

**STRUCTURED SETTLEMENT,
THE PROBATE COURT,
AND
SPECIAL NEEDS TRUSTS**

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I. INTRODUCTION

You do your homework, negotiate hard, and win your case. The settlement proceeds are distributed, and you hope your client's life will be better. But it doesn't always work that way. Too often, the client's award is improperly distributed. Too much money is structured, leaving little cash for the client's immediate needs or not enough to pay estate taxes on the client's death. Or no money is structured, and the entire settlement proceeds are squandered. Even worse, the client is on needs-based benefits and no steps are taken to protect eligibility for those benefits. Money meant to care for the person for a lifetime is gone after a single hospitalization. Who is the client going to blame?

Among the many post-resolution issues that must be considered by the personal injury lawyer pre-resolution are the use of structured settlements, special needs trusts, and the role of the probate court, all of which are the subject of this discussion.

II. IS FAILURE TO ADDRESS THESE ISSUES MALPRACTICE?

A. Legal malpractice claims against personal injury attorneys regarding advice and settlement and/or negotiation issues are on the rise due to a lack of consideration of one or more of these issues. Several legal malpractice cases, have been brought for failure to advise clients of their ability to protect benefit eligibility.

1. For example, Christina Grillo settled a personal injury case in Texas for a lump sum upon the advice of her personal injury attorney. She later sued the attorney and Guardian *ad Litem* for malpractice. She alleged that the defendants: (i) failed to consult competent experts concerning a structured settlement; and (ii) failed to plan to preserve her Supplemental Security Income ("SSI") and Medicaid eligibility. Ms. Grillo alleged that a structured settlement with a special needs trust would have protected her personal injury settlement from dissipation, provided tax benefits, and protected her SSI and Medicaid benefits. The case was settled by all defendants for a combined sum of \$4.1 million. *Grillo v. Petiete et al.*, 96-145090-92 (96th Dist. Ct., Tarrant Cty., Texas); and *Grillo v. Henry Cause*, 96-167943-96, (96th Dist. Ct., Tarrant Cty, Texas).
2. In Connecticut, a personal injury claim was settled for James A. Saunders, III (Jamie) by his conservator. The conservator requested that the net settlement amount be placed in a special needs trust for Jamie to preserve his Medicaid eligibility. The State of Connecticut objected. The Supreme Court of Connecticut rejected the attorney general's argument that the conservator should spend down all of Jamie's assets and then re-apply for Medicaid assistance. The court ruled: "By contrast, with the creation of the trust, Jamie will retain his Medicaid eligibility and [the special needs trust] can provide for his supplemental needs from the trust assets, while Medicaid provides for his basic medical care. Therefore, not only is the

latter course of action clearly the better one for Jamie, *it may be fairly stated that by failing to follow it, the Probate Court, and [the conservator] potentially could have been deemed to be in dereliction of their duties to Jamie* (italics added)." *Dept. of Social Services v. Saunders*, 724 A.2d 1093, 1105 (Conn. 1999). This duty requires the fiduciary of an estate and indirectly, the trial lawyer, to protect the disabled client's settlement.

- B. Who Do You Represent? If you are bringing a claim on behalf of a minor or incapacitated adult, you are likely doing so at the behest of a family member, such as a spouse, parent or adult child. Is there a conflict? What legal authority does the family member have to bring the claim, let alone settle it? Does the family member also have a claim, e.g., a derivative claim for loss of consortium? It may not be apparent at first, but when it comes down to the dollars and cents of it, the claims are conflicting and motivations may not be pure. It is sound practice to seek appointment of an independent conservator prior to settlement, and who will have the knowledge and experience to manage the settlement funds once received. If not cost effective, then seek the appointment of a Guardian *ad Litem* for the minor or incapacitated adult in the underlying civil proceedings.
- C. Protect Yourself. Your file should document the fact that the special needs trust option (and the option to structure the settlement) was presented to the client. If the client chooses not to use a trust, you should have the client sign a statement to the effect that he/she was advised about the trust, he/shes understands that he/she will lose his/her benefits after the settlement proceeds are received, and he/she has chosen not to use a special needs trust. Also remember that if your client, who is on need-based benefits, decides not to utilize a special needs trust, the client has a legal obligation to notify Social Security and Medicaid within ten (10) days of receipt (or availability) of the settlement funds. Failure to notify could result in an overpayment situation requiring repayment, or a fraud investigation in the future.
- D. Buy Yourself Time. There's no need to make hasty decisions, and doing so will result in liability exposure. A mechanism that will remove the time pressure is a § 468B Qualified Settlement Fund. Such funds allow for payment of the settlement into a trust. The defendant is released upon payment to the trustee, and the trustee can immediately pay the plaintiff's attorney's fees and costs, assuming they've been approved by the probate court. This "stops the clock" so that plaintiff's counsel can carefully evaluate settlement options. The plaintiff's attorney can continue to update the lien information and negotiate with lienholders. When the liens and the allocation of the settlement are resolved, the trustee can still use a structured settlement annuity and the special needs trust without adverse tax consequences. Qualified settlement funds can be used to settle cases of any value involving multiple plaintiffs or the personal injury victim with a derivatively injured spouse, child or parent. The trust must be established or approved by court

order, and must be a “trust” under applicable state law. The payment into the trust does not constitute constructive receipt! This arrangement preserves the opportunity to use the structured settlement annuity option, and to do so using one’s own brokers rather than that of the defendant.

III. PRESERVATION OF GOVERNMENT BENEFITS

Many persons with disabilities depend on government benefit programs for income and/or health care coverage. Some programs, such as Social Security Disability Insurance (“SSDI”) and Medicare, may be available regardless of the recipient’s income or property. Eligibility for these benefits is determined by prior work history, not by financial need. In contrast, needs-based programs, such as SSI and Medicaid, have strict income and asset guidelines for eligibility. Medicaid provides coverage for medical expenses, including prescription drugs, in-home health care services, and payment for long-term nursing home care.

Receipt of assets or income from any source, such as a personal injury settlement or inheritance, can impact one’s eligibility for these needs-based programs. A chronically ill or severely disabled person may be otherwise uninsurable, and the assets received from the settlement may be insufficient to privately pay for the care provided by Medicaid. Federal and state laws now permit a disabled individual to preserve assets in a trust to pay for supplemental needs and care while maintaining eligibility for Medicaid and other government benefits.

Any case in which the plaintiff is disabled should be analyzed to determine if a special needs trust is appropriate. In cases where the disability is severe, the need for government benefits should be reviewed early in the case. Your client may be eligible to receive various benefits which could make their lives more comfortable while the case is pending, which may also make resolution of the case easier, as the clients will have a better understanding of the benefits available, the value of those benefits, and the methods of protecting their eligibility after the settlement. Moreover, by obtaining eligibility for Medicaid waiver programs which do not deem income and assets of the spouse or parents to the injured person, allocation of a portion of the settlement to the spouse’s loss of consortium claim or the parents’ loss of services claims will not affect the Medicaid eligibility of the injured family member.

When making a determination of whether a special needs trust is appropriate in a case, consider whether the disability meets the Social Security definition, or medically qualifies the individual for Arizona Long Term Care System (“ALTCS”) benefits. You cannot use a special needs trust to protect low-income Medicaid eligibility for a non-disabled person. Also compare the anticipated costs of care with the expected net settlement proceeds. This analysis should be based on the person’s life expectancy and lifetime care plan, the expected growth of the funds under different investment models or the proposed structure, and how long the funds will last both with or without Medicaid and other government benefits. Alternative payment sources or providers of services must also be determined. These include additional income sources, including SSDI,

private disability insurance, private health insurance and other government insurance programs. Even if private insurance is available, the limitations of this coverage must be reviewed carefully. The policy may have a lifetime cap, exclusions from coverage for pre-existing conditions, and/or a child's coverage under the policy may terminate at age 18 or 22.

Despite the Medicaid payback requirement upon the death of the beneficiary, the special needs trust often preserves more funds for other family members than would be available if the trust were not used. Medicaid is entitled to reimbursement of the capitated rate it pays the program contractor or health plan, which is currently \$3,000 per month. Another reason to value the benefits the individual is receiving, if he/she has a short life expectancy and receives less than \$3,000 per month worth in services, and otherwise has medical coverage available, the special needs trust may not be worthwhile.

IV. GOVERNMENT BENEFITS

A. Benefits Not Based On Financial Need

Benefits not based on financial need include SSDI and Medicare.¹ Receipt of settlement funds will not affect eligibility for these benefits. These benefits will be lost only if the person can return to work and is no longer disabled.

SSDI. An individual is entitled to SSDI benefits if he or she is:

1. Under full retirement age;
2. Has at least 20 credits in the 40-quarter period ending with the quarter in which the individual became disabled (the 20/40 rule) and is fully insured (Social Security Handbook, http://www.ssa.gov/OP_Home/handbook/ssa-hbk.htm, § 207. See § 203 for the definition of fully insured [generally one quarter for each year after attaining the age of 21 up to a maximum of 40 quarters] and § 208 for a special exception to the 20/40 rule for workers disabled before age 31); and
3. Is disabled (To be disabled within the meaning of the Social Security Act, the individual must have a severe, medically determinable physical or mental impairment which has or is expected to last for one year or to result in death. In addition, the impairment must make the individual unable to engage in "substantial gainful activity" 20 C.F.R. § 404.1505 for SSDI, and 20 C.F.R. § 416.905 for SSI);
4. The person must file an application for benefits and establish a waiting period of five consecutive months beginning with a month in which the worker was both insured and disabled.

¹ Other benefits which are not based on financial need include special education services, and civil service and military survivors' benefits for disabled adult children. These include Railroad Retirement, and state retirement system benefits for teachers and public employees.

5. Children who became disabled before age 22 and have remained continuously disabled may draw benefits on the record of a disabled, deceased, or retired parent as long as the child is disabled and unmarried. These benefits are often referred to as CDB (Childhood Disability Benefits) or DAC (Disabled Adult Child) benefits.

Medicare. Medicare is a federal health insurance program. SSDI beneficiaries are entitled to Part A Medicare benefits after 24 months of qualified disability. There are some exceptions for specific conditions, for example the waiting period is one month for a person disabled with ALS. There is no waiting period for a person with End Stage Kidney Disease (“ESRD”) on kidney dialysis who does home dialysis. There is a three month waiting period for patients receiving treatment at a dialysis center, and coverage may start up to two months before a patient receives a transplant if certain criteria are met.

Medicare Part A covers inpatient hospital services, home health, and hospice benefits. It also pays for a very limited amount of Skilled Nursing Home Care, but not custodial care. SSDI beneficiaries who are eligible for Part A benefits may enroll for Part B and D benefits, but must pay a premium. Part B benefits cover physicians' charges, while Part D covers prescription drugs. There are significant deductibles and co-pays.

Under current law, there are no resource or income limits for Medicare eligibility; however the new Part D has enhanced drug coverage for persons with low income and resources.

B. Benefits Based On Financial Need

Needs-based programs, such as SSI and Medicaid are often critical to the care of the disabled individual. Medicaid can be especially important if the individual is uninsurable, or if he/she needs extensive home care. There are a number of other needs-based benefits which are not addressed in this outline, but must be carefully considered when settling a case. These include Section 8 housing, various utility assistance programs, Medicaid for low-income families, Temporary Assistance to Needy Families (“TANF” formerly AFDC), and food stamps.

Supplemental Security Income (SSI). SSI is a federal welfare program that provides a minimum level of income for some needy persons. To be eligible for SSI, a person must be age 65 or older, blind, or disabled; a U.S. citizen (with limited exceptions); and not a resident of a public institution. The 2007 monthly federal benefit rate for unmarried persons is \$623 and for a couple is \$934.00.

In addition, the individual must meet the income and resource tests. His/her income must be less than certain standards, and he/she may have no more than \$2,000 of countable resources (\$3,000 for a couple.)

Income is anything received in cash, with the following exclusions: (1) The first \$20 of most income received in a month; and (2) The first \$65 of earnings received in a month

and one-half of earnings over \$65. "Deemed" income is income of another attributed to the claimant. Deeming is an issue for spouses, and when a minor child lives with an ineligible parent. Deeming stops applying in the month following the child's 18th birthday.

Note, structured settlement annuity payments are "unearned" income for SSI income eligibility purposes, and, after the first \$20, reduces the SSI benefit amount dollar for dollar. And such payments to an ineligible spouse or parent of a minor, will be deemed to the claimant, with the same consequence! But, as long as the claimant continues to be eligible to receive at least \$1 of SSI, he/she remains automatically eligible for Medicaid.

An unmarried individual can have no more than \$2,000 of countable resources. A countable resource is property which is both **owned** by the individual, **available** to him or her, and not exempt. Generally, countable resources include cash, liquid assets, and any real or personal property that an individual owns (or has the right to liquidate) and could convert to cash to use for his or her support and maintenance. 20 C.F.R. § 416.1202.

Non-countable resources include:

- (1) A home owned and occupied by the person with a disability, or if institutionalized, in many states, a home the person intends to return to.
- (2) One automobile, if the vehicle is used for transportation for the individual or a member of the individual's household.
- (3) Household goods and personal effects.
- (4) Irrevocable funeral and burial arrangements. *See* POMS § SI 01130 for a list of non-countable resources.

Transfers of resources for less than fair market value within 36 months of an application for SSI will result in the imposition of a period of ineligibility (up to 36 months), which is determined by dividing the uncompensated value of the amount transferred by the federal benefit rate.

Amounts owned on the first of the month are resources, while amounts received during the month are income. Income retained into the next calendar month is then considered a resource. Income and resources become countable only when they are available to the recipient (or could be available upon request.) An individual has a duty to report increases in income or resources within 10 days of receipt.

Medicaid. Medicaid is a joint federal and state funded program to provide medical services to the aged, blind, and disabled who are financially needy, as well as those who are "merely" financially needy. In Arizona, it is administered by the Arizona Health Care Cost Containment System (AHCCCS) or the Arizona Department of Economic Security's Family Assistance Administration. The federal government provides about 60% of the funding and delegates the administration of each state's plan to the state.

Income and resource tests are almost identical to those used for SSI eligibility for those who are aged, blind, and disabled. For the “financially needy” only, various income tests exist dependent on number of individuals in the household, and, for all but one of these programs, there is no resource limit!

V. TRUSTS TO PRESERVE BENEFITS

A. Special Needs Trust or Medicaid Payback Trust. 42 U.S.C. § 1396p(d)(4)(A); A.R.S. § 36-2934.01

The special needs trust must meet the following three requirements to be an exempt resource for purposes of Medicaid eligibility: (1) The trust must be established by a parent, grandparent, legal guardian/conservator, or a court; (2) the trust must be for the sole benefit of a beneficiary who is an individual under age 65 (trust remains valid after 65 but additional assets cannot be added without penalty), and the beneficiary must be disabled according to the Social Security definition, or medically eligible for ALTCS benefits; and (3) the trust must provide that, upon the beneficiary's death, the State is reimbursed from the trust for all Medicaid benefits paid on behalf of the beneficiary.

The trust may be revocable or irrevocable for Medicaid purposes, but must be irrevocable to continue SSI benefits.

Funds entering and leaving the trust are generally treated according to SSI rules. Distributions directly to the beneficiary are unearned income, while expenditures for food and shelter are considered in-kind support and maintenance (ISM). Distributions of ISM result in a 1/3rd reduction of the beneficiary's SSI benefit. Payments made for non-food or shelter expenses, which are paid directly to the providers of goods or services, have no impact on benefit eligibility.

In Arizona, A.R.S. § 36-2934.01 further identifies what payments are allowable.

B. Pooled Trust. 42 U.S.C. § 1396p(d)(4)(C); A.R.S. § 36-2934.01

The pooled trust is similar in most respects to the payback trust discussed in section V.A. above, with the following exceptions. The trust may be established by the disabled individual himself or herself, as well as by the parent, grandparent, legal guardian, or court; the trust may be established for a beneficiary over the age of 65 if the individual was disabled before the age of 65; the trust must be managed by a non-profit association; a separate account must be maintained for each beneficiary, with the individual accounts pooled for investment and management; and an option exists whereby funds which are retained by the trust at the death of the beneficiary are not subject to payback to the state.

The pooled trust is appropriate in cases in which the assets are insufficient for a corporate fiduciary to handle, when there is no suitable individual to serve as trustee, when the beneficiary is over the age of 65, when the beneficiary is competent to establish the trust, has no living parent or grandparent, and does not want to go through the court.

A special needs trust cannot be established for an individual over the age of 65. A pooled trust can be used if the individual was disabled prior to the age of 65. The Center for Medicare and Medicaid Services (CMS) has indicated that states may consider transfers to a pooled trust after age 65 as a disqualifying transfer for nursing home Medicaid eligibility; Arizona, unfortunately, has taken that position.

Until recently, Arizona was without a pooled trust. In Tucson, Jewish Family and Children's Services ("JFCS") established a pooled trust about a year ago. New to the scene is The Arizona Special Needs Trust Coalition, a "coalition" of non-profit organizations, for which the trust is administered by North Side Bank & Trust in Ohio, a nationally chartered corporate trustee, and Knights Administration in Florida. Information and forms are available at: www.snthelp.com.

VI. THE USE OF STRUCTURED SETTLEMENT ANNUITIES

A. What is a structured settlement? Periodic payments or structured settlements pay compensation to the claimant over time rather than in one lump sum. The structured settlement is a promise by an entity to make future payments according to an agreed upon schedule. This method of settlement is beneficial to the defendant in that it perceives the ability to save money through such form of settlement, and it is beneficial to the plaintiff in that the lump sum invested on his/her behalf is not taxable to the claimant, nor are the payments made to him/her over time.

B. When is a structured settlement appropriate? Structured settlements are not appropriate in all cases. They are appropriate in many cases involving a large claim for severe and permanent injuries, as well as those where future obligations or costs are predictable and otherwise would not be met. They may also be appropriate in smaller cases where concerns about the claimant's ability to manage the money or withstand pressures that will result in rapid depletion of the settlement exist. In determining "how much is enough" to justify a structured settlement, figure out how much of a periodic payment would be generated from a settlement and whether that amount meets the needs of the particular claimant. Do not neglect to use the life care plan in this analysis!

The advantages of a structured settlement include lifetime payments, built-in money management, and tax-free receipt of income. Despite these advantages, the entire settlement should not be structured due to the potential insolvency of the obligor and lack of liquidity. It behooves the claimant to diversify his/her settlement.

C. How much of a settlement should be structured? The extent to which a settlement should be structured is dependent on the circumstances of the particular case. In cases involving life threatening injuries or a less than normal life expectancy, the rate of return on the structured settlement may be greater, thereby justifying structuring a more substantial portion of the settlement. Important in evaluating the foregoing is obtaining from the defendant information on the age

ratings forming the basis of the cost of the annuity. Although the defendant may be reluctant to provide the information, it is arguably discoverable. The claimant must also determine his/her need for up front cash or liquidity, particularly if large purchases are contemplated, such as a home or vehicle.

D. Structured Settlements and Special Needs Trusts. In those cases where a special needs trust is contemplated, it is imperative that the trust irrevocably designate the payee of the structure to prevent the payments from being treated as income for purposes of the beneficiary's public benefits eligibility.

The special needs trust also has the advantage of protecting against the risk of sale of the structured settlement on the secondary market, which can be for as little as 40%-60% of its fair market value and result in its rapid depletion.

In cases where the special needs trust is the payee of the structured settlement, consider who will be the contingent beneficiary in the event of death in light of the "payback" provision of the trust. Arguably, the special needs trust should remain the beneficiary so as not to circumvent Medicaid's claim for reimbursement.

E. Estate Taxation. Also important to bear in mind in planning for death is the potential for estate taxation on the then present value of the structure. To provide for that eventuality, sufficient lump sum cash must be available to pay the federal estate tax, or a commutation provision must be included in the annuity that provides for immediate cash in exchange for future payments.

F. Probate Court Approval of Structured Settlements. If any portion of the settlement is to be structured, then the probate court will have to approve the structure. The rationale behind the proposed structure should be made clear and, if a special needs trust is involved, the probate court should enter an order that the trust is the irrevocable payee of the structure and the contingent beneficiaries on death should be addressed.

G. Structured Settlements and Minors. Pursuant to A.R.S. § 14-5424.D., a conservator may act with court approval to compromise a personal injury or wrongful death claim for a Minor and, may be in exchange for an arrangement that defers the receipt of part or all of the consideration for the compromise until after the Minor reaches the age of a majority, i.e., a structured settlement or trust. If that is the case, then the appointment of a conservator may not be necessary, and court approval of the settlement may be sought pursuant to A.R.S. § 14-5409, which authorizes single transactions by court order.

VII. PROBATE COURT APPROVAL

A. When is Probate Court Approval Required?

1. **For an Incapacitated Adult**, or, rather, adult “in need of protection,” probate court approval is required pursuant to A.R.S. § 14-5401.2 if the adult is (a) unable to manage his/her estate and affairs effectively due to any of the conditions outlined therein; **and** (b) property will otherwise be wasted or dissipated, or unavailable for support, care and welfare.

In cases involving an incapacitated adult, the need to have someone in place who has legal authority to make decisions regarding the person of the incapacitated adult should also be considered and not neglected. The appointment of a guardian, if determined to be appropriate and necessary, can be sought at the same time the conservatorship is established or, at a minimum, the conservatorship provides a forum within which the issue of guardianship can be addressed.

2. **For a Minor**, A.R.S. § 14-5103 requires probate court approval on settlements for minor claimants above \$10,000 per year and, if under, permits payment or delivery to any of the following: The minor if married; any person having the care and custody of the minor and with whom the minor resides; the guardian of the minor; a financial institution incident to a deposit in a federally insured savings account in the sole name of the minor giving notice of the deposit to the minor. However, Gomez v. Maricopa County suggests that probate court approval is required on settlements for minor claimants below \$10,000. *See* 857 P.2d 1323, 175 Ariz. 469 (App. 1993).

B. Conservatorships and Special Needs Trusts. The interplay between a conservatorship and special needs trust is often overlooked. If a special needs trust is established, a trustee will have to be appointed to administer the trust. Again, the conservator and trustee of a special needs trust can be one and the same. However, if all assets of the estate are to be transferred to and held by the special needs trust, a conservator may not be necessary beyond the time of settlement. Note, in cases where a vehicle and/or home property are assets of the estate, the conservator may want to retain such assets in the conservatorship rather than in the special needs trust so as not to subject them to the “payback” provision of the trust. Remember, such assets are generally excluded and not counted for purposes of public benefits eligibility whether in trust or not.

The trustee of a special needs trust, whether co-existing with a conservator or not, will have the same duties of the conservator to account to the court on an annual basis and, if compensated for its services, seek approval of same. Furthermore, if a non-corporate trustee is appointed, the trustee will have to bond for the assets within his/her control and, to the extent he/she is not bonded, the assets will be restricted by court order.

Regarding choice of trustee, it is only natural to first consider family members who have a deeper understanding of the beneficiary’s daily needs and capabilities. However, family members will often view the trust estate as that of the family and

not for the “sole” benefit of the beneficiary and, as a result, are more inclined to misuse funds or poorly invest trust assets. Thus, more often than not the appointment of an independent third party as trustee, such as a corporate trustee, is advisable. The fees are worthwhile when balanced against the potential for misuse of funds and imprudent investments resulting in substantial loss to the beneficiary. A good compromise is to appoint a “trust protector” or “trust advisor” to whom the trustee is required to account and with whom the trustee must periodically consult concerning investments and discretionary distributions.

C. Approval of Attorney’s Fees and Costs. Last but not least, attorney’s fees and costs to be paid from the gross settlement must be approved by the Court despite the existence of any contingency fee agreement. Maricopa County Local Rule 5.7 requires that attorneys who seek to be paid from the estate of a protected person or minor, must submit a statement with the following information in support of its fees: the net value of the estate; a detailed statement of the services rendered, including the tasks performed, the date each task was performed, the amount of time involved in performing each task, the name and position of the person who performed each task; and the results achieved. The probate court has discretion to reduce fees if unreasonable under the circumstances of the case.

In discussing attorney’s fees, the personal injury lawyer should also determine whether the fees incurred by special needs counsel will be borne as a cost to the personal injury lawyer, or whether that attorney will be required to seek approval of its fees and costs from the net settlement. In the larger settlement cases, the “cost” of retaining the services of special needs counsel are minimal in comparison to other fees and costs incurred and worthwhile in thwarting the potential liability for failing to do so.