Birth of a Third Party Agency Trust

By Mark Brody and Sheila Shea

I. Introduction

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A supplemental needs trust[1] shelters the assets of a person with a disability for the dual purpose of securing and maintaining eligibility for programs of government benefits and assistance, such as Medicaid,[2] while enhancing the beneficiary's quality of life with supplemental care paid by his or her trust assets.[3] Typically, the supplemental care paid for by the assets of the trust is used to provide additional health care services and equipment, specialized or unique therapy, private health insurance, educational and vocational training, computers and software, case management services, or recreational activities for the benefit of a person with disabilities.[4] The policy of the State of New York encourages the creation of supplemental needs trusts for people with disabilities.[5]

Nonetheless, it may come as a surprise to advocates for people with disabilities that typical Medicaid planning tools, such as supplemental needs trusts, are ineffective in shielding after-acquired property from pre-existing claims by the Department of Mental Hygiene[6] for care and treatment costs. There is an alternative trust device, however, that may lessen the burden of a collection action upon patients,[7] while promoting preservation of funds for the patient's supplemental needs. This article introduces the reader to an innovative remedial device, the Third-Party Agency Trust (TPAT), that was created in 2006 to afford eligible beneficiaries the opportunity to: (a) voluntarily turn over a windfall of money to the state in satisfaction of a statutory debt owed to the state for care and treatment costs; and, in consideration of that voluntary payment, (b) the state would then allocate an agreed-upon sum of money into a trust administered by NYSARC, Inc., a voluntary agency serving people with disabilities; and, (c) upon the death of the beneficiary, the balance of the money, if any, in the trust, would be returned to the state in satisfaction of its statutory claim. The birth of the TPAT represented a collaboration between structural adversaries in plenary actions to recover care and treatment costs, the Office of the Attorney General representing the autonomous offices of the Department of Mental Hygiene and the Mental Hygiene Legal Service. The authors of this article were frequent adversaries in these actions. It became apparent over time that the resources directed at prosecuting statutory claims and defending actions could better be devoted to achieving outcomes benefiting both the state and the individual with a disability.

II. A Primer on Department of Mental Hygiene Collections

A basic familiarity with article 43 of the Mental Hygiene Law (MHL) is crucial to understanding the proper application of the TPAT. MHL § 43.01 establishes that the Commissioners of the Office of Mental Health (OMH) and the Office for People with Developmental Disabilities (OPWDD) shall charge fees for services to patients. Further, MHL § 43.03 (a) imposes liability upon a patient or any fiduciary for the cost of care and treatment.[8] Indeed, in *State v. Patricia II*,[9] the Court of Appeals held that a patient's "ability to pay" at the time services were rendered (or at any time thereafter) is not a condition precedent to the State's article 43 collection action.[10] Patients receiving care and treatment in mental hygiene facilities are often unable to pay for the cost of care either because they are indigent or lack insurance. In addition, Medicaid has long excluded inpatient care and treatment in psychiatric hospitals from its funding scheme.[11] Thus for indigent patients, unexpected cash windfalls, such as inheritances, often become the staple of article 43 collection actions. Since there is a six-year statute of limitations for article

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43 claims, after-acquired property is not insulated from a collection action.[12]

III. Overview of Special Needs Trusts

The Restatement Third of Trusts defines a trust as "a fiduciary relationship with respect to property, arising from a manifestation of intention to create that relationship and subjecting the person who holds title to the property to duties to deal with it for the benefit of . . . one or more persons, at least one of whom is not the sole trustee."[13] In New York, a trust may be created for any lawful reason,[14] so long as there is "(1) a designated beneficiary, (2) a designated trustee, (3) a fund or other property sufficiently designated or identified to enable title of the property to pass to the trustee, and (4) actual delivery of the fund or property, with the intention of vesting legal title in the trustee."[15] Additionally, "[t]o constitute a trust there must be either an explicit declaration of trust or facts and circumstances which show beyond reasonable doubt that a trust was intended to be created."[16]

A supplemental needs trust (SNT) resembles a traditional trust in that there is a transfer of property into the trust, managed by a trustee, for the benefit of the beneficiary. However, the SNT differs from a traditional trust in two significant respects: (1) the beneficiary must have a disability,[17] and (2) the beneficiary has no control over any disbursements from the trust and no ability to revoke the trust.[18] As stated in case law, an SNT is a "discretionary trust established for the benefit of a person with a severe and chronic or persistent disability that is designed to enhance the quality of the disabled individual's life by providing for special needs without duplicating services covered by Medicaid [or other programs of government assistance]" or destroying eligibility for such programs.[19] Supplemental needs trusts may be first party[20] (funded with the assets of the person with a disability) or third-party[21] (established and funded by others for the person's benefit) in nature. In New York, case law recognized third party supplemental needs trust before federal and state enabling laws were enacted recognizing both first and third party trusts.[22]

A. Third Party Trusts

In re Escher[23] is the watershed case in New York that established the legal foundation for the creation of third-party special needs trusts.[24] *Escher* held that the trustee of a testamentary trust established by parents for their adult daughter with severe mental disabilities, which provided that the principal was to be used only "for the payment of expenses necessary for the maintenance and support," was not required to invade the trust principal to pay care and treatment costs incurred at a state hospital. The court further held that "a trustee could properly exercise discretionary powers by declining to make funds available to pay bills which had accrued for decades where payment would (1) have no impact on the present or future needs of the life beneficiary; (2) be unfairly prejudicial to the life beneficiary (by eliminating the trust as a source of income for future needs), and (3) result in "an arrogant disregard of the testator's intent."[25] In its decision, the Surrogate explained that public assistance had evolved from being a gift into an entitlement for people with disabilities, particularly considering the vast cost of institutional care.[26]

In 1993, the New York Legislature codified the holding of *Escher* at section 7-1.12 of the Estates Powers and Trusts Law. A statutory third-party trust is created when the following five statutory elements are satisfied:

(1) the person for whose benefit the trust is established suffers from a severe or chronic or persistent disability;

(2) the trust evidences the intent that the assets be used to supplement, not supplant, government benefits;

(3) the trust prohibits the trustee from using assets in any way that may jeopardize the beneficiary's entitlement to government benefits or assistance;

(4) the beneficiary does not have the power to assign, encumber, direct, distribute or authorize distribution of trust assets; [27]

(5) if an intervivos trust, the creator of the trust was a person or entity other than the beneficiary.[28]

If the requirements of section 7-1.12 are met, "[i]t shall be presumed that the creator of the trust intended that neither principal nor income be used to pay for any expenses which would otherwise be paid by government benefits or assistance."[29] Further and prospectively, the trustee of a conforming 7-1.12 trust shall *not* be deemed liable for care and treatment costs in a mental hygiene facility by operation of MHL § 43.03 (d).

B. First Party Trusts

The defining characteristic of a first party trust is that the person who is providing the legal consideration for the funding of the trust is also the beneficiary of the trust.[30] As a general rule, trusts funded with the beneficiary's property must be considered available resources for purposes of the beneficiary's eligibility for Medicaid and other "means tested" programs, such as Supplemental Security Income.[31] However, both federal and state law provide for an *exception* to the rule that a self-settled trust should be considered an available resource.[32] There are two types of exception trusts for people with disabilities: those with a single beneficiary and those operated by not-for-profit organizations with many disabled beneficiaries each with his or her own account; the "under 65 payback trust" and the latter "pooled trust. "[33] For a self-settled

under 65 payback trust to qualify as an exception trust, the following statutory requirements must be met:

1. The trust must be established by a parent, grandparent, legal guardian or court (as originally enacted) or by an individual with a disability (as amended by the Special Needs Trust Fairness Act);[34]
2. The beneficiary must meet the disability criteria under the Social Security Act;
3. The beneficiary must be under the age of 65 years old at the time the trust is funded with the beneficiary's assets; and
4. The trust must provide that upon the beneficiary's death, the State Medicaid program be repaid for medical assistance provided during the course of the beneficiary's life.[35]

The "pooled trust" has similar statutory elements but does not contain an age restriction and requires that the trustee be a not-for-profit association.[36] Amounts retained in the trust are pooled for purposes of investment and each beneficiary has a sub-account. Also, a pooled trust may be established for a beneficiary over the age of 65 and upon the death of the beneficiary, the trust is permitted to retain the balance in the beneficiary's sub-account for the charitable purposes of the trust.[37]

C. Third Party Agency Trust

The TPAT is third party trust agreement originally executed on January 26, 2006 by and between OMH and OPWDD (then OMRDD) as "grantor" and NYSARC, Inc., as trustee. The trust instrument recognizes two distinct circumstances where the state agency, as grantor, will establish a beneficiary sub-account for a person who has or is currently receiving inpatient care and treatment: (1) when the state agency is presented with a voluntary payment in full or partial satisfaction of a non-Medicaid funded statutory debt; and (2) when the state agency has received a lump sum payment as representative payee and may use the award to pay for future costs of care as authorized by state and federal law.[38] The TPAT expressly provides that upon the death of the beneficiary, the balance of the sub-account shall be paid to the respective grantor state agency in satisfaction of the article 43 debt. The trust also provides that it is the intent of the grantor (the state agencies) to create a supplemental needs trust which conforms with the provisions of section 7-1.12 of the EPTL and that trust assets are to be used to supplement and not supplant any programs of government benefits and assistance.[39]

The TPAT becomes a viable planning device when a person who has accrued an article 43 debt for care and treatment costs, receives a cash windfall of some type, most likely an inheritance, or lump sum Social Security Award. The article 43 liability may vastly exceed the amount of the windfall which jeopardizes the ability of the person to retain any funds for his or her lifetime use and enjoyment. Until the advent of the TPAT, the state agency may have asked the Office of the Attorney General's civil recoveries bureau to proceed with a plenary article 43 action to secure a judgment for the cost of care. A CPLR article 12 guardian ad litem would often be appointed for the person to defend the action if the person was otherwise incapable of defending his or her rights. In some judicial departments, the Mental Hygiene Legal Service was appointed as guardian ad litem or private counsel would be assigned to defend the action. The matter often proceeded to summary judgment and a turnover proceeding would soon follow to secure the property of the patient and satisfy the judgment. The TPAT was conceived between adversaries striving to identify a remedial approach that would enable the state agencies to pursue recoveries, while allowing patients to have the lifetime use and enjoyment of their property.

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In practice, once the nature of the patient's liability is established as being within the ambit of article 43 of the MHL and not a Medicaid recovery, the TPAT can be explored. The use of the TPAT as a vehicle to compromise or settle an article 43 debt is initially predicated upon two provisions of article 43 of the Mental Hygiene Law; section 43.07(a) and section 43.03(b). Regarding the former, section 43.07(a) authorizes the Commissioner (either of OMH or OPWDD) to enter into agreements to satisfy article 43 debts. Further section 43.03(b) provides that the Commissioner may "reduce or waive fees" in cases of inability to pay or for other reasons. Thus, these two statutes do not require the Commissioner to waive claims, but they clearly authorize the agency to do so in appropriate cases.[40]

Consequently, the TPAT may be characterized as a combination of section 43.07(a) agreement and section 43.03(b) conditional waiver. The following case example illustrates the steps that result in the creation of a TPAT account under a hypothetical set of facts:

(1) A patient in a state psychiatric hospital has unpaid article 43 care and treatment costs in the amount of $500,000.

(2) The patient or the patient's fiduciary acquires a $100,000 inheritance.

(3) The patient or the patient's fiduciary, such as a guardian, agrees to partially satisfy the article 43 debt by making a voluntary payment to OMH in the amount of $100,000.

(4) In consideration of the voluntary payment, OMH provides a release or satisfaction of claim to the patient or fiduciary in the amount of $100,000.

(5) Pursuant to the section 43.07 settlement agreement, OMH applies an agreed upon portion to the funds (which can be a nominal amount depending on the facts of the case) toward immediate recovery of its statutory claim and agrees to fund the TPAT with the balance received.

(6) Because OMH received the funds in consideration of satisfying or, partially satisfying, an article 43 claim, it is OMH (and not the patient) furnishing the legal consideration for the creation of the trust.

While best understood as a third party trust, the TPAT also borrows from the Medicaid (first party) payback and pooled exception trusts in two respects: (1) similar, but not identical to the payback feature of the Medicaid exception trust, upon the death of the beneficiary, the remainder interest in the trust is "returned" to the State; and (2) the trustee of the TPAT (NYSARC) pools the investments of the (OMH/OPWDD) beneficiaries. Thus, it is proper to refer to the TPAT as a "pooled trust" (but not a Medicaid exception trust) because its purpose is to permit management of funds subject to article 43 claims (not Medicaid claims).

IV. Conclusion

Commentators have observed that SNTs create opportunities for independent living, innovative rehabilitation and therapy, employment and other activities that give life meaning.[41] The TPAT is a unique planning device available to people who obtain a financial windfall but have a pre-existing article 43 debt. Eligible beneficiaries benefit from the lifetime use and enjoyment of a windfall, while deferring until after death satisfaction of the article 43 claim. The authors commend the agencies, the Office of the Attorney General and NYSARC for their vision and continued support of this unique trust device.

Endnotes

1. This article refers to "supplemental needs trusts" or "special needs trusts" interchangeably. Both terms broadly describe a trust designed to benefit a person with a disability (the beneficiary) without jeopardizing the beneficiary's eligibility for public benefits.
2. Medicaid is a joint federal-state program established pursuant to title XIX of the Social Security Act. The primary purpose of the Medicaid program is to enable each state, jointly with Federal government, to furnish "medical assistance on behalf of families with dependent children and of aged, blind, or disabled individuals, whose income and resources are insufficient to meet the costs of necessary medical services." *See* 42 U.S.C. § 1396-1. *See also Jennings v. Commissioner, N.Y.S. Dept. of Social Serv.*, 71 A.D.3d 98 (2d Dep't 2010).
3. *In re Abraham XX*, 11 N.Y.3d 429, 434 (2008); *In re Tinsman (Lasher)*, __AD3d__, 2019 N.Y. Slip Op. 01471.
4. *Jennings v. Commissioner, N.Y.S. Dept of Social Serv.*, A.D.3d 98, 105 (2d Dept 2010); *citing Joseph A. Rosenberg, Supplemental Needs Trust for People with Disabilities. The Development of a Private Trust in the Public Good*, 10 B.U. Pub. Int. L.J. 91 at 91-95 (2010).
5. *See In re Kamp*, 7 Misc. 3d 615 (2005).
6. The Department of Mental Hygiene is composed of three autonomous offices: Office of Mental Health, Office for People with Developmental Disabilities and Office of Alcoholism and Substance Abuse Services. *See* Mental Hygiene Law (MHL) § 5.01. The TPAT was created by OMH and OPWDD.
7. Patient is a term of art and means a person receiving services for the mentally disabled at a facility. See MHL § 1.03 (23).
8. MHL § 43.03 (a).
9. *State of New York v. Patricia II*, 6 N.Y.3d 160 (2006).
10. Seizing on the six-year statute of limitations for mental hygiene recoveries, the Court of Appeals in *Patricia II* concluded its ruling promoted the statutory scheme in favor of recoveries and enabled the State to obtain judgments that would be subject to collection for 20 years. *See, Patricia II*, 6 N.Y.3d at 164, *citing* CPLR 211 (b).
11. *See* Social Service Law (SSL) § 365(2). However, on November 18, 2018, the Center of Medicare and Medicaid Services announced a demonstration opportunity for states to include short-term stays in institutes for mental diseases within the Medicaid program. *See* https://www.medicaid.gov/federal-policy-guidance/downloads/smd18011.pdf – last accessed April 15, 2019.
12. MHL § 43.07. A peculiarity in the law enables OPWDD to interpose pre-June 1972 claims against people with developmental disabilities who have not been discharged from the agency's care. *In re Piper*, 145 A.D.2d 97 (3d Dep't 1989) holds that the "old law" statute of limitations applies for services furnished before the June 1972 re-codification of the MHL. The "old law" statute of limitations did not begin to run until the patient was discharged or died. Consequently, even a person receiving care and treatment in the OPWDD system may be subject to an article 43 debt if care and treatment costs for services rendered before 1972 remain unpaid.
13. Restatement (Third) of Trusts § 2 (2009).
14. Estates Powers and Trust Law (EPTL) 7-1.4 (2010).
15. *In re Doman*, 68 A.D.3d 862 (2d Dep't 2009).
16. *In re Estate of Fontanella*, 33 A.D.2d 29, 31 (3d Dep't 1969); *see* Matthew M. Shatzkes, *Supplemental Needs Trusts: The Movement Towards Reformation*, 25 J. Civ. Rts. & Econ. Dev. 739 (2011).
17. "An individual shall be considered disabled if he is unable to engage in any substantial gainful activity by means of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than twelve months," 42 U.S.C. 1382c(3).
18. Shatzkes, *Supplemental Needs Trusts: The Movement Towards Reformation*, 25 J. Civ. Rts. & Econ. Dev. at 748, *citing Sai Kwan Wong*

v. Daines, 582 F. Supp. 2d 475, 479 (S.D.N.Y. 2008), *aff'd*, 571 F. 2d 247 (2d Cir. 2009).

19. *Cricchio v. Pennisi,* 90 N.Y.2d 296 (1997); *In re Abraham XX.,* 11 N.Y.3d 429 (2008).
20. 42 U.S.C. § 1396p(d)(4)(A), enacted as part of the Omnibus Budget Reconciliation Act of 1993, Pub.L. No. 103-66 (1993)(OBRA 93).
21. *See In re Escher*, 94 Misc. 2d 952; *aff'd* 75 A.D.2d 531 (1st Dep't 1980), *aff'd*, 52 N.Y.2d 1006 (1981) which was later codified at EPTL 7.1.12; *Jennings*, 71 A.D.3d at 105.
22. *In re Escher*, 94 Misc. 2d 952; *aff'd,* 75 A.D.2d 531 (1st Dep't 1980), *aff'd*, 52 N.Y.2d 1006 (1981).
23. *Id.*
24. Edward V. Wilcenski & Tara Anne Pleat, *Administration of Special Needs Trusts*, 91-March N.Y. St. B. J. 13 (March 2019).
25. 94 Misc. 2d at 960.
26. 94 Misc. 2d at 959, stating that because of the high costs involved, programs to pay for the care of people with mental and physical disabilities were now seen as benefits, rather than charity.
27. EPTL 7.12 (a)(5)(i-iv).
28. After the enactment of OBRA'93, E.P.T.L. 7-1.12 was further amended to allow self-settled trusts that conformed to state implementing language. EPTL 7-1.12 (b)(5)(v).
29. EPTL 7-1.12(b)(1).
30. *Jennings v. Commissioner, N.Y.S. Dept. of Social Serv.,* 71 A.D.3d at 105.
31. 42 U.S.C. § 1396p (h)(1); *see* Shatzkes, *Supplemental Needs Trusts: The Movement Towards Reformation*, 25 J. Civ. Rts. & Econ, Dev. at 749; 42 U.S.C. § 1396p (d)(4)(A); § 1396p(d)(4)(C); the text of the federal Medicaid statutes allowing for first party special needs trust were later incorporated into New York's Social Service Law (SSL § 366[2][b][iii][A]; SSL § 366[2][b][2][iii][B]).
32. 42 U.S.C. 1396p(d)(4)(A); *see Sai Kwan Wong v. Doar,* 571 F3d 247,252 (2d Cir. 2009); *In re Kennedy*, 3 Misc. 3d. 907, 909 (2004).
33. *See Rosenberg*, 10 B.U. Pub. Int. L.J. at 131.
34. 21st Century Cures Act, Pub.L. No. 114-255 (2015) Section 5007.
35. 42 U.S.C. § 1396p(d)(4)(A); Social Services Law § 366 (2)(b)(2)(iii)(A). If the first party trust complies with all statutory requirements, the trust will receive the associated protections under federal Medicaid and Supplemental Security Income (SSI) laws. *See* Wilcenski & Pleat, *Administration of Special Needs Trusts*, 91-March N.Y. St. B. J. at 14. Congress extended the OBRA '93 trust rules to SSI in 1999 (*see*, 42 U.S.C. § 3826[e]][1-5]).
36. An unofficial list of the pooled trusts operating in New York State can be found at http://www.wnylc.com/health/entry/4 – last accessed April 15, 2019.
37. The provisions governing pooled trusts plainly state that "amounts remaining...which are not retained by the trust must be paid to the State up to the total value of all [Medicaid] paid on behalf of the individual." *See In re Altshuler*, 169 Misc. 2d 613, 616, *citing*, 18 N.Y.C.R.R. 360-4.5 (b)(5) (i)(b); *see also,* SSL § 366 (2)(b) (2)(iii)(B); 42 U.S.C. § 1396p (d)(4) (C)(iv).
38. A copy of the TPAT is uploaded on the website of the Mental Hygiene Legal Service for the Third Judicial Department, http://www.courts.state.ny.us/ad3/mhls/index.html.
39. *Id.*
40. Additional support for the TPAT may be found in a 2010 chapter amendment to the M.H.L. requiring the commissioners to create three types of trusts of property to the extent permissible by law when receiving property of patients .The three types of trusts are "… qualifying Medicaid exception trust, including a special needs trust or similar device…." The TPAT would be categorized as a "similar device" to the Medicaid exception trust or SNT. *See* L. 2010, c. 111; s*ee* MHL §§ 29.23, 33.07(e).
41. Rosenberg, 10 B.U. Pub. Int. L.J. at 151.

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