Brendan F. Daly and Paul T. Czepiga are the principals of CzepigaDaly, a law firm with offices in Newington, Wethersfield, and Vernon, where they practice in the areas of elder law; estate, tax, and disability planning; estate administration; and special needs trusts. Both attorneys are members of the CBA's Estates and Probate Section and Elder Law Section, serving on its executive committee; Attorney Czepiga is also a member of the CBA Tax Section.

The Use of Medicaid Spousal Immediate Annuities in Connecticut: The Aftermath of *Lopes v. Starkowski*

By Brendan F. Daly and Paul T. Czepiga

In 2010 the Connecticut Department of Social Services' (DSS) policy regarding the treatment of non-qualified annuities was challenged by a lawsuit against Michael Starkowski, the DSS commissioner at that time.[1] John F. Lopes sued DSS in federal district court, arguing that Connecticut's regulation related to the annuities is more restrictive than federal law governing the same issue.[2] Lopes purchased a single premium immediate annuity with $166,000, reducing her resources to slightly less than the sum protected for the spouse of an institutionalized individual for Medicaid. (She is referred to in Medicaid jargon as a "community spouse.") Her annuity complied with the requirements of federal Medicaid law so as not to be considered a disqualifying transfer of assets: the State was the remainder beneficiary in the first position for at least the total amount of Medicaid paid on behalf of the institutionalized spouse, it was irrevocable and non-assignable, it was actuarially sound based upon actuarial publications of the Social Security Administration, and it provided for payment in equal monthly amounts.

Suit was filed in federal district court requesting a preliminary injunction to enjoin the State from enforcing UPM Regulation § 4030.47, arguing that the regulation: (1) violated the Medicaid comparability doctrine as it was more restrictive than the SSI program's treatment of annuities[3] and (2) contravened the Medicaid spousal income rules in counting as an asset income that is exempt for a community spouse.[4] DSS requested a withdrawal of the motion for preliminary injunction and in return it agreed that, if the plaintiff was successful on the merits, it would grant the Medicaid application retroactively effective to the month in which the plaintiff had applied for Medicaid. The plaintiff agreed, provided that DSS

make a decision on the application within one month.

1. The Secondary Market Issue

The State had contacted, on their own and prior to taking any definitive action on the plaintiff's Medicaid application, Peachtree Financial (a purchaser on the secondary market of various income streams) and obtained paperwork for the plaintiff to assign her income stream to Peachtree in exchange for a lump sum payment of about $98,000. DSS then requested that the Peachtree Financial paperwork be completed in an attempt to assign the income stream, as it considered contacting Peachtree to be a required factor of eligibility. DSS further noted that it would deny the application if the plaintiff refused to comply. In anticipation of DSS's actions, a letter was obtained from the company that issued the annuity, which stated that no part of the annuity contract—including periodic payments—was assignable. This letter was provided to DSS before its request that the plaintiff cooperate in attempting to sell the income stream to Peachtree, and the plaintiff relied on the issuing company's letter as part of her justification for refusing to comply with DSS's request. DSS denied the application anyway—not because of UPM § 4030.47—but because of the plaintiff's refusal to cooperate in pursuing what it considered to be a potentially available resource. A motion for summary judgment was filed and the court granted it on August 12, 2010. DSS has appealed.

2. The State's Arguments

a. Standing.

DSS argued that the plaintiff lacked standing because it denied the Medicaid application based on her failure to pursue what it considered to be a potentially available resource, not on the application of UPM § 4030.47. The plaintiff's response stated that: (1) the stream of annuity payments cannot be characterized as a resource at all, but rather income belonging solely to the community spouse; and (2) DSS could not have denied the application without relying on UPM § 4030.47 for the legal justification of doing so. The court agreed: "Plaintiff has standing to challenge the DSS's treatment of Mrs. Lopes' annuity as an 'asset' in connection with DSS's conclusion that Mrs. Lopes failed to cooperate in collecting an 'asset'."

b. The DSS policy is not more restrictive than the policy set forth in the SSI program.

In its Memorandum, DSS stated that the requirement that a fixed annuity income be a resource (an available asset) under UPM § 4030.47 was not more restrictive than Supplemental Security Income rules and, since it was no more restrictive than SSI rules, it was a countable resource.[5] The plaintiff argued that DSS 1) ignored the fact that Mrs. Lopes had no right, authority or power to liquidate her annuity, 2) ignored the distinction between income and resources, and 3) ignored prior case law in *James v. Richman*[6] and *Weatherbee v. Richman.*[7] These cases held that an irrevocable annuity in payment status could not be counted as an available resource under SSI, therefore, the Medicaid program could not count it either because 42 U.S.C. § 1396a(a)(10)(C)(i)(III) prohibits Medicaid from using a more restrictive methodology for evaluating resources than the SSI program uses.

The court rejected DSS's reasoning: "Defendant fails to point to a single case supporting his position, and this court was unable to locate any."[8] Instead, the court followed the reasoning set forth in *James and J.P. v. Mo. State Family Support Div.*[9]: "UPM section 4030.47 violates federal law, as applied to Mr. and Mrs. Lopes, by treating Mrs. Lopes' income stream as an asset, a characterization which is more restrictive (admits less applicants) than would be applied to a similarly situated individual under the methodology utilized by SSI." [10] The court essentially tracked the *James* decision.

c. The Deficit Reduction Act (DRA) of 2005 permits states to treat annuity income as an asset.

DSS, relying on subsection (4) of 42 U.S.C § 1396p(e), argued that the DRA made it possible for states to treat annuity income as an asset.[11] The court applied the same statutory construction as the *Weatherbee* court, concluding that paragraph (4) of the relevant statute was limited to subsection (e).[12] Subsection (e) requires that Medicaid applicants disclose any interest in an annuity held by an applicant or spouse. The court noted that the purpose of subsection (e) is to permit states to determine whether an annuity meets all other statutory requirements.[13] The court found it illogical that Congress would have permitted states to deny Medicaid eligibility by treating an annuity income stream as an asset after setting forth the criteria[14] by which an applicant may avoid a transfer penalty. The court concluded: "If Congress had intended to 'ring the death knell' for otherwise compliant annuities, it would have said so. It did not."[15] DSS appealed the *Lopes* decision, and it is pending at the Second Circuit Court of Appeals where the court heard oral arguments in the case in September 2011.

3. Planning with Annuities Post-*Lopes*

While awaiting the outcome of the court of appeals determination of the *Lopes* decision, other married clients have continued to present themselves with concerns about themselves now that their spouses were in nursing homes or in need of home care benefits. Unfortunately for the community spouses in these cases, traditionally successful asset protection techniques would not be adequate to protect the at-risk assets. One community spouse had already spent about $138,000 for her husband's care in a nursing home and she still had at-risk assets of about $450,000 over and above the $113,000 community spouse protected amount. Setting aside, for now, the morality of asset protection planning for married couples when one spouse is suddenly in a nursing home, how much realistically should a non-institutionalized spouse have to spend before his or her institutionalized spouse is eligible for nursing home care?

Three community spouses, after a discussion with counsel about the options available and the risks of litigation, decided that they had no choice but to follow the path blazed by Mrs. Lopes and so a second case was filed on behalf of these community spouses, *Gale v. Bremby*.[16] Prior to the hearing on the motion for preliminary injunction, one spouse died. At the hearing, the court denied the motion for one of the other spouses because the State had denied the applicant's Medicaid application and, consequently, the court found that, as a result, there was no imminent risk of harm to that

plaintiff. A new complaint and motion for preliminary injunction have since been filed for that applicant.

Regarding the third plaintiff, Mr. Ehle, the court granted the motion for preliminary injunction, finding that, based on the uncontested portions of the case, the State would likely deny Mr. Ehle's application for Medicaid nursing home benefits because under UPM § 4030.47, as construed by DSS, Mr. Ehle would exceed the Medicaid asset threshold because the income stream from the annuity purchased by his wife would constitute a resource. According to the court, "there exists a strong likelihood that Ehle's application will be denied, given the unanimity amongst the parties that under the DSS practice at issue in this case the plaintiffs appear technically ineligible for Medicaid benefits."[17] This likelihood of denial presented the "imminent" form of irreparable harm necessary to allow the court to rule. The court additionally found that the denial of Medicaid benefits is irreparable harm, *per se*,[18] but did not explain why it dismissed the case as to the second plaintiff.

Having met the burden of irreparable harm for Mr. Ehle, the next question was whether there was a likelihood he would succeed on the merits. To prove this point, the district court was directed to the prior district court opinion in *Lopes*. The plaintiff asked the court to invoke the concept of offensive collateral estoppel and to use the district court decision in *Lopes* to bar the court from considering the issues in the instant matter because they were essentially the same as those in *Lopes*.

Although the court noted that the United States Supreme Court decision in *United States v. Mendoza,* 464 U. S. 154 (1984), bars the use of offensive collateral estoppels against the federal government, the court also noted that the Second Circuit in *Benjamin v. Coughlin* [19] refused to extend the *Mendoza* holding to state government entities.[20] Relying heavily on the fact that the parties in *Lopes* had fully litigated the same issues as presented in the instant case, the court concluded that the doctrine of offensive collateral estoppel is appropriate and that the decision in *Lopes* has preclusive effect that "b[ears] directly on the issue in dispute in this case," *see Ehle* at 14. Based on this, the court determined that Mr. Ehle has a likelihood of success on the merits sufficient to satisfy the second prong of the preliminary injunction standard.

There are, however, three points to note. First, having granted the preliminary injunction as to Mrs. Ehle, the court then stayed the execution of its order until the Second Circuit renders a decision in *Lopes*.

Second, after the initial court decision in the *Ehle* case, an administrative fair hearing with DSS regarding application delay about the resolution of some gifts that Mr. and Mrs. Ehle had made in 2007, 2008, 2009, and 2010 was requested. Regardless of the litigation outcome in *Ehle*, DSS would still need to address the gift issue and bring a conclusion to this aspect of the Ehle's Medicaid application. During discussions immediately before the fair hearing, DSS decided to grant long-term care Medicaid eligibility for Mr. Ehle retroactive to the date initially requested, and DSS did not impose any asset transfer penalties for the gifts. The case was granted, ending the court litigation despite the fact that *Lopes* has yet to be decided.

Third, should the Second Circuit affirm *Lopes,* a favorable ruling is not a panacea for all community spouses who have assets at risk. There are terms and conditions that the annuity must meet that may be unacceptable to the community spouse. For these and other reasons, attorneys must tread carefully into the complicated world of Medicaid.

Conclusion

Moving forward with the purchase of a nonqualified immediate annuity is likely to be met with a DSS request that the client attempt to assign the income stream. Counsel could challenge the State by requesting injunctive relief in federal court based on the *Lopes* decision. Another option is to actually go through the motions of attempting to sell the income stream and hope that a purchaser cannot be located and that DSS will accept this attempt as a bonafide effort to sell the annuity income stream. Otherwise, stay tuned and wait for the outcome of the appeal. **CL**

Notes

1. *See* Connecticut Uniform Policy Manual (UPM) § 4030.47: "Any payments from an annuity are considered income. Additionally, the right to receive income from an annuity is regarded as an available asset, whether or not the annuity is assignable."
2. *Lopes v. Starkowski*, No. 3: 10-cv-3072010, 2010 U>S> Dist. LEXIS 80829, at *3 (D. Conn. August 11, 2010).
3. *See* 42 U.S.C. §§ 1396(a)(10)(C)(i)(III) and 1396a(r)(2).
4. *See* 42 U.S.C. § 1396r-5(b)(1).
5. *See* 20 C.F.R. § 416.1201(a)(1): "If an individual has the right, authority or power to liquidate the property or his or her share of the property, it is considered a resource." § SI 01110.115 of the POMS defines this further as a legal right.
6. 547 F.3d 214, 218 (3d Cir. 2008).
7. 595 F. Supp. 2d 607 (W.D. Pa. 2009).
8. *Lopes* at *4.
9. No. WD 70994, 2010 WL 1539870 (Mo. Ct. App. Apr. 20, 2010).
10. *Lopes* at *4.
11. Subsection (4) of 42 U.S.C. § 1396p(e) provides that: "Nothing in this subsection shall be construed as preventing a State from denying eligibility for medical assistance for an individual based on the income or resources derived from an annuity described in paragraph (1)."
12. *Lopes*, at *5.
13. *Id.*
14. *See* 42 U.S.C. §§ 1396p(c)(1)(F) and (G).
15. *Id*., quoting *Weatherbee*, 595 F. Supp. 2d at 617.
16. CV-00972 (D. Conn. March 29, 2012)
17. *Id*. at 9.
18. *Id*. at 10.
19. 905 F.2d 571, 576 (2d Cir. 1990).
20. *See Gale*, *supra*, at 16.