

# SURVEY OF ILLINOIS LAW: TRUSTS AND ESTATES

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## I. IN RE ESTATE OF BOZARTH

Reversing the lower court on a narrow issue of law, the Illinois Appellate Court for the Fourth District recently held that when life-estate property consists of financial assets, a life tenant is entitled to consume only the interest that accrues during her lifetime, but not the principal.<sup>1</sup>

In October 1974, Harold Bozarth executed a will.<sup>2</sup> Harold's will provided:

After the payment of my just debts and burial expenses, I will, devise and bequeath all of my property of every kind, nature, and description, and wherever situated, and any property in which I have an interest, to my beloved wife, Frances Bozarth[,] to be hers to use and enjoy for and during the term of her natural lifetime.

...

At the death of my wife, all that remains of my estate . . . I will, devise[,] and bequeath the same to any trustee nominated by my said wife, . . . and all such property shall be held for the benefit of my son[,] Robert F. Bozarth[,] and the heirs of his body until the youngest of his children attains the age of forty years, at which time the entire corpus, and any

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1. *In re Estate of Bozarth*, 2014 IL App (4th) 130309, ¶ 42.

2. *Id.* at ¶ 8.

accumulation, shall be distributed equally among my grandchildren, after which the trust shall cease.<sup>3</sup>

Harold died in 1983.<sup>4</sup> In August 1984, as executrix of Harold's estate, Frances Bozarth filed a final report wherein she stated that she personally received "mortgages, notes and cash" worth a total of \$100,800.79.<sup>5</sup> Additionally, pursuant to Harold's will, she reported that Robert, Harold's son from a prior marriage, received \$5,000 and \$23,555.44 was used to pay Harold's end-of-life expenses.<sup>6</sup>

Frances died in October 2010.<sup>7</sup> In the petition to have her will probated, Robert stated that Frances's estate included approximately \$257,274.46 in personal property and \$780,000 in real property.<sup>8</sup>

Robert died in September 2011.<sup>9</sup> In June 2011, Robert's children filed four claims against Frances's estate, including the claim at issue in the appeal at bar.<sup>10</sup> In January 2013, the trial court denied all of petitioners' claims.<sup>11</sup>

With respect to the claim at issue on appeal, the trial court explained that the petitioners' claim for \$100,800.79 failed for two reasons.<sup>12</sup> First, petitioners had not proved by a preponderance of the evidence what exactly the personal property listed in Frances's final report consisted of.<sup>13</sup> Secondly, even if the petitioners had successfully identified the property, as the life tenant, Frances had the right to consume the property in the life estate because the property cannot be enjoyed without consuming it.<sup>14</sup>

On appeal, petitioners asserted that as the remaindermen of Harold's will, they were entitled to the personal property that Frances had received from Harold and held as a life tenant.<sup>15</sup> Specifically, the petitioners asserted that they were entitled to (1) "mortgages, notes and cash in the amount of \$100,800.79."<sup>16</sup> Petitioners also claimed to be entitled to "personal property, including grain and other personal property in the amount of \$67,248.38."<sup>17</sup> However, because petitioners failed to challenge

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3. *Id.*

4. *Id.* at ¶ 9.

5. *Id.* at ¶ 10.

6. *Id.*

7. *Id.* at ¶ 12.

8. *Id.*

9. *Id.* at ¶ 16.

10. *Id.* at ¶ 1.

11. *Id.* at ¶ 23.

12. *Id.* at ¶ 24.

13. *Id.*

14. *Id.*

15. *Id.* ¶¶ 25–28.

16. *Id.* ¶ 15.

17. *Id.*

the lower court's adverse ruling as to the \$67,248.38, the appellate court promptly disposed of that prong of petitioners' claim, ruling that the petitioners forfeited that portion of their claim.<sup>18</sup>

Reversing the lower court, the appellate court explained that "[a]lthough it might seem plain that the right to 'use and enjoy' life-estate property would include the right to liquidate and spend the financial assets at issue, Illinois law provides otherwise."<sup>19</sup> In Illinois, when life-estate property consists of cash or its equivalent—such as the Corn Belt Bank assets in this case—the life tenant is entitled to consume the interest that accrues during her lifetime, but not the principal.<sup>20</sup> To be entitled to consume principle, Harold would have had to have stated expressly that Frances was authorized to consume principle.<sup>21</sup>

The appellate court relied on *Quigley v. Quigley*.<sup>22</sup> In *Quigley*, the life estate at issue consisted of \$29,000 worth of capital stock in various corporations, bank deposits, checks, and a promissory note.<sup>23</sup> The *Quigley* court held that the language bequeathing the property to the testator's brother "'for his personal use during his lifetime'" was insufficient to vest the brother with the right to consume the financial assets at issue.<sup>24</sup> The *Quigley* court was of the opinion "that a gift 'for his personal use during his lifetime' has no different meaning than 'for life.'"<sup>25</sup> The appellate court found no distinction between the will's language in *Quigley* and the language of Harold's will bequeathing property to Frances "to be hers to use and enjoy for and during the term of her natural lifetime."<sup>26</sup>

Thus, as remaindermen, the petitioners were indeed entitled to \$100,800.79.<sup>27</sup> This sum is equivalent to the value of the financial assets that entered into the life-estate corpus at the inception of the life-tenancy period. Only the interest or return on investment that may have accrued from the financial assets during Frances's lifetime was hers to use and enjoy.

Harold's will created a life estate. According to the appellate court, an Illinois life estate does not allow for the consumption of principle.<sup>28</sup> If it is the intent of the grantor to allow the use of principle then the life estate

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18. *Id.*

19. *Id.* at ¶ 36.

20. *Id.* at ¶ 42.

21. *See id.* at ¶ 43.

22. *Id.* at ¶ 41.

23. 370 Ill. 151, 152, 18 N.E.2d 186, 187 (1938).

24. *Id.*

25. *Id.*

26. *Bozarth*, 2014 IL App (4th) 130309, ¶ 38.

27. *Id.* at ¶ 44.

28. *Id.* at ¶ 42.

must specifically authorize such distribution. Regardless, the law in Illinois strictly construed what a life estate includes.

## II. IN RE ESTATE OF ZAGARIA

### A. Introduction

The Appellate Court of Illinois for the First District ruled that where a “presumed dead” respondent is subsequently discovered alive, said respondent is required to pay attorneys’ fees incurred in administering the estate from assets returned to him from the now-closed probate estate.<sup>29</sup>

Interestingly, a majority of the *Zagaria* court found both statutorily-based fee obligations and equitable principles demanded that respondent pay attorneys’ fees incurred administering his estate from his personal estate.<sup>30</sup> The *Zagaria* dissent agreed that statutorily-based fee obligations arose, however, the dissent disagreed that in this instance respondent is responsible to pay said fees.<sup>31</sup> Instead, the dissent explains, equity demands that the administrator of the now-closed estate, who benefitted greatly from the estate, should pay the attorneys’ fees.<sup>32</sup>

### B. Facts

Samuel N. Zagaria, Jr. had no contact with his friends or family for over seven years.<sup>33</sup> His sister, Joanne Corlett, filed a petition with the probate court for letters of administration upon a presumption of death.<sup>34</sup> Upon finding that Zagaria had been neither seen nor heard from since August 10, 2000, and upon diligent inquiry could not be found, the court ruled that the facts created a presumption in law that Zagaria died intestate on August 10, 2007.<sup>35</sup> The court issued letters of office of the presumed-dead estate of Zagaria and appointed Corlett as independent administrator.<sup>36</sup> The primary estate asset was a stock account worth about \$500,000.00.<sup>37</sup>

Attorneys hired by Corlett prepared missing personal tax returns for Zagaria.<sup>38</sup> They recovered unclaimed assets owned by Zagaria that were

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29. *In re Estate of Zagaria*, 2013 IL App (1st) 122879, ¶ 38.

30. *Id.* at ¶ 42.

31. *Id.* at ¶ 54.

32. *Id.* at ¶¶ 67–68.

33. *Id.* at ¶ 1.

34. *Id.* at ¶ 3.

35. *Id.*

36. *Id.*

37. *Id.* at ¶ 1.

38. *Id.* at ¶ 4.

held by the State of Illinois.<sup>39</sup> Additionally, the attorneys attempted to collect annuity benefits owed to Zagaria.<sup>40</sup> To collect the annuity benefits, the attorneys were required to produce a “presumed-dead death certificate.”<sup>41</sup> When the attorneys contacted government officials to obtain such a certificate, they learned that someone had filed an application for public assistance using Zagaria’s social security number.<sup>42</sup> This discovery ultimately led to confirmation on June 8, 2010 that Zagaria was indeed still alive.<sup>43</sup>

On August 26, 2010, counsel for Zagaria filed a motion to revoke letters of administration.<sup>44</sup> On September 1, 2010, the court revoked the presumption of death and letters of administration.<sup>45</sup> The court also ordered Corlett to provide a full accounting of the estate and to turn over all remaining funds in an original stock account to Zagaria.<sup>46</sup> At this time, the estate was worth \$366,000.00.<sup>47</sup> As the dissent explains, it is undisputed that during the pendency of the estate Corlett, as administrator, made multiple distributions to herself.<sup>48</sup>

The attorneys hired by Corlett continued to work to close the estate.<sup>49</sup> During this time, they did not make a request for fees nor did they seek guidance from the court regarding the proper procedure for handling this unique set of circumstances.<sup>50</sup> The attorneys sent the final accounting of the estate to the court on November 4, 2010.<sup>51</sup> Five and a half months later, on April 21, 2011, the attorneys filed a petition for attorney fees and costs totaling \$30,859.21.<sup>52</sup>

On April 11, 2012, the court entered an order finding that the attorneys’ fees and expenses were fair and reasonable and imposed judgment against the estate for \$27,359.21.<sup>53</sup> On September 6, 2011, Zagaria filed an opposition to the fee petition.<sup>54</sup> Upon learning that Zagaria had a new stock account, the attorneys filed a motion for turnover of funds to satisfy the fee award judgment.<sup>55</sup> On June 1, 2012 the court froze the

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39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.* at ¶ 6.

43. *Id.* at ¶ 7.

44. *Id.*

45. *Id.*

46. *Id.* at ¶ 7.

47. *Id.* at ¶ 59.

48. *Id.*

49. *Id.* at ¶ 7.

50. *Id.*; see also *id.* ¶ 56.

51. *Id.* at ¶ 7.

52. *Id.* at ¶ 8.

53. *Id.* at ¶ 10.

54. *Id.* at ¶ 9.

55. *Id.* at ¶ 10.

amount of the judgment in Zagaria's new stock account.<sup>56</sup> On August 29, 2012, the court allowed the motion for turnover against Zagaria.<sup>57</sup> Zagaria appealed.<sup>58</sup>

On appeal, Zagaria argued "(1) petitioners failed to show cause to attach his nonprobate assets; (2) his claim to the estate property is superior to the petitioners' claim; and (3) the trial court's order is not supported by existing law."<sup>59</sup> "Alternatively, Zagaria argue[d] that if he is liable for attorney fees incurred in the administration of the estate, the attorneys for the estate owed him a fiduciary duty, and the trial court's finding to the contrary should be reversed."<sup>60</sup>

### C. Analysis

The Zagaria court recognized that administration of an estate upon a legal presumption of death is indeed permissible under section 9-6 of the Illinois Probate Act.<sup>61</sup> Furthermore, the court explained that such an estate is administered in the same fashion as an estate of one proved dead by other means.<sup>62</sup> Once the estate is opened, the estate administrator is entitled to the assistance of an attorney and said attorney is entitled to be paid for his or her services.<sup>63</sup> Additionally, as the majority explains, the attorney's compensation for his or her work performed on behalf of the estate is paid from the estate assets.<sup>64</sup>

The majority then highlights that pursuant to section 18-12 of the Illinois Probate Act, funds that were once held by the estate but which are no longer in the administrator's possession are nonetheless subject to claims against the estate to the extent that the distributee's share of the estate is not diminished below what the distributee would have received had the claim been paid by the estate representative.<sup>65</sup>

Although in this instance the estate was closed and the estate funds had already been returned to Zagaria, the majority found that the funds in the new stock account owned by Zagaria once belonged to the estate.<sup>66</sup> This fact is undisputed by the dissent.<sup>67</sup> Thus, following the estate funds to

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56. *Id.* at ¶ 11.

57. *Id.*

58. *Id.*

59. *Id.* at ¶ 12.

60. *Id.*

61. *Id.* at ¶ 19.

62. *Id.* at ¶ 20.

63. *Id.* at ¶ 16.

64. *Id.*

65. *Id.* at ¶ 16; *see also* 755 ILL. COMP. STAT. 5/18-12(d) (2010).

66. *Zagaria*, 2013 IL App (1st) 122879, ¶ 28.

67. *Id.*



Zagaria, the majority shows little hesitation in holding that Zagaria should be required to pay the attorney fees incurred in administering the estate.<sup>68</sup>

Relying on principles of equity, the majority offers further support for its conclusion stating if a person received a benefit from another, he is liable for payment.<sup>69</sup>

#### D. Dissent

In the dissent's view, "while a court of review must follow the letter and spirit of the law, it must also seek to infuse its rulings with justice and equity."<sup>70</sup> Corlett, as estate administrator, benefitted greatly from the estate. When she opened the estate it was worth \$518,000, by the time the letters of office were revoked the estate had dwindled to \$366,000.<sup>71</sup>

After finding Zagaria alive, the dissent points out that the attorneys for the estate took no steps to seek the court's guidance regarding the proper procedure for closing the "presumed dead" probate estate.<sup>72</sup> Furthermore, the estate attorneys never sought payments of expenses and fees within the parameters of the estate while the matter was actively pending, rather the attorneys waited a considerable length of time before filing to recover fees and expenses.<sup>73</sup>

Using the same equitable principles relied upon by the majority, the dissent would find that because Corlett benefitted greatly from administration of the "presumed-dead estate," she too should pay for that benefit.<sup>74</sup>

The dissent believes that the estate funds which were distributed to Corlett, especially those which she took after it became likely that Zagaria was alive, should be considered constructively held in trust by Corlett for the benefit of the estate.<sup>75</sup>

The dissent asserts that "[t]he outcome of this case leaves the impression that the courts have chosen to rescue the attorneys from a situation which is of their own making and reward Corlett for her personal use of estate funds."<sup>76</sup>

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68. *Id.* at ¶ 51.

69. *Id.* at ¶¶ 42–44.

70. *Id.* at ¶ 54.

71. *Id.* at ¶ 59.

72. *Id.* at ¶ 56.

73. *Id.*

74. *Id.* at ¶ 68.

75. *Id.* at ¶ 65.

76. *Id.* at ¶ 67.

### E. Conclusion

Although the appellate court offers little discussion of Corlett's and the estate attorneys' efforts to locate Mr. Zagaria prior to the presumed dead ruling, one must acknowledge that "diligent effort" was found by the lower court as the court-made "seven-year rule" requires "a diligent search." Given this, it is understandable why the court awarded fees and ordered the previous "estate funds" be used to pay said fees. Without such an award of fees, the chilling effect on the administration of presumed dead estates would be substantial as likely few people would be willing to risk administering these types of estates.

## III. SPECIAL NEEDS DECANTING

### A. Introduction

On January 1, 2013, Section 16.4 of the Illinois Trusts and Trustees Act became effective, codifying in Illinois what has become commonly known as "decanting."<sup>77</sup> Formally titled "Distribution of Trust Principal in Further Trust," Section 16.4 validated a trustee power that was already intuitively inherent under common law. The power to decant permits an authorized trustee of an existing irrevocable trust (the "first trust") to find or create a new or separate trust (the "second trust") and pour—as one pours wine from the bottle into a decanter—the assets of the first trust into the second trust. Recognizing the potential benefit to special needs planning, the drafters of the decanting statute included procedures specifically aimed at using decanting for the benefit of trust beneficiaries who have disabilities, including maximizing a disabled beneficiary's ability qualify for valuable, need-based government benefits including Supplemental Security Income (SSI) and Medicaid.

The potential benefit of decanting in a special needs trust setting is simple: where the terms of the first trust reduce or eliminate a disabled beneficiary's potential to qualify for government benefits or otherwise are not in the disabled beneficiary's best interest, the trustee may decant to a second trust whose terms effectively increase the benefits available to the disabled beneficiary or, at the least, cause the trust to be administered in a manner that is in the beneficiary's better interests. Of course, how this feat is accomplished, and in what manner, is a bit more complex. A trustee considering decanting for the benefit of a special needs beneficiary may have multiple avenues at hand to do so. This article is intended to give a brief overview of the decanting process in general, explain the methods by

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77. 760 ILL. COMP. STAT. 5/16.4 (2013).

which a trustee may decant in a special needs context, overview some of the potential problems with decanting in this context, and review examples of special needs decanting to aid the reader in understanding how special needs decanting may work.

#### B. A Decanting Primer<sup>78</sup>

Before considering the provisions of the decanting statute specifically addressing special needs decanting, it is necessary first to understand the basic decanting process. At its simplest, decanting is the act of “pouring” the principal of one trust into a different trust. The second trust need not be a new trust, nor need it be created by the trustee of the first trust. Rather, the trustee’s authority to decant is drawn from the discretion granted him under the first trust document, and, as one might imagine, the broader the trustee’s discretion, the broader the trustee’s authority to decant.

In general, decanting is one of a few tools in the trustee’s “toolbox” for modifying trust provisions either to assist in the proper administration of the trust or to better effectuate the settlor’s wishes.<sup>79</sup> Among other things, trust decanting may be useful to modify administrative and investment provisions, modify fiduciary appointment and succession provisions, change applicable law, convert certain trusts to more favorable trust forms, add or remove spendthrift provisions, adjust to changing tax laws or environments, and of course, protect assets for the use of beneficiaries, including special needs beneficiaries.

To decant, the trustee must first be an “authorized trustee;” that is, the trustee must have the authority to distribute principal of the trust.<sup>80</sup> Where a trustee’s discretion is limited only to distributions of income, the trustee is not an “authorized trustee,” and may not decant. Assuming that the trustee has some authority to distribute principal, the trustee’s ability to decant is defined by the breadth of the trustee’s discretion to distribute trust principal. Where a trustee has absolute discretion to distribute trust principal, the trustee’s ability to decant is very broad.<sup>81</sup> Alternatively, where a trustee’s

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78. For a broader review of decanting in Illinois, in general, see Susan T. Bart, Jennifer L. Bunker & Sonia D. Coleman, *Survey of Illinois Law: Trusts and Estates, Section III, Decanting: Refining a Vintage Trust*, 38 S. ILL. U. L.J. 615 (2014).

79. Other tools include trust revision via a virtual representation agreement, *see* 760 ILL. COMP. STAT. 5/16.1 (2013) (authorizing virtual representation agreements in Illinois), trust merger, and trust division.

80. 760 ILL. COMP. STAT. 5/16.4(a) (2013) (“‘Authorized trustee’ means an entity or individual, other than the settlor, who has authority under the terms of the first trust to distribute the principal of the trust for the benefit of one or more current beneficiaries.”).

81. *See id.* § 5/16.4(c) (2013) (governing the trustee’s ability to decant when the trustee absolute discretion).

discretion to distribute principal is narrow, his ability to decant is likewise narrow.<sup>82</sup>

### *1. Trustee with Absolute Discretion*

Where a trustee has absolute discretion, his authority to decant is controlled by Section 16.4(c) of the decanting statute. A trustee with “absolute discretion” has “the right to distribute principal that is not limited or modified in any manner to or for the benefit of one or more beneficiaries of the trust...”<sup>83</sup> A trustee whose authority is described as “best interests,” “welfare,” or “happiness,” is generally considered to have absolute discretion.<sup>84</sup>

Under Section 16.4(c), a trustee may distribute the assets of the first trust into a second trust for the benefit of one, some, or all of the current trust beneficiaries, and for the benefit of one, some, or all of the remainder beneficiaries.<sup>85</sup> Accordingly, the beneficiaries of the first trust need not all be beneficiaries of the second trust, although they can be. The trustee may also grant a power of appointment to one, some, or all of the current beneficiaries if the beneficiary was entitled to outright distribution under the first trust, and the power of appointment may give the beneficiary broad discretion to select beneficiaries.<sup>86</sup> The trustee with absolute discretion is otherwise restricted only by those limitations found in the remainder of Section 16.4, which significant restrictions are discussed in Section B(3) *infra*, or in the trust document itself.

### *2. Trustee with Less than Absolute Discretion*

Conversely, a trustee who does not have absolute discretion to distribute trust principal is significantly more limited in his authority to decant. Subsection 16.4(d) controls decanting in a situation where the trustee’s authority does not meet the ‘absolute discretion’ definition discussed above.<sup>87</sup> In that case, the trustee may decant to a second trust *only* if: (1) the second trust has the same current beneficiaries and the same successor and remainder beneficiaries as the first trust; (1) the second trust has the same beneficiary class members as the first trust; and (3) the second trust includes all powers of appointment of the first trust.<sup>88</sup> In other words,

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82. See *id.* § 5/16.4(d) (governing the trustee’s ability to decant when the trustee has less than absolute discretion).

83. *Id.* § 5/16.4(a) (defines “absolute discretion”).

84. *Id.*

85. *Id.* § 5/16.4(c).

86. *Id.* §§ 5/16.4(c)(1)-(2).

87. *Id.* § 5/16.4(d).

88. *Id.* §§ 5/16.4(d)(1)-(3).

the trustee decanting under Subsection (d) may not decant in a way that alters the trust's distributive terms or beneficiaries. However, the trustee without absolute discretion may still decant for a number of reasons other than altering the trust's distributive terms, such as altering administrative terms, correcting fiduciary succession provisions, and the like. Like a trustee decanting under Subsection (c), the trustee decanting under Subsection (d) is also limited by the restrictions found in other parts of Section 16.4, discussed below, and in the trust instrument.

### *3. Limitations on the Trustee's Ability to Decant*

In addition to any restrictions on decanting found in the trust document, Section 16.4 includes several specific limitations on the terms of the Second Trust designed to both restrict and protect the trustee. Two particular limitations are notable when discussing special needs decanting. First, Subsection 16.4(n)(1) provides that a second trust may not reduce, limit or modify a beneficiary's mandatory distribution or right of withdrawal, except where the second trust is a supplemental needs trust.<sup>89</sup> As discussed further in Section C, *infra*, this exception for supplemental needs second trusts is crucial to the concept of "special needs decanting" and may even be unique to Illinois' decanting statute. Second, Subsection 16.4(o) limits the trustee's ability to decant where doing so would subject the second trust to claims of reimbursement by a private or governmental body or reduce or jeopardize an individual's right to government benefits.<sup>90</sup> As discussed later in Section C, *infra*, this restriction is significant because it creates an ambiguity when decanting to a supplemental needs second trust with payback provisions.

In general, the terms of the second trust must further the purposes of the second trust.<sup>91</sup> The second trust may have a term longer than that of the first trust; however the second trust must have the same permissible rule against perpetuities as the first trust.<sup>92</sup> Assets belonging to the first trust that are discovered after decanting must be included in the decanting, but assets acquired by the first trust after decanting remain assets of the first trust.<sup>93</sup> In addition, the trustee may not decant if decanting is specifically prohibited by the first trust.<sup>94</sup> The trustee, generally, may not alter his own liability, compensation, or eliminate a right to remove the trustee.<sup>95</sup> And

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89. *Id.* § 5/6.4(n)(1).

90. *Id.* § 5/16.4(o).

91. *Id.* § 5/16.4(b).

92. *Id.* § 5/16.4(g).

93. *Id.* § 5/16.4(i).

94. *Id.* § 5/16.4(m) (a spendthrift clause alone does not prohibit decanting).

95. *Id.* §§ 5/16.4(n)(2)-(3) & § 5/16.4(q).

finally, the trustee must comply with certain notice provisions or seek court approval before decanting.<sup>96</sup>

#### 4. *The Process of Decanting*

Briefly, a few notes on the process required to decant. The “decanting” must be made by a written instrument, signed and acknowledged by the trustee, and filed with the records of the first trust and second trust.<sup>97</sup> Court approval and consent of the beneficiaries to the decanting is not required *but only* if there are one or more legally competent current beneficiaries and one or more legally competent presumptive remainder beneficiaries of the first trust *and* notice of the intended distribution is given to all legally competent beneficiaries.<sup>98</sup> If no recipient of the notice objects within 60 days, the trustee may decant. If a beneficiary objects to the decanting within 60 days or if notice cannot be made because there are no legally competent current and/or remainder beneficiaries of the first trust, the trustee may seek court approval of the decanting by filing a petition to order the proposed distribution.<sup>99</sup> A trust beneficiary may also file a written objection with the court.<sup>100</sup> The trustee has the burden of proving that the proposed decanting furthers the purposes of the trust.<sup>101</sup>

#### C. Decanting for Special Needs Beneficiaries

Having reviewed the decanting process generally, let us explore how decanting can be useful in a special needs context. A general understanding of special needs estate and trust planning is required. When considering “special needs planning,” the central concern is generally maximizing the disabled individual’s ability to qualify for governmental benefits. Although some benefits may be available to the disabled person simply by virtue of their disability, additional, valuable benefits are available where the disabled person is considered “low income.” These “need-based” benefits, including SSI and Medicaid, are available only to qualifying persons<sup>102</sup> whose monthly income and assets fall under a defined statutory cap.<sup>103</sup> If a

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96. *Id.* § 6/16.4(e).

97. *Id.* § 5/16.4(r).

98. *Id.* §§ 5/16.4(e)(1)-(2).

99. *Id.* § 16.4(f).

100. *Id.* § 16.4(f)(2).

101. *Id.*

102. For SSI, qualifying individuals are: a) 65 years or older; b) blind in both eyes; or c) disabled, as that term is defined in Title XVI of the Social Security Act, 42 U.S.C. § 1382 (2014).

103. To qualify for SSI, an individual’s assets must not have a cumulative value greater than \$2,000 (excepting the house the individual lives in and one vehicle). 42 U.S.C. § 1382 (2014).

disabled individual's income or assets exceed the defined cap, the individual must "spend down" those resources before he will be eligible for need-based benefits.<sup>104</sup>

The use of third party and special needs trusts has evolved as a method of maximizing a disabled individual's ability to receive government benefits where income or assets already owned by the beneficiary might otherwise prevent the disabled individual from qualifying for need-based benefits. Where a disabled individual is already the named beneficiary of a trust whose terms require payment of income or distributions of principal to the disabled individual, the trust will likely prevent the disabled beneficiary from qualifying for need-based benefits. Where that is the case, decanting to a supplemental needs second trust for the benefit of the disabled individual is a possible method by which the trustee can help the disabled beneficiary qualify for need-based benefits without having to spend down the trust assets, thereby retaining those assets for other "supplemental" needs of the disabled individual.

Disabled beneficiaries in Illinois are at an advantage over those in other states. Lawmakers in Illinois anticipated that a trustee might need to decant to a supplemental needs second trust, or otherwise decant for the benefit of a disabled beneficiary. Recognizing the unique challenges that might arise where a trustee attempted to decant to a supplemental needs second trust using "traditional" decanting methods, the drafters of Section 16.4 included a specific provision, Subsection 16.4(d)(4), that permits a trustee to decant to a supplemental needs second trust even though the decanting may limit the beneficiary's rights to distributions from the trust and even though the decanting may expand the trustee's discretion.<sup>105</sup> In fact, a trustee decanting under Subsection (d)(4) may go so far as to eliminate a disabled beneficiary's right to income or principal altogether if it appears that doing so will increase the beneficiary's ability to qualify for government assistance.<sup>106</sup> While these provisions seem intuitive, it appears that Illinois is nearly unique, as one of only a few states whose decanting

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104. Social Security Act Program Operations Manual § SI 01150.007 (2013), Rule 12.9.5.

105. 760 ILL. COMP. STAT. 5/16.4(d)(4) (2013).

106. *See id.* § 5/16.4(n)(1), which provides: (n) Restrictions. An authorized trustee may not exercise a power authorized by subsection (c) or (d) to affect any of the following: (1) to reduce, limit or modify any beneficiary's current right to a mandatory distribution of income or principal, a mandatory annuity or unitrust interest, a right to withdraw a percentage of the value of the trust or a right to withdraw a specified dollar amount provided that such mandatory right has come into effect with respect to the beneficiary, except with respect to a second trust which is a supplemental needs trust.

*See also, id.* § 5/16.4(d)(4)(ii) (defining "supplemental needs second trust" as one that the trustee believes would "allow the disabled beneficiary to receive a greater degree of government benefits than the disabled beneficiary will receive if no distribution is made.").

statute includes special needs decanting provisions allowing the expansion of a trustee's discretion in a supplemental needs second trust.<sup>107</sup>

Of course, it is not always necessary for a trustee to utilize the provisions of Subsection (d)(4) when decanting for the benefit of a disabled beneficiary, but the terms of Subsection (d)(4) are useful where the terms of the first trust are such that a trustee cannot otherwise decant to an appropriate second trust under Subsections (c) or (d). Accordingly, when considering decanting where a disabled beneficiary is involved, a trustee should consider all potential avenues to accomplish the proposed decanting: decanting under Subsection (c), when the trustee has absolute discretion; decanting under Subsection (d), when the trustee does not have absolute discretion, and decanting under Subsection 16.4(d)(4), when the trustee is decanting for the benefit of a disabled beneficiary and decanting under Subsections (c) and (d) cannot be accomplished.

Before addressing the specifics of special needs decanting, one additional point bears mentioning. There seems to be some difference of opinion between estate planners as to what type of trust is best suited to special needs planning—the plain discretionary trust versus the supplemental needs trust. Although supplemental needs trusts are more readily identifiable and may help streamline an initial application for benefits, discretionary trusts are arguably more flexible and easier to administer. Subsection (d)(4) was drafted broadly to allow for either approach. However, care must be taken to plan for the distinction between absolute discretion and no absolute discretion in the decanting context.

### *1. Special Needs Decanting with Absolute Discretion*

Naturally, the first inclination when considering decanting in a special needs context is to consider decanting under Subsection (d)(4). Where the trustee of the first trust has absolute discretion, however, it may be possible to accomplish the trustee's intended purpose simply by using the decanting process found in Subsection (c). In fact, if a trustee's "absolute discretion" is such that it meets the criteria for a special needs trust found in Section 15.1 of the Illinois Trust and Trustees Act,<sup>108</sup> it may be that it is not

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107. Other states whose decanting statutes permit some sort of expansion of trustee authority in a special needs context are: ALASKA STAT. § 13.36.157(e) (2014), N.Y. EST. POWERS & TRUSTS LAW § 10-6.6(n)(1) (2014), VA. CODE ANN. § 64.2-778.1(C)(9) (2014), and WIS. STAT. § 701.0418(2)(a)(2) (2014).

108. See 760 ILL. COMP. STAT. 5/15.1 (2013) (which states, "[a] discretionary trust for the benefit of an individual who has a disability that substantially impairs the individual's ability to provide for his or her own care or custody and constitutes a substantial handicap shall not be liable to pay or reimburse the State or any public agency for financial aid or services to the individual except to the extent the trust was created by the individual or trust property has been distributed directly to or is otherwise under the control of the individual, provided that such exception shall not apply to



necessary to decant at all. Rather, the beneficiary will likely qualify or continue to qualify for governmental benefits under the current trust terms. Thus, the first step for any trustee with absolute discretion considering special needs decanting should be to consider whether it is necessary to decant at all.

Where the trustee determines that the decanting is necessary, Subsection (c) permits the trustee to decant to any trust as long as the second trust is to be held for the benefit of one or all of the current beneficiaries and one, more than one, or all of the successor and remainder beneficiaries of the first trust. Subsection (c) does not require that all beneficiaries of the first trust be legally competent, therefore the trustee with absolute discretion may be able to decant for the benefit of a special needs beneficiary under Subsection (c) even where one or more of the trust beneficiaries is disabled. Where one beneficiary is disabled, the trustee might consider a “partial decanting,” where the trustee decants part of the trust principal to a separate trust for the disabled beneficiary.

One potential problem arises, however, where the disabled beneficiary is the sole beneficiary of the first trust. In this case, the trustee may not be able to decant without obtaining court approval. Recall that Subsection (e) defines when a trustee may decant without the approval of a court or the beneficiaries. Subsection (e) provides, in pertinent part, as follows:

(e) Notice. An authorized trustee may exercise the power to distribute in favor of a second trust under subsections (c) and (d) without the consent of the settlor or the beneficiaries of the first trust and without court approval if:

(1) there are one or more legally competent current beneficiaries and one or more legally competent presumptive remainder beneficiaries and the authorized trustee sends written notice of the trustee’s decision, specifying the manner in which the trustee intends to exercise the power and the prospective effective date for the distribution, to all of the legally competent current beneficiaries and presumptive remainder beneficiaries, determined as of the date the notice is sent and assuming non-exercise of all powers of appointment; and

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a trust created with the disabled individual's own property or property within his or her control if the trust complies with Medicaid reimbursement requirements of federal law. Notwithstanding any other provisions to the contrary, a trust created with the disabled individual's own property or property within his or her control shall be liable, after reimbursement of Medicaid expenditures, to the State for reimbursement of any other service charges outstanding at the death of the disabled individual. Property, goods and services purchased or owned by a trust for and used or consumed by a disabled beneficiary shall not be considered trust property distributed to or under the control of the beneficiary. A discretionary trust is one in which the trustee has discretionary power to determine distributions to be made under the trust.”)

(2) no beneficiary to whom notice was sent objects to the distribution in writing delivered to the trustee within 60 days after the notice is sent (“notice period”).<sup>109</sup>

Under Subsection (e), a trustee may decant without approval of the court or other beneficiaries, but only if the trustee provides the notices contemplated above. To comply with Subsection (e), there must be at least one legally competent current beneficiary and one legally competent remainder beneficiary of the first trust. But in the special needs context, if the sole beneficiary of the first trust is disabled, there may not be a “legally competent” beneficiary of the first trust to whom notice can be given. Of course, this raises the question, what does “legally competent” mean? The Decanting Statute does not define “legally competent,” nor does the Illinois Trusts & Trustees Act or the Illinois Probate Act. A related term, “disabled,” is defined in both the Decanting Statute and the Illinois Probate Act, although it is not clear that the terms are synonymous.

The Decanting Statute defines “disabled beneficiary” as:

[A] current beneficiary, presumptive remainder beneficiary, or successor beneficiary of the first trust who the authorized trustee determines has a disability that substantially impairs the beneficiary’s ability to provide for his or her own care or custody and that constitutes a substantial handicap, whether or not the beneficiary has been adjudicated a ‘disabled person.’<sup>110</sup>

And the Probate Act defines “disabled person” as:

[A] person 18 years or older who (a) because of mental deterioration or physical incapacity is not fully able to manage his person or estate, or (b) is a person with mental illness or a person with a developmental disability and who because of his mental illness or developmental disability is not fully able to manage his person or estate, or (c) because of gambling, idleness, debauchery or excessive use of intoxicants or drugs, so spends or wastes his estate as to expose himself or his family to want or suffering, or (d) is diagnosed with fetal alcohol syndrome or fetal alcohol effects.<sup>111</sup>

As noted, it is not clear that legally “incompetent” and “disabled” are synonymous, and in fact the fact that both terms are used in the Decanting Statute seems to indicate that the legislature intended something different when it chose to use the term “legally competent” rather than “not disabled,” or the like. The legislature is presumed to have purposely used the terms it intended, and in fact, at least one Illinois court has highlighted a

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109. *Id.* § 5/16.4(e) (emphasis added).

110. *Id.* § 5/16.4(d)(4)(ii).

111. 755 ILL. COMP. STAT. 5/11a-2 (2013).

distinction between disability and competency in a statutory context.<sup>112</sup> In *In re Marriage of Kutchins*, the court examined whether a man who had been declared a “disabled person” and was under the care of a guardian could bring a petition for dissolution of marriage.<sup>113</sup> The court ruled that he could.<sup>114</sup> The test for determining “disability,” the court noted, was more demanding than the test for determining competency in a dissolution of marriage context.<sup>115</sup> Although the court limited its ruling to dissolution of marriage, the court’s distinction between “disabled” and “incompetent” is relevant when considering whether a first trust has at least “one legally competent current beneficiar[y]” to whom the trustee can provide notice.

Assuming that there is not at least one legally competent beneficiary to whom the trustee can give notice, the trustee must seek court approval of the proposed decanting.<sup>116</sup> Where the proposed decanting is simple and easily understandable, or where the decanting is deemed absolutely necessary, this may be acceptable. However, the trustee may wish to avoid court involvement for a variety of reasons, including cost and time. Whatever the reason, if the trustee wishes to decant but cannot without court approval, the trustee will have to consider whether decanting is necessary and whether other options are available to the trustee to avoid the need to decant.

On the other hand, where the first trust has more than one beneficiary, and at least one beneficiary is legally competent, the trustee may send notice as contemplated in Subsection (e). If the trustee receives no objection to the notice, the decanting may go forward without court approval.<sup>117</sup> The trustee could decant to one or more different trusts qualifying under Subsection (c).

## 2. *Special Needs Decanting without Absolute Discretion*

Where a trustee does not have absolute discretion and that limitation on discretion results in a denial of governmental benefits, the trustee’s ability to decant is restricted under the general provisions of Subsection (d) because the trustee is prohibited from altering the beneficiaries and distributive terms of the trust.<sup>118</sup> In a common special needs situation, mandatory principal distributions or rights to withdraw found in an existing first trust may prevent a disabled beneficiary from

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112. *In re Marriage of Kutchins*, 136 Ill. App. 3d 45, 46–47, 482 N.E.2d 1005, 1006–07 (2d Dist. 1985).

113. *Id.* at 46, 482 N.E.2d at 1006.

114. *Id.* at 47, 482 N.E.2d at 1007.

115. *Id.* at 46–47, 482 N.E.2d at 1006–07.

116. See 760 ILL. COMP. STAT. 5/16.4(f)(1)(b) (2013).

117. *Id.* § 5/16.4(e).

118. *Id.* § 5/16.4(d).

collecting governmental benefits. Because the trustee does not have absolute discretion, however, he is prohibited from decanting to a second trust eliminating those provisions. It was this situation precisely that spurred lawmakers to draft Section 16.4(d)(4).

Nonetheless, there are some circumstances where decanting under the general provisions of Subsection (d) within the special needs context may be useful. For example, where the first trust contains restrictions on the trustee's authority to distribute but does not contain mandatory distribution provisions, the disabled beneficiary may be able to qualify for needs-based benefits under the terms of the first trust. In that case, the trustee may wish to decant to alter certain administrative provisions but leave the distributive provisions intact. Examples would be where the trustee wishes to add a trust protector, alter the trust modification provisions, alter trust decanting provisions, or alter trust investment provisions. All of these modifications could be accomplished under Subsection (d), generally, without resorting to Subsection (d)(4).

### *3. Special Needs Decanting under Subsection (d)(4)*

Where the trustee is unable to decant under Subsection (c) or the general provisions of Subsection (d), perhaps because mandatory distribution provisions prevent the disabled beneficiary from qualifying for needs-based benefits, Subsection (d)(4) exists to fill in the gaps.

Subsection (d)(4) begins:

Notwithstanding the other provisions of this subsection (d), the authorized trustee may distribute part or all of the principal of a disabled beneficiary's interest in the first trust in favor of a trustee of a second trust which is a supplemental needs trust if the authorized trustee determines that to do so would be in the best interests of the disabled beneficiary.<sup>119</sup>

Note that, unlike decanting under Subsections (c) or (d), a trustee decanting under Subsection (d)(4) is not restricted by the amount of discretion granted him in the first trust. Instead, the trustee may decant to a supplemental needs second trust, even if the proposed decanting expands or restricts his distributive discretion, so long as the decanting is in the "best interests" of the "disabled beneficiary" and the trustee believes the decanting will allow the disabled beneficiary to receive a greater degree of governmental benefits.<sup>120</sup> In fact, a trustee decanting under Subsection

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119. *Id.* § 5/16.4(d)(4)(i).

120. *Id.* § 5/16.4(d)(4)(ii) (the Decanting Statute does not exhaustively define the term "best interests," but it does note that "best interests" includes "consideration of the financial impact to the disabled beneficiary's family.") *See also id.* ("[d]isabled beneficiary" means "a current beneficiary,

(d)(4) may go so far as to eliminate a disabled beneficiary's mandatory distributions of income or principal where doing so would increase the beneficiary's right to collect government benefits.<sup>121</sup>

As the goal of Subsection (d)(4) is to increase the disabled beneficiary's ability to receive governmental benefits, the trustee's power to decant to a supplemental needs second trust is deliberately broad. The supplemental needs second trust need not contain any particular "special needs" language, and in general, the trust need not take any specific form; third party trusts, pooled trusts, and OBRA payback trusts are all valid forms for a supplemental needs second trust.<sup>122</sup> However there are a few requirements to which the second trust must conform in order to ensure that Subsection (d)(4) is used only for the benefit of a disabled beneficiary.

First, the supplemental needs second trust must contain "lesser or greater restrictions on the trustee's power to distribute trust income or principal."<sup>123</sup> Thus, a trustee may not decant under Subsection (d)(4) if the degree of his discretion will remain unchanged. In such a case, however, decanting to a supplemental needs second trust may not be necessary, as the trustee may be able to achieve his purpose—likely to alter administrative provisions of the trust—using the general decanting provisions of Subsections (c) or (d).

Further, the trustee must believe that the second trust would "allow the disabled beneficiary to receive a greater degree of governmental benefits than the disabled beneficiary will receive if no distribution is made."<sup>124</sup> Accordingly, even where the trustee's discretion is altered between the first trust and the supplemental needs second trust, if the change does not increase or is not likely to increase the degree of governmental benefits the disabled beneficiary is eligible to receive, the second trust does not qualify as a "supplemental needs second trust," and decanting under Subsection (d)(4) is not possible.

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presumptive remainder beneficiary, or successor beneficiary of the first trust who the authorized trustee determines has a disability that substantially impairs the beneficiary's ability to provide for his or her own care or custody and that constitutes a substantial handicap, whether or not the beneficiary has been adjudicated a 'disabled person.'") *See also id.* (stating "[s]upplemental needs second trust" means "a trust that complies with paragraph (iii) of this paragraph (4) and that relative to the first trust contains either lesser or greater restrictions on the trustee's power to distribute trust income or principal and which the trustee believes would, if implemented, allow the disabled beneficiary to receive a greater degree of governmental benefits than the disabled beneficiary will receive if no distribution is made.").

121. *See id.* § 5/16.4(n)(1) (An authorized trustee may not "reduce, limit or modify a beneficiary's current right to a mandatory distribution of income or principal...except with respect to a second trust which is a supplemental needs trust.").

122. *See id.* § 5/16.4(d)(4)(ii) (defining "supplemental needs second trust").

123. *Id.* § 5/16.4(d)(4)(iii).

124. *Id.* § 5/16.4(d)(4)(ii).

Additional restrictions are placed on the naming of remainder or successor beneficiaries to the supplemental needs second trust. The supplemental needs second trust may name remainder and successor beneficiaries “other than the disabled beneficiary’s estate,” however the remainder and successor beneficiaries must be the same as those and in the same proportions as in the first trust.

#### D. Potential Problems with Special Needs Decanting

Although a trustee’s ability to decant to a supplemental needs second trust for the benefit of a disabled beneficiary is deliberately broad, like any new statute there remain questions as to its use and applicability. Many of those questions arise in the context of decanting to a payback or pooled trust, as discussed below.

##### 1. *Decanting to a Payback Trust*

As noted, Subsection (d)(4) specifically permits a trustee to decant to an OBRA payback trust for the benefit of a disabled beneficiary.<sup>125</sup> By doing so, the disabled beneficiary is eligible for need-based benefits immediately, without having to spend down current trust assets, even though the first trust was funded with assets belonging to the beneficiary himself.<sup>126</sup> The signature feature of the OBRA trust, however, is its payback requirements. Specifically, to qualify as an OBRA (d)(4)(A) trust, the terms of the trust must require that upon the death of the disabled beneficiary the State receive “all amounts remaining in the trust...up to an amount equal to the total medical assistance paid on behalf of the individual under a State plan under this subchapter.”<sup>127</sup>

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125. An OBRA trust is a highly specialized irrevocable trust sanctioned by Federal and Illinois law that operates very much like a special needs trust for a person with a disability, but which can be funded with the *ward’s own assets*. Use of such trusts allows immediate qualification for “need-based” governmental benefits based on the ward’s disability (“Medicaid”) and also Supplemental Security Income (“SSI”) from the Social Security Administration. See 42 U.S.C. §1396p(d)(4)(A) (2014) (defining an OBRA special needs trust); see also 760 ILL. COMP. STAT. 5/15.1 (2013) (providing authority for OBRA trusts in Illinois).

126. The OBRA trust mechanism is commonly used where a disabled beneficiary has received a settlement or inheritance that prevents the beneficiary from qualifying for need-based benefits. Prior to implementation of the OBRA trust concept, disabled individuals who, for example, received a settlement from a personal injury suit for the cause of their disability were ineligible for need-based benefits until the settlement amount was spent down. Under the OBRA concept, the disabled beneficiary maintains her eligibility for need-based benefits but also maintains the ability to access supplemental income if needed. An expanded discussion of the history OBRA trust can be found in the article, 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, 91 (2000).

127. 42 U.S.C. §1396p(d)(4)(A) (2014).

The requirement that the State be repaid from remaining OBRA trust funds upon the death of the disabled beneficiary, and Subsection (d)(4)'s specific permission of the use of OBRA trusts might at first appear to be in conflict, however, with another part of the Decanting Statute: Subsection 16.4(o). Subsection 16.4(o) provides:

(o) Exception. Notwithstanding the provisions of paragraph (1) of subsection (n) but subject to the other limitations in this Section, an authorized trustee may exercise a power authorized by subsection (c) or (d) to distribute to a second trust; provided, however, that the exercise of such power does not subject the second trust to claims of reimbursement by any private or governmental body and does not at any time interfere with, reduce the amount of, or jeopardize an individual's entitlement to government benefits.<sup>128</sup>

However, further analysis reveals that Subsection 16.4(o) should have no negative impact on one's ability to decant to a payback trust. In those cases where a payback trust would be required under Subsection (d)(4), the trust's interest would already be subject to a claim or reimbursement by a private or governmental body in nearly all cases. Thus, it is not the exercise of decanting power that subjects the trust to such claims—the trust was already subject to such claims. As a consequence, Subsection 16.4(o) is most likely not an impediment to payback trust decanting.

Even if this were not the case, in situations where statutory ambiguity arises the intent of the legislature is of paramount importance.<sup>129</sup> That the legislature drafted Subsection (d)(4), and specifically authorized decanting to an OBRA payback trust, in contrast to the multitude of states whose decanting statutes do not address special needs decanting at all, demonstrates that the legislative intent in drafting subsection (o) was not to prevent decanting to an OBRA payback trust in a special needs situation, but to permit such decanting for the best interests of the disabled beneficiary.

Moreover, where a general statutory provision conflicts with a more specific provision, both relating to the same subject, the specific provision controls and should be applied.<sup>130</sup> In this case, the general provision found in Subsection (o) (“provided, however, that the exercise of such power does not subject the second trust to claims of reimbursement by any private or governmental body”) conflicts with the specific provision found in Subsection (d)(4)(iii) (“where the first trust was created by the

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128. 760 ILL. COMP. STAT. 5/16.4(o) (2013) (emphasis added).

129. *Knolls Condominium Ass'n v. Harms*, 202 Ill. 2d 450, 458-59, 781 N.E.2d 261, 267 (2002).

130. *People v. Villarreal*, 152 Ill. 2d 368, 379, 604 N.E.2d 923, 928 (1992).

disabled beneficiary or the trust property has been distributed directly to or is otherwise under the control of the disabled beneficiary, the authorized trustee may distribute to a “pooled trust” as defined by federal Medicaid law for the benefit of the disabled beneficiary or the supplemental needs second trust must contain pay back provisions complying with Medicaid reimbursement requirements of federal law.”<sup>131</sup> Applying this rule, and particularly in light of the purpose of Section (d)(4), the specific provision should apply, and decanting to a payback trust permitted.

### *2. Notice Requirements when Decanting to a Payback Trust*

As discussed in Section C, *supra*, a trustee decanting for a disabled beneficiary may be required to seek court approval of the decanting if there is not at least one legally competent beneficiary to whom the trustee can give notice.<sup>132</sup> Implicit in any court proceeding under Subsection (f) is the requirement that all beneficiaries of the first trust receive notice of the proceeding and have an opportunity to object. But where the first trust is a payback trust who must receive notice? As an OBRA payback trust, the terms of first trust must provide for reimbursement to the State upon the death of the disabled beneficiary.<sup>133</sup> Therefore, since the State has an interest in the remainder of the trust assets, is the State a “remainder beneficiary” entitled to notice? Or, alternatively, is the State merely a creditor of the trust? The answer is not clear from the decanting statute, nor could any Illinois or related authority be located characterizing the State, in an OBRA context, as a beneficiary or creditor. Absent a more definitive answer, a trustee seeking court permission to decant from an OBRA payback trust to a second trust may wish to proactively provide notice of all court proceedings to the State to ensure compliance with Section 16.4 and to ensure that future actions of the trustee or orders of the court are enforceable.

### *3. Decanting Triggering Payback Provisions*

Another area of uncertainty arises where the disabled beneficiary currently owes the State money for Public Aid services rendered, and the trustee of the first trust wishes to decant to an OBRA payback trust for the disabled beneficiary. In that situation, it is unclear whether the disabled beneficiary’s outstanding liens must be paid back before the trustee may decant to the OBRA trust. In at least one case, *In re Estate of Calhoun*, a

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131. 760 ILL. COMP. STAT. 5/16.4(o) & (d)(4)(iii) (2013).

132. *Id.* § 5/16.4(e)(1).

133. 42 U.S.C. §1396p(d)(4)(A) (2014).



court found that a disabled beneficiary could not transfer the proceeds of her personal injury settlement to an OBRA payback trust without first paying an existing lien held by the State.<sup>134</sup> The disabled beneficiary, who suffered brain injury during birth, received \$3,500,000 as a settlement with the hospital and physicians who delivered her.<sup>135</sup> At the time she received the settlement, the disabled had received \$223,223.12 in Medicaid benefits from the Illinois Department of Public Aid (IDPA) for which the State held a lien.<sup>136</sup> When the disabled beneficiary's guardian sought to transfer the settlement amount into an OBRA trust for the disabled beneficiary's benefit, IDPA objected, arguing that its lien should be paid first prior to the OBRA trust being funded.<sup>137</sup> The Court agreed, finding that Medicaid provisions required the state to collect any amounts, up to the amount of the state's lien, received by a Medicaid recipient as the result of an injury by a third party, and that these liens must be paid before an OBRA trust could be funded.<sup>138</sup>

*Calhoun* did not involve a proposed decanting, however, and this distinction may be important. One of the general principals of decanting is that although the second trust is a separate trust, the grantor of the first trust is deemed to be the grantor of the second trust.<sup>139</sup> Thus, the second trust has characteristics of both a separate trust, and a continuation of the first trust. If this is the case and the second trust is a mere continuation of the first trust, it is possible that payback provisions might not be triggered as the result of the transfer. Further, unlike *Calhoun*, the transfer does not come directly from the third-party settlement funds to the beneficiary to the OBRA trust, but rather from the trustee of the first trust into what might be viewed as a new version of that same trust. This line is further blurred in situations where the decanting occurs before the beneficiary is entitled to any distributions under the first trust or where the first trust was settled by a third party.

Subsection (d)(4)(iv) expressly addresses the potential for payback provisions, providing “[a] supplemental needs second trust shall not be liable to pay or reimburse the State or any public agency for financial aid or services to the disabled beneficiary except as provided in the supplemental needs second trust.”<sup>140</sup> It would appear that this provision was added to address this precise question.

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134. *In re Estate of Calhoun*, 291 Ill. App. 3d 839, 842, 684 N.E.2d 842, 844 (1st Dist. 1997).

135. *Id.* at 840, 684 N.E.2d at 843.

136. *Id.*

137. *Id.*

138. *Id.* at 843, 684 N.E.2d at 845.

139. 760 ILL. COMP. STAT. 5/16.4(t) (2013) (“The settlor of the first trust is considered for all purposes to be the settlor of any second trust established in accordance with this Section.”).

140. *Id.* § 5/16.4(d)(4)(iv).

#### 4. *Statute of Limitations*

Finally, a word of caution regarding limitations. The ordinary two-year statute of limitations for decanting does not run for a person who was under a legal disability at the time a notice or report of decanting was sent and who then had no personal representative.<sup>141</sup> Accordingly, a trustee in this situation should exercise caution when considering whether to use court ordered decanting.

#### E. Decanting Versus Virtual Representation

Finally, where alterations to a trust are necessary for its desired performance, one potential alternative to decanting is the use of a virtual representation agreement to alter the terms of the trust by agreement of the trustee and beneficiaries.<sup>142</sup> From a trustee's perspective, the use of a virtual representation agreement may seem preferable since it amounts to an enforceable agreement as to all the beneficiaries, and thus the risk that the trustee will be criticized for abusing his discretion may be reduced. And, in fact, the decanting statute specifically highlights virtual representation agreements as an additional option to distribute property in further trust. Subsection (j) provides:

Other authority to distribute in further trust. This Section shall not be construed to abridge the right of any trustee to distribute property in further trust that arises under the terms of the governing instrument of a trust, any provision of applicable law, or a court order. In addition, distribution of trust principal to a second trust may be made by agreement between a trustee and all primary beneficiaries of a first trust, acting either individually or by their respective representatives in accordance with Section 16.1 of this Act.<sup>143</sup>

In some situations involving special needs planning, however, decanting may be a better planning tool. Decanting relies upon the judgment (and discretion) of the trustee instead of the beneficiaries and those representing the beneficiaries. Virtual representation, on the other hand, encourages beneficiaries to band together, but when one or more beneficiaries has a disability, there is a risk that no consensus can be reached as to how to properly care for the disabled beneficiary. In those instances where there are only a few beneficiaries, it is possible that there will be no individual property situated to represent the interests of the

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141. *Id.* § 5/16.4(u).

142. Illinois's virtual representation statute can be found at 760 ILL. COMP. STAT. 5/16.1 (2013).

143. 760 Ill. Comp. Stat. 5/15/4(j) (2013).

disabled beneficiary. Further, in situations where an OBRA payback trust is involved, it is highly unlikely that the practitioner could get the Illinois Department to sign a virtual representation agreement. In these cases, decanting may be preferable, even if court involvement may be required.

In addition, there could be at least some concern that where a representative for a disabled beneficiary enters into a virtual representation agreement and that agreement operates as the beneficiary's relinquishment of any form of beneficial interest in the trust, the act of signing the agreement could be deemed to constitute a transfer for less than adequate consideration for purposes of a governmental benefits application and might impact approval of that application. On other hand, with decanting, the changes to the trust are made in the trustee's sole discretion. One might argue that the decanting requirements of providing a disabled beneficiary's representative with notice or even seeking court ordered decanting do not rise to the level of voluntarily agreeing to a modification. Even if the beneficiary objects to the decanting after receiving notice and the decanting decision comes before a court, the trustee need only prove that the decanting "further the purposes of the trust."<sup>144</sup> Once the trustee succeeds in this proof, it appears that the act can only be challenged if the trustee is acting in bad faith.<sup>145</sup> As a result, unlike a beneficiary's right to refuse a proposed virtual representation, there is no unqualified right to object to decanting in the hands of the beneficiary.

#### F. Conclusion

If used correctly, the flexibility afforded by Section (d)(4) of the decanting provisions of the Illinois Trusts and Trustees Act can create new opportunities for special needs planners. Although the statute does not address all special needs situations, it does add to the list of tools that may be used to protect assets for persons with disabilities. Care should be taken, however. Given the complexity of the statute and the dearth of interpretive case law, there remain many unanswered questions as to the statute's application.

### IV. AMENDMENTS TO THE ILLINOIS VIRTUAL REPRESENTATION STATUTE

Significant amendments to the Illinois virtual representation statute, 760 ILL. COMP. STAT. 5/16.1, went into effect on January 1, 2015.<sup>146</sup> These

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144. *Id.* § 5/16.4(f)(2).

145. *Id.* §§ 5/16.4(f)(3), (u).

146. *See generally* Trusts and Trustees Act, Pub. Act No. 98-0946 (effective date January 1, 2015).

amendments provide greater certainty as to what matters can be resolved by a nonjudicial settlement agreement between the trustee and the beneficiaries. These amendments also expand the ways in which minor, disabled or unborn beneficiaries can be represented for purposes of entering into a nonjudicial settlement agreement.

#### A. A Short History of Illinois Virtual Representation

In litigating a matter involving a trust or a will, traditionally a party could be bound by a court order only if the party was properly represented. Wills and trusts, however, frequently have beneficiaries who are minors, disabled persons, unborn persons or even persons not yet identified. Some such beneficiaries may have interests that are contingent or even remote. Virtual representation is a legal doctrine that permits a party having a substantially identical interest and no conflict of interest on a particular question or dispute to represent and legally bind a minor, disabled person or unborn party, or other beneficiaries with contingent interests.

The doctrine of virtual representation developed in the U.S. between 1860 and 1940. Many of the early cases were from Illinois. For example, *Hale v. Hale*, held that virtual representation satisfied the necessary parties rule by both alleviating the necessity of joining the represented parties and by binding the represented parties.<sup>147</sup>

##### 1. 1993 Illinois Virtual Representation Statute

In 1993 the doctrine was extended by statute to private settlement agreements by section 16.1 of the Illinois Trusts and Trustees Act.<sup>148</sup> However, the extent of virtual representation under the original statute was limited to situations in which all the “primary beneficiaries” were adults and not disabled. Further, the statute did not permit the termination of a trust and arguably did not permit a substantive reformation of the trust terms.

##### 2. 2010 Illinois Virtual Representation Statute

Effective January 1, 2010 the Illinois virtual representation statute was amended to significantly expand the scope of nonjudicial virtual representation (the “2010 Statute”). Beneficiaries, including primary beneficiaries, who are not nondisabled adults may be represented by other beneficiaries. Further, the matters that can be properly addressed by a

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147. 146 Ill. 227, 258, 33 N.E. 858, 868 (1893).

148. 760 ILL. COMP. STAT. 5/16.1 (1993).

nonjudicial settlement agreement were expanded and to a great extent delineated. Further, the statute also covered trust terminations.<sup>149</sup>

### *3. 2015 Illinois Virtual Representation Statute*

Effective January 1, 2015, the Illinois virtual representation statute is further amended (the “2015 Statute”) to expand the concept of virtual representation, to clarify the matters that may be addressed by a nonjudicial settlement agreement and to make other improvements to the statute.

#### **B. Overview of Changes to Virtual Representation Statute**

The changes made by the 2015 amendments to the virtual representation statute generally fall into four categories: (1) changes to the types of matters that can be addressed in a nonjudicial settlement agreement; (2) changes to the rules for representation of beneficiaries; (3) changes to better define the trusts that are subject to the statute; and (4) changes to definitions and other clean up changes.<sup>150</sup>

##### *1. Matters that Can be Addressed in Nonjudicial Settlement Agreement*

The 2015 Statute clarifies and modifies the types of matters that can be addressed in a nonjudicial settlement agreement. The 2015 Statute:

- (1) Clarifies that the nonexclusive list of types of matters that can be dealt with in a nonjudicial settlement agreement is a safe harbor list, available without the necessity of satisfying the requirement that it be a modification that a court could approve.<sup>151</sup>
- (2) Provides that a nonjudicial settlement agreement may address the validity of terms of the trust.<sup>152</sup>
- (3) Provides that a nonjudicial settlement agreement that grants an administrative power or resolves property questions can do so only to the extent such change does not conflict with a material purpose of the trust.<sup>153</sup>
- (4) Clarifies that a nonjudicial settlement agreement may deal with removal or appointment of a trustee, trust advisor, investment

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149. See Lyman Welch and Susan Bart, *New Law Promotes Private Trust-Administration Agreements*, 97 ILL. B.J. 11 (2009); see also Susan Bart, *Illinois Virtual Representation Agreements* (2009), available at <http://www.cepcweb.org/assets/Councils/Chicago-IL/library/Handout.Bart.pdf> (last visited October 21, 2015) (providing materials to December 16, 2009 presentation to the Chicago Estate Planning Council).

150. See generally Trusts and Trustees Act, Pub. Act No. 98-0946 (effective date January 1, 2015).

151. 760 ILL. COMP. STAT. 5/16.1(d)(4)(A)-(L).

152. *Id.* § 5/16.1(d)(4)(A).

153. *Id.* §§ 5/16.1(d)(3)(D-E).

advisor or trust protector, including a plan of succession for such offices.<sup>154</sup>

(5) Clarifies that a change of place of administration may also change the law governing administration.<sup>155</sup>

(6) Clarifies that disputes that may be resolved by a nonjudicial settlement agreement must be bona fide disputes.<sup>156</sup>

## *2. Rules for Representation of Beneficiaries*

The 2015 Statute amends the rules for representation of beneficiaries as follows:

(1) Allows a parent to act for a child if there is no conflict of interest as to the particular question or dispute.

(2) Allows an agent under a power of attorney for property to act for the principal if there is no conflict of interest as to the particular question or dispute.<sup>157</sup>

(3) Clarifies that a specifically named charity can act for itself, but requires 60 days prior notice of any nonjudicial settlement agreement to the Illinois Attorney General's Charitable Trust Bureau if a charitable interest is involved.<sup>158</sup>

(4) Substitutes "substantially similar interest" for "substantially identical interest."<sup>159</sup>

(5) Clarifies that a guardian, agent or parent representing a beneficiary may also represent other beneficiaries with substantially similar interests and no conflict of interest with respect to the particular question or dispute.<sup>160</sup>

(6) Removes questions about the definition of "primary beneficiary" and the interrelationship of subsections (a)(2) and (a)(3) by combining those two subsections into one.<sup>161</sup>

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154. *Id.* § 5/16.1(d)(3)(F).

155. *Id.* § 5/16.1(d)(3)(H).

156. *Id.* § 5/16.1(d)(3)(J).

157. *Id.* § 5/16.1(a)(4).

158. *Id.* § 5/16.1(d)(4.5).

159. *Id.* §§ 5/16.1(a)(1) & (6).

160. *Id.* § 5/16.1(a)(6).

161. *Id.* §§ 5/16.1(a)(2-3).

### 3. *Trusts Subject to Statute*

The 2015 Statute provides that the virtual representation statute applies to trusts administered in Illinois (whether or not Illinois law applies) or that are governed by Illinois law as to meaning and effect, unless the governing instrument expressly prohibits the use of the statute. Section 16.1(f).

### 4. *Definitions and Other Changes*

The 2015 Statute modifies definitions used in the statute as follows:

- (1) Expands the definition of “interested persons” to include trust advisors and protectors when their powers are relevant to the particular question or dispute.<sup>162</sup>
- (2) Removes questions about the definition of a disabled beneficiary by substituting “has legal capacity” for “not disabled.”<sup>163</sup>
- (3) Adds definitions of “legal capacity” and “disabled person.”<sup>164</sup>

## C. Matters that Can be Addressed in Nonjudicial Settlement Agreement

### 1. *Safe Harbor List of Matters*

The 2010 Statute listed eleven matters that may be resolved by a nonjudicial settlement agreement.<sup>165</sup> The 2010 Statute also provided that modifications were valid only to the extent that the terms and conditions of the modification could be properly approved under applicable law by a court of competent jurisdiction.<sup>166</sup> It was unclear whether matters listed in section 16.1(d)(4) were subject to the additional requirement that the modification be one that could be properly approved under applicable law by a court of competent jurisdiction. Given the sparse and restrictive Illinois law on trust modifications, imposing the requirement that the modification be one that could be properly approved by a court created uncertainty about what matters could be addressed in a nonjudicial settlement agreement and might have needlessly restricted nonjudicial settlement agreements.

The 2015 Statute deletes section 16.1(d)(3) of the 2010 Statute to make clear that the eleven matters listed in the 2015 Statute section

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162. *Id.* § 5/16.1(d)(1).

163. *Id.* § 5/16.1(a).

164. *Id.* §§ 5/16.1(a)(3)(C) & (D).

165. 760 ILL. COMP. STAT. 5/16.1(d)(4) (2010).

166. *Id.* § 5/16.1(d)(3) (2010).

16.1(d)(4)(A) through (K) are “safe harbor” matters that can be addressed in a nonjudicial settlement agreement, without any inquiry into whether the modification could have been approved by a court.<sup>167</sup> The 2015 Statute then adds as an additional matter that can be addressed by a nonjudicial settlement agreement: “Any other matter involving a trust to the extent the terms and conditions of the nonjudicial settlement agreement could be properly approved under applicable law by a court of competent jurisdiction.”<sup>168</sup>

## 2. *Validity*

The 2010 Statute listed as a matter that could be resolved by a nonjudicial settlement agreement: “interpretation or construction of the terms of the trust.”<sup>169</sup> The 2015 Statute adds “validity” as an appropriate matter for a nonjudicial settlement agreement.<sup>170</sup>

## 3. *Grant of Power and Questions Relating to Property*

The 2010 Statute permitted a nonjudicial settlement agreement to grant to a trustee of any necessary or desirable administrative power or to resolve questions relating to property or an interest in property held by the trust. The breadth of these two areas arguably was restricted by the requirement, deleted in the 2015 Statute, that the modification be one that could have been approved by a court. In order to protect the settlor’s intent, the 2015 Statute adds a requirement that any modification that grants the trustee an administrative power or resolves a question relating to property must not conflict with a clear material purpose of the trust.<sup>171</sup>

The Restatement (Third) of Trusts comments on what is a material purpose:

Material purposes are not readily to be inferred. A finding of such a purpose generally requires some showing of a particular concern or objective on the part of the settlor, such as concern with regard to a beneficiary’s management skills, judgment, or level of maturity. Thus, a court may look for some circumstantial or other evidence indicating that the trust arrangement represented to the settlor more than a method of allocating the benefits of property among multiple intended beneficiaries, or a means of offering to the beneficiaries (but not imposing on them) a

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167. *See id.* at §§ 5/16.1(d)(4)(A-K).

168. *Id.*

169. 760 ILL. COMP. STAT. 5/16.1(d)(4)(A) (2010).

170. 760 ILL. COMP. STAT. 5/16.1(d)(4)(A) (2015).

171. *Id.* §§ 5/16.1(d)(4)(D-E).



particular advantage. Sometimes, of course, the very nature or design of a trust suggests its protective nature or some other material purpose.<sup>172</sup>

#### *4. Trustees and Other Fiduciaries*

The 2010 Statute permitted a nonjudicial settlement agreement to address “resignation or appointment of a trustee.”<sup>173</sup> The 2015 Statute expands this category as follows:

(F) Removal, appointment, or removal and appointment of a trustee, trust advisor, investment advisor, distribution advisor, trust protector or other holder, or committee of holders, of fiduciary or nonfiduciary powers, including without limitation designation of a plan of succession or procedure to determine successors to any such office.<sup>174</sup>

The 2015 Statute applies not just to trustees, but also to trust advisors and protectors, regardless of whether they hold their powers in a fiduciary capacity. Further, the 2015 Statute makes it clear that the nonjudicial settlement agreement can not only address the immediate succession of fiduciaries, advisors and protectors, but can also designate procedures for future fiduciary succession.

#### *5. Change of Law Governing Administration*

The 2010 Statute permitted a nonjudicial settlement agreement to transfer a trust’s principal place of administration.<sup>175</sup> Depending upon the particular facts, it can be unclear whether transferring a trust’s principal place of administration changes the law governing administration of the trust.<sup>176</sup> The 2015 Statute specifically permits the nonjudicial settlement agreement to change the law governing administration of the trust.<sup>177</sup>

#### *6. Bona Fide Disputes*

The 2010 Statute permitted a nonjudicial settlement agreement to resolve disputes or issues related to administration, investment, distribution or other matters. The 2015 Statute clarifies that these disputes must be

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172. Restatement (Third) Trusts, § 65 cmt. d (2007).

173. 760 ILL. COMP. STAT. 5/16.1(d)(4)(F) (2010).

174. 760 ILL. COMP. STAT. 5/16.1(d)(4)(F) (2015).

175. 760 ILL. COMP. STAT. 5/16.1(d)(4)(H) (2010).

176. See Restatement (Second) Conflict of Laws §§ 271, 272 (1971).

177. 760 ILL. COMP. STAT. 5/16.1(d)(4)(H) (2015).

bona fide.<sup>178</sup> Thus an artificially manufactured “dispute” will not serve as the basis for modifying a trust under the virtual representation statute.

### *7. Matters Unchanged in 2015 Statute*

In the 2015 Statute the following matters continue to be matters that may be resolved by a nonjudicial settlement agreement: (1) approval of a trustee’s report or accounting; (2) exercise or nonexercise of any power by a trustee; (3) determination of a trustee’s compensation; (4) liability or indemnification of a trustee for an action relating to the trust; and (5) modification of the terms of the trust pertaining to administration of the trust.<sup>179</sup>

### *D. Representation of Beneficiaries*

The 2010 Statute permitted certain individual beneficiaries who cannot represent themselves to be represented by other specific beneficiaries.<sup>180</sup> The 2010 Statute also provided that certain classes of beneficiaries may represent other classes of beneficiaries.<sup>181</sup>

#### *1. Guardian Represents Beneficiary*

If a beneficiary is a minor, disabled or unborn person, under both the 2010 Statute and the 2015 Statute, the court appointed guardian of the estate of the beneficiary, or if none, the guardian of the person for the beneficiary, represents the beneficiary.<sup>182</sup>

#### *2. Agent May Represent Principal*

If a disabled beneficiary does not have a court appointed guardian, the 2015 Statute allows an agent under a power of attorney for property to represent such beneficiary if the agent has authority to act with respect to the particular question or dispute and does not have a conflict of interest with respect to the particular question or dispute.<sup>183</sup>

An Illinois Statutory Short Form Power of Attorney for Property should give an agent the power to enter into a nonjudicial settlement agreement. The Illinois Power of Attorney for Property authorizes the

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178. *Id.* § 5/16.1(d)(4)(J).

179. *Id.* § 5/16.1(d)(4)(B); § 5/16.1(d)(4)(C); § 5/16.1(d)(4)(G); § 5/16.1(d)(4)(I); § 5/16.1(d)(4)(K).

180. 760 ILL. COMP. STAT. 5/16.1(a)(4) (2010).

181. *Id.*

182. 760 ILL. COMP. STAT. 5/16.1(a)(4) (2015).

183. *Id.*

agent to enter into “estate transactions,” which are defined in the statute to include authorization to “assert any interest in and exercise any power over any trust, estate or property subject to fiduciary control; . . . and, in general, exercise all powers with respect to estates and trusts which the principal could if present and under no disability.”<sup>184</sup> Although the power of attorney statute provides that an agent may not revoke or amend a trust revocable or amendable by the principal, a modification of a trust by a nonjudicial settlement agreement should not be considered to be a trust amendment.

### *3. Parent May Represent Child*

Under the 2015 Statute, a parent may represent a minor, disabled or unborn child if there is no conflict of interest between the child and the parent, and if the child does not have a guardian or agent who is authorized to act.<sup>185</sup> The parent need not have any interest in the trust.<sup>186</sup> If both parents are qualified to represent the child and the parents disagree, the parent who is a lineal descendant of the settlor of the trust, or if none, the parent who is also a beneficiary of the trust, is entitled to represent the child.<sup>187</sup>

### *4. Representation by Beneficiary with Substantially Similar Interest*

Under the 2010 Statute, if a minor, disabled or unborn beneficiary was not represented by a guardian, the minor, disabled or unborn beneficiary could be represented by another beneficiary with a substantially identical interest and no conflict of interest. Under the 2015 Statute, if a minor, disabled or unborn beneficiary is not represented by a guardian, agent or parent, the minor, disabled or unborn beneficiary may be represented by another beneficiary with a substantially similar interest and no conflict of interest. Note that the 2015 Statute requires only that the interests of the represented beneficiary and the representor beneficiary be “substantially similar,” not “substantially identical.” Both the determination of whether the beneficiaries have substantially similar interests and the determination of whether there is a conflict of interest should be made with respect to the particular matter being addressed.<sup>188</sup> A presumptive remainderman may be able to represent alternative remaindermen with respect to approval of the trustee’s account, for example, but not with respect to interpretation of the remainder provision of the trust. “Substantially similar” does not require

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184. 755 ILL. COMP. STAT. 45/3-4(n) (2014).

185. 760 ILL. COMP. STAT. 5/16.1(a)(5) (2015).

186. *Id.*

187. *Id.*

188. *See* UNIFORM TRUST CODE § 304 cmt. (2010).

identical interests. For example, if trusts for the settlor's grandchildren are the presumptive remainder beneficiaries, but the terms of the trusts vary as to whether income distributions are required, the age for withdrawal, and the extent of any power of appointment granted to the beneficiary, the grandchildren's interests may still be substantially similar as to matters other than the construction of the specific trust terms defining the grandchildren's interests.

#### *5. Charity May Represent Self*

Both the 2010 Statute and the 2015 Statute provide that the Illinois Attorney General may represent charities or charitable purposes that are not specifically named or otherwise represented.<sup>189</sup> The 2015 Statute now explicitly states that a charity that is specifically named as a beneficiary may act for itself.<sup>190</sup> Both statutes state that the Illinois Attorney General reserves the right to file an action or take other steps that it deems advisable at any time to enforce or protect the general public interest as to a trust that provides a beneficial interest or expectancy for one or more charities or charitable purposes whether or not a specific charity is named.<sup>191</sup>

#### *6. Representative May Represent Other Beneficiaries*

If a minor, disabled or unborn beneficiary (Beneficiary 1) is not represented by a guardian, agent or parent, under both statutes Beneficiary 1 could be represented by another beneficiary (Beneficiary 2) with a substantially similar (or identical) interest and no conflict of interest. What was not clear under the 2010 Statute was whether Beneficiary 1 could be represented by Beneficiary 2's representative (e.g., Beneficiary 2's guardian). The 2015 Statute makes it clear that Beneficiary 1 can be represented by Beneficiary 2's guardian, agent or parent, provided that Beneficiary 1 and Beneficiary 2 have substantially similar interests and no conflict of interest.<sup>192</sup>

#### *7. Eliminates Primary Beneficiary Representation*

The 2010 Statute provided for two types of class representation. First, if all primary beneficiaries of a trust were adults who were not disabled or were represented, the primary beneficiaries as a class could represent all other beneficiaries who would become primary beneficiaries only by reason

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189. 760 ILL. COMP. STAT. 5/16.1(c) (2010).

190. 760 ILL. COMP. STAT. 5/16.1(c) (2015).

191. *Id.*

192. 760 ILL. COMP. STAT. 5/16.1(a)(6) (2015).

of surviving a primary beneficiary. Second, if all presumptive remainder beneficiaries were adults who were not disabled or were represented, the presumptive remainder beneficiaries as a class could represent all other beneficiaries who have successor, contingent or other future interests in the trust.

Under the statute, a binding nonjudicial settlement agreement requires the consent of all “interested persons.”<sup>193</sup> “Interested persons” includes all persons and parties whose consent or joinder would be required in order to achieve a binding settlement were the settlement to be approved by the court.<sup>194</sup> Thus a binding nonjudicial settlement agreement requires that all successor, contingent or other future beneficiaries be represented, not just the beneficiaries who would become primary beneficiaries by reason of surviving a primary beneficiary. Consequently in almost all cases the class of presumptive remainder beneficiaries would need to consent to the nonjudicial settlement agreement, and as they would represent all beneficiaries with more remote interests, there would be no need to rely on primary beneficiary representation. The 2015 Statute eliminates primary beneficiary representation because it is unnecessary and causes confusion.

#### E. Trusts Subject to Statute

The 2015 Statute expressly states that it applies to a trust that is governed by Illinois law with respect to the meaning and effect of its terms or that is administered in Illinois.<sup>195</sup> The 2015 Statute also states that it shall be construed as pertaining to the administration of a trust, thus presumably making it applicable to any trust that is governed by Illinois law for purposes of administration.<sup>196</sup>

A trust may by express language making specific reference to Section 16.1 prohibit the application of the virtual representation statute.<sup>197</sup> *Id.*

#### VI. Definitions

##### 1. *Interested Persons.*

In light of the expansion of divided trusteeship, under which persons other than the trustee may have some of the powers traditionally exercised by a trustee, the 2015 Statute expands the definition of “interested person” to include “a trust advisor, investment advisor, distribution advisor, trust

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193. *Id.* § 5/16.1(d)(2).

194. *Id.* § 5/16.1(d)(1).

195. *Id.* § 5/16.1(f).

196. *Id.*

197. *Id.*

protector or other holder, or committee of holders, of fiduciary or nonfiduciary power, if the person then holds powers material to a particular question or dispute to be resolved or affected by a nonjudicial settlement agreement.”<sup>198</sup>

## 2. *Disability and Incapacity.*

The 2010 Statute provided for representation of a beneficiary who was disabled, but did not define disability. In addition, the 2010 Statute provided for class representation if all presumptive remainder beneficiaries were either adults and not disabled, or had representatives. It was unclear whether “disability” meant legal disability, in which case an adult who was not adjudicated disabled but who lacked capacity to understand the effect of a nonjudicial settlement agreement, might not be disabled and eligible to be represented by another beneficiary with a substantially identical interest.

The 2015 Statute adds the following definitions of “disabled person” and “legal capacity”:

(C) “Disabled person” as of any date means either a disabled person within the meaning of Section 11a-2 of the Probate Act of 1975 or a person who, within the 365 days immediately preceding that date, was examined by a licensed physician who determined that the person lacked the capacity to make prudent financial decisions, and the physician made a written record of the physician’s determination and signed the written record within 90 days after the examination.

(D) A person has legal capacity unless the person is a minor or a disabled person.<sup>199</sup>

The Illinois guardianship statute defines disabled person to include an adult who (a) because of mental deterioration or physical incapacity is not fully able to manage his person or estate, or (b) is a person with mental illness or a person with a developmental disability and who because of his mental illness or developmental disability is not fully able to manage his person or estate, or (c) because of gambling, idleness, debauchery or excessive use of intoxicants or drugs, so spends or wastes his estate as to expose himself or his family to want or suffering, or (d) is diagnosed with fetal alcohol syndrome or fetal alcohol effects.<sup>200</sup>

Thus it is clear under the 2015 Statute that a person whom a physician has determined lacks the capacity to make prudent financial decisions, but

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198. *Id.* § 5/16.1(d)(1).

199. *Id.* § 5/16.1(a)(3).

200. 755 ILL. COMP. STAT. 5/11a-2 (2013)

who has not been adjudicated disabled, may be represented by an agent, parent or another beneficiary with a substantially similar interest and no conflict of interest with respect to the particular question or dispute.

#### G. Conclusion

The doctrine of virtual representation is a valuable tool for trustees, trust beneficiaries and their legal counsel. Virtual representation, coupled with authority to enter into nonjudicial settlement agreements, has potential to reduce expenses and facilitate the resolution of disputes and operating difficulties in trust administration.

The 2015 amendments to the Illinois virtual representation statute make significant improvements to the statute, particularly by permitting beneficiaries to be represented by parents or agents under a power of attorney, and by clarifying the matters that may be resolved by a nonjudicial settlement agreement.

