THE ELASTIC DEFINITION

OF THE "TERMS OF THE TRUST"

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of the "Terms of the Trust"

by Fred Franke[1]

1.0 Introduction: The Statutory Definition. The Maryland Trust Act ("MTA") defines the phrase "terms of the trust" as follows:

> "Terms of a trust" means the manifestation of the intent of the settlor regarding the provisions of a trust as expressed in the trust instrument or as may be established by other evidence that would be admissible in a judicial proceeding.[2]

This definition is taken from the Uniform Trust Code ("UTC"), and, other than minor stylistic changes, the General Assembly did not modify this phrase to accommodate existing Maryland law.[3] The definition, however, undoubtedly reflects the Maryland common law and, for that matter, the common law in general.

1.1 The Restatement Definition. The definition set forth in the MTA and the UTC essentially carries forward the same definition used in all three Restatements of Trusts:

> The phrase "terms of the trust" means the manifestation of the intention of the settlor with respect to the trust provisions *expressed in a manner that admits of its proof in judicial proceedings*.[4]

Accordingly, it is not the language alone, but the language of the trust in its contextual circumstance, that comprises the terms of the trust:

> The phrase "the terms of the trust" is used in a broad sense in this Restatement, as in many statutes and cases. It includes any manifestations of the settlor's intention at the time of the creation of the trust, whether expressed by written or spoken words or by conduct, to the extent the intention as expressed in the manner that permits proof of the manifestation of intent in judicial proceedings. The terms of the trust may appear clearly from written or spoken words, or they may be provided by statute, supplied by rules of construction, or determined by interpretation of the words or

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[1] © The Law Office of Frederick R. Franke, Jr. LLC. Some of this material is from an article by Fred Franke and Anna Katherine Moody, *The Terms of the Trust: Extrinsic Evidence of Settlor Intent*, slated to appear in the Fall ACTEC Journal.

[2] MTA § 14.5-103(x).

[3] UTC § 103(18).

[4] Each restatement of trusts uses this definition. See Restatement (First) of Trusts § 4 (1935), Restatement (Second) of Trusts § 4 (1959), and Restatement (Third) of Trusts § 4 (2003) (emphasis added).

> conduct of the settlor in the light of all of the circumstances surrounding the creation of the trust.
>
> Among the circumstances that may be of importance in determining the terms of the trust, either in the absence of a written instrument declaring those terms or in matters about which a written instrument is silent or ambiguous, are the following: (1) the situations of the settlor, the beneficiaries, and the trustee, including such factors as age, legal and practical competence, personal and financial circumstances, and the relationships of these persons and these factors to each other; (2) the value and character of the trust property; (3) the purposes for which the trust is created; (4) relevant business and financial practices at the time; (5) the circumstances under which the trust is to be administered; (6) the formality or informality, the skill or lack of skill, and the care or lack of care with which any instrument containing the manifestation in question was drawn.[5]

Whether, and to what degree, extrinsic evidence may be used to determine settlor intent will depend on the evidentiary rules and other rules of construction that would be permitted at trial.

2.0 The Maryland Rule Governing Extrinsic Evidence Before the MTA. Before enactment of the MTA, Maryland followed the general common law that testamentary trusts were governed by the law of wills but that *inter vivos* trusts were governed by that of contract:

> *c. Trusts created by will.* If a trust is created by will, the terms of the trust are determined by the provisions of the will as interpreted in light of all the relevant circumstances and direct evidence of intention in accordance with the general rules of law governing interpretation of wills.
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> * * *
>
> *d. Trusts created inter vivos by written instrument.* If a trust is created by a transaction inter vivos and is evidenced by a written instrument, the terms of the trust are determined by the provisions of the governing instrument as interpreted in light of all the relevant circumstances and such direct evidence of the intention of the settlor with respect to the trust as is not denied consideration because of a statute of frauds, the parol-evidence rule, or some other rule of law.[6]

2.1 The Plain Meaning Rule Generally Excludes Extrinsic Evidence for Testamentary Trusts But Not for *Inter Vivos* Trusts. The general rule of will construction is that extrinsic evidence of a testator's intent is not admissible. This is the so-called "plain meaning rule."

[5] Restatement (Third) of Trusts § 4, cmt. a (2003).
[6] Restatement (Third) of Trusts § 4.

Extrinsic testimony related to the settlor's intent, however, in a case involving an *inter vivos* trust construction case is not governed by the plain meaning rule but may be admissible. Thus, testamentary trusts are not to be amplified or modified to correct a scrivener mistake or to more fully comport with the settlor's intent. The rule for reformation of *inter vivos* trusts, on the other hand, generally permits the use of extrinsic evidence. This was the long standing rule in Maryland before the MTA: "[T]he doctrine of (trusts) reformation is ordinarily applicable only in cases … involving *inter vivos* trust instruments. [For] a testamentary trust … the general prohibition against reformation of a will would prevail."[7] This non-reformation rule as to wills or testamentary trusts, as distinct from the treatment of non-probate transfers, was universal under the common law:

> The no-reformation rule is peculiar to the law of wills. It does not apply to other modes of gratuitous transfer - the so-called nonprobate transfers - even though many are virtually indistinguishable from the will in function. Reformation lies routinely to correct mistakes, both of expression and of omission, in deeds of gift, inter vivos trusts, life insurance contracts, and other instruments that serve to transfer wealth to donees upon the transferor's death. Alternatively, courts sometimes find it necessary to remedy mistakes in these nonprobate transfers by imposing a constructive trust on the mistakenly named beneficiary in favor of the intended beneficiary.[8]

2.2 Application of the Plain Meaning Rule Generally Shuts Out Extrinsic Evidence.

The general rule of interpretation of wills is, of course, governed by the plain meaning rule. Courts are to tease out the meaning from the four corners of the will without resort to extrinsic evidence, including extrinsic evidence from the drafter of the document:

> And the evidence of the draftsman of the will is not offered to contradict the will. In the case of Fersinger v. Martin, 183 Md. 135, on page 138, 36 A.2d 716, at page 718, this Court, speaking through Judge Collins, said, 'The general rule is that no expression as to the intention of the testator may be considered for the reason that an oral utterance would not be a compliance with the statutory requirement that the will be in writing. Miller on Construction of Wills, Section 40; Darden v. Bright, 173 Md. 563, 568, 198 A. 431. We cannot resort to extrinsic evidence to ascertain from the draftsman what the testator instructed or intended him to say, nor can we in order to establish the intention of the testator accept his declarations.' See also Board of

[7] *Shriners Hospital for Crippled Children v. Maryland Nat. Bank*, 270 Md. 564, 581-2, 312 A.2d 546, 555 (1973).
[8] John H. Langbein & Lawrence W. Waggoner, *Reformation of Wills on the Ground of Mistake: Change of Direction in American Law?*, 130 U. Pa. L. Rev. 521, 527 (1982).

> Visitors, etc., v. Safe Deposit & Trust Co., Md., 46 A.2d 280. The testimony of the draftsman is, therefore, clearly inadmissible to show what the testator intended by Paragraph II. A testator cannot be heard to say what were his intentions in putting a certain clause in his will, and his attorney, who drafted the will, cannot say what the testator told him about it unless there is a latent ambiguity in the words of the will. No such ambiguity exists here.[9]

The essential irrationality of the plain meaning rule has been long noticed:

> [W]e think that there is no principled way to reconcile the exclusion of extrinsic evidence in the law of wills with the rule of admissibility in the law of nonprobate transfers. Not surprisingly, the no-extrinsic-evidence rule has long been embattled even in the traditional law of wills; it has been subjected to a variety of exceptions …; and it is now on the decline. Wigmore's immensely influential critique of the no-extrinsic-evidence rule underlies its abrogation in California and New Jersey. Wigmore argued that any effort to limit the proofs to the words of a document runs afoul of the "truth ... that words *always* need interpretation ...." Wigmore coined the famous phrase that "the 'plain meaning' ... is simply the meaning of the people who did *not* write the document."[10]

Also:

> There is no surer way to misread any document than to read it literally; in every interpretation we must pass between Scylla and Charybdis; and I certainly do not wish to add to the barrels of ink that have been spent in logging the route. As nearly as we can, we must put ourselves in the place of those who uttered the words, and try to define how they would have dealt with the unforseen situation; and, although their words are by far the most decisive evidence of what they would have done, they are by no means final.[11]

2.3 Traditional Exceptions to the Plain Meaning Rule in Maryland. The plain meaning rule is not, however, absolute. In Maryland there were at least two formal exceptions involving will interpretation that permit extrinsic evidence despite the plain meaning rule: (1) the latent ambiguity exception, and (2) evidence of the facts and circumstances of the settlor's situation at the time of trust creation. Additionally, there were cases permitting extrinsic evidence to rebut the presumption that a document that complies with all the testamentary formality rules does not necessarily mean that the decedent had read and understood the will thus permitting the document

[9] *Bradford v. Eutaw Sav. Bank of Baltimore City*, 186 Md. 127, 135-6, 46 A.2d 284, 288 (1946).
[10] John H. Langbein & Lawrence W. Waggoner, *Reformation of Wills on the Ground of Mistake: Change of Direction in American Law?*, 130 U. Pa. L. Rev., page 526 (1982).
[11] *Guiseppi v. Walling*, 144 F.2d 608, 624 (2d Cir. 1944) (Learned Hand in a concurring opinion.)

to be set aside. Finally, there were evidentiary cases involving charitable bequests that, if having general application which they seem to have, would foretell a more modern, permissive approach to the admissibility of extrinsic evidence. The plain meaning rule has been characterized as an historic relic with limited utility recognized by several Courts:

> Because of a growing distrust and dissatisfaction with the application of hidebound interpretive rules to testamentary documents, the law of will interpretation has gradually evolved from a stiff and often artificial formalism to an almost organic approach to interpretation that extols the quest for the testator's intention. Courts today, seeking to temper technical rigidity, contemplate a reduced role for the application of rules of construction in the wills context, with the trend toward admitting extrinsic evidence to cure a multiplicity of ills in wills. In the course of this evolution, the use of will interpretation manuals has fallen from favor and the rules governing the admission of extrinsic evidence have been increasingly relaxed and refined.[12]

2.3.1 The Latent Ambiguity Exception in Maryland. The exception for an ambiguity turned on whether the ambiguity is latent or patent. A latent ambiguity is one where the terms of the will are definite but that term could yield more than one meaning because of facts not showing on the face of the instrument. An example of the latent ambiguity would be a bequest to "John Doe" without any further identification where extrinsic evidence would be required to determine which John Doe was intended for the bequest. A patent ambiguity is one arising from an apparent contradiction within the document or where a term is used in the document that could yield several meanings. Obviously, in the example of the latter case the line between patent and latent ambiguity is fine:

> That a latent ambiguity does not exist in the provisions of Roberts' will is equally clear. Such an ambiguity occurs when "the language of the will is plain and single, yet is found to apply equally to two or more subjects or objects." *Darden v. Bright*, 173 Md. 563, 569, 198 A. 431 (1938). Extrinsic evidence is generally admissible to resolve a latent ambiguity. *Monmonier v. Monmonier*, 258 Md. 387, 390, 266 A.2d 17 (1970); *Bradford v. Eutaw Savings Bank*, 186 Md. 127, 136, 46 A.2d 284 (1946); *Fersinger v. Martin, supra*, 183 Md. at 138-39, 36 A.2d 716; *Darden v. Bright, supra*, 173 Md. at 569, 198 A. 431; *Cassilly v. Devenny*, 168 Md. 443, 449, 177 A.

[12] Richard F. Storrow, *Judicial Discretion and the Disappearing Distinction Between Will Interpretation and Construction*, 56 Case W. Res. L. Rev. 65 (2005).

> 919 (1935). Indeed a latent ambiguity is "not discoverable until extrinsic evidence is introduced to identify the beneficiaries or the property disposed of by will, when it is developed by such evidence, either that the description in the will is defective, or that it applies equally to two or more persons or things." 4 W. Bowe & D. Parker, *Page on the Law of Wills* § 32.7, p. 255 (rev. ed. 1961).[13]

If the ambiguity, however, is latent then the extrinsic evidence may come in.

2.3.2 Exception to Plain Meaning for Surrounding Circumstances in Maryland. The second exception to the plain meaning rule has likewise been long-standing: that evidence of the circumstances surrounding and informing the testator's situation is admissible if there is an ambiguity regardless of whether that ambiguity is latent or patent:

> ***(b) Qualifications and true scope of (plain meaning) rule***
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> The statement of the rule given in the next preceding subdivision is too broad, and has led to much confusion among the courts. No such unqualified rule can stand in the face of the numerous cases admitting some extrinsic evidence where the indefiniteness, inaccuracy, or ambiguity was apparent on the face of the instrument.
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> * * *
>
> According to the better view, or the more accurate statement of the true rule, extrinsic evidence is admissible to show the situation of the testator and all the relevant facts and circumstances surrounding him at the time of the making of the will, for the purpose of explaining or resolving even a patent ambiguity.[14]

This evidence frames the settlor's point of view when he or she drafts the document:

> Of the competency of this evidence there can be no doubt. The purpose of it was to place the court, as far as possible, in the situation in which the testator stood, and thus bring the words employed by him into contact with the circumstances attending the execution of the will. Such proof does not contradict the terms of that instrument, nor tend to wrest the words of the testator from their natural operation. It serves only to identify the institutions described by him as 'the Board of Foreign and

[13] *Emmert v. Hearn*, 309 Md. 19, 26-7, 522 A.2d 377, 381-2 (1987). In *Emmert*, the "ambiguity" was whether "personal property" meant tangible personal property or tangible and intangible personal property. The excluded evidence was that of the draftsman of the will and various family members who would have testified that the term only meant tangible personal property. The Court, however, held that it could determine the issue without resort to extrinsic evidence and determined that the language meant tangible and intangible property. A Florida Court, wrestling with the identical issue, saw an ambiguity and brought in extrinsic evidence ruling the other way. As for the Maryland case, the Florida Court stated "We treat it (the Maryland decision) as a minority view in conflict with the view expressed here." In *Estate of Walker*, 609 So.2d 623, 625 (Fla. 1992).

[14] Admissibility of extrinsic evidence to aid interpretation of will, 94 A.L.R. 26 (Originally published in 1935.) (Section IIe(4)(b)).

> the Board of Home Missions;' and thus the court is enabled to avail itself of the light which the circumstances in which the testator was placed at the time he made the will would throw upon his intention. 'The law is not so unreasonable,' says Mr. Wigram, 'as to deny to the reader of an instrument the same light which the writer enjoyed.' Wig. Wills, (2d Amer. Ed.) 161.[15]

Thus Courts look to the particular circumstances of a decedent to ascertain the "plain meaning" of the words used: "If we put ourselves, in the traditional place, behind the armchair of the testator as he contemplates the disposition he wished to be made to the objects of his bounty, we would be standing behind a man who was not unaware of the problems and methods of early, as contrasted to late, vesting of trust estates and one upon whom had been urged the desirability of continuing property in trust."[16] Also: "Sitting in Loretta's armchair, her testamentary intent becomes clear …"[17]

This exception to the plain meaning rule that enables the Courts to sit in a testator's "armchair" does not permit direct evidence of intent by extrinsic evidence but may yield a close approximation. In one Maryland case, for example, the Court addressed the meaning of the phrase "upon the youngest living grandchild (of the testator's sister) … attaining the age of twenty-one years" in a testamentary trust.[18] The Court concluded that the phrase could have one of two different interpretations – vesting when the sister's grandchildren then in being had all reach twenty-one years of age as of any point in time or, effectively measured after all of the sister's children had died (thus closing the class) and then waiting for the youngest to reach twenty-one years of age. The Court opted for the second reading based on the extrinsic evidence of the testator's situation. This evidence concluded that early vesting had caused adverse tax issues in his mother's estate and that he was urged, upon receiving assets from his family, to continue those assets in trust. Examining the circumstances at the time of the execution of his will in order to place the Court in

[15] *Gilmer v. Stone*, 120 U.S. 586, 590, 7 S.Ct. 689, 690 (1887).
[16] *Marty v. First Nat. Bank of Baltimore*, 209 Md. 210, 218, 120 A.2d 841, 845 (1956).
[17] *Bregel v. Julier*, 253 Md. 103, 111, 251 A.2d 891, 895 (1969).
[18] *Marty v. First Nat. Bank of Baltimore*, 209 Md. 210, 120 A.2d 841 (1956).

his "armchair" at the critical moment, required that extensive extrinsic evidence be entertained in order to interpret what certain words in his testamentary trust meant. In a word, it established his intent as that intent was expressed in the language of the trust. This was not a case where the Court found a latent ambiguity.

2.3.3 Other "Exceptions" to the Plain Meaning Rule in Maryland. Not rising to an exception to the plain meaning rule per se, there are Maryland cases that permit direct extrinsic evidence of a testator's intent nevertheless. In one case, a will was challenged solely based on whether it properly followed the testamentary formalities and whether that document was, in fact, an expression of the testatrix's last wishes. The testatrix was ill, facing surgery, and had executed two wills within two days of each other. The wills were dramatically different from each other. The second will was upheld despite the fact that the last name of a legatee had been crossed out and a new name substituted by hand in the will. The Court based its ruling that the second will was valid on the parol evidence offered by witnesses to the will that the actual intent of the testatrix as expressed to them was reflected in the second will not in the first will. Additionally, because the second will was more in line with the testatrix's older wills this likewise demonstrated that she would have wanted to have the provisions that were contained in the second will apply at her death.[19]

In another case, where the testatrix signed a document purporting to be her will when she was ill and under the influence of narcotics, the will challenge was based on whether the decedent knew the contents of the document that she had signed. That, in turn, raised the issue of what she had attempted to accomplish with her will (what her intent was) and whether the signed document accomplished that intent. The Court held that in these "unusual and exceptional" circumstances, extrinsic evidence of the draftsman's error could be used to support the contention that she had not

[19] *Gage v. Hooper*, 165 Md. 527, 169 A. 925 (1934).

read and understood her will before signing it thus not having it admitted to probate.[20]

2.4 Plain Meaning and *Inter Vivos* Trusts. The restrictions imposed by the plain meaning rule on the introduction of extrinsic evidence of intent do not apply to *inter vivos* trusts: "If the meaning of the writing is uncertain or ambiguous, evidence of the circumstances is admissible to determine its interpretation."[21] Such evidence is permitted to aid in the construction of the language of a trust:

> Oral evidence will be received, however, to remove an ambiguity in the construction of the trust instrument by explanation of the meaning of the words therein, based on the situation of the parties and other facts. This principle (applies) … both as to private and charitable trusts.[22]

Indeed, in Maryland a trust of personalty may be created solely by parol evidence.[23] Because parol evidence can be used to interpret trusts that were created *inter vivos*, parol evidence may also be used to reform or modify such a trust:

> In trust law, a settlor's unilateral mistake is sufficient to reform an inter vivos trust, provided the settlor received no consideration for the creation of the trust. The same rule applies even after the death of the settlor, provided the reformation is necessary to carry out his intent. Courts have frequently corrected scriveners' errors by reforming unilateral mistakes in trust instruments. In addition, courts have corrected omissions resulting from scriveners' mistakes. Because a revocable inter vivos trust can imitate a will, in that the settlor can retain the equitable life interest and the power to alter or revoke the beneficiary designation, the differing result hinges on terminology. Significantly, a scrivener's error can serve as a basis to reform a pour over will. A court, however, generally will not reform a testamentary trust under similar circumstances, unless the will which contained the trust can be reformed. It seems arbitrary for the law to hold that an inter vivos trust used as a receptacle for assets poured over from probate can be reformed, while a testamentary trust cannot.

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[20] *Lyon v. Townsend*, 124 Md. 163, 91 A. 704 (1914). See also *Effective Mistake of Draftsmen (Other Than Testator) In Drawing Will*, 90 A.L.R.2d 924 (originally published in 1963).

[21] Restatement (Second) of Trusts § 38 (1959).

[22] George G. Bogert and George T. Bogert, *The Law of Trusts and Trustees*, § 51. Also: "The Courts have, however, distinguished between using oral evidence to supply a term entirely missing and offering oral testimony to clear up ambiguities, explain doubtful terms, and give a setting to the writing. If all of the essential elements of the writing are present, they may be clarified by non-documentary evidence." George G. Bogert and George T. Bogert, *The Law of Trusts and Trustees*, § 88.

[23] *Shaffer v. Lohr*, 264 Md. 397, 287 A.2d 42 (1972) (A joint bank account was regarded as an *inter vivos* trust because an expression of clear and unmistakable intent to create such a trust could be proved by parol evidence.) Presumably, the *Shaffer* decision would be now impacted by the multiple account statute. Parol evidence can also be used to establish a resulting and constructive trust, including such trusts regarding land. *Jahnigen v. Smith*, 143 Md.App. 547, 795 A.2d 234 (2002); *Fasman v. Pottashnick*, 188 Md. 105, 51 A.2d 664 (1947).

> If will substitutes, including revocable trusts, can be reformed for scriveners' errors, then wills should also be able to be reformed under similar circumstances, especially when both kinds of instruments accomplish the same testamentary objectives.[24]

A Maryland case held that after the death of the settlor, the beneficiary could press for a modification due to mistake to the same degree that the settlor could have brought such an action for modification.[25]

3.0 The Extrinsic Evidence Rule Under the MTA. The MTA follows the UTC approach to trust reformation by liberalizing the use of extrinsic evidence to establish settlor intent, and once such intent is established, to permit a court to conform the language of the trust to that intent.[26]

The MTA tracks exactly the UTC treatment for extrinsic evidence which (i) creates a uniform rule for all trusts, whether testamentary or *inter vivos*, (ii) removes any requirement that extrinsic evidence can only be introduced to explain ambiguity, and (iii) imposes a "clear and convincing" rule to guard against fraud.[27]

As noted, the plain meaning rule has been criticized as a barrier to applying a settlor's actual intent when interpreting a document. The Restatement (Property: Wills and Other Donative Transfers) Third "disapproves" of the plain meaning rule.[28] Thus, § 12.1 ("Reforming Donative Documents to Correct Mistakes") permits extrinsic evidence of settlor intent "to conform the text (of the Will or testamentary trust) to donor's intention even if the text of the document is unambiguous:

> When a donative document is unambiguous, evidence suggesting that the terms of the document vary from intention is inherently suspect but possibly correct. The law

[24] 40 Cath. U. L. Rev. 1, 34-35.
[25] *Kiser v. Lucas*, 170 Md. 486, 185 A. 441 (1936). See also *Roos v. Roos*, 42 Del. Ch. 40, 203 A.2d 140 (1964) (Citing *Kiser* for the proposition that a declaration of trust may be amended to reflect the intent of the settlor after his or her death.)
[26] MTA § 14.5-413; UTC § 415. The comments to the UTC draw a distinction between resolving an ambiguity and reforming a trust to coincide with settlor intent. Generally, rules of construction for wills are to be used to resolve ambiguity when *inter vivos* trusts are used as will substitutions under the UTC. UTC § 112. This tracks the Restatement (Third) of Trusts § 25(2). The MTA, on the other hand, carries forward existing Est. & Trusts § 14-102 as a re-numbered MTA § 14-112 to bootstrap some, but not all, will construction provisions to trusts.
[27] MTA § 14.5-413; UTC § 415.
[28] No pretense is made that the reworking of the rule by the Restatement is based on case law development.

> deals with situations of inherently suspicious but possibly correct evidence in either of two ways. One is to exclude the evidence altogether, in effect denying a remedy in cases in which the evidence is genuine and persuasive. The other is to consider the evidence, but guard against giving effect to fraudulent or mistaken evidence by imposing an above-normal standard of proof. In choosing between exclusion and high-safeguard allowance of extrinsic evidence, this Restatement adopts the latter. Only high-safeguard allowance of extrinsic evidence achieves the primary objective of giving effect to the donor's intention.[29]

The Uniform Trust Code follows a similar approach:

> SECTION 415. REFORMATION TO CORRECT MISTAKES. The court may reform the terms of a trust, even if unambiguous, to conform the terms to the settlor's intention if it is proved by clear and convincing evidence what the settlor's intention was and that the terms of the trust were affected by a mistake of fact or law, whether in expression or inducement.[30]

Each approach imposes a "clear and convincing" standard to guard against fraudulent testimony.

It is clear from the comments under UTC § 415 that it is meant to abolish the plain meaning rule for testamentary trusts and accordingly make the proof issue the same for a testamentary trust as with an *inter vivos* trust. Section 415, however, does not stop there: it authorizes extrinsic evidence to reform a trust even if its terms are not ambiguous.

MTA § 14.5-413 and UTC § 415 accordingly make a radical change to the proof of settlor intent for both *inter vivos* and testamentary trusts. Given the long history of courts embracing the plain meaning rule, it may be necessary to demonstrate that MTA § 14.5-413 was specifically meant to incorporate the approach of the Restatement (Property: Wills and Other Donative Transfers) Third § 12.1 to counteract the rich case law that relied on the plain meaning rule to exclude extrinsic evidence in those circumstances.

4.0 The State of Mind/Intent Exception to the Hearsay Rule. The Maryland rules provide an exception to the hearsay rule that covers a declaration of intention:

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[29] Restatement (Third) of Property (wills and other donative transfers) § 12.1, cmt. b (2003).

[30] Unif. Trust Code § 415 (2000). The MTA provides the same rule, albeit with cleaner language: "The court may reform the terms of a trust, even if unambiguous, to conform the terms to the intention of the settlor if it is proved by clear and convincing evidence that both the intent of the settlor and the terms of the trust were affected by a mistake of fact or law, whether in expression or inducement."

> (3) *Then Existing Mental, Emotional, or Physical Condition.* A statement of the declarant's then existing state of mind, emotion, sensation, or physical condition (such as intent, plan, motive, design, mental feeling, pain, and bodily health), offered to prove the declarant's then existing condition or the declarant's future action, but not including a statement of memory or belief to prove the fact remembered or believed unless it relates to the execution, revocation, identification, or terms of declarant's will.[31]

This hearsay exception, the "state of mind" exception, is a true exception: it permits someone else to testify to the declarant's statements and those statements are offered for the truth of the assertions made. Thus, in *Ederly v. Ederly*, 193 Md. App. 215, 996 A.2d 961 (2010) the Court held that a woman's supposed declaration of where she wanted to be buried (Israel not Maryland) was admissible in a dispute among her children as to the eventual disposition of her body. *Ederly* is a remarkable case because the then state of mind obviously was not offered to prove "the declarant's future action" which, as the *Ederly* Court observed, is the usual circumstance. In *Ederly*, by definition, others and not the declarant would need to take the further action.

4.1 Exception Covers the Declarant's Later Action. In *Figgins v. Cochrane*, 403 Md. 392, 942 A.2d 736 (2008) the Court of Appeals ties the state of mind for state of intention to the declarant's (and no one else's) later action:

> In order to side-step the ruling of the Court of Special Appeals that correctly articulated that Maryland law does not permit testimony regarding the forward-looking aspect of the state of mind of a declarant when the declarant takes no further action after making a declaration, *see Figgins,* 174 Md.App. at 23–43, 920 A.2d at 585–97, Ms. Figgins contends that the trial judge erred because the proffered statement was admissible to show the state of mind of Mr. Borison, her father's attorney, rather than her father.
>
> We, however, have concluded consistently that evidence of a "forward-looking" state of mind is admissible only to show that the declarant, *not the hearer,* subsequently acted in accord with his or her stated intention.[32]

4.1.1 Future Action May Include No Action. In *Farah v. Stout*, 112 Md. App. 106, 684 A.2d 471 (1996), the Court upheld the exclusion of a decedent's statements purportedly

[31] Maryland Rule 5-803(b)(3).
[32] *Figgins v. Cochrane*, 403 Md. 392, 420-1, 942 A.2d 736, 753 (2008).

saying that he was going to leave his caretakers money in his will as compensation for their services. The *Farah* case upheld the exclusion of the testimony on the basis that the decedent's will did not reflect that he made such a provision, and therefore did not result in the future action required by Maryland Rule 5-803(b)(3). The Appellants, of course, regarded the failure to take the further action as a breach of the decedent's contract with them. The *Farah* case, therefore, appears to hold that future action must be an element of the admissibility of the statements.

Subsequent Court of Appeals' decisions, however, do not follow this tack. In *Yivo Institute for Jewish Research v. Zalenski*, 386 Md. 654, 874 A.2d 411 (2005), for example, the Court permitted testimony of the decedent's intent or state of mind that did not result in future action. In *Yivo*, the decedent left a bequest in his will to a charity and then he later made a gift to the same institution. The issue was whether the subsequent gift adeemed the bequest in the will. The testimony sought to be excluded was that of a friend who said that the decedent declared years after making the subsequent charitable gift, that he did not need to change his will because the charitable institution would understand that the gift that he had made was adeeming the bequest in the will.

Another Maryland case illustrated the backward looking element of Maryland Rule 5-803(b)(3). *National Society of Daughters of American Revolution v. Goodman*, 128 Md. App. 232, 736 A.2d 1205 (1999) involved whether a restricted gift to the D.A.R. for the purpose of funding its nursing home facility lapsed because the D.A.R., in fact, did not maintain a nursing home. The decedent had prepared a will leaving part of her estate to Gallaudet University and part of her estate to the D.A.R. for the nursing home. After execution, the attorney contacted D.A.R. to discuss the gift and learned that the D.A.R. did not maintain a nursing home. He thereupon contacted his client who said that she did not want any gift going to the D.A.R. in that situation but all to Gallaudet University. The attorney prepared a new will but his client died before she adopted to execute the new will. Nevertheless, the testimony was permitted as a backward looking declaration of what she

intended to do with her original will.

5.0 Extrinsic Evidence: The Maryland Dead Man's Statute. The dead man's statute in Maryland states:

> A party to a proceeding by or against a personal representative, heir, devisee, distributee, or legatee as such, in which a judgment or decree may be rendered for or against them, or by or against an incompetent person, may not testify concerning any transaction with or statement made by the dead or incompetent person, personally or through an agent since dead, unless called to testify by the opposite party, or unless the testimony of the dead or incompetent person has been given already in evidence in the same proceeding concerning the same transaction or statement.[33]

This statute purportedly seeks to "equalize the position of the parties by imposing silence on the survivors as to transactions with or statements by the decedent or at least by requiring those asserting claims against a decedent's estate to produce testimony from disinterested persons."[34] The dead man's statute has long been subject to criticism: "[T]he dead man's statute (is) an anachronism and an obstruction to truth."[35]

5.1 Dead Man's Statute is Strictly Construed. The dead man's statute may have the purpose of equalizing the playing field but it is narrowly construed because it is an exception to the general rule permitting evidence to be heard: "The statute is an exception to the general rule that all witnesses are competent to testify … and is strictly construed 'in order to disclose as much evidence as possible' without ignoring the purpose of the statute. … In close cases involving the dead man's statute, Maryland precedent consistently has favored the admission of testimony." *Walton v. Davy*, 86 Md. App. 275, 285, 586 A.2d 760, 765 (1991).

One example of the narrow construction of the dead man's statute is reflected by the case *Reddy v. Mody*. *Reddy* involved three causes of action in a medical malpractice case that resulted in death. The first cause of action was an action by the decedent's estate and the other two causes of

[33] Courts & Judicial Proceedings § 9-116.
[34] *Reddy v. Mody*, 39 Md.App. 675, 679, 388 A.2d 555, 558-9 (1978).
[35] 1938 ABA Report on evidence as quoted in Ed Wallis, *An Outdated Form of Evidentiary Law: A Survey of Dead Man's Statutes and A Proposal for Change*, 53 Clev. St. L. Rev. 75, 80 (2006).

action were by the decedent's husband and the decedent's child for wrongful death. The Court held that the dead man's statute did not apply as to the wrongful death actions because those actions were not brought by or against the personal representative. The estate case, on the other hand, fell directly into the statute. In *Reddy*, the testimony of a nurse (an employee of the defendant hospital) and the testimony of the attending physician (one of the defendants) were admitted. On appeal, the Court held that the testimony of the nurse was admissible but not that of the doctor:

> The first two issues raised by the appellants attack the trial court's ruling that Nurse Nella Williams was a competent witness. It is the appellants' position that the working relationship of the appellee, Dr. Mody, and Nurse Williams was such as to render her a "party" for the purposes of the Dead Man's Statute and, therefore, she was rendered incompetent to testify. We disagree.
>
> The purpose of the Statute, as was pointed out above, is to prevent the surviving party from having the benefit of his own testimony where, by reason of the death of his adversary, his representative is deprived of the decedent's version of the transaction or statement. Ortel v. Gettig, 207 Md. 594, 116 A.2d 145 (1955). This disability, while protecting the deceased's estate, can create a great injustice to the survivor. As was stated in C. McCormick, Evidence, § 65 (2d ed. 1972):
>
> "Most commentators agree that the expedient of refusing (to) listen to the survivor is, in the words of Bentham, a 'blind and brainless' technique. In seeking to avoid injustice to one side, the statute-makers have ignored the equal possibility of creating injustice to the other. The temptation to the survivor to fabricate a claim or defense is obvious enough, so obvious indeed that any jury will realize that his story must be cautiously heard."
>
> Faced with the uncertainty and injustice created by the Dead Man's Statute, the Maryland Courts have sought to construe strictly the Statute in an effort to disclose as much evidence as the rule will allow.[36]

5.1.1 Examples of Strict Construction of the Dead Man's Statute. The exclusion of the nurse in *Reddy* as a non-party, although obviously very much associated with the party, illustrates the narrow interpretation of the statute. In *Trupp v. Wolff*, the Court of Special Appeals listed some witnesses who had been permitted to testify regardless of the statute:

> 1. "the husband of a party who would obviously benefit emotionally as well as tangibly by his wife's recovery, *Marx v. Marx*, 127 Md. 373;

[36] *Reddy v. Mody*, 39 Md. App. 675, 681, 388 A.2d 555, 560 (1978).

> 2. a stockholder of a party corporation notwithstanding obvious similarity of tangible interest differing in degree only, *Downs v. Md. & Del. Ry. Co.*, 37 Md. 100;
> 3. an officer of a corporation which was a party, *Guernsey v. Loyola Fed., etc.*, *supra*;
> 4. witnesses, not parties to the suit, who were stockholders or directors of a party corporation, *Whitney v. Halibut*, 235 Md. 517;
> 5. legatees under a will where the estate would benefit from a recovery by the executor, *Schaefer v. Spear, Ex'r.*, 148 Md. 620;
> 6. a daughter named as party defendant called by the plaintiff mother notwithstanding her "identity of interest" with the "opposite party" calling her, *Cross v. Iler*, 103 Md. 592;
> 7. a son where his mother's estate was suing his creditors to enforce a prior lien on stock in his name. In spite of the obvious benefit to the son who was named a party defendant by the estate, he was permitted to testify when called by opposite party. *Duvall, Adm'r v. Hambleton & Co.*, 98 Md. 12." (*Trupp* at 599-600).[37]

In *Farah v. Stout*, the purported caretaker's husband was not permitted to testify, not because of his indirect interest as the husband, but because he had originally claimed to be directly owed money from the decedent in the original pleading. His amendment to the pleading to remove himself as a party plaintiff was to no avail.[38]

5.2 A "Transaction" for Purposes of the Statute. The dead man's statute precludes testimony "concerning any transaction with or statement they made by the dead or incompetent person." The test for determining whether there has been a "transaction" within the meaning of the dead man's statute is whether the deceased, if living, could contradict the assertion by his own knowledge. In *Boyd v. Bowen*, 145 Md. App. 635, 806 A.2d 314 (2002) one part of the lawsuit was whether money paid by a third party to a lawyer to facilitate the decedent's new will constituted a "transaction" between the third party and the decedent. The Court held that it was such a transaction:

> The appellant maintains she was not a party to the transaction because the transaction was solely between Mr. Arch and Mrs. Cole. Admittedly, the professional relationship being established at the meeting was between Mr. Arch and Mrs. Cole, and did not include the appellant. The term "transaction" as used in the dead man's statute, however, has a broader meaning than it might in other situations. Mrs. Cole,

[37] *Trupp v. Wolff*, 24 Md. App. 588, 599-600, 335 A.2d 171, 178-9 (1975).
[38] *Farah v. Stout*, 112 Md. App. 106, 684 A.2d 471 (1996).

> if alive, could, based on personal knowledge, contradict the appellant's testimony on the issue of reimbursement of the legal fees. Accordingly, the meeting was a "transaction with" the decedent, and the trial court properly precluded the appellant's testimony on the matter.
>
> The dead man's statute expressly prohibited the appellant from testifying about anything Mrs. Cole may have said to indicate her intention to reimburse the appellant.
>
> Further, the appellant could not testify that she paid Mrs. Cole's legal fees because she "understood" that she would be reimbursed at some point in the future.

The documents themselves, however, can be introduced into evidence but not testimony that links the documents to a "transaction" or other arrangement between the party and the decedent. The Court of Appeals in *Stacy v. Burke*, 259 Md. 390 (1970), on the other hand, permitted the nephew/claimant to identify and introduce two critical letters sent to him by the uncle/decedent, regardless of the Dead Man's Statute. In that case, the Court made certain important distinctions:

- "The statute does not make the party in an action to which the statute applied incompetent as a witness for all purposes but only in regard to 'any transaction had with or statement made by' the decedent.

- Although the letters permitted to be introduced by the nephew/claimant, in fact, related directly to the transaction, the introduction of these documents "was not testifying in regard to any transaction had with or statement made by Uncle Erle."

This was despite the fact that those very letters had to do with the "transaction" in question.

Likewise, in *Ridgely v. Beatty*, 222 Md. 76 (1960), checks and payments by the son-in-law/claimant were admissible by him because those checks and payments were not a "transaction" with the mother-in-law/decedent. This was despite the fact that those very checks and payments were the proof of his support of the decedent (the disputed contention in that case). In *Ridgely*, the distinction was made between permitting the introduction of documents versus the introduction of testimony as to what the "agreement or understanding" was between the claimant and the decedent about those payments:

> "In the instant case the claimant, over the objection of the executor, was allowed to

> testify as to some sixty checks given by the claimant to third persons during the period of time when he and his family resided with the decedent. The checks represented payments which had been made on the mortgage and expenditures for coal, electricity, telephone, taxes, legal expenses and hospital bills. The court permitted the clamant to identify each check, describe it and to state the item for which the check was given, but it would not permit him to connect such payments with any 'agreement or understanding or transaction' the claimant had with the decedent."

5.3 Opening the Door to Excluded Evidence. The dead man's statute explicitly permits otherwise excludable evidence to be admitted if the door is opened. The statute holds that such testimony is excluded "unless (the party is) called to testify by the opposite party, or unless the testimony of the dead or incompetent person has been given already in evidence in the same proceeding concerning the same transaction or statement." Thus, if a party is cross-examined by an adverse party in regard to the transaction with the decedent then the protection of the dead man's statute has been waived.[39] Additionally, the Maryland dead man's statute applies only to "testimony of a party to a cause which would tend to increase or diminish the estate of the decedent."[40] Thus it should not apply in any suit among various legatees as to what is to be distributed to them.

6.0 Conclusion: Drafting Issues. The phrase "terms of the trust" is defined as the manifestation of the settlor intent "expressed in a manner that admits of its proof in judicial proceedings."[41] Under the Maryland Trust Act, extrinsic evidence of settlor intent may be used regardless of whether the language in the instrument is ambiguous.[42] Indeed, such evidence may be introduced even to contradict the otherwise unambiguous language of the trust instrument.[43] Thus, under the Maryland Trust Act, the only barriers to enhancing the terms of the trust with extrinsic material are either the dead man's statute or the hearsay rule, to the extent these rules preclude such extrinsic evidence.

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[39] *DeMarco v. DeMarco*, 261 Md. 396, 275 A.2d 471 (1971); *Stacy v. Burke*, 259 Md. 390, 260 A.2d 837 (1970).
[40] *Reddy v, Mody*, 39 Md.App. 675, 679, 388 A.2d 555, 559 (1978).
[41] Restatement (First) of Trusts § 4 (1935), Restatement (Second) of Trusts § 4 (1959), and Restatement (Third) of Trusts § 4 (2003) (emphasis added).
[42] MTA 14.5-413.
[43] *Id.*

For attorneys charged with drafting trusts, the goal ought to be to capture settlor intent within the four corners of the instrument regardless of the extrinsic evidence rules. This can be an elusive goal. Language, even supposedly precise language, can prove slippery.

There is a long line of cases involving beneficiaries and trustees arguing over the proper exercise of discretionary distributions.[44] These arguments may be reduced, if not avoided, by spelling out settlor intent beyond the use of generic phrases:

> One of the most difficult tasks trustees face is how to exercise broad (and generic) discretion in the administration of trusts, whether the trust is fully discretionary, with no standards whatsoever, or discretionary subject to an ascertainable standard. To the extent that the settlor's intent is expressed in the trust, it is much easier for the trustee to carry out that intent. For example, if the primary purpose of passing property in trust, rather than outright, is to gain tax and asset protection advantages, and separating the control over the property from the beneficial enjoyment of the property (more than necessary to obtain tax and asset protection benefits) is not a primary motivation behind using a trust, then the trust can be drafted to make the intent clear, so that the trustee can act more liberally than might be the case where control *is* a key issue.[45]

Another approach would be to set forth settlor intent in a side "letter of wishes." Such a document, although precatory, would offer practical guidance to the fiduciary:

> As attorneys, we habitually draft discretionary trusts offering no real guidance to the trustees in the exercise of their discretion with respect to distributions to beneficiaries. And despite the obvious shortcomings of this approach and the causal treatment of this critical element of a trust, we continue the practice. Instead, I believe we should strongly encourage each settlor to provide a non-binding written expression of the manner in which she would like to see the trustee exercise his discretion, so that the administration of her trust will have a good chance of reflecting the manner in which the settlor herself would have administered it.[46]

Whether contained in the trust instrument, or as a side letter of wishes directed to the trustee, these statements of settlor intent are usually precatory guidance, not mandatory instructions. The

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[44] 76 Am. Jur. 2d Trusts § 550 (West 2013).
[45] Benjamin H. Pruett, *Tales from the Dark Side: Drafting Issues from the Fiduciary's Perspective*, 35 ACTEC J. 331, 341 (2010).
[46] Alexander A. Bove, Jr., *The Letter of Wishes: Can We Influence Discretion in Discretionary Trusts?*, 35 ACTEC J. 38, 44 (2009).

fiduciary must still exercise discretion.[47]

In any event, the drafting attorney should memorialize the settlor's intent. Whether this should be within the instrument itself, in a side letter, in the files of the drafting attorney, or in all three places will depend on the degree of the client's concern.

Drafting in anticipation of later disputes is not a new phenomenon. A well-respected trial lawyer, for example, described the steps he took to immunize a will from later contest in a situation where such a dispute was likely:

> "These steps were taken to assist in preserving the will: All discussions with the testatrix were had in the absence of the favored beneficiary, the son. After the initial conference with the testatrix, she was requested to write me a letter in her own handwriting, setting forth in detail the disposition she wished to make of her estate and the reasons that motivated her desire to provide more favorably for her son than for her daughters. Upon receipt of this letter, a draft of the will was prepared and forwarded to her under a covering letter in which she was required to give close and careful consideration to the inequality of the disposition as between her children and the reasons supporting such action. She was requested again to transmit her final decision in her own handwriting. This was done, and thereupon the will was placed in final form. Four persons were then selected in whose presence this will was to be reviewed, explained, discussed and executed. Two of those were to be used as attesting witnesses in keeping with the legal requirements of the laws of our state. The other two were not to sign as attesting witnesses and would be used only in the event of a contest. These four persons were carefully selected as to age and other qualifications as witnesses. Upon completion of the execution, each witness recorded the discussions that took place, and particularly the statements of the testatrix, for future reference in the event of a contest. When the testatrix died, the daughters were disappointed – one was embittered, and there was talk of a contest. She employed a reliable attorney, and in the course of his investigation, there was revealed to him a part of the somewhat elaborate steps that had been taken to discourage the filing of a contest. The daughter's attorney advised against a contest, and the will was probated." [48]

Elaborate, or unusual, precautions could, in themselves, raise issues. Presumably no

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[47] There can be tension between flexible powers intentionally drafted into the instrument as a hedge against an unforeseeable future and general statements of settlor intent meant as non-binding guidance. A very public dispute illustrating this tension involved Leona Helmsly's charitable trust. The trust itself permitted the trustees broad discretion to make charitable gifts. Ms. Helmsly's "mission statement", on the other hand, set her priorities to assisting indigent people and, of course, dogs. The Surrogate's Court for New York County upheld the broad powers clause not the narrow mission statement. Given Ms. Helmsly's known love for dogs, one questions whether she would have approved of the result. See Susan N. Gary, *The Problems with Donor Intent: Interpretation, Enforcement, and Doing the Right Thing*, 85 Chi.-Kent L. Rev. 977, 1014.

[48] Leon Jaworski, *The Will Contest*, 10 Baylor L. Rev. 87, 92 (1958).

drafting attorney would use the elaborate procedure set out by Mr. Jaworski in every case. Why did the lawyer believe unusual steps were required in one particular case?

A best practice would be to memorialize settlor intent in sufficient detail in a manner clear to the trustees and in a way that will be admissible if a contest arises.

SPECIAL NEEDS TRUST

AND THE MARYLAND TRUST ACT

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Special Needs Trust and the Maryland Trust Act

by Fred Franke[1]

1.0 Supplemental Needs Trust and the Maryland Trust Act.

1.1 The MTA Preamble – A Questionable Beginning.

The Maryland Trust Act ("MTA") has a "preamble" which states in part:

> The fact that a beneficiary cannot compel distribution from a discretionary trust has justified not counting trust assets in determining the beneficiary's eligibility for need-based programs such as Medicaid.

The preamble then goes on to say: "A trust with no enforceable rights for a beneficiary is a trust in name only" and: "The judiciary must be able to intervene aggressively to protect all trust beneficiaries.

1.1.1 The Faulty Assumptions of the MTA Preamble.

The first proposition (beneficiaries cannot compel) is not, and never was, true under Maryland law or under the general Common Law. The second proposition (no enforceable rights means no trust) always has been, and continues to be, true under Maryland law and under the general Common Law. The third proposition (equity court enforcement) has been true, although whether the courts must be able to intervene "aggressively" is a puzzle.

The cardinal rule for statutory interpretation is to ascertain and effectuate the real and actual intent of the Legislature.[2] If a statute is clear and unambiguous, the courts need not dig further but may rely on its plain meaning. If such legislative intent is not clear, however, then the courts will look for legislative intent.[3] Preambles may be considered when determining legislative intentions.[4]

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[1] © The Law Office of Frederick R. Franke, Jr. LLC.
[2] *Lockshin v. Semsker*, 412 Md. 257, 275, 487 A.2d 18 (2010).
[3] *Bonemann v. Bonemann*, 175 Md.App. 716, 931 A.2d 1154 (2007).
[4] *Georgia-Pacific Corp. v. Benjamin*, 394 Md. 50, 81, 904 A.2d 511 (2006) ("In an attempt to determine legislative intent, it is well settled that preambles to a statute may be considered."). But see *Comptroller v. Glenn Martin Co.*, 216 Md. 235, 249, 140 A.2d 288 (1958) ("Preambles are not operable parts of the statute.").

The proposition in the preamble that beneficiaries cannot compel a distribution from a discretionary trust is why third party special needs trusts are not counted as an available resource in determining the beneficiary's eligibility for public benefits. The shorthand for the proposition is that the creditor cannot reach those assets because the beneficiary cannot reach the assets. This was not true, in any regard, under the Common Law, under the Uniform Trust Code ("UTC") or the Maryland Trust Act ("MTA"). It was, however, the basis of an early objection to the UTC and the Restatement (Third) of Trust that served as the UTC's inspiration.

2.0 Eliminating the Categories under the UTC and Restatement (Third). The Restatement (Third) of Trusts and the UTC eliminated the distinction between support and discretionary trusts, generally treating a support trust "as a discretionary trust with a standard."[5]

This approach drew heated debate. Critics of the approach adopted by the Restatement (Third) and the UTC perceived that there was a change from the Common Law of trusts and that this change exposed trust assets to heightened exposure to the claims of the beneficiaries' creditors. Mark Merric & Steven J. Oshins, *Effect of the UTC on the Asset Protection of Spendthrift Trusts*, 31 Est. Plan. 375 (2004).

Such criticism has drawn pronounced refutation. Kevin D. Millard, *Rights of Trust Beneficiaries Under the Uniform Trust Code*, 34 ACTEC L.J. 57, 63 (2008) ("[N]ote that the theory that a creditor could not reach the trust because the creditor stood in the shoes of the beneficiary and the beneficiary could not force distributions from the trust was flawed, because no matter how broadly worded the trustee's discretion was, it was always subject to review by a court for abuse."); Robert T. Danforth, *Article Five of the UTC and the Future of Creditors' Rights in Trusts*, 27 Cardozo L. Rev. 2551, 2581 (2006) ("Implicit in the critics' argument is the assertion that, by granting a trustee extended discretion, the trustee's exercise of that discretion becomes essentially

[5] George G. Bogert and George T. Bogert, *The Law of Trusts and Trustees* § 228 (2011).

unreviewable. But this has never been true at Common Law. An essential principle of the Common Law of trusts is that a trustee's exercise of discretion is always subject to judicial review, no matter how broadly the trustee's discretion may be described … [T]hat will not be interpreted so as to relieve the trustee from an obligation to account for its discretionary judgments. Because a trustee is a fiduciary, it would be inconsistent with the concept of a trust to insulate a trustee's exercise of discretion from all judicial review."); also see Alan Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code*, 40 Real Prop. Prob. & Tr. J. 567, 601-618 (2005). The relationship of the blurring of the distinctions between support and discretionary trusts as related to supplemental needs trusts is discussed below.

2.1 Beneficiary Right to Enforcement and the Supplemental Needs Trust. As noted, under the Common Law a beneficiary has the right to enforce his or her rights to a distribution from a discretionary trust. Historically (per Professor Scott), this right of enforcement was described as a right to force the trustee to act "in a state of mind which it was contemplated by the settlor that he should act."[6]

The Court of Appeals, in *First Nat. Bank of Md. v. Dept. Health and Mental Hygiene*, described the right to force a distribution from a discretionary trust upon a showing "that the trustees have acted arbitrarily, dishonestly, or from an improper motive in denying the beneficiary the funds sought," citing both Bogert and the Restatement (Second).[7] Elsewhere, the Maryland Court of Appeals has stated that the trustee's exercise, or non-exercise, of the power to distribute from a discretionary trust must be "honestly and reasonably exercised."[8]

Despite the position of the first two Restatements of Trusts, the Common Law always gave the Equity Court oversight of a trustee's exercise of discretion to assure that it was handled

[6] Restatement (Second) of Trusts § 187.
[7] 284 Md. 720, 725, 399 A.2d 891, 894 (1979).
[8] *Waesche v. Rizzuto*, 224 Md. 573, 587, 168 A.2d 871, 877 (1961) (emphasis added.).

reasonably to implement the settlor's intent. That a trustee must act "reasonably" means that there is an objective standard by which the Court can judge the trustee's actions. This is the basis of the description of a beneficiary's rights to enforcement of a discretionary trust by the Restatement (Third) of Trusts.[9] It is not a departure from existing law; it is a clearer statement of existing law.

2.2 Pre-UTC Justification for SNTs. Nationally, the cases involving supplemental needs trusts break down into three categories of approaching the trust to determine whether the assets of such a trust can be an available resource – (i) a traditional searching for settlor intent, (ii) a balancing of the competing interests, or (iii) an enforcement of a public policy restricting government benefits regardless of settlor intent:

> The case law from the various states offers three quite different answers whether discretionary trusts can be held liable for the support costs of an institutionalized beneficiary. An apt analogy might be three parallel rivers each carving a distinct channel. First, some courts approach the issue as merely a standard problem in the interpretation of trust language in which the parties differ as to the degree of authority granted by the settlor to the trustee. For these courts, the path to "justice" is to carry out the intent of the settlor. Most courts that have used this analysis have held that the trust was not liable for the costs of institutionalization. If the court finds, however, that the settlor intended that the trust support the beneficiary, then the trust will be held liable even if the beneficiary resides in a state institution. If the settlor created a "discretionary trust" and yet intended the trust to provide minimum support, the court may require the trustee to assist the beneficiary even though state support is available. If courts choose to follow this rather narrow route and rely solely upon interpretation of the trust language, then over time discretionary trusts should have little trouble avoiding the costs of institutionalization.
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> * * *
>
> A second judicial approach is one of balancing the competing interests. These courts do not see the problem as a narrow one of mere interpretation of trust language since a finding of discretionary trustee power does not end the discussion. They are troubled by the prospect of an individual receiving state assistance while enjoying the status of being the beneficiary of a trust. To these courts, it is significant that the state is the creditor who must bear the burden of support if the

[9] Restatement (Third) of Trusts § 50.

> trustee fails to assist the beneficiary. The courts' solution is to balance the intent of the settlor against the legitimate state interest in reimbursement. While the outcome of this balancing is not altogether certain, in general, the courts have favored the right of the trustee to refuse to assist the beneficiary and to resist state attempts at reimbursement. Typical is the New York case of *Estate of Escher*, in which the court held that (a) the testator would prefer the state to support the beneficiary, and (b) to invade the trust would not benefit the beneficiary but only exhaust the trust assets and destroy the testator's intent. Hence, the trust could not be held liable.
>
> * * *
>
> The third judicial approach has been to eschew any balancing of interests and to look solely to the anomaly (at least to these courts) of a trust beneficiary being supported by the state. If a resident of a state institution is the beneficiary of a trust, then the beneficiary "owns" something of value. Because state law requires reimbursement from institutional residents, the trust beneficiary is indebted to the state. Since the trust represents value that belongs to the beneficiary, the trust in turn is liable to reimburse the state.
>
> The issue is not one of mere statutory interpretation, however. State statutes that require reimbursement speak of the "estate" of the recipient, which is not a self-defining term. The court's definition of an "estate" is therefore critically dependent upon the court's view about the propriety of a trust beneficiary receiving state services. The justification for holding a trust liable is the public policy argument that the state is a unique creditor since it is the provider of last resort. An individual's right to these state services arises out of poverty, not out of a mere desire for free support. As such, all other support sources ought to be exhausted prior to turning to the state. A discretionary trust is perceived, not as a legitimate manner of effecting the settlor's intent, but as an attempt to shirk the costs of institutionalization. As a policy matter, assets available to support the beneficiary cannot be hidden behind the mantel of a trustee's discretionary authority.[10]

Professor Frolik classifies the *First National* approach as fitting into the second category of balancing competing interests. But that is not really the Court's holding in *First National*. The trust in *First National* was a hybrid, somewhere between support and discretionary: distributions "in (the

[10] Lawrence A. Folik, "Discretionary Trusts for a Disabled Beneficiary: A Solution or Trap for the Unwary?", 46 U. Pitt. L. Rev. 335, 363-4 (1985); also see Carol Ann Mooney, "Discretionary Trusts: An Estate Plan to Supplement Public Assistance for Disabled Persons," 25 Ariz. L. Rev. 939 (1983); Joseph A. Rosenberg, "Supplemental Needs Trusts for People with Disabilities: the Development of a Private Trust in the Public Interest," 10 B.U. Pub. Int. L. J. 91 (2000).

trustees') absolute and uncontrolled discretion … for her maintenance, comfort and support."[11] The Court saw its task as determining settlor intent from the text set forth in the instrument. If the settlor intended a support trust, then the funds were available to reimburse the government for its assistance. On the other hand, if the settlor intended a discretionary trust, the funds were not able to be reached by the state. At base, the Court's role was to determine settlor intent: "[O]ur task becomes one of ascertaining, from the four corners of the will, which form of trust the testatrix-settlor intended to create."

In Maryland, whether a supplemental needs trust will be reached to pay for governmentally supplied services to a disabled beneficiary depends on whether the settlor intended to create a support trust or a discretionary trust – it depends, in other words, on ascertaining, then following settlor intent. Presumably, a trust instrument giving extended discretion to the trustee ("absolute" or "unlimited" discretion) that also states that the trust is intended to supplement, but not replace, governmental assistance meets the *First National* test.[12] Whether a trustee is bound to follow that direction "reasonably" ought not change the character of the trust.

2.3 The UTC Approach. The UTC does not categorize trusts as either mandatory or discretionary, and its lack of distinction does not alter present law so to jeopardize supplemental needs trusts:

> Many supplemental needs trusts are drafted specifically to enable the beneficiary to qualify for Medicaid or other public assistance and to provide the beneficiary with amounts other than for the beneficiary's basic support. Such a trust would typically preclude the trustee from making distributions for the beneficiary's basic support needs and authorize the trustee to make distributions for the beneficiary's supplemental needs--that is, to make distributions for non-essentials such as travel, vacations, cultural activities, private (as opposed to shared) institutional housing, elective medical care, etc. There is substantial and consistent case law holding that the assets of such

[11] *First Nat. Bank of Md. v. Dept. Health and Mental Hygiene*, 284 Md. 720, 722, 399 A.2d 891, 892 (1979).
[12] The proposed Maryland Trust Act would define a trust like the one in the *First National* case as involving discretionary, not mandatory, distribution provisions. Md. Trust Act § 14.5-103(F), (M) and (W).

trusts are not considered available resources for Medicaid qualification purposes; moreover, the result is codified by statute in many jurisdictions. The UTC will have no effect on the continued effectiveness of such trusts for this purpose. Under section 814(a), the trustee is required to carry out the terms of the trust in good faith; if the trust terms prohibit distributions for the beneficiary's basic support needs, the UTC will require adherence to this prohibition.

Next, consider a trust expressly intended to be a supplemental needs trust. To what extent will such a trust be considered an available resource for Medicaid purposes, and what effect, if any, will the UTC have on that result? In general, a trust under which the trustee is required to make distribution for the beneficiary's basic support needs will be considered an available resource for Medicaid qualification purposes. The UTC will have no bearing on the treatment of such trusts. On the other hand, in general a wholly discretionary trust without a support standard will not be considered an available resource for Medicaid purposes. As discussed earlier, the UTC should not enhance a beneficiary's ability to compel distributions from such trusts; thus the UTC should not adversely affect the effectiveness of wholly discretionary trusts for purposes of Medicaid qualification.

A more difficult issue is the Medicaid treatment of third-party trusts in which the trustee is granted discretion in making distributions for the beneficiary's support. Putting aside the effect that the UTC may have on this question, the case law concerning such trusts is inconsistent, with some cases holding that the trust assets are an available resource for Medicaid qualification purposes, and others holding that they are not. The cases turn on the court's interpretation of the settlor's intent and thus the outcome of any particular case is largely fact-driven. The UTC should have little, if any, effect on the outcome of these cases, although for several reasons it may help somewhat for those seeking to qualify for public assistance. First, as earlier discussed, the UTC treats support trusts as discretionary, thereby limiting a beneficiary's ability to compel distributions. Second, under a 2005 amendment, the comment to section 814 cites with approval language from the Restatement (Third) to the effect that, in exercising its discretion, a trustee should do so in a manner that avoids disqualifying the beneficiary for public benefits. In a borderline case, the comment to section 814 may help produce a favorable interpretation of the language of a discretionary trust that also includes a support standard. [13]

[13] Robert T. Danforth, "Article Five of the UTC and the Future of Creditors' Rights in Trusts," 27 Cardozo L. Rev. 2551, 2589-90 (2006); also see Richard E. Davis, "Uniform Trust Code and SNTS: Should UTC Be Feared, Embraced or Ignored?", 5 NAELA J. 13 (2009).

Again, to the extent that settlor intent drives the outcome, careful drafting will immunize a supplemental needs trust.

2.4 The Maryland Trust Act. Unlike the UTC, the MTA distinguishes between support and discretionary trusts. Almost any discretionary provision, however, sweeps the trust into the discretionary trust category under the Maryland law.[14]

Discretionary trusts are subject to Court oversight for trustee abuse of discretion (including the failure to act reasonably in exercising discretion) and the claims creditors can make on discretionary trusts are severely limited: [15]

> (a) (1) A beneficiary of a discretionary distribution provision has no property right in a trust interest that is subject to a discretionary distribution provision.
>
> (2) A beneficial interest that is subject to a discretionary distribution provision may not be judicially foreclosed, attached by a creditor, or transferred by the beneficiary.
>
> (b) (1) The creditor of the beneficiary of a discretionary distribution provision created by someone other than that beneficiary has no enforceable right to trust income or principal that may be distributed only in the exercise of the discretion of the trustee.
>
> (2) Trust property that is subject to a discretionary distribution provision is not subject to the enforcement of a judgment until income or principal or both is distributed directly to the beneficiary.
>
> (c) A creditor of a beneficiary may not compel a distribution that is subject to a discretionary distribution provision created by someone other than that beneficiary.
>
> (d) A trust may contain a discretionary distribution provision with respect to one or more but less than all beneficiaries.
>
> (e) If a beneficiary of a discretionary distribution provision has a power of withdrawal created by someone other than that beneficiary:
>
> (1) During the period the power may be exercised, the portion of the trust the beneficiary may withdraw may not be deemed to be subject to the discretionary distribution provision with respect to that beneficiary;
>
> (2) During the period the power may be exercised, the portion of the trust the beneficiary may not withdraw shall be deemed to be subject to the discretionary distribution provision with respect to that beneficiary; and

[14] Maryland Trust Act § 14.5-103(f)(1) and (w)(2) ("Discretionary Distribution Provision"); § 14.5-103(m)(2) ("Mandatory Distribution Provision"); § 14.5-103(w)(2) ("Support Provision").
[15] Maryland Trust Act § 14.5-203.

(3) During periods in which the beneficiary does not have a power of withdrawal, the trust interest of the beneficiary shall be deemed to be subject to the discretionary distribution provision with respect to that beneficiary.

(f) If a beneficiary and one or more others have made contributions to a trust subject to a discretionary distribution provision, the portion of the trust attributable to the contributions of the beneficiary may not be deemed to be subject to that discretionary distribution provision with respect to that beneficiary, but the portion of the trust attributable to the contributions of others shall be deemed to be subject to the discretionary distribution provision with respect to that beneficiary.

(g) The interest of a beneficiary who is blind or disabled as defined in 42 U.S.C. § 1382c(a)(3) may be subject to a discretionary distribution provision notwithstanding:

(1) Precatory language in the trust instrument regarding the intended purpose of the trust of providing supplemental goods and services to or for the benefit of the beneficiary, and not to supplant benefits from public assistance programs; or

(2) A prohibition against providing food, clothing, and shelter to the beneficiary.[16]

Thus, by the statute – which parallels the *First National* case – a creditor does not reach a discretionary trust in Maryland.

2.5 Self-Settled Special Needs Trusts ("SNTs"): The Statutory Safe-Harbor: (d)(4)(A) trusts. The Omnibus Budget Reconciliation Action of 1993 ("OBRA '93") provides a safe-harbor for a trust without disqualifying beneficiaries for public benefits. 42 U.S.C. § 1396p(d)(4)(A) states:

> A trust containing the assets of an individual under age 65 who is disabled (as defined in section 1382c(a)(3) of this title) and which is established for the benefit of such individual by a parent, grandparent, legal guardian of the individual, or a court if the State will receive all amounts remaining in the trust upon the death of such individual up to an amount equal to the total medical assistance paid on behalf of the individual under a State plan under this subchapter.

The most common use of the (d)(4)(A) trust is, of course, to hold a medical injury or other tort recovery awarded to a disabled person. Other possible uses are to hold inheritance, equitable distributions, alimony or child support.[17]

[16] Maryland Trust Act § 14.5-502. Subsection (g) specifically addresses special needs trusts.
[17] Thomas D. Begley, Jr. and Angela E. Canellos, Special Needs Trusts Handbook, (2010 Aspen Publishers), § 6.02 at 6-18.

2.5.1 The Link Between (d)(4)(A) trusts and the Supplemental Security Income (SSI) Rules. Most states, including Maryland, provide that any individual who qualifies for SSI automatically qualifies for Medicaid. Also, Medicaid is not permitted to have eligibility rules more restrictive then SSI qualification rules. 42 U.S.C. § 1396a(a)(10)(C)(i)(III).

The Social Security Administration publishes the Program Operations Manual System (POMS) which establish the rules for when special needs trusts are or are not counted as an available resource. Consequently, POMS must be taken into consideration when drafting SNTs.

2.5.2 POMS and Deference. Courts have held the POMS to have no legal authority but only to be "persuasive."[18] It has been argued that the Social Security Administration and the administrative handbook for its employees have no expertise in trust law and should therefore not be afforded deference.[19] One thing is clear: POMS, or for that matter OBRA'93, was not written by, or for, trust lawyers. This makes drafting difficult.

2.6 The "Establishment" Issue. OBRA '93 mandates that a (d)(4)(A) trust is "established for the benefit of such individual (the disabled person) by a parent, grandparent, legal guardian of the individual or a court …" POMS declares that therefore a (d)(4)(A) trust is ineffective if established by the disabled individual himself or herself or by the person's agent acting under a power of attorney.[20] Given that (d)(4)(A) trusts are designed to hold and administer the disabled person's property, this restriction (arguably from OBRA '93 itself) creates a drafting hurdle. Either a "dry" or "seeded" mechanism must be employed.[21]

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[18] *Davis v. Security of Health and Human Services*, 867 F.2d 336 (1989).
[19] Ron M. Landsman, When Worlds Collide: State Trust Law and Federal Welfare Programs, 10 NAELA J. 25, 39 (2014); Mary F. Radford and Clarissa Bryan, Irrevocability of Special Needs Trusts: The Tangled Web That is Woven When English Federal Law is Imported into Modern Determinations of Medicaid Eligibility, 8 NAELA J. 1, 9 (2012). Mr. Landsman alerted the author of the position of SSA regarding "dry" trusts and the appeal of the South Dakota case. See Footnote 27.
[20] POMS SI 01120.203B(g).
[21] *Id.*

2.6.1 The "Dry" Trust. That begs the question of whether Maryland law permits a valid trust to be formed without being funded. The Social Security Administration apparently believes it does.[22] The basis for this holding is because settlor intent controls trust interpretation, including whether a trust exists.[23] Whether this actually reflects Maryland law has been questioned.[24] By statute, of course, unfunded trusts are recognized as valid to receive a legacy.[25] That statute was not abrogated by the MTA. Under the MTA, however, the existence of a trust may be created by the act of funding a trust:

> A trust may be created by:
>
> (1) Transfer of property to another person as trustee during the lifetime of the settlor or by will or other disposition taking effect on the death of the settlor;
>
> (2) Declaration by the owner of property that the owner holds identifiable property as trustee; or
>
> (3) Exercise of a power of appointment in favor of a trustee.

This provision is taken verbatim from the UTC. These are <u>permissive</u> ways a trust "may" be created. The Comments for UTC § 401 state that this section tracks the Restatement (Third) approach that a trust is not created until it receives property. Those Comments also state that the methods of creating a trust contained in § 401 are not exclusive.

MTA § 14.5-402 contains the requirements for trust creation. This likewise tracks the UTC (§ 402). MTA § 14.5-402 does not state that a trust is only created upon receiving property:

> (a) A trust is created only if:
>
> (1) The settlor has capacity to create a trust;
>
> (2) The settlor indicates an intention to create the trust;
>
> (3) The trust has a definite beneficiary or is:
>
> (i) A charitable trust;

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[22] POMS PS 01825.023 (8/27/03). This is listed on the SSA website as current. This is a regional directive.

[23] *Heart Church Ministries, Inc. v. African Methodist Episcopal Zion Church*, 370 Md. 152, 181-82, 803 A.2d 548, 516 (2002).

[24] Landsman, at Note 122, (The POMS state that Maryland does authorize such trusts, citing and relying on From the Heart Church Ministries, Inc. v. African Methodist Episcopal Zion Church, 370 Md. 152, 167, 803 A.2d 528, 557-558 (2002), although the court states the opposite: 'A trust [only] exists where the legal title to property is held by one or more persons. "') This supports Mr. Landsman's point that the Social Security Administration should not be afforded deference in its opinions.

[25] Est. & Trusts § 4-411(a), *Trusch v. Md. Nat'l Bank*, 32 Md.App. 249, 359 A.2d 564 (1976).

(ii) A trust for the care of an animal, as provided in § 14.5–407 of this subtitle; or

(iii) A trust for a noncharitable purpose, as provided in § 14.5–408 of this subtitle; and

(4) The trustee has duties to perform.

Arguably, a "dry" trust is permitted under the MTA.[26]

The issue of whether a (d)(4)(A) trust may be created "dry" has serious consequences. In a South Dakota case, the SSA determined a trust was not a (d)(4)(A) trust because it was established upon the funding with the settlement proceeds awarded the disabled person. The SSA held, and the U.S. District Court upheld, that the parents were not acting as parents but under their daughter's power of attorney in establishing the trust.[27]

2.6.2 The "Seed" Trust. A "seed" trust is authorized by SSA[28]: "A parent, or grandparent may establish a 'seed' trust using a nominal amount of his or her own money … After that trust is established, the legally competent disabled adult may transfer his or her own assets to the trust or another individual with legal authority (e.g., power of attorney) may transfer the individual's assets into the trust."

Although explicitly permitted by the POMS, does the funding after nominal funding cause any other issue under MTA § 14.5-103(t)? It states:

(1) "Settlor" means a person, including a testator, that creates or contributes property to a trust.

(2) "Settlor" includes a person that, with other settlors, creates or contributes property to a trust in which case each such person is a settlor of the portion of the trust property attributable to the contribution of that person except to the extent another person has the power to revoke or withdraw that portion.

In this regard, the MTA definition tracks the UTC definition. Settlor, of course, has meaning to a trust lawyer. POMS defines settlor in a similar fashion: "A grantor (also called a settlor or trustor)

[26] "Arguably" because it requires that the trustee has duties to perform. Whether a trustee can be said to have "duties" without corpus is problematic.

[27] *Draper v. Colvin*, ____F.Supp. ____, 2013 WL 34772 (D. S.Dakota 2013). It is on appeal. Ron Landsman, of Maryland, is on the amicus brief for NAELA in that case.

[28] POMS SI 01120.203 Bf.

is the individual who provides the trust principal (or corpus).[29] For SSI purposes, and under OBRA'93, the requirement is that the trust must "be established" by certain people or by a court.[30] The SSI rules do not require the person deemed the grantor or settlor to be someone other than the disabled person, it only requires that the person "establishing" the trust be the parent or grandparent. The fact that the disabled individual may be the settlor as to his or her funding does not seem to be an issue.

The formation of a (d)(4)(A) trust may be problematic due to the mismatch of the law of trusts (whether under the MTA, the UTC, or the Common Law), and OBRA '93 and the POMS. Nevertheless, the safest course would seem to be creating a seeded trust in Maryland.

[29] POMS SI 01120.200B(2).
[30] POMS SI 01120.203. This contemplates that one step is "establishing" the trust and that another step is its funding with the disabled person's assets.