate Chief Justice Durham dissented in both cases, excoriating the reasoning of the majority. In the *S.S.* case, the dissent argued that the OBRA '93 provisions were explicit exceptions to the general "collection scheme."[260] Additionally, Justice Durham pointed to the structure of the federal statute to demonstrate the lack of distinction between eligibility provisions (i.e., the trust) and reimbursement (the general recovery framework). In particular, the OBRA '93 trusts are part of a section that includes provisions concerning liens, recoveries of correctly paid assistance, transfers of assets, trusts, and definitions. The section protects certain property from liens and recoveries during the lifetime of Medicaid recipients, including people with disabilities. Perhaps the most persuasive point made by Justice Durham is that the definition of assets in 42 U.S.C. § 1396p includes the proceeds of a lawsuit.[261] Justice Durham concludes that supplemental needs trusts are "intended to be an explicit, specific, and narrow exception [to the general recovery scheme] available to persons who are totally disabled—the extraordinary case."[262]

In the *Wallace* case, Justice Durham used the procedural posture of the case to demonstrate that the lien was actually being enforced against the property of the Medicaid recipient, in violation of the federal statute. The State did not exercise its right to pursue the tortfeaser independently or to intervene in the case. Instead, it interposed a cross-claim directly against Daniel McNeil for reimbursement. Justice Durham argues that Congress intended the State to pursue responsible third parties directly, either by an independent action or by intervening in the lawsuit prior to a settlement or verdict.[263]

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[257] 972 P.2d 446 (Utah 1998).

[258] *Id.* at 447.

[259] *Id.*

[260] S.S. v. Utah, 972 P.2d at 444.

[261] *Id.* at 444-45 (citing 42 U.S.C. § 1396p(e)(1)). Justice Durham also cited portions of the Utah statute governing trusts to illustrate that it encompasses both eligibility and reimbursement issues.

[262] *Id.* at 445.

[263] *See* Wallace, 972 P.2d 446. Justice Durham points out that the Utah statue allows, in violation of the federal statute, a lien directly against the Medicaid recipient. In addition, a June 5, 1996 memorandum from the Health Care Finance Administration states that a potential personal injury settlement is subject to a lien, and to avoid the "lien issue" suggests that a

Justice Durham's dissents contain some of the most cogent and powerful arguments against allowing enforcement of a Medicaid lien prior to the funding of the SNT. It is difficult to argue that the property of a Medicaid recipient is not subject to a lien on a settlement, particularly when the statutory definition of assets includes the proceeds of a settlement to which a person is entitled. Nevertheless, the majority prevailed by relying on *Cricchio* and a selective reading of the federal law. Although the Utah cases did not explicitly discuss the medical expense issue, it soon appeared in the next cluster of cases that ended the controversy.

3. The Final Answer: The Medicaid Lien Can Be Satisfied Against the Entire Proceeds of a Personal Injury Lawsuit

The final unresolved issue was the scope of the Medicaid lien: is it only enforceable against the portion of a settlement or award allocated for past medical expenses, or against the entire proceeds of the lawsuit? An appellate court in New Jersey addressed the issue first. In *Waldman v. Candia*,[264] the Superior Court unequivocally held it is not necessary to determine the liability of a tortfeaser. The court stated that to hold otherwise would be "[t]o elevate form over substance. Patently, the settlements in both of these matters eventuated from claims of injury for the treatment of which Medicaid funds had been expended."[265] The *Waldman* court also cited the decisions of the Eighth Circuit and the District Court in the *Norwest* case with approval. The court agreed with the *Norwest* District Court that "[I]nterpreting the SNT provision as shielding recoveries in tort actions from a state's recovery action would tend to render the state's right of recovery meaningless."[266] This is a flaw in the reasoning of *Waldman* and *Norwest*. The payback requirement in the SNT protects the interest of the State and its lien, therefore, the state's right of recovery would be meaningful even if only past medical expenses were subject to the lien prior to the funding of the trust.

In *Calvanese v. Calvanese*[267] the New York Court of Appeals finally addressed the medical expense issue. The court held that Medicaid liens can be enforced against a settlement, without regard to any allocation made between pain and suffering and past medical expenses. As in *Cricchio*, the Court endorsed New York's assignment, subrogation, and lien provisions as appropriate means to comply with the federal subrogation requirement.[268] The Court rejected arguments limiting the

State could intervene directly to protect its interests; the memo does not include the option to impose a lien after liability is established. Justice Durham also cites 42 C.F.R. § 433.140(f)(1) (must seek reimbursement from a liable third party when recovery will exceed costs) and 42 U.S.C. § 1396b(p)(15% rebate of money recovered as incentive). Durham asserts that when a state imposes a lien against the Medicaid recipient, it is getting a free ride and a windfall.

[264] 722 A.2d 581 (N.J. Super. Ct. App. Div. 1999).

[265] *Id.* at 586.

[266] *Id.*

[267] 710 N.E.2d 1079 (N.Y. 1999).

[268] *See id.*; *see also* 42 U.S.C. § 1396k(a)(1); 42 C.F.R. 433.146(c); N.Y. SOC. SERV. Law § 366-4(h)(1); § 360-7.4(a)(6).

scope of the Department's right to reimbursement from third parties on the grounds that it weakens the role of Medicaid as the payor of last resort.[269] The court noted that limiting the right of recovery creates an "anomalous situation in which Medicaid applicants could be disqualified from eligibility for financial resources that include prior personal injury settlements allocated to pain and suffering, but Medicaid recipients could shield such funds from recoupment by the Department after having received significant public assistance."[270]

In reality, this "anomalous situation" would not exist. A Medicaid applicant would not be disqualified because of a personal injury settlement allocated solely for pain and suffering if the applicant transferred the funds into a supplemental needs trust as permitted by law.

C. *Concluding Thoughts on Medicaid Liens and OBRA '93 Trusts*

The trust provisions for people with disabilities enacted under the OBRA '93 added a new layer of public policy to the Medicaid provisions of the Social Security Act. A disabled person who receives a lump sum of money from any source is allowed to utilize a trust to provide a better quality of life than is available by subsisting on SSI and Medicaid. In return, Medicaid receives a new, enlarged right of recovery upon the person's death.

Courts should have rejected the position that immediate satisfaction of Medicaid liens from legally responsible third parties is mandated prior to the trust's funding.[271] The federal mandate to seek recovery is satisfied even if recovery on the lien is deferred until the death of the beneficiary. In reality, when a trust is established for, and funded with the assets of, a disabled person under the age of 65, the State receives a greatly expanded right of recovery.[272] Pursuant to the clear language of the federal statute and regulations, the third party is only "responsible" if it has a legal liability to pay for medical expenses already covered by Medicaid. Courts fail to recognize that Medicaid should only be entitled to recover from the portion of the settlement or verdict intended for past medical expenses.

A court's failure to allocate the proceeds of a settlement or verdict should not hurt the plaintiff who devoted the time, energy, and money to bring the lawsuit. Under federal law, a Medicaid agency has two options: to proceed directly against

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[269] *See id.*; *see also* Seeman v. Iowa Dep't of Human Serv., 604 N.W.2d 53 (1999) (upholding subrogation rights of the Department as equitable).

[270] Calvanese, *supra* note 267, at 1082.

[271] *See, e.g.*, Costello on behalf of Stark v. Geiser, 647 N.E.2d 1261 (N.Y. 1995) (upholding a limitation on the extent of the State's right of recovery of medical expenses against a father who was a responsible third party).

[272] The State's right of recovery from the remainder of an OBRA '93 trust should be viewed as an additional tool that enhances the State's recovery arsenal. This remainder interest is broader than the right of estate recovery, which is limited to individuals who received Medicaid over the age of 55, and may not include property passing outside a person's will or under a state's laws of intestacy. 42 U.S.C. § 1396p(b).

the responsible third party or to make a claim on the proceeds of the lawsuit.[273]

This unique model maximizes the benefits available to the disabled person during his lifetime and protects and expands the State's right of recovery. The OBRA '93 individual trust is consistent with two primary objectives of Medicaid: to maintain the health of recipients and to maximize the recovery of benefits to the largest extent possible.

V. THE POLICY RATIONALE OF SUPPLEMENTAL NEEDS TRUSTS AND PROPOSALS FOR REFORM

The law governing SNTs developed significantly during the latter part of the twentieth century. Indeed, one could make the case that most of the major legal obstacles to using an SNT have been addressed satisfactorily. However, the status of SNTs is never secure. They are continually vulnerable to budget-cutting efforts by state legislatures, Congress, and judges viewing SNTs as antithetical to public policy.[274]

The nature and perception of disability is complex. It is increasingly difficult to identify people with disabilities severe enough to justify special protection because disability is relative. Disabilities include visible physical conditions and an array of mental and psychosocial aspects that are not visible, not universally accepted, and subject to multiple definitions and categories.[275] Proposals to expand eligibility or services offered by government programs raise concerns about diminishing informal support networks and raise concerns that additional people will emerge "out of the woodwork" to take advantage of the services.[276] There is also a fundamental tension between the presumption of need on which eligibility for benefits is based and the quest for services that support independent living in the community.[277] If community services will not lead to employment, they are considered a luxury that will not be offset by productive work; to the extent that the potential for employment exists, the rationale for income support and health insurance is challenged.[278] The value society places on productive employment makes the justification of re-

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[273] In Cole v. State Dept. of Transportation & Development, 755 So. 2d 315 (La. Ct. App. 1999), a Louisiana court of appeal refused to allow the Medicaid agency to recover past medical expenses against a tortfeaser where the agency failed to intervene in the lawsuit.

[274] *See* Lang v. Commonwealth, 528 A.2d 1335 (Pa. 1987) (Larsen, J. dissenting).

[275] VLADECK ET AL., *supra* note 21, at 87. The elimination of alcoholism and drug addiction as qualifying conditions for SSI, the termination of benefits for thousands of recipients that disproportionately affected people with mental illness, and the public perception in the aftermath of the Sullivan v. Zebley case that children who were not really disabled received benefits demonstrates the public ambivalence toward certain groups of disabled people. *Id.*

[276] *Id.* at 88 (offering the example of personal care services contained in the Omnibus Budget Reconciliation Act of 1990, which was subsequently repealed under pressure by the states fearing that new costs would be greater than any savings achieved through greater use of these services). *Id.*

[277] *Id.*

[278] *Id.*

habilitation and treatment services that will not result in a return to work more difficult.[279] This ambivalence may be due to the low (3%) number of people who are able to work after rehabilitation.[280]

A. *The Critique of SNTs and a Response*

The obvious critique of SNTs is that they allow people with private resources to utilize the SSI and Medicaid programs at the expense of people who are truly indigent. From the left, SNTs may be perceived as devices allowing the middle class and wealthy to access government benefits intended only for the indigent. From the right, SNTs offend the individualistic story of self-reliance and independence that is part of our heritage. Both critiques are based in large part on the dichotomy between "welfare" and "social insurance" that was at the heart of the New Deal.[281]

In the United States, the two major categories of programs are "social insurance" and "welfare." The major federal social insurance programs include Social Security Retirement, Survivor, and Disability Insurance benefits and Medicare.[282] These benefits are available to workers, their dependents and survivors without regard to

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[279] *Id.* at 86.

[280] *Id.* 69% of disabled adults of working age are unemployed and 28% of people with disabilities live below the poverty line, compared with 11% of the general population. VACHON, *supra* note 29, at 118-119.

[281] The New Deal legislation preferred a social insurance model to welfare programs. However, welfare programs remained because of a number of factors: 1) unemployment and under-employment persisted and therefore a substantial number of people failed to qualify for the employment record based social security benefits; 2) the U.S. failed to enact any form of universal medical insurance; 3) the demographic shift of the welfare population from widows and children (who would qualify for Social Security Survivor's Insurance) to families headed by divorced or never married women; and 4) the inadequacy of non-Social Security Income from workers' compensation, pension, savings, and part-time work, causing many elderly and disabled people to be poor enough to qualify for means tested programs. The size of the major programs of social insurance—the various social security programs and Medicare—dwarfs the expenditures of welfare, SSI, Medicaid, and food stamps. A large percentage of Americans receive income support and medical insurance as retirees, people with disabilities, and survivors of insured workers. THEODORE R. MARMOR ET AL., AMERICA'S MISUNDERSTOOD WELFARE STATE 79 (1990). Social Security and Medicare accounted for approximately 35% of federal expenditures in 1999. Comm. on Ways and Means, U.S. House of Representatives, 2000 Green Book 1335 (2000). In contrast, Medicaid and the other means-tested programs comprised only about 10% of the federal budget in 1999. *Id.*

[282] The goals of a system of social insurance are to promote economic security and prevent destitution. Its primary design is not to rescue those who have fallen. The goal is to "universalize" financial security against the threats of involuntary unemployment, widowhood, sickness, injury, retirement and large families. MARMOR, *supra* note 281, at 95. Although the public's misperception about the fiscal impact of welfare programs to the non-disabled poor may have contributed to the political momentum behind welfare reform, the perception that the programs fostered family disintegration and dependency made it a potent symbol of what was wrong with social welfare policy.

financial need. The cluster of welfare or "means-tested" programs include: cash benefits under the Personal Responsibility and Work Opportunity Reconciliation Act of 1996;[283] Supplemental Security Income for the aged, blind and disabled;[284] Food Stamps;[285]and Medicaid.[286] These programs are often perceived as taxpayer-financed handouts to people seen as defective or decrepit because of poor character, physical or mental disability, or old age.

A closer look at these programs pierces the myth of this distinction. For example, most Social Security and Medicare recipients receive more in benefits than their FICA contributions generated. Current workers pay the benefits for current retirees, just as current taxes pay the benefits of current welfare recipients. Therefore, like welfare recipients, beneficiaries of social security retirement are "on the dole."

The myth of the earned entitlement has great political and ideological power. The social insurance programs have a broad constituency, compared to welfare programs that focus on the most marginalized and powerless in society (a small percentage of whom actually vote). Ironically, welfare for working age adults engenders the greatest controversy and discontent despite its relatively minimal expenditures.[287]

One response to the SNT critique is that Medicaid already opened the "floodgates" to the middle class through its transfer of assets rules, resource exemptions, and loopholes in estate recovery requirements. Categorical and financial eligibility criteria means tests are designed to exclude people who are "undeserving" because they neither fit into the acceptable personal categories nor do they meet the poverty tests. [288] The categorical tests for SSI and Medicaid require a person to be "disabled"[289] or over the age of 65.[290] The financial eligibility criteria require a Medicaid applicant or recipient to meet strict income and resource limits.[291] The SSI and Medicaid programs mitigate the harshness of these rules through resource "exemptions" disregarding the value of a primary residence, automobile, and other necessary personal property. Moreover, individual programs have incorporated addi-

[283] Pub. L. 104-193, 110 Stat. 2105 (codified at 42 U.S.C. §§ 601 *et seq.* (2000)).

[284] The SSI program is somewhat of a hybrid because it is part of the Social Security Act and of a federal entitlement program. Because it is limited to the elderly and disabled—the "deserving poor"—it does not have the stigma often associated with welfare benefits for the able-bodied poor.

[285] 7 U.S.C. §§ 2011 *et seq.*

[286] 42 U.S.C. §§ 1396a *et seq.*

[287] *See* Stephen Loffredo, *Poverty, Democracy and Constitutional Law*, 141 U. PA. L. REV. 1277, 1315-25 (1993).

[288] Means-tested programs, primarily Supplemental Security Income, TANF, and Medicaid each have complex eligibility rules that define the kind and amount of income and assets a person can have and retain eligibility.

[289] *See supra* note 224.

[290] Medicaid is also available to certain families, children, pregnant women, and single adults who meet the applicable eligibility requirements. *See* HELEN HERSHKOFF & STEPHEN LOFFREDO, RIGHTS OF THE POOR 179-83 (1997).

[291] *See id.*

tional "special" exemptions designed to achieve a targeted purpose.[292]

Politically, Medicaid enjoys wider support precisely because a broad cross-section of recipients utilizes the program. A program that benefits only the working age poor, such as AFDC, was so politically vulnerable that it was abolished in 1996, ending six decades of federal social policy that guaranteed a minimum level of assistance. Medicaid retained its status as an entitlement program despite efforts to make it a block grant program.[293]

B. *The Rationale for SNTs: Mitigating the Impact of Disability and the Inadequacy of Government Benefits*

Social welfare policy and government benefits are designed to help people who cannot fully support themselves and their families through employment due to age, illness, disability, or inability to obtain work. Medicare and Medicaid are often the primary sources of health insurance for the disabled. These programs reflect the traditional, prevailing emphasis on acute inpatient hospital services and post-hospital care[294] and do not provide adequate mental health services, community based services, or access to assistive technology.[295]

The ability to supplement the basic level of support provided by government benefits may enable the beneficiary to reside longer in the community, require less acute medical care, and ultimately reduce the need for the state to provide costly hospital and institutional care. For example, the SNT can provide the beneficiary

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[292] For example, the Medicaid program permits the "community" spouse of a person living in a nursing home enhanced income and resource allowances. The income and assets of the institutionalized spouse are used to the extent that the "community spouse" does not have sufficient income or assets individually. The Medicaid transfer rules provide opportunities for people to preserve assets and limit the duration of any "penalty periods" of ineligibility. The TANF program gives states the option to allow recipients to keep earned income within certain limits so that employment does not result in a loss of benefits and services. SSI's PASS program allows recipients to put aside earnings in a special account in order to achieve self-support. It is noteworthy that in an era of cutting benefits and increasingly difficult qualification standards, these targeted funds, including supplemental needs trusts, have been strengthened. Together they reflect a social welfare policy that implicitly recognizes that achieving goals of employment or independent living requires flexible eligibility standards.

[293] President Clinton initially vetoed two versions of the proposed welfare reform bill because it made Medicaid a block grant program. George J. Church, *Ripping Up Welfare With Not a Little Drama, Clinton Grudgingly Approves the G.O.P. Bill, and the U.S. Starts a Vast and Risky Experiment*, TIME MAGAZINE, Aug. 12, 1996, at 18, *available in* 1996 WL 10668485.

[294] Medicare is the paradigmatic example of a program that was originally designed to meet the health care needs of the elderly as they were perceived in 1965 and created a system of coverage that was oriented to the treatment of acute illnesses. Thirty-five years later, Medicare fails to meet the exploding need for prescription drugs outside the hospital setting, home care, and nursing home care.

[295] VLADECK ET AL., *supra* note 21, at 83.

with access to assistive technology and technology in general. Technology has "[d]ramatically changed the potential of people with disabilities, and American social values of equity and fairness have brought about changes in law in relation to people with disabilities. . . ."[296]

The replacement of the institutional model with community-based treatment for people with disabilities ushered in a new era of social welfare policy. Prior to the community-based model, institutions that defined the scope of care and the state's responsibility provided treatment for people with disabilities, particularly those with cognitive impairments.[297] The "Willowbrook" case[298] greatly increased public awareness of the inhumane conditions inside these institutions. [299] Numerous lawsuits forged legal protection intended to provide habilitation services in the least restrictive setting.[300] In 1999, the United States Supreme Court recognized the right to receive services in the community under the Americans with Disabilities Act.[301]

The needs of people with disabilities in the community are very different than in an institutional setting. These needs vary according to the particular residential setting and the functional impact of the disability. A variety of residential settings have replaced the large institutional setting for people with developmental disabilities and mental retardation. Group homes offer opportunities for independent living in the community with appropriate supervision levels. The SNT supports independent living in the community for people whose disabilities render them unable to fully support themselves through employment.

C. *Proposals for SNT Reform*

The goal of these reforms is to enable SNTs to achieve their full potential to enhance the quality of life for people with disabilities. This often conflicts with the interests of the State in preserving the public purse and limiting government benefit expenditures.

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[296] DISABILITY: CHALLENGES FOR SOCIAL INSURANCE, HEALTH CARE FINANCING & LABOR MARKET POLICY 2 (Virginia P. Reno et al. eds., 1997). This report was produced by the National Academy of Social Insurance and focused on the relationship between work incentives and Social Security disability benefits. The report found that in 1991, the U.S. spent 0.7% of the gross national product on disability benefits, less than the United Kingdom 1.9%, Germany 2.0%, and Sweden 3.3%, countries that emphasize rehabilitation and employment. *Id.* The report also concluded that lack of health care coverage—or more precisely, the fear of losing Medicare or Medicaid—is more of a "structural impediment" to work than income support. *Id.* at 3.

[297] VLADECK ET AL., *supra* note 21, at 90.

[298] New York State Association for Retarded Children, Inc. v. Carey, 393 F.Supp. 715 (E.D.N.Y. 1975) (approving consent judgment).

[299] *See, e.g.*, DAVID J. ROTHMAN, THE WILLOWBROOK WARS (1984).

[300] VLADEK ET AL., *supra* note 21, at 91.

[301] Olmstead v. Zimring, 527 U.S. 581 (1999).

1. Establish Superceding Rules of Construction

The continuing litigation that parses the language of third-party trusts and strains to discern the creator's intent is, in reality, a court's judgment about what a state's public policy with respect to trusts should be. Establishing clear rules of construction that presume a trust is not an available asset would eliminate harmful litigation. If the beneficiary receives SSI or Medicaid, the starting point should be the existing criteria in the SSI Program Operations Systems Manual.[302] If the trust conformed to those criteria, it should not be considered an available asset. If the trustee has any degree of discretion, there should be a presumption that the trust supplements government benefits, rather than replaces them. Absent a clear expression of intent that the trust should be used to replace government benefits, the trust should not be considered an available asset for purposes of eligibility for government benefits.

2. Recommendations to Improve OBRA '93 Trusts

a. Expand the Class of People Allowed to Establish an OBRA '93 Trust.

Under current law only a parent, grandparent, legal guardian, or court can establish an individual payback trust for a disabled beneficiary under the age of 65. In the case of a pooled trust, the disabled beneficiary can also establish the trust account.

A disabled individual should be allowed to establish an individual trust. This would recognize that the protections of OBRA '93 includes people with physical disabilities who are not cognitively impaired. It also would acknowledge that not every person with a cognitive disability or mental illness lacks the capacity to establish a trust.

In addition, a sibling, spouse, or significant other who qualifies as a domestic partner, or the executive director of a not-for-profit corporation that provides services to the person with a disability should be authorized to establish an individual trust or a pooled trust account. This would enable trusts to be established for a greater number of beneficiaries without a court order or the appointment of a guardian.

b. Eliminate the Age Limit for Individual OBRA '93 Trusts.

Congress' intent to close Medicaid loopholes available to the elderly resulted in the under-65 age limit for individual trusts. Eliminating the age limitation would not create opportunities for abuse of Medicaid by the affluent elderly for two reasons. First, the mandatory payback to the State prevents a person from sheltering assets for the purpose of passing it on to family members. Second, eliminating the

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[302] *See* source cited *supra* notes 169, 172 and accompanying text.

age limit makes OBRA '93 trusts available to people with disabilities over 65 who either do not live in an area served by a pooled trust, or who do not trust an organization to manage their money. The State benefits from the use of individual trusts in that the State will receive a mandatory payback. If the only option for a disabled person over the age of 65 is a pooled trust, the remainder may be retained by the pooled trust, and the State would receive nothing upon the death of the beneficiary who funded the trust.

c. Defer Medicaid Liens until the Beneficiary's Death

In a personal injury case, Medicaid lien enforcement until the beneficiary's death if the proceeds are being transferred into an OBRA '93 supplemental needs trust. An allocation for past medical expenses should be subject to the Medicaid lien, but only to the extent it doesn't exceed ten percent of the settlement or judgment. A Medicaid recipient should not be able to configure the settlement to avoid satisfying the lien by not claiming past medical expenses. Furthermore, assuming the Medicaid agency does not exercise its right to proceed independently against the defendants who are the responsible parties, the agency should have the burden of intervening in the case early enough to protect its interest. If the agency is provided with notice of the lawsuit and no allocation for past medical expenses is made, the Medicaid lien should be incorporated into the State's remainder interest in the trust.

Regulations can help to reasonably assure that the Medicaid lien will be satisfied upon the death of the beneficiary.[303] In addition, the trustee has an inherent obligation to balance its duty to the life beneficiary and those parties with an interest in the remainder.

D. *Replicate and Expand the Concept of Supplemental Needs Trusts*

In the SSI program, exemptions for supplemental needs trusts[304] and the Plan for Achieving Self Support ("PASS") program[305] allow "special" accounts for the purpose of improving the recipient's quality of life. Medicaid grants enhanced income and resource allowances to a "community spouse" living at home whose spouse reside in a nursing home.[306] These allowances break the cycle of impoverishment that occurs when a spouse can no longer receive proper care at home. Supplemental needs trusts can also provide important benefits to Medicaid recipients.[307]

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[303] The State of New York Department of Social Services promulgated regulations that require notification of the creation and funding of the trust, distributions for less than fair market value, distributions that substantially deplete the trust, and the death of the beneficiary. N.Y. CODES R. & REGS. TIT. 118 § 360-4.5(B)(5)(III).

[304] 42 U.S.C. § 1382b; *see also supra* notes 172-74 and accompanying text.

[305] 20 C.F.R. §§ 416.1180-.1182 (1996).

[306] 42 U.S.C. § 1396r-5 (1996).

[307] 42 U.S.C. § 1396p(d)(4)(A) & (C) (2000). For a discussion of third-party trusts created for a Medicaid beneficiary, see *infra* Part III.A.3.

Even in "welfare" programs under Temporary Assistance to Needy Families block grants, states are required to allow welfare recipients with dependent children to maintain their benefits despite increased earnings.[308] States also have the option to eliminate resource limits for pregnant women and children applying for Medicaid.[309] Finally, a state is permitted to use a portion of its TANF block grant to fund "individual development accounts" that will allow recipients to save earned income and use it for post-secondary educational expenses, for the purchase of a first home, or to capitalize a business.[310]

These developments may potentially narrow the gap between means-tested programs and social insurance. Recipients of means-tested programs are allowed to maintain additional income and resources, establish special accounts for specific purposes, or enjoy the benefit of assets that are placed in certain forms of trusts. These allowances and exemptions mitigate the limitations, inadequacies, and gaps of these benefit programs and provide a supplemental source of funds that can be used for "beneficiary-centered" treatment, care, and services.[311] Therefore, supplemental needs trusts, or similar "dedicated" resource accounts, improve people's lives and complement the benefits available from means-tested government benefit programs.

VI. CONCLUSION

Supplemental needs trusts play an important role in enhancing the quality of life for people with disabilities who are unable to cure their poverty through employment. Pooled supplemental needs trusts provide opportunities for nonprofit groups to expand the scope of their services for the benefit of a greater number of people. Supplemental needs trusts create opportunities for independent living, innovative rehabilitation and therapy, employment, and other activities that give life meaning. The concept of the supplemental needs trust should be strengthened, replicated, and expanded.

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[308] *See, e.g.*, N.Y. SOC. SERV. LAW § 131-a(8)(a)(iii) (McKinney 2000) (excluding a percentage of earned income, but imposing a limit on eligibility if income exceeds the applicable poverty level).

[309] 42 U.S.C. § 1396a(a)(17) (1996). *See also*, HERSHKOFF & LOFFREDO, *supra* note 290, at 219 n.34.

[310] HERSHKOFF & LOFFREDO, *supra* note 288, at 39 (*citing* Pub. L. No. 104-93, 110 Stat. 2105, § 103 (1996)).

[311] VLADEK ET AL., *supra* note 21, at 100.