

First Supplement to Memorandum 91-64

Subject: Study L-708 - Special Needs Trust for Disabled Minor or Incompetent Person (Report of Executive Committee of State Bar Probate Section)

CHANGES RECOMMENDED BY STAFF

Exhibit 1 is the report of the Executive Committee of the State Bar Estate Planning, Trust and Probate Law Section. The staff recommends we accept the following revisions suggested by the ExComm:

(1) Section 3604 should be broadened to provide that reimbursement also applies to a special needs trust created under the substituted judgment provisions of conservatorship law. (This point was also made by attorney James Palmer -- see basic memo).

(2) The Comment to Section 3604 should say something like: "Section 3604 permits reimbursement from trusts established under Section 3602 or 3611, or under the substituted judgment provisions of conservatorship law (Sections 2580-2586). Section 3604 does not affect reimbursement rights with respect to other trusts."

(3) The Comments to Sections 3602 and 3611 should say something like: "In approving the terms of the trust, the court may, for example, require periodic accountings, court approval for certain kinds of investments, and the giving of a surety bond."

Suggestions (1) and (2) above may be implemented by further revising Section 3604 as set out on pages 1 and 2 of the basic memo as follows:

Prob. Code § 3604 (added). Reimbursement from trust for public support  
3604. ~~If a trust is established under Section 3602 or 3611 on or after January 1, 1993:~~  
(a) This section applies only to a trust established on or after January 1, 1993, that satisfies one of the following requirements:  
(1) The trust is established under Section 3602 or 3611.  
(2) The trust is established under Article 10 (commencing with Section 2580) of Chapter 6 of Part 4 of Division 4 to receive money or other property paid or delivered pursuant to a compromise or judgment for the conservatee.  
(a) (b) Notwithstanding any provision in the trust instrument, on the death of a minor or incompetent person who

is the beneficiary of the trust, trust property is subject to claims of public entities for reimbursement to the extent authorized under the Welfare and Institutions Code.

~~(b)~~ (c) The trustee shall give written notice of the beneficiary's death to all public entities having a potential claim against trust property pursuant to subdivision (a). Failure to give notice to a public entity as required by this subdivision prevents the running of the statute of limitations on that entity's claim against trust property.

Comment. Section 3604 is new. It permits public entities to obtain reimbursement from trust assets at death of the beneficiary to the extent reimbursement is authorized by the Welfare and Institutions Code. See, e.g., Welf. & Inst. Code §§ 7513-7513.2 (reimbursement for state hospital costs), 14009.5 (reimbursement for Medi-Cal benefits).

Section 3604 permits reimbursement from trusts established under Section 3602 or 3611, or under the substituted judgment provisions of conservatorship law (Sections 2580-2586). Section 3604 does not affect reimbursement rights with respect to other trusts.

#### EXCOMM SUGGESTIONS ALREADY RECOMMENDED IN THE BASIC MEMO

Two suggestions of the ExComm were anticipated by the following revisions recommended in the basic memo:

(1) Section 3604 was made to apply only prospectively to trusts established after the operative date.

(2) The following language was deleted from the Comment to Section 3604: "On the death of the beneficiary, trust property becomes subject to such claims under Section 3604." This language was misleading, and might have been read to broaden the reimbursement authority in the Welfare and Institutions Code.

#### EXCOMM SUGGESTIONS NOT RECOMMENDED BY STAFF

##### Assets From Other Sources Added to the Trust

The ExComm would make clear that reimbursement applies only to damages or settlement proceeds, and not to assets added to the trust from other sources, such as a devise from a parent. To do this, the ExComm would revise what is now subdivision (b) of Section 3604 in the draft above to refer to "trust property consisting of money or other property paid or delivered pursuant to a compromise or judgment for a minor or incompetent person is subject to claims of public entities for reimbursement . . . ."

The staff's problem with this is that it creates a question whether income from damages or settlement proceeds will be subject to

reimbursement. And, if assets from other sources are commingled with damages or settlement proceeds and payouts are made to the beneficiary, by what formula is the amount of trust assets subject to reimbursement to be determined?

The staff thinks the change suggested by the ExComm would require complex drafting to deal with these questions. If damages or proceeds of settlement are subject to reimbursement, the staff thinks it would be hazardous and ill-advised for an attorney to recommend putting assets from other sources into the trust.

Applicability of Federal Law

The ExComm says federal law may limit reimbursement, and federal law will control over state law. We could say in subdivision (b) of Section 3604 (see draft above) that trust property is subject to reimbursement claims "to the extent authorized under the Welfare and Institutions Code as limited by federal law." We do not recommend this change. It states the obvious, and is potentially true of every statute we recommend.

Respectfully submitted,

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RE: Tentative Recommendation Special Needs Trust for Disabled Minor or Incompetent Person

Dear Commissioners:

The Executive Committee as a whole considered the above Tentative Recommendation. The ExComm strongly supports the proposed amendments to §§3602 and 3611 authorizing the establishment of a trust for the proceeds of a compromise or judgment involving a minor or incompetent person.

Properly drawn, the trust offers many advantages to a court-blocked account, a guardianship, or a conservatorship:

(1) Public benefits may be maintained.

(2) Administration of assets in trust can be substantially less expensive and more flexible than the court-blocked account, guardianship or conservatorship alternatives. In structuring such trust, most courts are very willing to minimize the extent of court involvement while insuring protections for the

beneficiary. For example, the trial court may allow the trustee to invest without court approval, change trustees without court approval, sell real estate, etc. On the other hand, it is common for courts to require periodic accountings and bonds where necessary.

(3) Assets held in trust avoid the expense and delay of probate in passing property to heirs of the disabled person on death whereas assets held in a court-blocked account, guardianship, or conservatorship are subject to probate administration.

ExComm nevertheless has serious concerns with proposed §3604.

1. The Section May Violate Federal Law

In Citizens Action League v. Kizer (1989) 887 F2d 1003 (a copy of which is enclosed), the U.S. Court of Appeals, Ninth Circuit, held that the part of Welfare and Institutions Code §14009.5 which allows recoupment of Medi-Cal benefits from the decedent's interest in joint tenancy assets was inconsistent with federal law and void.

Federal law provides that "No adjustment or recovery of any medical assistance correctly paid on behalf of an individual under the State plan may be made, except...in the case of any other individual who was 65 years of age or older when he received such assistance, from his estate." 42 U.S.C. §1396p(b)(1)(B). The Court noted that because Congress did not define "estate" it must be guided by the common law meaning of the term.

After a review of Powell On Property and several New York cases, the Court concludes that the term "estate" excludes interests in property held in joint tenancy.

Kizer may be read to stand for the proposition that States may recoup Medicaid benefits only from the probate estate of a decedent. Claims against non-probate property, such as joint tenancy or trust property, are permissible only if federal law is amended to expressly authorize such claims.

If the Commission determines that this section is not inconsistent with federal law, then we offer the following policy concerns:

2. Policy

ExComm noted that new §3604 for the first time gives the Medi-Cal program a right of recoupment against trust assets. There were strong feelings expressed that such a lien should not be permitted since it would establish a precedent for the future. The ExComm is very strong in its opposition to any Medi-Cal lien or

recoupment right which would apply to inherited funds or to any trust property during the life of the beneficiary.

On a vote of 21 to 4, ExComm decided to oppose §3604 unless it is clarified as follows:

(a) Federal Protections Must Apply

Federal law allows a Medicaid lien on "the estate" of a recipient only if (1) the eligible person was over age 65 when services were received, (2) there is no surviving spouse, and (3) there is no surviving child of the eligible person under 21 or who is blind or who is permanently disabled. These protections also must apply to claims under §3604.

The Comment to §3604 states that "On the death of the beneficiary, trust property becomes subject to such claims under §3604."

This sentence is misleading since it might be construed to authorize a claim immediately on death notwithstanding the protections of federal law and W & I §14009.5. Consequently, the sentence should be revised to state "On the death of the beneficiary, trust property becomes subject to such claims under §3604 in accordance with the provisions of law regarding such claims."

(b) Trusts with Combined Assets

Trusts established for a disabled minor or adult under §3602 et. seq. are frequently used to receive assets from other sources, such as devises from parents. As noted above, we are strongly opposed to a lien on inherited funds.

Instead of providing in §3604(a) that "trust property is subject to a claim....", this section should provide that "trust property consisting of any money or property paid or delivered pursuant to a compromise or judgment for a minor or incompetent person is subject to a claim...."

(c) Limiting Recoupment Right to Trust Established Under 3600 et. seq.

The Comments should indicate that the right of recoupment is limited only to trusts established under §3600 et. seq. With respect to creditors' rights regarding other trusts, the law remains unchanged.

(d) Effective Date

Proposed §3604 includes no effective date for claims made under this section. Because the changes made by §3604 are

substantial, for planning purposes we strongly urge that §3604 apply only to trusts which are established after the effective date of the legislation.

3. Amendments to §§3602 and 3611

ExComm considered whether a trust established by a trial court judge would have sufficient protections for beneficiaries. After discussion and vote, we adopted the following proposal with only one dissent:

(a) In the Comments include a list of provisions the court might consider in reviewing trusts (e.g. periodic accountings, court approval for certain investments, surety bond, etc.). We believe it would be unwise to require any specific provision or protection in the statute itself since this would deprive the trial court of the flexibility to fashion a trust to suit the particular circumstances of the case.

(b) If the Commission believes that the above is insufficient, it might consider transferring responsibility for approval of the trust's provisions to the Probate Department.

Respectfully submitted,



Sterling L. Ross, Jr.

cc: Members of Team 1  
Members of the Executive Committee  
Bob Temmerman (ExComm's LRC Representative)