Impact of the Uniform Trust Code on Third-Party SNTs

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Introduction

The National Conference of Commissioners on Uniform State Laws ("NCCUSL") was born in 1892 of our federalist system, with the common law and statutory law of the several states governing most aspects of daily life. It has had a long history of success in drafting proposed state laws that either make more uniform the various states' approaches, or forge new ground in an effort to liberalize commerce and promote the smooth administration of law. Particular successes have been the Uniform Commercial Code, the Uniform Transfers to Minors Act, and Uniform Acts regarding partnerships, limited partnerships, and limited liability companies. Even when forging new ground, however, NCCUSL has never disrupted enduring principles of established common law.

That record appears to have come to an end with the Uniform Trust Code ("UTC").

On the one hand, the UTC has been adopted in some form by 19 jurisdictions in the 6 years since its promulgation, due to intense lobbying by NCCUSL and those it has recruited in the several states to promote the UTC, along with NCCUSL's reputation based on over a century of drafting uniform state laws.

But on the other hand, the reaction against the UTC has been quite simply without precedent in the history of proposed Uniform Laws. Of the jurisdictions that have adopted it, most have made significant changes. North Carolina, South Carolina, and Maine have rejected the UTC's abolition of the discretionary-support distinction in the comments. Kansas dropped Sections 503 & 504, and Oregon dropped Section 504. The UTC appears to have no chance of adoption in the leading trust jurisdictions of Alaska, Delaware, Nevada, and South Dakota. In fact, after almost two years of meeting weekly, South Dakota's UTC study committee abandoned the UTC and decided to model its proposed trust code after the Iowa Trust Code, an excellent settlor-oriented trust code. An ad-hoc UTC study committee in Massachusetts, a state steeped in centuries of trust law, composed of trust officers, academics, and practitioners, has made significant changes in its review, including deletion of Sections 503 and 504. Texas, Minnesota, and Indiana enacted such minor portions of the UTC that they are not even considered among the adopting states (although NCCUSL attempted to claim both Texas and Iowa in its count of "substantial similar" states until Texas and Iowa attorneys complained). Two state legislatures have rejected the UTC

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outright: Oklahoma and Colorado. The most stunning event was in Arizona. Arizona adopted the UTC in 2003, and, in response to the criticisms from that state's estate planning and elder law bar, unanimously and retroactively repealed the UTC the following year. NCCUSL makes light of all of this on its website, but these actions by state legislatures is unprecedented in uniform law history. If nothing else, the UTC has already failed in its most basic and most important mission: to create near uniformity among state law.

And where elder law attorneys have looked deeply into the issues, the results are often not promising for the UTC, either. For example, after hearing debate between proponents and opponents in May 2005, the Michigan Elder Law Committee voted 67-0 against the UTC. And on February 16, 2006, the Elder Law Section of the Colorado Bar Association voted unanimously against the UTC.

The pace of initial adoption by the UTC is strange, indeed. There has been no outcry by estate planning lawyers, nor by the general public, that trust law (developed over 700 years by the courts) is terribly broken, and must be "fixed" immediately. Sure, trust law could be improved, in some states more than others. It would be lovely were it more uniform among the states. But the rush to codify cannot be explained by any crisis in the common law…indeed, the proponents of the UTC claim that the UTC merely codifies the common law (a claim with which I disagree). Codification of common law is a risky undertaking, and ought be undertaken only with great deliberation, and not to pursue some other agenda.

Problems with the UTC: Introduction

There is a catalog of problems with the UTC, some major, some minor. The UTC has been roundly criticized for: opening up lines of attack by divorcing spouses or otherwise weakening creditor protection in some respects; the relative ease with which a trust may be modified or terminated; strict requirements to account and report to a large number of beneficiaries, including contingent beneficiaries and beneficiaries the settlor does not wish to be kept informed; beneficiary control over trustee removal; and the large number and serious nature of mandatory provisions: provisions the settlor is not permitted to draft out of.

A very serious problem is that almost all provisions of the UTC are effective as of the date of its enactment for all trusts, whether revocable or irrevocable on that date.[1] In its zeal for uniform compliance with its view of trust law, the UTC strives for uniformity not only among the states, but amongst the living and the dead. But does not this upset the settlor's intent, who created his or her trust under a different set of rules? Why should an irrevocable trust, silent as to whether a trustee should consider other resources available to a beneficiary, suddenly have its common-law presumption reversed?[2] For all of you with irrevocable trusts that are amendable by the trustee, or revocable trusts, do you relish the prospect of deciding whether and how to amend trusts, and if so, notifying all of your clients and implementing the amendments?

[1] UTC §1106. Duties to inform beneficiaries are prospective only, UTC §813(e).

[2] UTC §814 cmt references Reporter's Notes to *Restatement (Third) of Trust*s (hereinafter "Restatement (Third)") §50 comment e, which admits it is reversing the position of the prior restatements. The *Restatement (Second) of Trusts* (hereinafter "Restatement (Second)") position was that if the trust was silent, there was a presumption that the trustee would disregard the beneficiary's other resources. *Restatement (Second)* §128 cmt e.

As Roy Adams remarked about the UTC and whether he as a practitioner felt comfortable practicing under it: "I could live with it if it is the state's law as long as I was certain my change of situs clause would let me get out of it in certain circumstances. Sir, overall, this might be, and I know is going to be a dangerous comment, perhaps one step forward and two steps backward."[3]

In response to criticism of the UTC, to its credit, NCCUSL has addressed some problems in changes to the UTC in 2001, 2003, 2004, and most significantly in 2005. (While to its credit, these changes are also an "admission against interest" regarding criticisms of the UTC.) As of this writing, it has not been amended for 2006.

However, the most serious problems remain. The key is to understand the common thread that ties all of these problems together: the pervasive underlying philosophy of the UTC is a switch from a settlor-orientation in trust law to a beneficiary-orientation. This is discussed at greater length near the end of these materials, at "Philosophy" on page 23.

Problems with the UTC: A Beneficiary's Enforceable Right to Distributions[4]

This paper focuses on the most serious specific problem of all in the UTC.[5] The other problems listed above tend to affect all trusts. Unlike the problems listed above, the problem this paper focuses on affects Third-Party Supplemental Needs Trusts ("TPSNTs") almost exclusively and could be absolutely fatal to all of them.

This problem is also the most subtle and difficult to detect: a beneficiary's enforceable rights to distributions. Like many of the problem areas of the UTC, the provision that gives rise to the problem[6] is one that is mandated: the attorney is not permitted to draft around it.[7]

Why Are Third-Party SNTs Effective? Enforceable Rights vs. Spendthrift Clauses

Why are Third-Party SNTs ("TPSNTs") effective in benefiting the disabled beneficiary, while not being a countable asset respecting public benefits? It is not, as is commonly thought, because of the protections that most states afford the beneficiary's interest in the trust if the trust has a spendthrift clause. A spendthrift clause is a restraint on alienation by the beneficiary of the beneficiary's interest in the trust. If there is a valid and enforceable spendthrift clause, courts in the United States have near universally extended the effect of the clause to say that a creditor of the beneficiary may not access the trust.

But for means-tested public benefits *eligibility* purposes, the creditor protection of a third-party trust spendthrift clause is irrelevant. The beneficiary does not owe anyone a dime. Instead, the beneficiary seeks money that is in the government's pocket, by complying with its rules. One of the rules for many programs is a limitation on financial resources. So, what matters is: is the

[3] Roy M. Adams and Charles A. Redd, *The Uniform Trust Code: Nineteen Down and Thirty-Two to Go,* Cannon Financial Institute teleconference, July 18, 2006.

[4] Statements in this paper about the general state of common law or Medicaid law may be disturbed here and there by particular state statutes or other quirks of law. Ohio is a good example.

[5] The major problems permeating the UTC, in my estimation, are discussed at "Overarching Problems with the UTC at page 22.

[6] UTC §814(a)

[7] UTC §105(b)(2)

beneficiary's interest in the trust a countable resource? The answer is: it is countable only if it is "available" to the beneficiary, and this means "actually available".[8] And it is "actually available" to the beneficiary only if the beneficiary has the right to compel the use of trust funds for the beneficiary, or the right to compel a distribution to the beneficiary by order of a court.[9] On this point all agree, regardless of their position on the UTC. The points in this paragraph were well put forth by Richard Davis and Stan Kent in one section of their *NAELA Journal* article.[10]

One more word about spendthrift clauses and eligibility before we proceed. One might also think that a spendthrift clause is still necessary for a trust interest to be deemed unavailable, as without one, a beneficiary could sell their interest in the trust to a third party for cash. But the interest could only be sold for cash if it were worth something, and it could only be worth something if the beneficiary had an enforceable right to distributions.[11] So, either the trust gives the beneficiary an enforceable right to distributions, in which case the trust is a countable resource anyway and the spendthrift clause does not help; or the trust does not give the beneficiary an enforceable right to distributions, in which case the beneficiary's interest is worthless on the open market even in the absence of a spendthrift clause, the beneficiary will be eligible, and the spendthrift clause is unnecessary. Don't get me wrong: a spendthrift clause is almost always a good idea to have in a trust, and is particularly important where the trust does give the beneficiary an enforceable right to distributions. But it is not the only, nor best, source of creditor protection, and is not the reason a trust can be considered not an available resource for means-tested public benefits.

Discretionary Trusts

So, the next question becomes: what sort of trust gives the beneficiary no enforceable rights to distributions?

The answer at common law is simple: a discretionary trust where the trustee's discretion is complete. If the trust makes clear that the trustees discretion is "uncontrolled," the beneficiary has no enforceable rights to distributions.[12] This concept, and how to draft it, is developed below at "Structuring a Trust with No Enforceable Rights to Distributions" on page 12.

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[8] See Clifton B. Kruse, Jr., *Third Party and Self-Created Trusts – Planning for the Elderly and Disabled Client*, Ch. 3 subhead "Asset Protection Trusts: Construct "Legal Availability" (3rd Ed. 2002); *Emerson v. Wynia*, 754 F.Supp. 705 (D.Minn 1991); *Zeoli v. Commissioner of Social Services*, 179 Conn. 83, 425 A.2d 553 (1979).

[9] This is the same principle that applies to make my money not a countable resource should you need public benefits: my money was never your money, and even though I could give you some if I chose, I do not have to, and you have no right to force me to.

[10] Richard E. Davis and Stanley C. Kent, *The Impact of the Uniform Trust Code on Special Needs Trusts*, 1 NAELA Journal 235 at §III(D) (Number 2, 2005).

[11] The Restatement (Second) cuts through the analysis and says "…if by the terms of a trust it is provided that the trustee shall pay to or apply for a beneficiary only so much of the income and principal or either as the trustee in his uncontrolled discretion shall see fit to pay or apply, a transferee or creditor of the beneficiary cannot compel the trustee to pay any part of the income or principal." *Restatement (Second) of Trusts* (1959) §155(1). It then provides the reason at cmt (1)(b): "…because the beneficiary could not compel payment to himself or application for his own benefit."

[12] *Restatement (Second) of Trusts* (1959) §128 cmt d ("If the settlor manifests an intention that the discretion of the trustee shall be uncontrolled, the beneficiary cannot compel the trustee to make any payment to him or application for his benefit, if the trustee does not act dishonestly or arbitrarily or from an improper motive."); *Scott on Trusts* (4th Ed. through Supp 2005) §128.3 ("If the settlor manifested an intention that the discretion of the trustee should

Discretionary Trusts and Support Language

Next, let's consider the effect of adding some sort of distribution standards or support-type language in a trust that grants the trustee discretion. This may seem to the reader a bit of a digression in these materials, but it will be relevant when we discuss the UTC and enforceable rights. And it has caused a great deal of confusion in some of the literature and a few of the courts.

To facilitate this discussion, let me begin by employing the following terms. Categorizing trusts in this way will help us to understand how trusts are treated and why they have been treated that way by the courts…even when the courts themselves (and commentators) were unclear!

There are really just two trust language factors for us to consider in how a trust is drafted in order to understand not only when a beneficiary has enforceable rights to distributions, but also why some of the literature, and a few courts, can get confused when "standards" types of distribution language is thrown in. Those two factors are: (1) the type of discretion granted, and (2) the presence or absence of a standard. Regarding discretion, a trust (other than one with strictly mandatory payouts, like a unitrust) necessarily gives a trustee discretion, even if only implied. That discretion may have strings attached or other limits, or not. If there are limits, we'll call it "mere discretion" for our purposes. If there are no limits, we'll call it "absolute discretion."

The types of trusts are:

- Classic Discretionary Trust ("CDT"): A completely discretionary trust that clearly gives sole and absolute, or uncontrolled, discretion to the trustee, whether or not a standard is employed. This is what the literature refers to variously as a "purely discretionary trust," a "wholly discretionary trust," or an "absolute discretionary trust."[13] Some may mention standards-like language, some may not.
    - No-Standard Discretionary Trust ("NSDT"): A Classic Discretionary Trust with no standard.[14] In other words, a trust that clearly gives absolute discretion, and no mention of a standard.
    - Discretionary-Support Trust ("DST"): A Classic Discretionary Trust with standards-like language making an appearance.[15] In other words, a trust that clearly gives absolute discretion, with some mention of standards.[16]
- Support Trust ("ST"): Like is always the case for a DST, this trust usually has discretionary and standards-like language.[17] However, the discretionary language is not

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be uncontrolled, the court will not interfere unless he acts dishonestly or from an improper motive, or fails to use his judgment.")

[13] *See, e.g.*, Bogert, Bogert, & Hess, *The Law of Trusts and Trustees* (2nd Ed. Rev. 1980 Supp. through 2005) §560 text heading "Absolute or Uncontrolled Discretion".

[14] Example: "The trustee may, in its sole, absolute, and unfettered discretion, make distributions to or for the benefit of the beneficiary. The trustee need not make any distributions at all in its sole, absolute, and unfettered discretion."

[15] Example: "The trustee may, in its sole, absolute, and unfettered discretion, make distributions for the support or maintenance of the beneficiary. The trustee need not make any distributions at all in its sole, absolute, and unfettered discretion."

[16] This is only a subset of trusts referred to as "Discretionary-Support Trusts" in Clifton B. Kruse, Jr., *Third Party and Self-Created Trusts – Planning for the Elderly and Disabled Client* (3rd Ed. 2002) at p. 54 *et seq*.

of an "uncontrolled" or "absolute" nature, but rather "mere" discretion. The trustee's discretion is only to operate within a standard, and as we shall see, courts will generally not interfere so long as the trustee is being reasonable in the exercise of that discretion. This is *not* a CDT, as the trustee does *not* have uncontrolled discretion. Sometimes the trust will not mention discretionary language at all; however, it is implied anyway: *someone* has to decide how much the beneficiary needs, unless distributions are a fixed amount or determinable by formula (e.g., a unitrust) or circumstances (tuition at Harvard).

- Standards Trust ("TS"): Any trust that has some mixture of discretionary and standards-like language. A Standards Trust may be a Discretionary-Support Trust (DST), a Support Trust (ST), or not particularly clear about which it means to be. I'm dumping these two different kinds of trusts into one bucket here, but I have a reason. I invented this category for our discussion because sometimes both (all trusts with any standards-like language at all) are collected together[18] or analyzed together. By looking at each type separately, we see that with minor exceptions, DSTs behave in one way, while STs behave in another way.

Now, contrary to what you might think from having worked in elder law lo these many years, a beneficiary does not have a right to compel a distribution from a completely discretionary trust even if there is a standard in the trust, such as "health, education, maintenance, and support;" that is, to use my terminology above, a DST.[19] Indeed, and this may surprise you, of all of the cases listed in Bogert §560 under "Absolute or Uncontrolled Discretion," and immediately prior to that at Footnote 96 ("Other examples of lack of abuse of a discretionary power"), only one case did not have a standard.[20] Yet they are (correctly) listed as purely discretionary trusts.

Put another way, a trustee's discretion is subject to judicial review for an abuse of that discretion.[21] The standard for judicial review in a Support Trust (ST) is: was the exercise of the

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[17] Examples: "The trustee shall in its discretion make distributions for the health, education, maintenance, and support of the beneficiary" or "The trustee shall make distributions for the support, comfort, happiness, and welfare of the beneficiary."

[18] *See* Clifton B. Kruse, Jr., *Third Party and Self-Created Trusts – Planning for the Elderly and Disabled Client*, Ch. 3 subhead "Asset Protection Trusts: Construct "Legal Availability" (3rd Ed. 2002) for an extremely useful and large single collection of Standards Trust cases. What I am referring to as "Standards Trusts" is under the heading "Discretionary Support Trusts Created by Nonbeneficiary Settlors or Their Spouses" at page 54 *et seq* of Attorney Kruse's work. What I refer to as "Discretionary-Support Trusts" is a subset of what he refers to by that name.

[19] *Restatement (Second) of Trusts* (1959) §187 cmt j ("The mere fact that the trustee is given discretion does not authorize him to act beyond the bounds of a reasonable judgment. The settlor may, however, manifest an intention that the trustee's judgment need not be exercised reasonably, even where there is a standard by which the reasonableness of the trustee's conduct can be judged. This may be indicated by a provision in the trust instrument that the trustee shall have 'absolute' or 'unlimited' or 'uncontrolled' discretion. These words are not interpreted literally but are ordinarily construed as merely dispensing with the standard of reasonableness.").

[20] Bogert, Bogert, & Hess, *The Law of Trusts and Trustees* (2nd Ed. Rev. 1980 Supp. through 2005) §560 n.96 and text heading "Absolute or Uncontrolled Discretion". The case with no standard was *Rowe v. Rowe*, 219 Or. 599, 347 P.2d 968 (1959).

[21] Criteria for determining abuse of discretion may include "(1) the extent of the discretion conferred upon the trustee by the terms of the trust; (2) the purposes of the trust; (3) the nature of the power; (4) the existence or non-existence, the definiteness or indefiniteness, of an external standard by which the reasonableness of the trustee's conduct can be judged; (5) the motives of the trustee in exercising or refraining from exercising the power; (6) the existence or nonexistence of an interest in the trustee conflicting with that of the beneficiaries." *Restatement*

trustee's discretion "reasonable?"[22] But if the trust is a Classic Discretionary Trust (CDT), a court will not interfere with the trustee's exercise of discretion even if the trustee was unreasonable. The court will only interfere if the trustee was acting dishonestly or from an improper motive, or simply ignored the trust altogether.[23] [24]

The general misunderstanding among practitioners (and a few courts) about the effect of a standard in a discretionary trust on the right of a beneficiary to compel distributions has three primary causes.

First, sometimes all trusts that talk about both discretion and standards – Standards Trusts in my terminology – are analyzed together. Without the right criteria by which to judge and filter cases, it can appear that courts are all over the map: sometimes ruling the trust is a support trust and the beneficiary has a right to compel distributions, other times not.

Second, we do indeed have cases with badly drafted trusts; and, as the maxim goes, "bad facts make bad law." Sometimes, we just can't tell if a Standards Trust is a ST or a DST, even if it contains "sole and absolute discretion language." For example, a trust may say in one part "The trustee may in its discretion make distributions to or for the benefit of the beneficiary for the care, comfort, and support of the beneficiary," and in another part, "The trustee shall in its sole and absolute discretion make distributions for the beneficiary's welfare." The mixture of permissive and mandatory language ("may" vs. "shall"), mere discretion vs. absolute discretion, and different standards language in different places, invites an uncertain result and the substitution of the judge's judgment for the settlor's and trustee's. What is the judge to do? Of course, we can't discount the fact that judges are human. (Then, in some cases, a trust may have been clear, but an anomalous result is obtained anyway. This is bound to happen simply because not every judge is an expert in every area of law.)

Third, besides the occasional anomalous case here or there, there is indeed a tiny minority of three states (Iowa was a fourth, since changed by statute, and North Dakota may be becoming one) – Pennsylvania (with a few other factors), Ohio, and Connecticut – where any mention of standard-type words creates an enforceable right, no matter how carefully worded to indicate

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(Second) of Trusts (1959) §187 cmt d. However, it is important to understand that the criteria for determining abuse of the trustee's exercise of discretion is not the same thing as the judicial standard for review of the trustee's exercise of discretion.

[22] *Restatement (Second) of Trusts* (1959) §187 cmt e ("If discretion is conferred upon the trustee in the exercise of a power, the court will not interfere unless the trustee in exercising or failing to exercise the power acts dishonestly, or with an improper even though not a dishonest motive, or fails to use his judgment, or acts beyond the bounds of a reasonable judgment. The mere fact that if the discretion had been conferred upon the court, the court would have exercised the power differently, is not a sufficient reason for interfering with the exercise of the power by the trustee.").

[23] *Restatement (Second) of Trusts* (1959) §187 cmt j (see quote at fn 19). See also fn. 48.

[24] Think of it this way. A DST that said "sole and absolute discretion to make distributions for health, education, maintenance, and support" gives the trustee "sole and absolute" discretion, even to distribute nothing, but IF the trustee makes distributions, the distributions must be for the health, education, maintenance, or support of the beneficiary. In this case, we might think of HEMS not as a standard, but rather something like "the class of things the trustee can spend money on." Since, the trustee doesn't have to distribute anything at all, it makes no sense to speak of the trustee being "reasonable" as a reason for a court to interfere.

otherwise.[25] As we shall see, it is this minority position that is adopted by the Restatement (Third).

In the other states, carefully worded so as to be clear that the discretion is absolute, even if the trust contains a standard the vast majority of the time[26] no enforceable right to distributions will be found, especially if there are multiple current beneficiaries with trustee discretion to make unequal distributions.

Nonetheless, the most common practice, a practice with which I agree, is to put no standards-type language in TPSNTs at all, or to put language in that is clearly precatory in nature, expressing a wish for the beneficiary to live a as fulfilling a life as possible and so forth, and nonetheless still dancing around and avoiding words like "support," for fear that Social Security and state Medicaid agencies will divine an enforceable right to support from these trusts, at least for purposes of determining that the trust is an available asset for public-benefits purposes. And indeed, not being known as scholars of trust law and having ulterior monetary motives, some have. Prudence is the better part of valor, and it seems an unnecessary risk to draft a TPSNT as a DST, no matter how much law is on your side in your state.

Discretionary Trusts and Supplemental Needs Language

As means-tested government benefits became more and more important in the lives of more and more people after the mid-1960's, and particularly as the programs' financial rules became more restrictive during the 1980's and into the 1990's, the ability to design a trust with a lack of

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[25] Ohio: *Metz v. Ohio Dept. of Human Services*, 762 N.E. 2d 1032 (OH App. 2001); *Bureau of Support in the Department of Mental Hygiene and Correction v. Kreitzer*, 243 N.E.2d 83 (Ohio 1968); *Matter of Gantz*, 1986 WL 12960; *Samson v. Bertok*, 1986 WL 14819 (the creditor did not recover because it was not a governmental claim); *Matter of Trust of Stum*, 1987 WL 26246; *Schierer v. Ostafin*, 1999 WL 493940 (the creditor did not recover because it was not a governmental claim). In the above SNT cases, the government was able to attach the beneficiary's interest and force a distribution pursuant to the standard.

Pennsylvania: Pennsylvania courts have generally held that if a discretionary support trust was for one beneficiary and such sole beneficiary was not receiving governmental benefits at the time of creating the trust, then the settlor intended that the principal of the trust as an available resource to the beneficiary. *Estate of Taylor v. Department of Public Welfare*, 825 A.2d 763 (Penn. 2003); *Shaak v. Pennsylvania Department of Public Welfare*, 747 A.2d 883 (Penn. 2000); *Estate of Rosenberg v. Department of Public Welfare*, 679 A.2d 767 (Penn. 1996); Commonwealth Bank and Trust Co., 598 A.2d 1279 (Penn. 1991).

Connecticut: *Corcoran v. Department of Social Services*, 271 Conn. 679, 859 A.2d 533, (Conn. 2004) (discretionary trust coupled with any standard is a support trust).

Iowa: *Strojek v. Hardin County Board of Supervisors*, 602 N.W. 2d 566 (Iowa App. 1999) also see the follow up unpublished opinion where the Iowa Appellate Court expanded the definition of the distribution language as much broader than "basic needs": *Strojek v Hardin County Board of Supervisors*, 2002 WL 180377 (Iowa App. 2002); Also see *McCabe v. McKinnon, 2002 WL 31757533* (Iowa App. 2002) an unpublished decision. These cases overturned by Iowa Code 633.4702.

North Dakota: While Iowa has left the ranks of using a hybrid classification, North Dakota may have joined these ranks to become the fourth state that follows the distinctly minority view that whenever a trust contains a standard, a beneficiary is entitled to some type of distribution. In *Eckes v. Richland County Social Services*, 621 N.W.2d 851 (N.D. 2001), when the distribution language coupled a support standard with the uncontrolled discretion of the trustee, the Supreme Court stated the trust was a hybrid trust. However, due to other factors, unrelated to the distribution standard, Social Services was not able to recover from the trust. Further, in *Kryzsko v. Ramsey Social Services*, 607 N.W.2d 236 (N.D. 2000), a support standard took precedence over the uncontrolled discretion of the trustee.

[26] See, e.g., fns. 12, 19, and 20.

enforceable rights in a beneficiary to compel distributions took on new importance. It was no longer important only for creditor protection and to protect an imprudent beneficiary from himself or herself. It was critical for parents and others planning for disabled children dependent upon these programs.

Practitioners responded in a variety of ways, some more cautious and defensive than others. In a 2001 article, Cynthia Barrett set forth six common distribution standards and their typical or most likely effects on means-tested government benefits.[27] This list was modified slightly in a recent update to the Elder Law Portfolio.[28] Combining these two and using the terminology of this paper yields seven distribution standards. (The first – Mandatory Support – is one no elder law attorney would intentionally use for a TPSNT.)

1. Mandatory Support
2. DST
3. NSDT, no mention of Supplemental Needs
4. NSDT, Precatory Language regarding Supplemental Needs
5. NSDT, with explicit authority to reduce benefits
6. NSDT, but with SSI restrictions, including prohibiting in-kind support and maintenance (ISM)
7. NSDT, but with SSI restrictions, except distributions for ISM permitted

This brings a few other possibilities to mind, such as:

8. NSDT, except that Trustee must take into account other resources of beneficiary (no explicit prohibition of paying for things that government programs will pay for)[29]
9. NSDT, with mandatory "supplement but not supplant" language
10. NSDT, with mandatory "non-support" language

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[27] Cynthia Barrett, *Distribution Standard for the Special and Supplemental Needs Trust*, NAELA Q. (Summer 2001).

[28] Thomas D. Begley, Jr., Lisa Nachmias Davis, and Robert B. Fleming, *Special Needs Trusts*, Elder Law Portfolio Series (Portfolio 3, Release 24 dated March 2006, Julie A. Braun – General Editor, Harry S. Margolis – Founding Editor, Aspen Publishers), , §3-5.1(a).

[29] In the absence of explicit language, the common law is that a trustee need not consider other resources of a beneficiary. *Restatement (Second) of Trusts* (1959) §128 cmt e. The UTC §814(a) cmt states that "whether the trustee has a duty in a given situation to make a distribution depends on … whether the beneficiary has other available resources." It is not entirely clear from the context of that comment if the trustee must always take other resources into account. However, the Restatement (Third) 50 cmt (e) clearly reverses the common law presumption and, if the trust is silent, requires the trustee to take other resources into account, though the trustee has some discretion in the matter.

It is extremely doubtful that Standard #8 would be effective to make a trust unavailable for means-tested government benefits if it were anything less than completely discretionary, thus giving the beneficiary no enforceable rights. The addition of "the trustee must take into account other resources" is more of a "belt and suspenders" approach, and not a substitute for complete trustee discretion.

Standard #8 is a softer approach than Standard #9 that so angered four of the seven justices in *Young v. Ohio*, but does it carry a risk with it?: if the trustee must take other resources of the beneficiary into account before making a distribution, does this imply that the distributions relate to the beneficiary's support?

The especially cautious and defensive approaches[30] arose in particular in the early years of SNTs, when no one was exceptionally sure just what would work. After all, practitioners were dealing with a sometimes politically charged issue, frequently irrational state Medicaid agencies, and the occasional judge with an agenda. This caution was likely fueled by adverse court decisions involving Standards Trusts, where either the trust was a support trust with discretionary language (a ST), or poorly drafted so as to make interpretation difficult, or (in the case of a truly discretionary trust with support-type language (a DST)) a judge simply too eager to latch onto any kind of standards language in order to achieve the result of an available resource.

My informal observation is that the trend among practitioners has been away from the restrictive approaches.[31] The most recent update to the Elder Law Portfolio describes the key to a successful TPSNT is trustee discretion.[32] Clifton Kruse wrote that "pure discretionary trusts, with or without spendthrift protections, [insulate] the trusts' assets from consideration by the state Medicaid agency … as an available asset of the trust beneficiary."[33] One practitioner with a national reputation has even stated that "Supplemental trust language is for sissies!"[34]

Nonetheless, it seems to me that Distribution Standard #4 – "NSDT with precatory language" – is, or is becoming, the favored standard except in a small minority of states where there may be statutes or cases that contraindicate that approach. Cynthia Barrett wrote in 2001 that "the discretionary precatory distribution language is likely to become the most common third party created trust SNT distribution standard".[35] And at this year's Suffolk University Elder Law Institute XII, the panel on drafting TPSNTs was unanimous in stating that they were now drafting all TPSNTs as "NSDT with precatory language" trusts.[36]

Why is this? Permit me to work backwards from Standard #10. This Standard would surely be the "safest" from an eligibility viewpoint, but is overly restrictive, as it prohibits the trustee from providing support for the beneficiary, whether or not there are other resources available. (Imagine a trust where the only thing the trustee was permitted to provide the beneficiary was "so much caviar as the beneficiary can personally consume.") But at least it would be clear to even the most aggressive judge that this was not an available resource. The desired outcome really is that expressed by Standard #9: the trust can pay for anything, but the trustee is

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[30] Standards 6, 9, and 10, and to some extent 7.

[31] I by no means assert that more restrictive standards are "wrong" or that they may not be appropriate at times even for a practitioner who favors less restrictive approaches.

[32] Thomas D. Begley, Jr., Lisa Nachmias Davis, and Robert B. Fleming, *Special Needs Trusts,* Elder Law Portfolio Series (Portfolio 3, Release 24 dated March 2006, Julie A. Braun – General Editor, Harry S. Margolis – Founding Editor, Aspen Publishers), §3-3.1.

[33] Clifton B. Kruse, Jr., *Third Party and Self-Created Trusts – Planning for the Elderly and Disabled Client,* (3rd Ed. 2002), p. 71.

[34] Julie Osterhaut and Britton G. Swank, *Third Party Trusts for the Person with Disabilities*, materials for The Basics of Special Needs Trusts, Stetson University College of Law, October 23, 2003, p. 9.

[35] Cynthia Barrett, *Distribution Standard for the Special and Supplemental Needs Trust,* NAELA Q. (Summer 2001).

[36] Response of Panel on Drafting to question by Panel Moderator. Panel consisted of Harry S. Margolis, Emily S. Starr, Neal A. Winston, Ken W. Shulman, and Mark W. Worthington (moderator). Suffolk University Elder Law Institute XII (March 16, 2006) The Suffolk University Elder Law Institute is an annual full-day program of CLE sponsored by Suffolk University Law School and the Massachusetts Chapter of the National Academy of Elder Law Attorneys, Inc. The sole topic of the Institute XII was Third-Party Supplemental Needs Trusts. The entire morning was devoted to the Panel on Drafting.

prohibited from paying for things the government will pay for. But this is just the sort of language that the dissent in *Young v. Ohio*[37] found so detestable. As Clifton Kruse put it:[38]

> Young is certainly a warning to us who draft third-party [supplemental needs] trusts. It is our clients' money; they have a right to describe its use, but in a milieu where government dollars for 36 million Medicaid beneficiaries must be carefully allocated, the policy expressed [by the *Young* dissent] suggests that we best not flaunt what we perceive now as a right. Our language directing our trustees should be created to emphasize pure discretion without flouting comments; our words should clearly affirm use of the trust funds for supplemental care only – for goods and serves not otherwise available from any source, public or private, for it is clear that the language which we use makes a difference and should be structured to cause the least offense to those who will be later determining whether what we have said is lawful judged by changing concepts of what is right and good for us – public policy by any name.[39]

There are a few cases, such as *Young* and *Kryzsko v. Ramsey County Social Services*,[40] that indicate that the expression of intent by the settlor that the trust be used to supplement and not supplant other sources of support was a factor in determining that the trust was not an available resource. This is very different from the sort of prohibition that so enraged *four* of the seven justices in *Young*.[41] Rather, it is a message to the judge that when the settlor wrote that this is a

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[37] *Young v. Ohio Dept. of Human Serv.*, 76 Ohio St. 3d 547, 668 N.E.2d 908 (1996).

[38] Clifton B. Kruse, Jr., *Third Party and Self-Created Trusts – Planning for the Elderly and Disabled Client*, (3rd Ed. 2002), p. 72.

[39] It is often remarked that the dissent in *Young* was just one short of a majority (the vote was 4 to 3). The truth is scarier. One of the majority strongly agreed with the dissent, saying that "the world of Medicaid eligibility is rife with … duplicity and treachery" and that the Young trust was an "abuse," but voted with the majority because by the time the case came to the Ohio Supreme Court, "the loophole exploited in this case has been closed by [recently adopted Ohio legislation]." *Young* p. 552.

[40] 607 N.W.2d 237 (N.D. 2000).

[41] Although not the only factor, what particularly seemed to stick in the craw of the *Young* dissent was that the beneficiary had an enforceable right to distributions, *except* for what the government would pay for. This is somewhat akin to the reaction to "supplement but not supplant" language in pre-OBRA93 self-settled Medicaid Qualifying Trust (42 USC §1396a(k)(1)) cases, as in these self-settled trusts, the settlor-beneficiary, absent the attempted "supplement but not supplant" restriction, also had an enforceable right in to distributions from the trust. The reason the beneficiary has an enforceable right in a self-settled discretionary trust is that at common law the beneficiary's creditors have access to that trust to the maximum extent of the trustee's discretion. See, e.g., *Ware v. Gulda*, 331 Mass. 68, 117 N.E.2d 137 (1954); *Outwin v. Commissioner*, 76 T.C. 153 (1981); *Restatement (Second) of Trusts* (1959, through Supp. Sept. 2005) §156(2); *Scott on Trusts* (4th Ed. through Supp 2005) §156(2); Bogert, Bogert, & Hess, *The Law of Trusts and Trustees* (2nd Ed. Rev. 1980 Supp. through 2005) §223. (Alaska, Delaware, Nevada, Rhode Island, and Utah have statutes that may prove to allow self-settled asset protection trusts.)

Some of these MQT "supplement but not supplant" cases are: In *Romo v. Krischner*, 889 P.2d 32 (Az. App. 1995) the court stated, "The approach merely gives license to transfer assets into a trust which, if the trust documents recite an intent to supplement governmental benefits, will be shielded from otherwise applicable eligibility. In our view, that would reopen the very loophole that Congress sought to close.; *In re Lennon*, 683 A.2d. 239 (Super. Ct. 1996) cites N.J.S. § 30:4D-6f that provides "Any provision in a . . . trust agreement . . . which reduces or excludes coverage or payment for goods and services to an individual because of that individual's eligibility for or receipt of Medicaid benefits shall be null and void, and no payment shall be made under this [governmental benefit act] as a result of any such provision." In *Williams v. Kansas Department of Social and Rehabilitation Services*, 899 P.2d. 452 (Kans. 1995), the Kansas Supreme Court states, "The plaintiff argues that the funds in trust cannot be deemed available to Gregory because the trustee does not have discretion to use the trust funds to pay for basic support

NSDT (a discretionary trust with no mention of support), the settlor meant it, and that the beneficiary has no enforceable rights to distributions, even if the beneficiary is impoverished.

Structuring a Trust with No Enforceable Rights to Distributions – Common Law

As described earlier at "Discretionary Trusts," on page 4, in order for the beneficiary to have no enforceable rights to distributions,[42] we need a Classic Discretionary Trust – a trust that gives the trustee uncontrolled discretion in making distributions. At common law, in the vast majority of states, we have bright-line rules about how to structure a CDT. The primary factors used to determine if a trust is a CDT under common law are as follows.

- The most important, and frequently determinative factor, is if words such as "sole and absolute" are used to describe the trustee's discretion, or other words that clearly manifest the settlor's intent that the trustee's discretion by uncontrolled.[43]
- Close in importance is coupling uncontrolled discretion with permissive language. Many cases emphasize the importance of permissive language: that the word "may" is used rather than "shall" in describing the trustee's exercise of discretion.[44] Combined with "sole and absolute" discretion, these two factors are nearly always determinative of the existence of a CDT.
- Some courts have noted that when uncontrolled discretion is coupled with the ability to make unequal distributions among multiple current beneficiaries, there is little if any question that the settlor intended to create a discretionary trust.[45]

Some courts have noted that words such as "comfort and general welfare" may not be capable of judicial determination, and that this language may remove a trust from being classified as a support trust.[46] Personally I would not view this as a fourth factor. Few courts have taken such a position. And while "to or for the benefit of the beneficiary" may be nebulous enough, and possibly even "general welfare," it seems to me that if my beneficiary is starving to death, that my beneficiary cannot be very comfortable, and that "comfort" could be read as a "support plus a whole lot more" standard. I would simply draft to include no standard whatsoever.

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which is available from any source, including state or federal benefits. In *Estate of Wallace v. Director,* 628 S.W.2d 388 (Mo. App. 1982), the court considered a similar argument and stated: 'The defect in the logic of this argument lies in the fact that the appellant is asking the Division to premise its determination of claimant's need on the assumption that claimant will be entitled to assistance. Entitlement to assistance, however, is the end product of the Division's inquiry; it may not be assumed as the first step.'" *Also see, Forsyth v. Rowe,* 1995 WL 152124 (Conn. Super. 1995); *Hatcher v. Department of Health and Rehabilitative Services,* 545 So. 2d 400 (Fla. 1989), and *Barham by Garham v. Rubin,* 816 P.2d 965 (Hi. 1991).

[42] I've taken a tip from Harry Margolis' Elder Law Forms Manual to emphasize that the beneficiary has no enforceable rights by adding: "Neither the Beneficiary nor any person acting on his or her behalf as guardian, conservator, guardian ad litem, attorney, or agent, except for the Trustee alone, shall have any right, power, or authority to liquidate the Trust, in whole or in part, or to require payments from the Trust to or for the Beneficiary for any purpose."

[43] *Restatement (Second) of Trusts* (1959) §187 comment j; *Scott on Trusts* (4th Ed. through Supp 2005) §187 and cases cited.

[44] *State ex. rel. Secretary of SRS v. Jackson,* 822 P2d 1033 (KS 1991); *Tidrow v. Director, Division of Family Services,* 688 S.W.2d 9 (Mo. App. 1985); *Matter of Henry's Estate,* 565 P.2d 1166 (Wash 1977).

[45] *Dryfoos v. Dryfoos,* 2000 WL 1196339 (Conn. Super. 2000) unreported case; *McNiff v. Olhstead County Welfare Dept.,* 176 N.W.2d 888 (Minn. 1970).

[46] *Bohac v. Graham,* 424 NW 2d. 144 (ND 1988).

Recall that the standard for judicial review of the exercise of a trustee's discretion for Support Trusts is: did the trustee act within the bounds of reasonable judgment?[47] But once a trust is determined to be a CDT, the judicial standard for interference with the trustee's exercise of discretion is:[48]

1. Did the trustee act dishonestly?
2. Did the trustee act with an improper motive?
3. Did the trustee fail to exercise judgment?

Due to the high threshold of judicial review, the beneficiary of a CDT does not have a property right, has no enforceable right to distributions, and holds nothing more than a mere expectancy.[49]

Structuring a Trust with No Enforceable Rights to Distributions – UTC

It is absolutely critical for the drafter of a third-party SNT to have bright-line rules, to know what language is safe so as to create no enforceable rights in the beneficiary. The common law gives this to us.

"Good Faith" Standard of Judicial Review

The UTC itself is silent on the issue of a beneficiary's enforceable rights and how to achieve a lack thereof. Unlike the Restatement (Second), there is no section describing how to create a trust with absolute discretion. Unlike the Restatement (Second), there is no section that states that if a trustee has absolute discretion, the beneficiary has no enforceable rights. The one relevant section is the section on judicial review, which establishes the following single standard for all trusts:

> Notwithstanding the breadth of discretion granted to a trustee in the terms of the trust, including the use of such terms as "absolute," sole", or "uncontrolled", the trustee shall exercise discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries.[50]

What is a judge to do with a "good faith" standard for review?

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[47] *Infra* note 22.

[48] *Restatement (Second) of Trusts*, § 187 cmts e, j; *Scott on Trusts* (4th Ed. through Supp 2005) §§187.2, 187.3, and 187.4; Bogert, Bogert, & Hess, *The Law of Trusts and Trustees* (2nd Ed. Rev. 1980 Supp. through 2005) §560 at "Update: Absolute Or Uncontrolled Discretionary Powers Of Trustees". Some have construed *Bogert* as implying a continuum of discretion that does not allow for the full spectrum of trustee discretion (that is, that does not allow for such complete discretion that a beneficiary has no enforceable right to distributions). Case law strongly favors the position of *Scott* and the *Restatement (Second).* E.g., *In Re Jones*, 812 P.2d 1152 (Colo. 1991); *Ridgell v. Ridgell*, 960 S. W. 2d 144 (Tex. App. 1997); *Kansas Dept. of Social and Rehabilitation Services*, 866 P.2d 1052 (KS 1994); *Simpson v. State, Dept. of Social and Rehabilitation Services*, 906 P.2d 174 (Kan.App.,1995); *Wright v. Wright*, 2002 WL 1071934 (Iowa App. 2002)(not cited for publication); *First Nat. Bank of Maryland v. Department of Health and Mental Hygiene*, 399 A.2d 891 (Md. 1979); *In re Tone's Estates*, 39 N.W.2d 401, (Iowa 1949); *Town of Randolph v. Roberts*, 195 N.E.2d 72 (Mass. 1964). It appears that virtually all case law draws a line indicating where a trust does not create an enforceable right. I know of no case holding that there is a "continuum of discretion," must less one that says "and the continuum isn't allowed to include the discretion to give the beneficiary nothing."

[49] *U.S. v. O'Shaughnessy*, 517 N.W.2d 574 (Minn. 1994); *In re Marriage of Jones*, 812 P.2d 1152 (Colo. 1991).

[50] UTC §814(a).

As with almost all areas of trying to apply the UTC, a judge has three options. (1) Decide that this is a new statute that does away with prior trust law, and make up his or her own mind what it means. (2) Look to prior common law of the state. (3) Look to the comments under UTC §814.

Meaning of "Good Faith" Option 1: New Statute, Make Up New Law

If the judge starts making up new law, particularly in an era of increasing and sometimes extreme hostility to Medicaid recipients, we can have no confidence whatsoever in the result. The judge could decide that "good faith" means "reasonable," or something less than reasonable, or even merely "not dishonest, not with improper motive, and not failing to exercise judgment."

Meaning of "Good Faith" Option 2: Look to Prior Common Law

If the judge turns to prior common law for the definition of "good faith," what will the judge find? A confusing and inconsistent mish-mash of cases and commentary. Black's Law Dictionary (6th Ed.) said that "good faith [has] no technical or statutory meaning" and defined "bad faith" as the opposite of "good faith." The 8th Edition under a new editor does not say that, but says the concept is "elusive," quoting from Brownsword's "Good Faith in Contracts." The contrast is stark: "good faith" and "bad faith" are something akin to "unascertainable standards" compared to the clear and well defined "dishonesty, improper motives, or failure to exercise judgment."

Sometimes courts and commentators will use both terms. The courts (and *Scott* to some extent) tend to use the terms "good faith" and "bad faith" rather loosely. Often no distinction is made, other than that they are opposite. Sometimes a distinction is made, as where Scott on Trusts says (1) that a court will not interfere with the trustee's exercise of discretion if the trustee acts in good faith, from proper motives, and is reasonable; and (2) the court will interfere if the trustee acts in bad faith.[51] The distinction to be made in *Scott*, of course, is that we are not told that the court *will* interfere if the trustee acted without good faith, but without bad faith, either.

What do the cases actually say? When courts use the judicial review standard of only improper motive, dishonesty, or failure to exercise judgment, I am not aware of any case where there is not a bright line established: the cases hold that a beneficiary has neither an enforceable right nor a property interest.

But where courts have used "good faith," as the standard for judicial review, or have used the terms "good faith" and "bad faith" as pure antonyms, the results are inconsistent, with some cases resulting in discretionary trusts conferring enforceable rights.[52] But in cases that only speak

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[51] *Scott on Trusts* (4th Ed. through Supp 2005) §187 (second paragraph) and §187.2 at fn. 10.

[52] *In re Ferrels Estate,* 258 P.2d 1009 (Cal. 1953) (beneficiary of a discretionary trust coupled with a standard does not have an enforceable right under a good faith or bad faith standard); *Ventura County Dept. of Child Support Services v. Brown,* 117 Cal.App.4th 144, 11 Cal.Rptr.3d 489 (2004) (discretionary trust coupled with a standard invaded by court for creditor under good faith/bad faith analysis even though court found that the debtor/beneficiary had no enforceable right).

Sometimes courts conflate "good faith" with "reasonableness". At other times, they may speak of "good faith" and "bad faith" but nonetheless use the standard of "dishonesty, improper motive, or failure to exercise judgment" in deciding the case. For example, *In re Estate of McCart,* 847 P.2d 184 (Colo. App. 1992), where the court found an abuse of discretion due to improper motives in a Classic Discretionary Trust where the trustee did not make distributions to current discretionary beneficiary because the trustee was the remainder beneficiary and wanted the trust assets for himself, but the court went on to say that this was a breach of the trustee's duty to act in good faith.

of "bad faith," with no reference to "good faith," it appears that there is no case where the court found a that beneficiary held an enforceable right.[53]

Some states that have enacted, or are considering enacting, the UTC, have substituted "bad faith" for "good faith" in UTC §814(a), apparently convinced that the "good faith" language is a problem, convinced from the UTC's inconsistent application of the two terms that there is indeed a difference between "good faith" and "bad faith" standards, and hoping that "bad faith" will be the equivalent of "dishonest, with improper motive, or failing to exercise judgment."[54]

But in any event, the point is not to debate the terms. It is best to simply to avoid a "good faith" and a "bad faith" standard altogether.

Meaning of "Good Faith" Option 3: look to UTC §814 Comments

Finally, the judge might turn to the comments under UTC §814. What will the judge find there as to the meaning of "good faith" for a judicial standard of review? And for its implications as to a beneficiary's enforceable right to distributions?

First, a bright spot is that the comment to UTC §814 says that UTC §814(a) does not impose a reasonableness standard, although a court may impose one if the trust has a standard by which reasonableness of the trustee's judgment can be tested. So, if the UTC won't tell us, at least a comment tells us we are to never put standards in the trust, or if we do to put in meaningless ones, if we wish to avoid a reasonableness standard for judicial review.[55]

So, even though we do not know what "good faith" means, if we include no standards, at least it seems plain that we do not have a "reasonableness" standard. Right?

Well, the comment to UTC §814 also speaks of distribution standards, and cites to Restatement (Third) §50, which says:

> Sometimes trust terms express no standards or other clear guidance concerning the purposes of a discretionary power, or about the relative priority intended among the various beneficiaries. Even then a general standard of reasonableness, or at least of good-faith judgment, will apply to the trustee (Comment b), based on the extent of the trustee's discretion, the various beneficial interests created, the beneficiaries' circumstances and relationships to the settlor, and the general purposes of the trust.[56]

And:

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[53] *SunTrust v. Children's Hospital*, 2003 WL 21085046 (Va. Cir. Ct. 2003); *In re Estate of McInery*, 289 Ill. App. 3d 589 (Ill. App. 1997); *Simpson v. State, Dept. of Social and Rehabilitation Services*, 906 P.2d 174 (Kan.App.,1995); *First Nat. Bank of Maryland v. Department of Health and Mental Hygiene*, 399 A.2d 891 (Md. 1979); *Town of Randolph v. Roberts*, 195 N.E. 2d 72 (Mass. 1964); *In re Maeder's Estate*, 329 N.Y.S.2d 663 (N.Y.Sup. 1972); *Greenwich Trust Co. v. Tyson*, 10 Conn. Supp. 147 (Conn. Super. 1941). According to Andy Strauss of the North Carolina UTC committee, this was the primary reason why North Carolina chose the term "bad faith" over "good faith" as the judicial review standard under UTC § 814(a).

[54] North Carolina; Ohio in its amendments to the UTC for "wholly discretionary trusts." Missouri limited UTC §814(a)'s "good faith" standard to the presence of an ascertainable standard for distributions.

[55] This UTC comment cites to *Restatement (Second)* §187 cmt f. "cmt f" is the wrong cite, as "cmt f" is a two short sentences and a brief example regarding dishonesty. And in any event, the proposition that a distribution standard will cause a court to impose a reasonableness standard for judicial review is not true for Classic Discretionary Trusts (CDTs).

[56] *Restatement (Third)* §50 cmt d.

> It is not necessary, however, that the terms of the trust provide specific standards in order for a trustee's good-faith decision to be found unreasonable and thus to constitute an abuse of discretion.[57]

So, follow along now. We do not have a reasonableness standard for judicial review if we have no standards for distribution. (That's UTC §814(a) comment, which references Restatement (Third) §50.) But even if the trust provides no standards at all, a good-faith decision may be found unreasonable. (That's Restatement (Third) §50 comment d). That's OK: "reasonableness" is supposed to be a higher standard than "good faith," so it should be possible to pass "good faith" and nonetheless flunk "reasonableness." But now look: if you do flunk "reasonableness," *you have committed an abuse of discretion!* (That's Restatement (Third) §50 comment b). Can the UTC then be fairly read by a judge to have imported, by the backways and byroads of comments and the Restatement, a *reasonableness standard* into your completely discretionary, no-standards trust?

Perhaps. Perhaps not. For a Classic Discretionary Trust, which the Restatement (Third) refers to as giving the trustee "extended discretion," Comment c to Restatement (Third) §50 modifies Comment b:

> Although the discretionary character of a power of distribution does not ordinarily authorize the trustee to act beyond the bounds of reasonable judgment (Comment b), a settlor may manifest an intention to grant the trustee greater than ordinary latitude in exercising discretionary judgment. …
>
> [W]ords such as "absolute" or "unlimited" or "sole and uncontrolled" are not interpreted literally.

So far this is fine, and is in concert with common law. But then the comment continues:

> Within these limits, it is a matter of interpretation to ascertain the degree to which the settlor's use of language of extended (e.g., "absolute") discretion manifests an intention to relieve the trustee of normal judicial supervision and control in the exercise of a discretionary power over trust distributions. …

So the comment refuses to give us any bright-line language we can use to signal the judge that we intend to have our trustee's exercise of discretion judged by the standard of dishonesty, improper motive, and failure to exercise judgment. It is always a matter of interpretation, and always a matter of degree.

And then the bombshell:

> The overall tenor of the terms of a power may … in the context of the trust's more general purposes, lead to an interpretation granting the trustee ordinary discretion with respect to the benefits to which the discretionary beneficiary is minimally entitled (e.g., reasonable support), with the extended discretion applicable to the trustee's allowance of more.

Nothing about "if the trust contains ascertainable standards" then maybe we can find minimal entitlements despite the grant of "sole and absolute discretion."[58] Just "the overall tenor,"

[57] *Restatement (Third)* §50 cmt b.

"context," and "general purposes." And once again, a reasonable judge could fairly read a reasonableness standard into your discretionary trust, deciding that your trustee has only ordinary discretion regarding the beneficiary's minimal entitlements. And that's a reasonable judge. What about a judge with an agenda?

With such a marvelous variety of comments to choose from, how much confidence do you have that the judge will pick the one you want?

What Enforceable Rights *Does* the Beneficiary Have?

UTC §814

Now, if your judge has chosen to seek the meaning of "good faith" in the comment to UTC §814, presumably he or she will also be prone to looking to the UTC comments for guidance as to the beneficiary's rights to distributions. What will the judge find there? Under common law, the absence of a reasonableness standard for judicial review went hand-in-hand with the absence of a beneficiary's enforceable right to distributions: both were tightly coupled to Classic Discretionary Trusts (trusts with "uncontrolled" or "sole and absolute" discretion.) But they need not be hand-in-hand under the UTC, as we no longer have the concept of a Classic Discretionary Trust.

The comment to UTC §814 says:

> Subsection (a) does not otherwise address the obligations of a trustee to make distributions, leaving that issue to the caselaw.

If that were so, if the UTC were leaving undisturbed the common law rights of a beneficiary to compel a distribution, then all would be well. This is the implication created in the NAELA Journal article, where it first laments, regarding the right of a beneficiary to compel distributions: "Unfortunately, the UTC is silent on this important question."[59] It then attempts to give the impression that nothing has changed regarding a beneficiary's enforceable rights to distributions, by reciting the common law proposition that a beneficiary has no right to compel a distribution from a discretionary trust with words like "sole and absolute" discretion,[60] and then jumping to an attempt to argue that a "good faith" standard for judicial review is not a change from common law.[61] But it leaves behind the glaring statement: *the UTC is silent on this important question.*

Now, if I am correct, and a "good faith" standard for judicial review of a CDT is a change from the common law, then existing caselaw, predicated on the standard of "dishonesty, improper motive, and failure to exercise judgment" is irrelevant. But even if I am not correct on that point, immediately after the UTC §814 comment says that it leaves the issue to caselaw, it *doesn't* leave that issue to caselaw. It immediately refers us to Restatement (Third) of Trusts, Section 50, "with numerous case citations," which appears to emphasize its importance over the next cite, which is simply the Restatement (Second) (does that mean it is without numerous case citations?). It also refers to the 1961 Columbia Law Review article by the Reporter for the

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[58] Which proposition would be contrary to common law. See "Discretionary Trusts and Support Language" at page 5.

[59] Richard E. Davis and Stanley C. Kent, *The Impact of the Uniform Trust Code on Special Needs Trusts*, 1 NAELA Journal 235, ¶III(B) (Number 2, 2005).

[60] *Id.* at ¶III(C).

[61] *Id.* at ¶III(E).

Restatement (Third), wherein the author takes the view that beneficiaries nearly always have enforceable rights to at least some distributions.[62]

The comment to UTC §814 then claims to summarize these references by stating that under these standards (which are not standards, but factors), whether the trustee has a duty in a given situation to make a distribution depends on:

- the exact language used;
- whether the standard grants discretion and its breadth;
- whether this discretion is coupled with a standard;
- whether the beneficiary has other available resources; and
- the overriding purpose of the trust.

Can you find in these bullets a way to give the beneficiary no enforceable rights to distributions? Especially given the Restatement (Third) comments quoted herein so far?

But let's press on, for at last we find a hopeful statement, if you're willing to bet your life on comments:[63]

> For example, distilling the results of scores of cases, the Restatement (Third) of Trusts concludes that there is a presumption that the "trustee's discretion should be exercised in a manner that will avoid either disqualifying the beneficiary for other benefits or expending trust funds for purposes for which public funds would otherwise be available."[64]

The portion of the Restatement (Third) that is referred to is not a comment about judicial standards for review, nor about a beneficiary's rights to distributions. It is about the Restatement (Third's) reversal of the common law presumption that the trustee need not take into account a beneficiary's other resources in the exercise of its discretion, but it is not about expanding the trustee's discretion to a degree that the beneficiary has no enforceable rights. The Restatement (Third) presumption is that the trustee "is to consider the other resources but has some discretion in the matter."[65] This presumption can be overridden by the settlor. If the settlor does not override it, then:

> If a discretionary beneficiary is or may be eligible to receive public benefits, this factor, like the availability of other resources generally, is to be taken into account by the trustee under the usual rule of construction. Thus, to the extent consistent with the terms and purposes of the trust, and allowable by applicable benefits statutes (see Reporter's Notes), the presumption is that the trustee's discretion should be exercised in a manner that will avoid either disqualifying the beneficiary for other benefits or expending trust funds for purposes for which public funds would otherwise be available.[66]

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[62] Edward C. Halbach, Jr., *Problems of Discretion in Discretionary Trusts*, 61 Columbia L. Rev. 1425 (1961).

[63] UTC §814 cmt.

[64] Query if this ought not to say "should be exercised *and exercisable only* in a manner that will avoid…" (added language in italics).

[65] *Restatement (Third)* §50 cmt e.

[66] *Restatement (Third)* §50 cmt e(4).

But look at what we've done. Recall the list of distribution standards from "Discretionary Trusts and Supplemental Needs Language" on page 8. In the comment e(4) to Restatement (Third) §50, what are we relying on to achieve means-tested program eligibility, to have the trust be regarded as unavailable? We're *not* relying on complete discretion giving the beneficiary no enforceable rights, as in Distribution Standards #3 and #4. Instead, we're relying on a requirement that the trustee take public benefits into account in exercising its discretion. Respecting the issue of taking into account a beneficiary's other resources, we've created a hybrid between Distribution Standard #8 and Distribution Standard #9. This hybrid "comment e(4) trust" requires the trustee to take into account other resources, like Distribution Standard #8, and singles out public benefits, like Distribution Standard #9.[67] That's the same Distribution Standard #9 that so enraged four of seven judges in *Young*, and that Clifton Kruse warned us against using.[68]

Further, as we apparently have no sure way to ensure the beneficiary has no enforceable rights under the UTC, to the extent that "comment e(4)" requirement to take public benefits resources into account is successful in blocking the trustee from paying for such expenses, we have a beneficiary with an enforceable right to both luxuries and support, but not support that public benefits will pay for. This is exactly the *Young* case, and it was exactly this that particularly galled the four *Young* judges. The trust in *Young* directed that:[69]

> The Trustee **shall** pay such amounts of the net income and, if necessary, principal of this Trust as she deems **necessary for the benefit of** JANET LEE YOUNG…
>
> Distributions of income or principal to or for the benefit of JANET LEE YOUNG **shall** be made **liberally and generously**, but not for the purpose of providing for anything which could otherwise be provided for her by governmental or other assistance.
>
> … the Trustee shall not make any distributions of income or principal for the benefit of JANET LEE YOUNG which shall render her ineligible or cause a reduction in any benefit she may be entitled to receive, including, but not limited to, the following: institutional care provided by the State or Federal government, Social Security, Supplementary Security Income, Medicare, and Medicaid.

The *Young* dissent response to this?

> [T]hese assets … were to be "liberally and generously" used for [Janet's] benefit, unless the government could pick up the tab. I would find that to allow a trust to distribute income or principal for virtually any purpose except for purposes that would eliminate or reduce Medicaid is against public policy.[70]

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[67] Respecting the issue of taking into account a beneficiary's other resources, the hybrid "comment e(4) trust" differs from Distribution Standard #9 in that Distribution Standard #9 prohibits distributions for good and services for which the beneficiary is eligible to have paid by pubic benefits, whereas the hybrid "comment e(4) trust" requires the trustee to take public benefits into account. Based on comment e(4), it seems that the Restatement (Third) believes that any Trustee taking public benefits into account would be compelled to not make distributions that would supplant said public benefits, which in effect makes the hybrid "comment e(4) trust" identical to Distribution Standard #9 respecting the issue of taking other resources into account.

[68] See text citing fn. 38.

[69] *Young v. Ohio Dept. of Human Serv.*, 76 Ohio St. 3d 547 at 549, 668 N.E.2d 908 (1996). [My emphasis.]

[70] *Id.* at 553.

To this it may be argued: "But settlor intent rules the day, and no settlor would intend to supplant public benefits." But if that is so, why are there hundreds of SNT cases that have litigated this very point?

UTC §504

Article Five of the UTC is typically thought of as the "creditors' rights" article. And for the most part, it is. But Article Five is not entitled "Creditor's Rights." It is titled "Creditor's Claims; Spendthrift and Discretionary Trusts". And UTC §504 is titled, "Discretionary Trusts; Effect Of Standard." Those aren't colons, they are semicolons. The Article is indeed about, among other things, discretionary trusts.

Consistent with our findings that the UTC gives us does not seem to allow for a Classic Discretionary Trust (a CDT – one with uncontrolled discretion that grants the beneficiary no enforceable rights to distributions), UTC §504 contains no distinction between discretionary and support trusts with respect to creditors' rights. Even if a beneficiary has an enforceable right to a distribution, it blocks creditors from compelling a distribution from a discretionary trust,[71] while preserving whatever rights the beneficiary may have had to compel a distribution.[72] That is a great result, and I'm all for it. UTC §504 speaks of all trusts where the trustee has any discretion, whether or not there is a standard, and makes no mention of the extent of the trustee's discretion as being a factor.

But the comment to UTC §504, at least prior to 2005, was very disturbing and revealing. The comment to UTC §504 states that "This section, similar to the Restatement, eliminates the distinction between discretionary and support trusts, unifying the rules for all trusts fitting within either of the former categories. See Restatement (Third) of Trusts Section 60 Reporter's Notes to cmt. a (Tentative Draft No. 2, approved 1999)." Now, we can see that the distinction has been eliminated respecting creditors' rights by virtue of UTC §504 itself: it addresses all trusts. But the pre-2005 comment only addressed "this section," and was silent about whether the distinction was alive for other purposes, such as a beneficiary's right to distributions. This reinforced the conclusion arrived at above in this paper, which is that it was impossible to create a Classic Discretionary Trust, or at least, impossible to know how to create one.

In response to concerns that under the UTC it was impossible to remove a beneficiary's right to distributions, the UTC in 2005 amended, not §814(a) or its comments, but the comment to UTC §504. The 2005 amendment hastens to add that "Eliminating this [discretionary-support] distinction affects only the rights of creditors. The affect of this change is limited to the rights of creditors."[73] But the context of this addition is what "this section" does. Yes, This Section eliminates the distinction respecting creditors, and This Section does not eliminate the distinction in other respects. But it is not clear that the distinction is not eliminated in other respects by other means; only that this Section 504 eliminates the distinction only with respect to creditors.

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[71] UTC §504(b).

[72] UTC §504(d). However, if a trustee has not complied with a standard of distribution or has abused a discretion, the court may order a distribution for support or maintenance of the beneficiary's child, spouse, or former spouse. UTC §504(c).

[73] UTC §504 cmt. This addition to the comment was added in 2005. Strangely, although other amendments to the UTC and comments are meticulously documented, the comment to UTC §504 does not acknowledge this particular addition, but is simply silent on the matter.

If we follow the comment to UTC §504's reference to Restatement (Third) of Trusts Section 60 Reporter's Notes to cmt. a, our comfort level degrades. Section 60 is about creditors' rights; it is entitled "Transfer Or Attachment Of Discretionary Interests". The Reporter's Notes to Comment a of Section 60 says:

> This Section *(like § 50)* departs significantly from prior Restatements, and from some lines of cases that were largely influenced by the prior Restatement positions (and cf. Miss. Code Ann. §§ 91-9-505 and -507), in that this Restatement Third does not attempt to draw a bright line between "discretionary" interests (Restatement Second, Trusts § 155) and "support" interests (id. § 154)…[74]

And indeed, Restatement (Third) §50, entitled "Enforcement And Construction Of Discretionary Interests," confirms that the elimination of the discretionary-support distinction applies to a beneficiary's enforceable rights to distributions.[75]

The comment to UTC §504, having to do with creditors, naturally refers to Restatement (Third) §60 (having to do with creditors) at comment a. Comment e[76] of Restatement (Third) §60 contains perhaps the most disturbing words from the UTC or Restatement (Third) we have encountered yet:

> A transferee or creditor of a trust beneficiary cannot compel the trustee to make discretionary distributions if the beneficiary personally could not do so. *It is rare, however, that the beneficiary's circumstances, the terms of the discretionary power, and the purposes of the trust leave the beneficiary so powerless."*[77]

Where does the UTC Leave Us?

The common law tells us it is possible to draft a trust that gives a beneficiary no enforceable rights to distributions, and it tells us how to draft such a trust (a CDT).

In contrast, the UTC not only does not tell us *how* to draft a trust that gives a beneficiary no enforceable rights, but by its silence, and comments at UTC §814(a), it utterly dispenses with the common law distinction between CDTs (which give the trustee uncontrolled discretion and the beneficiary no enforceable rights) and all other trusts, leaving us in grave doubt that it is even possible to draft a trust with no enforceable rights to distributions.

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[74] My emphasis. The Note attempts to clothe with authority the *Restatement (Third)'s* position regarding the continuum of discretion, asserting that it is not changing the law; minimizing the work of the Restatement (Second), *Scott*, *Bogert*, and the significance of the majority (actually, near universal) line of cases (not merely "some cases") that support the discretionary-support distinction; and implying that the courts were all merely willing dupes of an unsupported position taken by the prior Restatements.

[75] *Restatement (Third)* §50 Reporters Notes (first paragraph). "Little of the contents of this Section appears in prior Restatements. … On the rejection in this Third Restatement of artificial distinctions between "discretionary" and "support" trusts, see extensive explanation in § 60, Reporter's Note to Comment a."

[76] Other comments to Restatement (Third) §60 that are not directly referred to by the UTC comments are legitimate to scrutinize. For example, UTC §504 itself, in a comment to the amendment that added UTC §504(e), states that the amendment was added "because of concerns that Restatement (Third) of Trusts Section 60, comment g, otherwise might allow a beneficiary-trustee=s creditors to reach the trustee=s beneficial interest." Yet, comment g was never previously referenced by the UTC or any of its comments at all.

As well, the UTC emphasizes that the UTC and the Restatement (Third) were drafted in close cooperation.

[77] *Restatement (Third)* §50 cmt e. My emphasis.

The Restatement (Third)'s and UTC's contention that there is a "continuum" of discretion and "only degrees of discretion" sounds oh-so-reasonable, oh-so-modern, but is oh-so-illusory and oh-so-anything-but-useful. Is there a "continuum of discretion"? Maybe there is. But whether or no, the common law allows a much *greater range* of discretion than the Restatement (Third) and the UTC. The United States is a continuum of territory 3000 miles wide; that does not mean that when you cross the Mississippi heading westward at St. Louis you have not traveled from Illinois to Missouri: there is a threshold, a useful demarcation. In their zeal to create a world where no beneficiary is without a right to bust a trust, the Restatement (Third) hasn't just erased the border between Illinois and Missouri. They don't want to acknowledge that the West exists. The slight of hand that the Restatement (Third) and UTC hope you won't notice is that while talking of "continuum of discretion," they have chopped off the part of the range of discretion they do not like. It is like a cartographer who dislikes westerners, drawing his maps of the US with nothing west of the Mississippi.

Overarching Problems with the UTC

Structure

A very serious and pervasive problem with the UTC is that it so heavily depends upon its comments and cross-references in the comments. Statutes are enacted, not comments. A statute must be able to stand on its own. Even if a judge looks to the comments of the UTC, the judge will be confronted with about 100 pages of comments, containing 107 cross references to the 900+ page Restatement (Third), which itself contains untold references to cases and law review articles. Within the UTC comment to §106 originally was the strong implication that the Restatement (Third), not prior common law, is the primary source of authority in interpreting the state's new statute (the UTC as enacted). This was reversed by the 2005 amendment to the §106 comment; however, the UTC comments are so shot-through with references to the Restatement (Third), which departs fundamentally from majority states' common law, most particularly respecting enforceable rights of beneficiaries, that in combination with §1101 (UTC shall be interpreted considering the need to promote uniformity of the law among enacting States), it is far from clear that the new comment to §106 will have any effect.

How important are the comments and the Restatement of Trusts (Third)? Remember that the UTC comments fairly invite the judge to refer to the Restatement (Third) for all guidance where the UTC does not specifically contradict the Restatement (Third). And if you think the Restatement is something you'll be able to argue is not law, we have the following from a retired justice of the Delaware Supreme Court, courtesy the official NCCUSL publication "UTC Notes":

> A judge considering a trust law question covered in the Trust Code … will have a wonderful tool to use for research and will have the solace of knowing that a particular provision in the Uniform Trust Code is positive law and therefore the judge can ignore any argument of counsel that the Restatement is not binding because it has not been enacted by a legislature.[78]

[78] Hon. Maurice A. Hartnett III, *A Judge's View of the Uniform Trust Code*, UTC Notes (Fall 2003) p. 2.

Philosophy

The genesis of the UTC was a 1961 law review article by a young associate professor, Edward C. Halbach, Jr. He took issue with the Restatement (Second), maintaining that beneficiaries nearly always have at least some enforceable rights to distributions. Professor Halbach became the Reporter for the Restatement (Third), and his views from the 1961 article are clearly reflected therein. And, as can be seen from the heavy cross-referencing, the UTC is the child of the Restatement (Third).

The whole point of a trust is for the settlor to control the settlor's funds on terms the settlor wants, via the trustee. Absent this, there is little reason for anyone to settle a trust; the settlor might as well just give the money to the beneficiary directly. In many ways not immediately obvious, the UTC fundamentally changes this orientation developed over 700 years.

The UTC orientation may come from the fact that happy beneficiaries don't sue trustees, and trustees don't typically sue beneficiaries. Only when beneficiaries are unhappy do we have a lawsuit. These are the cases that are studied, particularly in academia, and which drive the UTC and its ideological parent, the Restatement (Third).

Some call the UTC a "beneficiary's bill of rights," but the UTC goes further, and shifts the entire orientation of a trust to beneficiaries, and especially to judges. This is reflected in numerous provisions, including the ease of termination: not when necessary to conform to the settlor's intent, but merely if a court agrees with the beneficiaries that the trust is not *necessary* to achieve any "material purpose" of the settlor. (And a spendthrift provision is defined as "not a material purpose.")

While beneficiaries' rights might have appropriately been the dominant issue in trust law prior to an age of litigiousness, high divorce rates, and public benefits, now is hardly the time to make it impossible, or highly uncertain how or whether it is possible, to draft a trust giving a beneficiary no enforceable rights. Clients and their lawyers do know what they are doing when drafting discretionary trusts with no enforceable rights, and in any event it should not be up to academics or authors of uniform laws to decide that they know best how clients and their lawyers should be drafting trusts.

Because of this philosophy of trusts that imbues the Restatement (Third) and the UTC, the issue of UTC §814(a) and enforceable rights to distributions is one I do not expect proponents of the UTC will ever be willing to change. Fortunately, an increasing number of lawyers are finally aware of the problems, and several ad-hoc committees are at work on major re-write of the UTC.[79]

Conclusion

I do not at all believe that it is the intent of the UTC nor of the Restatement (Third) to make TPSNTs available assets for means-tested public benefits purposes. I think the Restatement comment quoted in the text at fn. 66 is good evidence of that. But I am not at all convinced that that the UTC will not in fact open the door to just that result. It is a beneficiary-oriented code,

[79] One such committee of over twenty attorneys has drafted multiple versions of an alternative to UTC Article Five/§814(a) that retains the common law distinction between a discretionary trust and support trust, and their different standards for judicial review.

born today but conceived in a day before means-tested public benefits. It is so bound to that orientation through its thicket of comments and references to the Restatement (Third) that it is unable to clearly, unambiguously, and simultaneously, without any apparent conflict, accommodate the concept of a trust with no enforceable rights that is the essence of a third-party supplemental needs trust.

Could the UTC be interpreted just as we are used to at common law, with a discretionary trust yielding no enforceable rights to distributions? I think so. Could it be interpreted in several other ways? Absolutely, likely even, and that is the problem. We as SNT drafters cannot afford uncertainty. We are constructing a code here. It should be clear and unambiguous, and furthermore should be so within the four corners of the statute. Assurances by proponents that judges will interpret the statute the way the proponents say should give no one comfort. Arguably, the fact that assurances need to be given should be more than enough to alarm us. If we are enacting a code, we have a chance to make it do what we need, and not be bound by arguing over just exactly what the status of the common law is. We can make it provide us with a bright-line method of giving a beneficiary no enforceable rights to distributions. Why not take that opportunity now?

Resources

Common Law

Scott on Trusts

Restatement (Second) of Trusts (1959)

UTC

Halbach, Edward C. Jr., *Problems of Discretion in Discretionary Trusts,* 61 Columbia L. Rev. 1425 (1961)

Restatement (Third) of Trusts (Professor Edward C. Halbach, Jr., Reporter; 1st Tentative Draft approved 1996; Final approved 2003)

Uniform Trust Code (First Draft 1995; Final 2000; Annual revisions since then except for 2002. www.nccusl.org).

In Favor of UTC

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Newman, Alan, *Spendthrift and Discretionary Trusts: Alive and Well under the Uniform Trust Code,* 40 Real Property, Probate, and Trust Journal 567 (Fall 2005).

Davis, Richard E. and Kent, Stanley C., *The Impact of the Uniform Trust Code on Special Needs Trusts,* NAELA Journal (2005, Vol. 1, No. 2, p. 235).

Opposed to UTC

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Merric, Mark and Oshins, Steven J.: *Effect of the UTC on the Asset Protection of Spendthrift Trusts,* Estate Planning Journal (August 2004, Vol. 31, No. 8, p. 375); *UTC May Reduce the Asset Protection of Non-Self-Settled Trusts,* Estate Planning Journal (September 2004, Vol. 31, No. 9, p. 411); *How Will Asset Protection of Spendthrift Trusts Be Affected by the UTC?,* Estate Planning Journal (October 2004, Vol. 31, No. 10, p. 478).

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