



Settlements on Behalf of Minors and Incompetents

The protection of the settlement proceeds belonging to minors or incompetent adults should be an important consideration to an attorney when settling a personal injury case. In general, there can be a risk of imprudent investments or improper use of the funds, including the potential squandering by adults who are in charge. When the minor or incompetent adult is receiving public benefits such as Supplemental Security Income (SSI) and/or Medi-Cal, or may want to qualify for those benefits in the future, additional care and consideration are necessary.

Unless handled correctly, eligibility for public benefits can be lost. Under San Diego Superior Court Local Civil Rule 10.7, no action brought on behalf of a minor or incompetent can be settled, compromised, voluntarily discontinued, dismissed or terminated without court order or judgment. This places the question of the best interests of the minor or incompetent with the court and court approval is required. In considering the options available for settlement, the attorney should consult California Probate Code §§3600 et. seq. for the various alternatives to hold the funds from a settlement on behalf of a minor or incompetent. Each alternative has particular advantages and disadvantages. Where eligibility for public benefits is concerned, only one of the alternatives is suitable for use. These alternatives for consideration include:

1. Blocked Accounts and Deferred Annuities:

In general, upon a petition by the guardian or guardian ad litem on behalf of the minor or incompetent, the funds may be deposited in an FDIC insured account subject to withdrawal only upon court order [Probate Code §3602(c)(1)].

This method works best where a relatively small lump sum (\$25,000 or less) is involved and immediate need of the money is not anticipated. The money is available to the minor at age 18. Withdrawals are permitted before the minor is 18 years old by court order for good cause. Good cause is typically based upon circumstances involving the welfare of the child such as medical or educational needs. Since parents are under a general obligation for the support of the child, requests for support type expenses are usually denied.

The funds must be deposited in a federally insured bank account. Brokerage accounts, mutual funds and other such investments are generally not approved because of the “risk” involved and so are not appropriate for these circumstances.

Deferred annuities through insurance policies should be placed with insurance companies rated A+ by the A.M. Best Co. These annuities often pay out in installments starting at age 18, or thereafter. The payment schedule is typically set to meet the future needs of the minor as anticipated by the guardian ad litem.

If the annuity is going to pay out during the minority or incapacity, then some other alternative like a guardianship or trust should be considered because the guardian ad litem is not authorized by law to handle the proceeds of a settlement of judgment once the litigation is concluded [C. C. P. § 372]. The guardian ad litem is appointed as a representative to act for the minor or incompetent for the purpose of engaging counsel, filing suit and directing the litigation

on behalf of the minor or incompetent. The appointment terminates with the settlement or judgment of the case.

2. Payment to a Guardianship or Conservatorship:

The funds may be delivered to the appointed guardian of the estate of the minor or conservator of the estate of a disabled adult. The guardianship or conservatorship itself is created in a separate proceeding in Probate Department for the purpose of administering the settlement funds. This method also places continued supervision in the Probate Department for bonding, accounting and approving investments.

The guardian or conservator (also called the “fiduciary”) has some discretion for investment but must use the “care, skill, prudence, and diligence under the circumstances then prevailing, including . . . the general economic conditions and the anticipated needs of the trust and its beneficiaries” [Probate Code §2401(a)].

The guardianship or conservatorship provides more flexibility than the blocked account and gives the fiduciary some powers which can be exercised without petitioning the court, such as: maintaining a home; collecting debts or benefits owed to the minor or incompetent; endorsing and depositing checks; purchasing and selling stocks, bonds, etc.; filing tax returns; and payment of debts and reasonable expenses in maintaining the guardianship or conservatorship. Other fiduciary acts may require court approval.

This method works best in cases where the minor or incompetent has private medical coverage or does not have a disability which requires ongoing medical care. The amount going into a guardianship should also be a consideration because the total proceeds will be available to the minor upon reaching age eighteen (18) by operation of law.

3. Payment to a Revocable Trust:

A trust under Probate Code §3611(g) is revocable by the minor upon attaining the age of 18 years. If the minor is incompetent at age 18, a conservatorship would need to be established through a court proceeding, and the court could continue the trust under the power of “substituted judgment” [Probate Code §2580]. A trust of this type for an incompetent is revocable if competency occurs.

Local Rule 10.7 (C) requires that any settlement of a proceeding which contemplates the creation of a trust with the proceeds from the settlement, including trusts authorized under Probate Code §3600 et seq., must be reviewed by the Probate Department prior to approval in the Civil Department.

The trust may not contain provisions disposing of the remaining assets in the trust upon the minor’s or incompetent’s death. This is contrary to law because a minor or incompetent lacks testamentary capacity to create a will or a trust and the estate must pass by intestate succession.

The Superior Court typically requires a surety bond in an amount at least equal to the amount of the settlement funds, plus one year of income if the trustee is a private individual. The cost is typically \$50 per \$10,000 in coverage (i.e., \$500 for \$100,000 coverage) for a court supervised trust and would be an appropriate expense of the trust.

If a settlement is over \$250,000, a corporate trustee is often the best choice given the risk, investment needs, record keeping, tax returns and court accounting requirements. For smaller settlements, a private professional fiduciary or a family member may be appropriate, as this arrangement can save on trustee's fees. If a family member is being considered, it should be someone with some degree of professional sophistication and financial stability.

This method gives the trustee some investment discretion, but requires adherence to the "prudent investor standard." The §3611(g) trusts are supervised by the court and the trustee is required to account to the court on an annual basis.

4. Special Needs Trusts

A Special Needs Trust allows a disabled individual to retain eligibility for needs based government assistance programs. When properly created, the Special Needs Trust assets are excluded from the \$2,000 limit on resources imposed for SSI eligibility [42 U.S.C. § 1396p].

The Court must make specific findings pursuant to Probate Code §3604(b) when authorizing transfer of funds to a Special Needs Trust created for that purpose, which includes:

- That the minor or incompetent person has a disability that substantially impairs the individual's ability to provide for the individual's own care or custody and constitutes a substantial handicap;
- That the minor or incompetent person is likely to have special needs that will not be met without the trust;
- That the money to be paid to the trust does not exceed the amount that appears reasonably necessary to meet the special needs of the minor or incompetent person.

The benefit of a Special Needs Trust is that the individual doesn't have to give up all the public benefits due to the settlement, since the assets in the Special Needs Trust are not counted as assets when calculating financial needs, and the settlement funds can be used for medical needs and services not covered by public benefits in whole or in part. Often if a Special Needs Trust is not used to receive settlement proceeds, the individual temporarily loses his or her public benefits and has to spend the settlement proceeds down to the allowable \$2,000, and then go back on SSI and Medi-Cal, essentially putting them right back where they started before the lawsuit.

A Special Needs Trust is subject to the continuing jurisdiction of the Probate Department for purposes of accounting, bonding and approving extraordinary expenditures.

There are substantial limitations on the use of the funds. Any pre-existing liens must be paid at the time of settlement, the trust is irrevocable, and on death or termination of the trust,

Medi-Cal is entitled to repayment for benefits extended during the life of the trust. The trust cannot be used to provide food, clothing or shelter without causing a reduction of the beneficiary's SSI benefits.

The trustee is authorized to pay for medical costs not typically provided for by public benefits. Such expenses might include expenses for attendant care, rehabilitation, special facilities and equipment, and transportation. In addition, an automobile up to \$4,500 in value, or one of any value which is specially equipped, can be purchased by the Special Needs Trust. The trust can purchase a home or pay for remodeling of an existing home in order to better accommodate the individual's disabilities.

The proceeds establishing the trust must pass from the defendant to the trust without receipt, constructive or otherwise, by the plaintiff, as receipt will compromise eligibility for public benefits. Placing the settlement proceeds in an attorney's client trust account is constructive receipt by the client and will compromise the client's eligibility.

Special Needs Trusts are also available to competent disabled adults who wish to preserve their eligibility for public benefits. An individual's qualification for SSI and Medi-Cal is accepted by the San Diego Superior Court as evidence sufficient to make the finding relative to the requisite disability.

If there are several "settlements" at different times or stages of a case for a particular individual, then the same trust may be used to provide for the special needs of the plaintiff. However, each subsequent settlement requires a new petition pursuant to Local Rule 10.7 and notice must again be provided to the state public benefits departments. If the settlement is in the form of an annuity contract with a sequence of future payments, those "additions" to the trust should be authorized under the initial order of the court and separate court orders authorizing the additions are unnecessary.

5. California Uniform Transfers to Minors Act ("CUTMA"):

Small amounts (usually less than \$20,000) may be transferred to the custodian for a minor, usually the parent, under the California Uniform Transfers to Minors Act ("CUTMA") [Probate Code §§ 3602 (c)(2), 3611(f), and 3900, et. seq.]. The transfer is irrevocable.

The money belongs to the minor and is transferred to the custody of the minor at age 18, unless, at the time of the original transfer, a later distribution date, not later than the minor's 25th birthday was designated [Probate Code §3920.5]. The custodian has specific statutory duties set forth in Probate Code § 3912, but there is no ongoing supervision by the court, nor any regular accounting to the court. A judgment or settlement which is paid under CUTMA will not maintain public benefits and will be considered "available" by SSI and Medi-Cal.

Personal injury attorneys will often find that their clients are simply not aware of the options and benefits available to them. This lack of awareness can be especially tragic when the benefit of the settlement is lost due to misuse and/or mismanagement of funds. Additional tragedy can occur when disabled clients lose the opportunity to protect their public benefits and

end up no better off than they were before the lawsuit was initiated. Clients will often look to their attorneys to guide them in making the best decisions for the receipt of the settlement funds, and the attorneys need to be informed about the alternatives in order to best counsel their clients.