

**CASE NO. 12-2224**

**IN THE UNITED STATES COURT OF APPEALS  
FOR THE EIGHTH CIRCUIT**

CAROL K. OLSON, in her official capacity  
as Executive Director of the  
North Dakota Department of Human Services  
Defendant-Appellant,

vs.

JOHN AND CAROLYN GESTON  
Plaintiffs-Appellees.

**ON APPEAL FROM THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF NORTH DAKOTA  
SOUTHWESTERN DIVISION**

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**BRIEF OF APPELLANT**

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## SUMMARY OF CASE

Plaintiff-Appellees John and Carolyn Geston brought a civil action against Carol K. Olson, in her official capacity as Executive Director of the North Dakota Department of Human Services (NDDHS), challenging the decision of NDDHS to deny Medicaid due to excess resources comprised of an annuity, based upon North Dakota Century Code § 50-24.1-02.8(7)(b). The Gestons filed an action in the District Court alleging the state statute was more restrictive than, and preempted by, federal law, and sought declaratory and injunctive relief.

Both parties filed Motions for Summary Judgment. Plaintiffs' Motion was granted and Defendant's Motion was denied. The District Court found that § 50-24.1-02.8(7)(b) was more restrictive than, and preempted by, federal law and granted the Plaintiffs the relief they requested. Judgment was entered April 25, 2012. NDDHS filed a timely Notice of Appeal.

Defendant, Carol K. Olson, Executive Director of NDDHS requests 20 minutes of oral argument. Oral argument is warranted because the issues before the Court are both complex and important to the taxpayers of North Dakota, and are subject to conflicting decisions across the country.

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## STATEMENT OF SUBJECT MATTER JURISDICTION

The District Court had subject matter jurisdiction pursuant to 28 U.S.C. §1331 (relating to federal question jurisdiction). The Court has appellate jurisdiction of the District Court's final Order pursuant to 28 U.S.C. §1291 (relating to final decisions of district courts). The appeal was timely filed within thirty days of the date of entry of the District Court's April 25, 2012 order.

## STATEMENT OF THE ISSUE

Whether the District Court erred when it held that N.D.C.C. §50-24.1-02.8(7)(b), a North Dakota Medicaid statute under which the annuity in question is a countable resource, could not be enforced against plaintiffs because the statute is more restrictive than, and thus pre-empted by, applicable federal law. *James v. Richman*, 547 F.3d 214 (3<sup>rd</sup> Cir. 2008); *Johnson v. Guhl*, 357 F.3d 403 (3<sup>rd</sup> Cir. 2004); *Estate of Gross v. N.D. Dept. of Human Services*, 687 N.W.2d 460 (N.D. 2004); *Eilbert v. Pelican*, 162 F.3d 523 (8<sup>th</sup> Cir. 1998). The most apposite statutory provisions are 42 U.S.C. §1382a(a)(2); 42 U.S.C. §1396p(e); 42 U.S.C. §§1396r-5(b)(1), (c)(2), (d)(6) & (f)(2).

## STATEMENT OF THE CASE

Appellees John and Carolyn Geston commenced an action seeking declaratory and injunctive relief against Appellant Carol K. Olson, in her official capacity as the Executive Director of the North Dakota Department of Human

Services (NDDHS), pursuant to 42 U.S.C. §1983. The Gestons alleged that their rights under certain provisions of the federal Medicaid Act, 42 U.S.C. §1396 *et seq.*, were violated when the Department of Human Services denied John Geston's application for Medicaid on the ground that an annuity purchased by Carolyn Geston constituted excess resources under federal law and North Dakota Century Code (N.D.C.C.) §50-24.1-02.8(7).

Both parties filed Motions for Summary Judgment and on April 25, 2012, the District Court granted the Gestons' Motion for Summary Judgment against the State and ordered the relief requested, including Medicaid coverage for John Geston's institutional care and a declaration that N.D.C.C. §50-24.1-02.8(7) is more restrictive than, and thus preempted by, the federal Medicaid Act pursuant to the Supremacy Clause of the United States Constitution, Art. VI, cl.2.

Appellant filed a Notice of Appeal on May 22, 2012.

### **STATEMENT OF THE FACTS**

Appellee John Geston entered Edgewood Vista Memory Care Facility (Edgewood) July 21, 2010. For Medicaid purposes, he is considered to be an "institutionalized individual." He is married to Carolyn Geston, who lives in her home in Bismarck, North Dakota. She is considered to be a "community spouse" for Medicaid purposes.

After John Geston entered Edgewood, the couple completed an “asset assessment” and filed it with the Burleigh County Social Service Board November 19, 2010. (J.A. 71). As of July 21, 2010, the couple’s resources were comprised of various investments totaling \$699,145.00 (J.A. 72) and a principal residence that was sold subsequently for \$153,150.00. (J.A. 74).<sup>1</sup> The Burleigh County Social Service Board determined that Carolyn Geston was entitled to a “spousal share” of \$109,560.00, an amount of the couple’s countable resources which would be disregarded in determining John Geston’s eligibility for Medicaid. (J.A. 72). John Geston also receives monthly gross income of \$2,877.00 and Carolyn Geston receives monthly gross income of \$2,319.00. (J.A. 85-88, 96, 100).

Mr. Geston moved to Missouri Slope Lutheran Care Center (Missouri Slope) on April 21, 2011 and applied for Medicaid eight days later. (J.A. 29). The community spouse’s house and car are not counted as resources for the purpose of determining the institutional spouse’s financial eligibility for Medicaid. Between the time Mr. Geston began institutional care at Edgewood and the date of his Medicaid application, Mrs. Geston sold her home for \$153,150.00, and bought a new home for \$276,874.00 (J.A. 74-75), and traded in her car, a 2007 Buick

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<sup>1</sup> Except where exact amounts are provided, the figures in this brief are rounded to the nearest dollar.

Lucerne with 44,485 miles on it, to purchase a new Nissan Murano for \$36,098.00. (J.A. 78).

Mrs. Geston also purchased a single premium immediate annuity with \$400,000.00 of the remaining resources, which paid to Mrs. Geston \$2,734.65 monthly for 13 years, for a total return of \$426,605.40. (J.A. 90-94). In calculating the financial eligibility of Mr. Geston for Medicaid, NDDHS valued the annuity at \$383,592.16, the difference between the purchase price and the payments already paid to Mrs. Geston; or, in other words, the corpus remaining equal to the total value of the outstanding payments due on the contract.

The application was denied by NDDHS June 8, 2011 because it found the Gestons' countable resources, which were calculated to be \$454,691.33, exceeded the maximum resource limit of \$112,560.00. (J.A. 24) The couple's excess resources included the annuity, pursuant to N.D.C.C. §50-24.1-02.8 governing transfers involving annuities, and in particular, subsection (7), N.D.C.C. § 50-24.1-02.8(7).

Contending that NDDHS could not treat the annuity as a countable resource, the Gestons commenced federal litigation on May 13, 2011.

## SUMMARY OF ARGUMENT

The opinion of the District Court is unsupported by the plain text of the governing law and utterly defeats the intent of Congress. The Court's holding upsets carefully balanced interests and negates the lines drawn by Congress by permitting a couple, regardless of wealth, to qualify for Medicaid simply by purchasing a nonassignable, single premium annuity. *Infra* Part II.B.

First, the District Court incorrectly held that under the Medicaid Act, a single premium annuity purchased by a "community spouse" of a nursing facility resident, and the payments made pursuant to the contract, could not be considered a countable resource in determining the Medicaid eligibility of the "institutionalized spouse" because under its terms, the annuity could not be assigned. Instead, the District Court incorrectly held the payments were unearned income of the community spouse under the Act. *Infra* Part II.A.

Additionally, the District Court misconstrued provisions of the Deficit Reduction Act that do not govern whether an annuity can be counted as a resource and misapplied them to reach the conclusion that the provisions bar states from doing so. *Infra* Part II.C. The District Court erred further by failing to correctly apply the "spousal impoverishment" provisions of the Medicare Catastrophic Coverage Act (MCCA) designed to prevent pauperization of the community

spouse while preventing those not truly needy from gaming the system. *Infra* Part II.B.

The misapprehensions of the District Court led the Court to the mistaken conclusion that a North Dakota Medicaid statute, N.D.C.C. §50-24.1-02.8(7)(b), which governs whether single premium annuities are countable resources to be used for the care of the institutionalized spouse, is more restrictive than, and therefore preempted by, federal law. In reality, N.D.C.C. §50-24.1-02.8(7)(b), which allows a community spouse to protect a greater share of the couple's resources in certain situations than she would be able to under federal law, is *less* restrictive than federal law. *Infra* Part II.C., II.D.

The District Court further erred when it failed to recognize that annuities are “trust-like devices” under the Medicaid Act and, as such, are subject to the trust counting rules of the Medicaid Act, under which they are indisputably countable resources. *Infra* Part III. The District Court also committed reversible error by failing to recognize that the community spouse's annuity was on its face almost entirely, merely a return of the original premium, initially comprised of and then paid out again as countable cash resources freely available for the support and maintenance of the institutionalized spouse. *Infra* Part IV.

Finally, the District Court committed reversible error by wholly disregarding North Dakota contract law despite the state's retention of its traditional regulatory authority over annuity contracts. Under North Dakota law, anti-assignment provisions designed to thwart Medicaid requirements by destroying the liquidity of an annuity would be ineffective as well as unenforceable on public policy grounds. *Infra* Part V.

For these reasons, the judgment below should be reversed.

## ARGUMENT

“The question with which courts of equity have been compelled to struggle is how far it is possible to go without crossing the line which separates the legitimate use of the trust device from an illegal evasion of the letter or the policy of the law.”<sup>2</sup>

Austin W. Scott, *The Trust as an Instrument of Law Reform*, 31 Yale L.J. 457, 458 (1922)

### **I. THE MEDICAID ACT REFLECTS CONGRESSIONAL INTENT TO PRESERVE TAXPAYER-PROVIDED LONG TERM INSTITUTIONAL CARE FOR THE TRULY NEEDY WHILE PROTECTING SPOUSES REMAINING IN THE COMMUNITY**

This appeal involves the complex interaction between two distinct, but related statutory and regulatory regimens under the federal Medicaid Act and their interaction with state law under the North Dakota cooperative state medicaid program. One set of rules, involving the complex provisions governing the transfer of an individual’s assets to qualify for Medicaid, are intended by Congress to ensure that those who can afford to, must use their assets to pay for their own care before the taxpayer can be expected to pay. The other equally complex set of

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<sup>2</sup> An annuity is a legal instrument or device that is similar to a trust. *See King v. Secretary, Louisiana Dept. of Health and Hospitals*, 956 So.2d 666, 669 (La.Ct.App. 2007); *see also Sable v. Velez*, 388 Fed. App’x. 235, 238 (3<sup>rd</sup> Cir. 2010); Soc. Sec. Admin. Program Operations Manual System (POMS)§SI 01120.201.G.2; *cf.* 42 U.S.C. §1396p(d)(6).

rules, involving the special treatment of institutionalized spouses' eligibility for benefits under the Medicaid program, are intended by Congress to ensure that spouses do not become impoverished when one spouse enters a nursing facility.

Seeking to ensure state law complied with recent changes to both the transfer rules and the spousal rules, North Dakota amended its laws by enacting N.D.C.C. §50-24.1-02.8 governing transfers involving annuities. The provisions implement, in part, the federal Medicaid Act amendments contained in the Deficit Reduction Act of 2005, (DRA), Pub. L. 109 - 171, Title VI, Subtitle A, Subchapter 2, Secs. 6011- 6021, 120 Stat. 61 - 68 (Feb. 8, 2006), particularly sections 1396p(c)(1)(F), 1396p(c)(1)(G), and 1396p(e) (governing dispositions of assets used to purchase annuities); and section 1396r-5(d)(6) (establishing a mandatory “income-first rule” under the spousal rules; see *Wisconsin Dept. of Health and Family Services v. Blumer*, 534 U.S. 473 (2002)).

The issues associated with financing long term care for our nation's elderly couples for the last quarter century since Congress enacted into law the “Spousal Impoverishment Provisions” of the Medicare Catastrophic Coverage Act of 1988 (MCCA), Pub. L. No. 100-360, 102 Stat. 754 (July 1, 1988) (adding Section 1924 to Title XIX of the Social Security Act, codified at 42 U.S.C. § 1396r-5 *et seq.*), are complex and difficult. The “primary purpose” of MCCA's spousal

impoverishment provisions “was to ‘end the pauperization [of the community spouse] by assuring [she] has a sufficient – but not excessive – amount of income and resources available’ when the other spouse is institutionalized in a nursing home.” *Cleary v. Waldman*, 959 F.Supp. 222, 229 (D.N.J. 1997) (citing H.R. Rep. No.100-105 (II), *reprinted in* 1988 U.S.C.C.A.N at 888, *aff’d* 167 F.3d 801 (3<sup>rd</sup> Cir. 1999). *See also Blumer*, 534 U.S. at 480.

“To achieve this aim, Congress installed a set of intricate and interlocking requirements with which States must comply in allocating a couple’s income and resources.” *Blumer, id.* The rules permit the community spouse to retain a carefully defined share of the couple’s resources, up to a maximum, and protects a carefully defined level of income, up to a maximum, if available from the combined income of the couple.

The spousal income and resource rules and the minimum and maximum guarantees established by Congress in the Act carefully balance the economic interests of elderly couples to enjoy a certain level of support in their retirement years against the economic interests of the taxpayers who would otherwise have to shoulder the burden. The line drawn by Congress allocated the full economic burden upon couples beyond the income and resource limits which it established.

These spousal rules and other statutes and regulations governing the treatment of resources are designed to ensure that Medicaid is the “payor of last resort.” However, as the Court of Appeals for the Third Circuit observed, “[b]ecause Medicaid is available only to the needy, creative lawyers and financial planners have devised various ways to ‘shield’ wealthier claimants’ assets in determining Medicaid eligibility.” *Johnson v. Guhl*, 357 F.2d 403, 405 (3<sup>rd</sup> Cir. 2004)(quotations in original).

Since 1985, with the enactment of the "Medicaid Qualifying Trust" provisions of the Medicaid Act, Consolidated Omnibus Reconciliation Act of 1985, Pub. L. No. 99-272, Title IX, Sec. 9506(a), 100 Stat. 216 (April 7, 1986)(adding 42 U.S.C. §1396a(k) to the Medicaid Act governing the treatment of Medicaid Qualifying Trusts), Congress continually has amended the Act to eliminate planning opportunities to preserve wealth for well-to-do elderly by shifting catastrophic medical costs to the taxpayer.<sup>3</sup> With the passage of the

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<sup>3</sup> See, e.g., Medicare Catastrophic Coverage Act of 1988, Pub. L. No. 100-360, Title III, Sec. 303(b), 102 Stat. 760 (July 1, 1988) (amending 42 U.S.C. §1396p(c), increasing the look back period to 30 months and adding §1924 to the Social Security Act, 42 U.S.C. §1396r-5, governing the liability of the spouse of an institutionalized individual); Omnibus Budget Reconciliation Act of 1993; Pub. L. No. 103-66, Title XIII, Secs. 13611, 13612, 107 Stat. 622 to 628 (Aug. 10, 1993) (amending 42 U.S.C. §1396p(c), increasing the look back period to 36 or 60 months, repealing 42 U.S.C. §1396a(k) and adding 42 U.S.C. §1396p(d),  
(continued...)

Deficit Reduction Act of 2005, Congress sought to close the “loopholes” in the Medicaid program that permitted those who could afford to pay for their own long term care, instead to qualify for Medicaid by employing ever more aggressive planning techniques which policy makers considered to be “gaming” the system. *See, e.g.*, Statement by President, 2006 U.S.C.C.A.N. S3 (“The Bill gives Governors more flexibility to design Medicaid benefits that meet the needs of their States efficiently and affordably. The bill tightens the loopholes that allowed people to game the system by transferring assets to their children so they can qualify for Medicaid benefits.”).

As will be discussed in greater detail *infra* Parts II.C. & D., included in the DRA were several new provisions addressing the purchase of annuities in order to qualify for Medicaid, *see* 42 U.S.C. §§1396p(c)(1)(F),(G) & 1396p(e); and a Congressional adoption of a mandatory “income first rule.” *See* H.R. Conf. Rep. No. 109-362, *reprinted in* 2006 U.S.C.C.A.N. at 90-96. (Relevant portions attached as part of Addendum). One provision, paragraph (G), was a codification of the Secretary’s existing guidelines contained in the Center for Medicare-

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<sup>3</sup>(...continued)  
governing the treatment of trusts).

Medicaid Services (CMS) State Medicaid Manual (SMM) issued in 1994. SSM §3258.9(B).

Coupled with the complex rules of the spousal impoverishment provisions, these annuity provisions have spawned numerous and conflicting interpretations by state and federal district courts around the country which have split the courts on whether, in particular circumstances, an annuity is a countable resource or a disposition of assets for less than fair consideration. *See, e.g., Hughes v. Colbert*, No. 5:10 CV 1781, 2012 WL 1933702 (N.D. Ohio 2012)(An annuity purchased by a community spouse is a transfer for less than fair consideration); *Morris v. Okla. Dep't of Human Servs*, 758 F. Supp.2d 1212 (W.D. Okla. 2010) (same) *rev'd* No. 10-6241, 2012 WL 2689824 (10<sup>th</sup> Cir. 2012); *Jackson v. Selig*, No. 3:10-CV-0026-WRW, 2010 WL 5346198 (E.D. Ark. 2010) (An annuity purchased by a community spouse is not a transfer for less than fair consideration); *Johnson v. Guhl*, 166 F. Supp. 2d 42 (D.N.J. 2001) *aff'd* 357 F.3d 403 (3<sup>rd</sup> Cir. 2004) (Spousal annuity trust is a countable resource); *McNamara v. Ohio Dep't of Human Servs*, 744 N.E.2d 1216 (Ohio Ct. App. 2000) (Spousal annuity trust is a transfer for less than fair consideration); *N.M. v. N.J. Division of Medical Assistance and Health Servs*, 964 A.2d 822 (N.J. Super. Ct. App. Div. 2009) (Annuity purchased by a community spouse is a countable resource); *Estate of*

*Gross v. N.D. Dept. Of Human Services*, 687 N.W.2d 460 (N.D. 2004) (same);  
*Lopes v. Starkowski*, No. 310-CV-307, 2010 WL 3210793 (D.Conn. 2010) (An annuity purchased by a community spouse is not a countable resource);  
*Weatherbee ex rel Vecchio v. Richman*, 595 F.Supp.2d 607 (W.D.Pa 2009), *aff'd* 351 Fed. App'x 786 (3<sup>rd</sup> Cir. 2009) (same).

Although to date the law is unsettled, the critical facts before this Court are beyond dispute: John and Carolyn Geston possessed approximately \$700,000 in liquid assets they could use to pay for Mr. Geston's own long-term care at the time he entered a nursing facility. These assets exceeded the Congressionally established maximum share by approximately \$586,500. Instead of using the resources to pay for the care John Geston required, they chose to use \$400,000 to purchase an annuity, and the annuity they selected included non-assignability language designed to make the annuity no longer available for Mr. Geston's care.

That Mrs. Geston chose to receive these resources over 13 years under the terms of the contract was an act of her own volition, but it did not change the underlying character of the asset - only the terms by which she enjoyed its benefit. John and Carolyn Geston's "excess" resources, comprised of the corpus remaining in the annuity, which the District Court held were not resources but unearned

income, cannot and should not escape the force of the Medicaid Act by hiding behind legal formalities of Appellees' own advisors' design.

The District Court committed reversible error when it directed NDDHS to provide Medical Assistance to John Geston, whose resources were determined by NDDHS to be approximately \$454,700 at the time he applied, on the grounds that the annuity purchased with countable resources of \$400,000 by his wife was not countable for purposes of determining Medicaid eligibility. These resources exceeded Congressionally mandated limits by approximately \$342,000. The District Court should be reversed.

**II. THE DISTRICT COURT COMMITTED REVERSIBLE ERROR BY MISCONSTRUING APPLICABLE FEDERAL MEDICAID LAW WHEN IT INVALIDATED A NORTH DAKOTA STATUTE HOLDING THE BALANCE PAYABLE UNDER A SINGLE PREMIUM IMMEDIATE ANNUITY WAS NOT A RESOURCE**

An annuity is a purely generic term which refers to a contract by which an individual purchases the right to receive periodic payments for a specified time in exchange for the payment of a lump sum. The Supreme Court has recognized that “annuities are primarily investment products,” quoting David Shapiro & Thomas F. Streiff, *Annuities* 7 (1992), that “must be recognized as investments rather than insurance,” quoting John A. Appleman & Jean Appleman, *1 Insurance Law and*

Practice § 84, at 295 (1981); and that, “[b]y making an initial payment in exchange for a future income stream, the customer is deferring consumption, setting aside money for retirement, future expenses, or a rainy day. For her, an annuity is like putting money in a bank account, a debt instrument, or a mutual fund.” *Nations Bank of North Carolina, N.A. v. Variable Annuity Life Insurance Co.*, 513 U.S. 251, 259 (1995); *see also SEC v. Variable Life Insurance Co.*, 359 U.S. 65 (1959).

In this case, the District Court held that a non-qualified annuity such as those described above by the Supreme Court, was not a resource but rather unearned income based upon its construction and application of certain provisions of the SSI statute and regulations and the terms of the annuity contract.<sup>4</sup> The District Court found that, although “an irrevocable annuity can be considered either income *or* a resource depending on its terms,” *Geston v. Olson*, No. 11-CV-044, 2012 WL 1409344 at \*12 (D.N.D. 2012), the SSI regulations “generally treat annuities as income,” citing 20 C.F.R. §416.1121(a) and the POMS §SI 00830.160.B.1, *id.* at \*10 and concluded that because the annuity was irrevocable

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<sup>4</sup> The Medicaid Act distinguishes between qualified annuities, which meet the requirements of section 408 of the Internal Revenue Code, 26 U.S.C. §408, and non-qualified annuities which are purchased with non-qualified resources. *See* 42 U.S.C. §1396p(c)(1)(G). *See also* 20 C.F.R. §416.1202(a)(1)(the pension funds, including those described in section 408 of the Internal Revenue Code of the ineligible spouse, are excluded).

and could not be transferred, assigned, surrendered or commuted, it was not a resource. *Id.* at \*12-\*13, quoting *James v. Richman*, 547 F.3d 214 (3<sup>rd</sup> Cir. 2008).

Appellant submits that the District Court, in invalidating N.D.C.C. §50-24.1-02.8(7)(b) and in determining that the annuity was not a countable resource, ignored the text and structure of the Medicaid Act, exalted form over substance, ignored governing regulations and reality, and ran roughshod over clear Congressional intent. As a result, the District Court committed reversible error.

**A. The Single Premium Immediate Annuity Constitutes a Resource Under the Applicable Federal Law, Not Unearned Income**

“A word is not a crystal, transparent and unchanged; it is the skin of living thought and may vary greatly in color and content according to the circumstances and the time in which it is used.”

*Towne v. Eisner*, 245 U.S. 418, 425 (1918) (Holmes, J.)

At the outset, it is important to emphasize that all determinations of what constitutes countable income and resources of an individual are made as of the first of the month in which the required determination is made. 20 C.F.R. §416.1207(a) (Resource determinations). As the Secretary made clear in the preamble to the publication of this final rule, “In a program such as SSI [or Medicaid], it is necessary to have some point in time at which resources are evaluated.” 52 Fed. Reg. 4283 (Feb. 11, 1987). Furthermore, when determining

when income becomes a resource, the focus of the regulations “is on how and when the Secretary counts an item as income or resources *and not on a transformation in the nature of the item*. [Therefore], the final rule breaks out a separate subsection (e) the rule related to changing the form of a resource and shows the relationship between this provision and the transfer of assets provisions of [20 C.F.R.] §416.1246.” *Id.* (emphasis added).

Federal regulation provides as follows:

(a) Resources; defined. For purposes of this subpart L, resources means cash or other liquid assets or any real or personal property that an individual (or spouse, if any) owns and could convert to cash to be used for his or her support and maintenance.

(1) If the individual has the right, authority or power to liquidate the property or his or her share of the property, it is considered a resource. If a property right cannot be liquidated, the property will not be considered a resource of the individual (or spouse).

20 C.F.R. §416.1201.

The regulations further emphasize that a resource held in another form remains a resource, rather than transforming into income. Subsection (e) of 20 C.F.R. §416.1207, which governs resource determinations, provides:

(e) Receipts from the sale, exchange, or replacement of a resource. *If an individual sells, exchanges or replaces a resource, the receipts are not income. They are still considered to be a resource.* This rule includes resources that have never been counted as such because they were sold, exchanged or replaced in the month in which they were received. See

§416.1246 for the rule on resources disposed of for less than fair market value (including those disposed of during the month of receipt).

20 C.F.R. §416.1207(e) (emphasis added).

Additionally, a subsection entitled “what is not income” provides that “*what you receive from the sale or exchange of your own property is not income; it remains a resource.*” 20 C.F.R. §416.1103 (emphasis added).

In accordance with these regulations, as of the first of the month when the Gestons’ resources were assessed by NDDHS for purposes of determining “the community spouse’s share,” it is undisputed that the Gestons owned \$700,000 which they could convert to cash to pay for Mr. Geston’s care.<sup>5</sup> When Mrs. Geston sold \$400,000 of her countable resources in exchange for the annuity, the contract itself, and all of the payments payable pursuant thereto, which replaced the resources she owned as of the first of the month, are still considered to be resources pursuant to SSI methodology. In finding the annuity payments

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<sup>5</sup> The term “community spouse’s share” is commonly referred to as, and used interchangeably with the term, Community Spouse Resource Allowance (CSRA). However, the community spouse’s share of resources under the Medicaid Act is the total of the resources which a spouse may retain at the time of the initial eligibility determination, regardless of ownership. *See* 42 U.S.C. §1396r-5(c)(2)(B) (incorporating by reference 42 U.S.C. §1396r-5(f)(2)(A)). The CSRA on the other hand is only a portion of the community spouse’s share. It is equal to the amount by which the community spouse’s share exceeds the amount of resources otherwise available to the community spouse. 42 U.S.C. §1396r-5(f)(2)(A)&(B). *See Blumer*, 534 U.S. at 483 n. 5 (2002).

exchanged for these indisputably cash resources were unearned income, the District Court completely ignored the plain meaning of 20 C.F.R. §416.1207(e) and 20 C.F.R. §416.1103, under which the annuity *does not qualify as income at all*.

Income is defined by statute under the SSI program to mean both earned income, which includes wages, net earnings from self-employment, remuneration for services performed, royalties and honorariums, 42 U.S.C. §1382a(a)(1); and unearned income, which is defined to mean all other income, including for purposes of this appeal, “any payments received as an annuity, pension, retirement, or disability benefit, including veterans' compensation and pensions, workmen's compensation payments, old-age, survivors, and disability insurance benefits, railroad retirement annuities and pensions, and unemployment insurance benefits.” 42 U.S.C. §1382a(a)(2). Similarly, the SSI regulations describe some types of unearned income to include “annuities, pensions, and other periodic payments.”

However, the regulation qualifies these terms by stating “*this unearned income is usually related to prior work or service*. It includes, for example, private pensions, social security benefits, disability benefits, veterans benefits, worker's

compensation, railroad retirement annuities and unemployment insurance benefits.” 20 C.F.R. §416.1121(a) (emphasis added).

The District Court, *Geston*, 2012 WL 1409344 at \*10, and most of the courts that have held such annuities are income of the “community spouse,” have relied in part on the use of the term “annuity” in this statutory and regulatory context to include these non-qualified annuities. *See, e.g., Lopes*, 2010 WL 3210793 at \*4; *Weatherbee*, 595 F.Supp.2d at 617. However, as this Court recognized in *Eilbert v. Pelican*, 162 F.3d 523, 527 (8<sup>th</sup> Cir. 1998), that because the use of the term annuity is “broad and generic,” the Court must construe the term by applying well-settled canons of construction.

In *Eilbert*, the Court was called upon to construe the term “annuity... on account of age” in an exemption contained in Iowa’s bankruptcy code where a judgment debtor sought to shelter her estate from the claims of a judgment creditor through the purchase of an annuity. In construing the term, the court applied the familiar canons of construction *noscitur a sociis* ( a term is known by its associates) and *eiusdem generis* (general words in an enumeration are construed as similar to more specific words in the enumeration). These rules of construction are applied to avoid ascribing to a word a meaning so broad it is inconsistent with the intent of Congress. *See Jarecki v. Commissioner*, 367 U.S. 303, 306 (1961).

The *Eilbert* Court found that the term annuity, like a pension, describes a plan or contract to provide benefits in lieu of earnings and held that the non-qualified annuity purchased by the judgment debtor in that case did not qualify for the exemption. Quoting the bankruptcy court, the Court observed that, if the term included all annuities, “Under this scheme, no debtor would have assets subject to execution, could live in a million-dollar home, have a substantial stream of income, virtually live off his creditors, and yet be judgment proof.” *Eilbert*, 162 F.3d at 526.

Here too, under a regime that would include as unearned income of a spouse, all non-qualified annuities purchased with what are incontrovertibly countable resources exceeding the maximum set by Congress, no couple is too wealthy to qualify for Medicaid. This result clearly was not intended by Congress when it enacted the spousal impoverishment provisions of MCCA, especially after the DRA.

The provision in *Eilbert* is strikingly similar to the language of the SSI unearned income statute and implementing regulation. *Compare* Iowa Code §627.6(8)(e) (exemption for a payment under a pension, annuity, or similar plan or contract on account of illness, disability, death, age or length of service) *with* 20 C.F.R. §416.1121(a) (annuities, pensions, and other periodic payments... *usually*

*related to prior work or service...*for example, private pensions, social security benefits, disability benefits, veterans benefits, worker's compensation, railroad retirement annuities and unemployment insurance benefits). Appellant respectfully submits the term annuity as used in the Medicaid context, as in *Eilbert* means only a qualified retirement plan annuity within the meaning of section 408 of the Internal Revenue Code, 26 U.S.C. §408.

That the term annuity under the SSI program means a qualified annuity is consistent with the Medicaid Act, *i.e.* it is consistent with the enumeration of the other terms included as unearned income; it is consistent with the text and structure of the spousal impoverishment provisions which protect the income benefits of the community spouse that are akin to earnings, 20 C.F.R. §416.1202(a)(1) (the pension funds, including those described in section 408 of the Internal Revenue Code of the ineligible spouse are excluded); *see also* N.D.C.C. §50-24.1-02.8(8) (excluding annuities described in section 408 of the Internal Revenue Code of 1986 as resources); it is consistent with the SSI regulations bearing on the determination of what is (or is not) income or a resource, 20 C.F.R. §416.1207(e) and 20 C.F.R. §416.1103; and most importantly, it does not render meaningless the resource limits which Congress has established

under the spousal impoverishment provisions of the Act. *See* 42 U.S.C. §1396r-5(d)(6)(“income first rule”) and discussion *infra* Part II.B.

Given the foregoing, it is submitted that where non-qualified, countable and liquid resources, assessed to establish the excluded “community spouse’s share,” are sold or exchanged for a payment stream from a non-qualified single premium annuity, the annuity contract itself, which replaces the non-qualified, countable resources, and all of the payments made pursuant thereto, as a matter of law, *are not income, earned or unearned -they remain countable resources* within the meaning of the Medicaid Act. This is so regardless of whether the annuity is irrevocable or non-assignable.

**B. The District Court’s Determination that the Single Premium Annuity was not a Countable Resource is Inconsistent with the Text and Structure of the Spousal Impoverishment Provisions of MCCA**

A complete understanding of the spousal impoverishment provisions of MCCA is essential to the proper resolution of this matter. It is respectfully submitted that the decision of the Court of Appeals for the Third Circuit in *James v. Richman*, and the decisions of all the courts, including the District Court below, that have relied on *James* to hold a non-qualified annuity is not a resource because “to hold otherwise would tend to undermine the rule that ‘no income of the

community spouse shall be deemed available to the institutionalized spouse,” *Geston*, 2012 WL 1409344 at \*13, quoting *James*, 547 F.3d at 219, are based upon a flawed construction of the statute.

The spousal impoverishment provisions were intended by Congress to assure the community spouse has a “*sufficient - but not excessive-* amount of income and resources available.” *Blumer*, 534 U.S. at 480 (quoting H.R.Rep. No.100-105, pt. 2, p.65) (emphasis added). “To achieve this aim, Congress installed a set of intricate *and interlocking*, requirements ...in allocating a couple’s income and resources.” *Id.* (emphasis added).

Resource allocation is controlled by sections 1396r-5(c) and (f), 42 U.S.C. §§1396r-5(c), (f). Resources are assessed and “attributed” to the community spouse or institutionalized spouse at two points in time to establish both the community spouse’s share, which will be disregarded at the time of the initial eligibility determination, and the balance of the countable resources allocated to the institutionalized spouse, which must be spent down before eligibility is established. The community spouse’s standard share is equal to one-half of the resources assessed on the date of initial institutionalization, but could have not fallen below a minimum - \$21,912, nor exceeded a maximum - \$109,560, when

Mr. Geston was assessed. 42 U.S.C. §1396r-5(c)(2)(B) (incorporating by reference 42 U.S.C. §1396r-5(f)(2)(A)).

However, as will be discussed, resources in excess of this standard share may be allocated to the community spouse, but only where the community spouse's income, including the income available from the institutionalized spouse, falls below the amount established by Congress deemed to be sufficient - but not excessive - to maintain the community spouse independently in the community. This amount is called the Minimum Monthly Maintenance Needs Allowance (MMMNA), 42 U.S.C. §1396r-5(d)(3).<sup>6</sup>

The income rules are governed by sections 1396r-5(b) and (d), 42 U.S.C. §1396r-5(b), (d). Like the resource rules, income is assessed and "attributed" to one spouse or the other at two points in time - at the time of institutionalization and following the initial eligibility determination. 42 U.S.C. §1396r-5(b)(1) (separate treatment of income during any month in which a spouse is in an institution); *cf.* 42 C.F.R. §435.602 (state must consider the income of a spouse in

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<sup>6</sup> The District Court, in its opinion, incorrectly confused this protected level of income defined at 42 U.S.C. §1396r-5(d)(3) (defining the MMMNA) for what is defined as the Community Spouse Monthly Income Allowance (CSMIA) defined at 42 U.S.C. §1396r-5(d)(2). *See Geston*, 2012 WL 1409344 at \*8. This error is one of several made by the District Court which underscore its flawed construction of the spousal impoverishment provisions resulting in its erroneous holding in this case.

determining eligibility until the couple ceases to live together); 42 U.S.C. §1396r-5(b)(2) (attribution of income for purposes of the post-eligibility determination described in subsection (d) [42 U.S.C. §1396r-5(d)]).

Congress further restricted a couple's right to preserve wealth with the changes made by the DRA. It amended the MCCA provisions by adding a new paragraph (6) to section 1396r-5(d) commonly referred to as the "income first rule." *Blumer*, 534 U.S. at 484. "Under this method, the assets of an institutionalized spouse (*e.g. an annuity or other income producing asset*) cannot be transferred to the community spouse to generate additional income for the community spouse *unless the income transferred by the institutionalized spouse would not enable the community spouse's total monthly income to reach the state-approved monthly maintenance needs allowance.*" H.R. Conf. Rep. No. 109-362, *reprinted in* 2006 U.S.C.C.A.N. at 95 (emphasis added). *See* 42 U.S.C. §1396r-5(d)(6) (For purposes of this subsection and subsections (c) and (e) of this section, a State *must* consider that all income of the institutionalized spouse that could be made available. . . has been made available *before allocating additional resources.*) (Emphasis added). The Committee report, besides making clear the effect of the income first rule, also makes clear that Congress understands that annuities are "income producing assets"-not unearned income.

Once an institutionalized spouse is determined to be eligible for Medicaid, all of his income must be used to pay for the required care except for specified deductions, one of which is the CSMIA. This is the amount of income the institutionalized spouse is permitted to transfer to the community spouse only if necessary to raise her income to the MMMNA. 42 U.S.C. §1396r-5(d)(1)(B).

The design and structure of all of these provisions make it necessary to project the income and resource allowances prospectively from the time when a spouse enters a nursing home in order to achieve the outcome intended by Congress. One of the reasons for this, as the District Court noted, “is because it is easier to value assets contemporaneously rather than to reconstruct values for a date or years in the past.” *Geston*, 2012 WL 1409344 at \*8 (citing Lawrence Frolick and Melissa Brown, *Advising the Elderly or Disabled Client*, ¶14.03(2) (2<sup>nd</sup> ed. 2011)).<sup>7</sup>

A more important reason to make, in particular, the income projections when first entering a nursing facility is because, where a couple’s combined income is less than the MMMNA, or there are exceptional circumstances resulting in significant financial duress, it is possible, even likely, a couple will have spent

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<sup>7</sup> Ironically, given the District Court’s holding in this case, eligibility will always immediately follow a resource assessment and subsequent purchase of an annuity. There will never be a gap of years.

resources on the nursing facility which they otherwise would have been permitted to retain under Congress' scheme. *See* 42 U.S.C. §1396r-5(e)(2)(B) (Revisions to the MMMNA); and 42 U.S.C. §1396r-5(e)(2)(C) (Revisions to the CSRA [the community spouse's share])

As the Supreme Court observed, the hearing available under section 1396r-5(e) to revise the MMMNA or the community spouse's protected share of resources pursuant to these two provisions, is "properly comprehended as a pre-eligibility projection of the couple's post-eligibility situation." *Blumer*, 534 U.S. at 491. This understanding of the structure and application of the rules governing revisions to the MMMNA and the community spouse's share, *i.e.* that it is a pre-eligibility projection of the couple's post eligibility situation, applies to the structure and application of all of the interlocking provisions, if the balancing of interests envisioned by Congress is to be achieved.

Thus, as of the first of the month at the point in time a spouse enters a nursing facility, in order to achieve the outcome intended by Congress under the interlocking provisions of MCCA, the couple's income and countable resources are established, as is the projected MMMNA, the CSMIA, the community spouse's share (CSRA) and those resources allocated to the institutionalized spouse to pay for his care. Barring the accumulation of additional resources

(which would not alter the community spouse's share), any changes in the couple's assessed resources thereafter, on the date of the initial eligibility determination, are either merely a transformation in the nature of a resource or a disposition of a resource which must be assessed under the fair consideration rules. 20 C.F.R. §416.1207(e); *cf. Towne v. Eisner*, 418 U.S. 418, 426 (1918) (proportionate distribution of stock dividend to shareholders of record is not income...the property of the corporation is not diminished and the shareholders' proportional interests are not increased; the only change is the evidence which represents that interest).

Given the interlocking design and structure of the spousal provisions, it is clear that by purchasing the annuity following the resource assessment, the Gestons attempted to evade the plain mandate of subsection (d)(6). The Gestons' combined monthly income from pension, Social Security and oil royalties, 20 C.F.R. §416.1121(a), (c), when their resources were first assessed, was approximately \$5,200.00. The greatest MMMNA at that time, absent exceptional circumstances, was \$2,739.00. Thus, Mrs. Geston did not require and was not permitted to increase her share of the resources by \$400,000 as she attempted to do. Stated another way, NDDHS was not required under the federal income first

rule to allocate to Mrs. Geston an additional \$400,000 of the couple's resources because Mrs. Geston's available income was sufficient to achieve the MMMNA.

Accordingly, the District Court's determination, and the *James* court's, that to treat the annuity as a resource would tend to undermine MCCA's stricture that "no income of the community spouse shall be deemed available to the institutionalized spouse," was inconsistent with the text and structure of MCCA and the intent of Congress, because the income referred to by the courts in subsection (b), 42 U.S.C. §1396r-5(b)(1), means, according to Congress, the income attributed to the community spouse as of the date of institutionalization, not at anytime thereafter. 42 C.F.R. §435.602 (deeming income from the non-applicant spouse terminates following the month when the couple ceases to live together); see *Herweg v. Ray*, 455 U.S. 265 (1982).

At the relevant time when Mrs. Geston's income was evaluated for purposes of the protections afforded by Congress - the date of institutionalization - Mrs. Geston did not receive any payments from an annuity. Thereafter, NDDHS is not required to allocate a greater share of the resources because they are not needed to achieve the outcome anticipated by Congress.

The District Court's conclusion to the contrary was erroneous and should be reversed.

**C. The District Court Erred When it Used Medicaid Act Provisions Penalizing Some Annuity Purchases by an Institutionalized Spouse as Improper Asset Transfers to Determine that a Community Spouse's Annuity Was Not a Resource**

It appears from its discussion of whether the Geston annuity was income or resources, the District Court conflated the transfer rules governing the purchase of annuities, 42 U.S.C. §1396p(c)(1)(F) & (G), with the resource rules. The same is true for all of the district court decisions cited by the District Court to reach its holding that such an annuity is not a countable resource. *See, e.g., Weatherbee ex rel. Vecchio v. Richman*, 595 F.Supp.2d 607, 617 (W.D. Pa 2009) (Congress did not ring the death knell for otherwise compliant annuities when it enacted the DRA) (Internal quotations omitted). The District Court stated:

[T]he Defecit [sic] Reduction Act provides that an annuity is not to be treated as a transfer of assets for less than fair market value if the state is named as the first remainder beneficiary up to the amount paid on behalf of the institutionalized spouse. 42 U.S.C. §1396p(c)(1)(F). In addition, an annuity will be treated as an asset *unless* the annuity is (1) irrevocable and nonassignable; (2) actuarially sound; and (3) provides for payments in equal amounts during its term with no deferral or balloon payments. 42 U.S.C. §1396p(c)(1)(G)(ii). The Deficit Reduction Act of 2005 also requires the disclosure on the Medicaid application of any annuities held by the community or institutionalized spouse. 42 U.S.C. §1396p(e)(1). Annuities which comply with these requirements are considered qualifying annuities. *See Lopes v. Starkowski*, No. 3:10–CV–307, 2010 WL 3210793, at 5

(D.Conn. Aug. 12, 2010); *see also Jackson v. Selig*, No. 3:10–CV00276, 2010 WL 5346198, at 3 (E.D.Ark. Dec. 22, 2010).

*Geston*, 2012 WL 1409344 at\*9 (emphasis in original). By engrafting the distinct transfer rules onto the rules governing the determination of resources, the District Court, in effect, held that annuities purchased by a community spouse that comply with the transfer rules are “qualifying annuities” that are not assets of the community spouse. However, the transfer rules and the resource counting rules are distinct. As was noted by the Court of Appeals, for example, in *Sable v. Velez*, 388 Fed. App’x. 235, 238 n. 4 (3<sup>rd</sup> Cir. 2010), the transfer provisions of §1396p(c) and the trust provisions of §1396p(d) do not affect each other. “Subsection (d) addresses counting resources for eligibility, whereas subsection (c) addresses punishing sham transactions in which assets are transferred for less than fair market value. Because the two are different, instruments can be relevant under both subsections. For example, annuities are punishable under §§1396p(c)(1)(F) and (G) and can be analyzed as trust-like devices for eligibility.” (Citing POMS §SI 1120.201(G)(2) (listing annuities as trust-like devices). *See also* CMS Letter to State Medicaid Directors, No. SMDL-#06-018, Enclosure (Section 6012; Changes in Medicaid Annuity Rules) (July 27, 2006), CCH Medicare Medicaid Guide, ¶51,673 (attached hereto as part of the Addendum)

(Even though an annuity is not penalized as a transfer for less than fair market value, it must still be considered in determining eligibility, including spousal income and resources, and in the post-eligibility calculation, as appropriate).

The Court of Appeals for the Tenth Circuit is only the latest court to mistakenly conflate the transfer of assets and resource counting eligibility rules and then reach an erroneous conclusion based on the resulting concoction. Earlier this week, the appeals court, overturning a grant of summary judgment by an Oklahoma district court, held that because community spouse Leroy Morris's "annuity met the requirements found in 42 U.S.C. § 1396p(c)(1)(F) and (G)," the state "should therefore have considered the annuity as Mr. Morris' income. And such income would not affect Mrs. Morris's eligibility [under] § 1396r-5(b)(1)." *Morris v. Okla. Dep't of Human Servs*, No. 10-6241, 2012 WL 2689824, at \*7 (10<sup>th</sup> Cir. 2012) (internal quotations omitted). The Court compounded its error by relying additionally on CMS's "Transmittal 64," SMM § 3258.11, *see id.*, at \*7, promulgated before the passage of the DRA, instead of the superseding CMS Letter cited above, issued for the purpose of implementing the DRA.

The District Court's similar construction is not in accordance with the express language of the statutes and is clearly erroneous. First of all, the provisions governing the purchase of annuities contained in the transfer

provisions, by their express terms, apply only to an annuity purchased by an institutionalized individual. *See* 42 U.S.C. §1396p(c)(1)(G) (“an annuity purchased by or on behalf of an annuitant who has applied for medical assistance with respect to nursing facility services,” *i.e.*, the institutionalized individual); *see also* 42 U.S.C. §1396p(c)(1)(F) (An annuity shall be treated as a disposal of an asset for less than fair consideration unless the state is named in the second position *after the community spouse*, as the remainder beneficiary) (emphasis added). These provisions do not apply to an annuity purchased by a community spouse. *Hughes*, 2012 WL 1933702 at\*7. *Cf.* CMS Letter to State Medicaid Directors, *supra* (Unlike the new section 1917(c)(1)(F) which applies to all annuities, section 1396p(c)(1)(G) does not apply to annuities for which the community spouse is the annuitant).

The text of these transfer provisions means only that conforming annuities purchased by institutionalized medicaid applicants are not assets transferred for less than fair consideration. *See* H.R. Conf. Rep. No. 109-362, *reprinted in* 2006 U.S.C.C.A.N. at 90-93 (Annuity purchased by or on behalf of an annuitant that has applied for medical assistance which complies with the requirements will not be treated as a disposal of an asset for less than fair market value).

These annuity provisions were aimed at a specific abuse which utilized annuities with unrealistically long payout terms or balloon payments that were purchased by nursing facility residents to pass those assets onto children. *See, e.g., Bird v. Pa. Dep't of Public Welfare*, 731 A.2d 660 (Pa. Cmwlth. Ct. 1999); *see also* H.R. Conf. Rep. No. 109-362, *reprinted in* 2006 U.S.C.C.A.N. at 90-93 (discussing the intent of the annuity provisions). They were intended by Congress to ensure that all countable resources used to purchase an annuity by an individual in a nursing facility were channeled to the nursing facility to defray the costs, not channeled eventually to his children at the expense of the taxpayer.

As noted, these provisions are inapplicable to annuities purchased by a non-applicant spouse. These annuity provisions are not properly implicated in this appeal. There is absolutely no authority and no cause under the Medicaid Act to construct a “medicaid qualifying annuity” which a community spouse may purchase.

More importantly, the House Conference Report makes clear, contrary to the District Court and the *Weatherbee* court construction, the new annuity provision of subsection (e), which was added by the DRA, Pub. L. 109-171, Sec. 6012(a), 42 U.S.C. §1396p(e), along with the annuity transfer provisions added by the DRA, Pub. L. 109-171, §§6012(b),(c), was specifically intended to allow a

state to deny eligibility for Medicaid based on the income or resources derived from an annuity.

Both courts, in addressing the states' claims that subsection (e)(4) allows states to deny medicaid on the basis of income and resources derived from an annuity, emphasized in their analysis the introductory phrase "Nothing in this subsection" to limit the reach of the provision by divorcing it from the other two provisions. *See, e.g., Weatherbee*, 595 F.Supp.2d at 616 (The provision "does not purport to alter the well-established rule that 'no income of the community spouse shall be deemed available to the institutionalized spouse.'"); *see supra*, discussion Part II.B. However, the House Conference Report makes clear that all of the annuity provisions together were aimed at the abusive use of annuities. Congress, by including (e)(4) in the amendments, intended it to be applied more broadly to all annuities, including those purchased by the community spouse, to give states broad flexibility to deny eligibility where their use was deemed to be abusive. *See* H.R. Conf. Rep.109-362, *reprinted in* U.S.C.C.A.N. at 92 ("Secretary may provide guidance to states on categories of arm's length transactions....The House bill would not prevent a state from denying Medicaid eligibility based on the income or resources derived from an annuity.) (House Bill); and *id.* at 93 ("Secretary may provide guidance to states on categories of transactions that may be treated as a

transfer of assets for less than fair market value. *States may deny eligibility for medical assistance for an individual based upon the income or resources derived from an annuity.*”) (Conference Agreement) (emphasis added) describing 42 U.S.C. §1396p(e)(3),(4), added by DRA, Pub. L. 109-171, §6012(a) and 42 U.S.C. §1396p(c)(1)(F), (G), added by DRA, Pub. L. 109-171, §§6012(b),(c).

Based upon the foregoing, NDDHS correctly denied eligibility in this case based upon the income and resources derived from the annuity. Furthermore, the District Court’s holding, that the requirements of N.D.C.C. §50-24.1-02.8(7)(b), when compared with the requirements of the transfer annuity provisions, 42 U.S.C. §1396p(c)(1)(F) & (G), were more restrictive and therefore preempted, was clearly erroneous because the state statute applies to annuities purchased by the non-applicant spouse; whereas the requirements of the annuity transfer provisions apply only to annuities purchased by an institutionalized medicaid-applicant. The Court of Appeals for the Third Circuit observed that, “using the no more restrictive rule . . . without consideration of Congress’ underlying intent is like using a yardstick without knowing where to start measuring.” *Lewis v. Alexander*, No. 11-3439, 2012 WL 2334322, at \*16 n. 21. Here, the District Court used the wrong yardstick entirely.

**D. The District Court Erred When it Held N.D.C.C. §50-24.1-02.8(7)(b), Which is Consistent with the Intent of Congress, Was More Restrictive Than and Preempted by the Federal Law**

When deciding whether a state statute is more restrictive than, and therefore preempted by, the federal law, the Court of Appeals for the Third Circuit, noted “[T]he basic principles of preemption analysis are familiar. First, the intent of Congress is the ultimate touchstone of preemption analysis. Second, we start with the basic assumption that Congress did not intend to displace state law. Third, when we are dealing with Spending Clause legislation, we require Congress to speak unambiguously because such legislation is in the nature of a contract...” *Lewis v. Alexander, id.* at \*15 (internal quotations and citations omitted).

As discussed above, the DRA amended the spousal impoverishment provisions by adding paragraph (6) to 42 U.S.C. §1396r-5(d) to make the “income first rule” a mandatory part of the Medicaid Act. Prior to this change, states were free to allocate a greater share of the resources to a community spouse, without regard to her husband’s income, if, but only if, such resources were necessary to generate income to achieve the MMMNA. *See Blumer*, 534 U.S. at 484 for a discussion of the “resource first rule.” Now, Congress has further restricted the rules governing the allocation of resources to the community spouse by requiring

the state first to consider the available income of the institutionalized spouse before allocating a greater share of the resources to the community spouse. The new rule provides:

(6) Application of “income first” rule to revision of community spouse resource allowance

For purposes of this subsection and subsections (c) and (e) of this section, a State must consider that all income of the institutionalized spouse that could be made available to a community spouse, in accordance with the calculation of the community spouse monthly income allowance under this subsection, has been made available before the State allocates to the community spouse an amount of resources adequate to provide the difference between the minimum monthly maintenance needs allowance [MMMNA] and all income available to the community spouse.

42 U.S.C. §1396r-5(d)(6). Whether the prior law was or was not ambiguous, this rule now is clear and unambiguous. No greater resources may be allocated to the community spouse, including “an annuity or other income producing asset,” H.R. Conf. Rep. 109-362, *reprinted in* 2006 U.S.C.C.A.N. at 95, where they are not needed to raise her income, including her spouse’s income, to the minimum monthly allowance.

N.D.C.C. §50-24.1-02.8(7)(b) was designed to implement this change. It provides:

The monthly payments from all annuities owned by the purchaser that comply with this subsection do not exceed the minimum monthly

maintenance needs allowance for a community spouse of the maximum amount allowed pursuant to 42 U.S.C. 1396r-5 and, at the time of application for benefits under this chapter, the total combined income from all sources of the purchaser and the purchaser's spouse, or the annuitant and the annuitant's spouse, does not exceed one hundred fifty percent of the minimum monthly maintenance needs allowance [MMMNA] allowed for a community spouse of the maximum amount allowed pursuant to 42 U.S.C. 1396r-5; ...

N.D.C.C. §50-24.1-02.8(7)(b). The District Court correctly noted this provision places limits on how much monthly income may be generated by an annuity(ies) in relation to the MMMNA. This provision permits a couple to purchase annuities using their countable resources provided the payments from the annuity itself do not exceed the *maximum* MMMNA and, when combined with the total income of the couple, do not exceed 150% of the *maximum* MMMNA. If the annuity payments, when combined with couple's combined income, do not exceed the 150% of the limit set by Congress, NDDHS does not treat the annuity as a resource.

Thus, the state statute in effect permits an allocation of the resources to the community spouse to generate income greater than that required under federal law by 50%. Nevertheless, consistent with the new, more restrictive resource limitations established by Congress, the statute permits NDDHS to treat such annuities as countable resources when determining the institutionalized spouse's

initial eligibility, where those resources are not needed by, and not required by NDDHS to be allocated to, the community spouse under the federal law.

Because a state is not required by federal law to allocate a greater share of the couple's resources to the community spouse when those resources are not needed to generate income to achieve the MMMNA, the North Dakota state statute is less restrictive than the federal law. However, consistent with the intent of Congress, it prevents higher income couples from sheltering a greater share of their resources beyond the limits set by Congress.

Thus, it is clear that the District Court's holding preempting the state law was clearly erroneous because N.D.C.C. §50-24.1-02.8(7)(b) is consistent with the unambiguous intent of Congress.

### **III. THE DISTRICT COURT ERRED BY FAILING TO RECOGNIZE THAT AN ANNUITY IS A TRUST-LIKE DEVICE AND AS SUCH IS A COUNTABLE RESOURCE UNDER MEDICAID LAW**

As explained above, the annuity purchased by Mrs. Geston is properly considered a countable resource under the general rules applicable to assets. Even if it were not, however, the annuity would have been countable under the special trust counting rules of the Medicaid Act because it is a "trust-like device" under the Act and the accompanying POMS sections. *See Sable*, 388 Fed. App'x. at 238.

Before 1999, many Medicaid applicants who would not otherwise qualify for assistance put their excess funds beyond the reach of the standard resource counting rules by placing them into irrevocable trusts. *Id.* at 237-238. Congress effectively ended this practice by establishing separate, stricter rules for trusts providing that even irrevocable trusts must be included in calculations of countable resources, *id.*, 42 U.S.C. §1396p(d), and authorizing such treatment for “trust-like devices,” *see* POMS §SI 01120.201.G.1.

Annuities are recognized as trust-like devices. *See* POMS §SI 01120.201.G.2 (Listing examples of trust-like devices including annuities); *Sable*, 388 Fed. App’x. at 238 (annuities can be analyzed as trust-like devices for purposes of determining eligibility). Indeed, Congress clearly understood the potential for annuities to be abused in the manner that trusts had been, expressly granting the Secretary the authority to *require* all states to apply the mandatory trust counting rules to annuities. 42 U.S.C. §1396p(d)(6).

The Court of Appeals for the Third Circuit has discussed a state’s authority to analyze a trust-like financial instrument used by families to evade Medicaid financial requirements – in *Sable*, promissory notes given to children by their parents – as a “trust-like device”. *Sable v. Velez*, Civ. No. 09-2813, 2009 WL 3379939 (D.N.J. 2009) *vacated and remanded*, 388 Fed. App’x. 235 (3<sup>rd</sup> Cir.

2010); 2010 WL 5140004 (D.N.J. 2010) *aff'd* 437 Fed. App'x. 73 (3<sup>rd</sup> Cir. 2011). Observing indications that the note, like the annuity in the instant case, bore indicia of “artifice designed to provide the [institutionalized spouse] with undeserved Medicaid,” *Sable II*, 2010 WL 5140004 at\*2 n.4, the Court agreed that “there is nothing in the Medicaid Act that forbids a state from instead analyzing a promissory note as a trust-like device if the facts warrant such an analysis,” provided the result is consistent with the intent of Congress under the Medicaid Act. *Sable I*, 388 Fed. App'x at 238 (quotation omitted). Again, it is difficult to see why Congress would “assault” other financial instruments but erect a citadel around the single premium annuity.

The decision of the Court of Appeals for the Third Circuit in *Johnson v. Guhl*, 357 F.3d 403 (3<sup>rd</sup> Cir. 2004) throws this implausibility into even greater relief. In *Johnson*, the Court was called upon to determine whether “community spouse annuity trusts” (CSAT) were countable resources under the Medicaid Act. CSAT’s were described by the Court as irrevocable trusts which “are designed to provide a stream of annuity payments to the community spouse for the duration of his or her life.” *Id.* at 406.

The Court turned to the following provision of the Medicaid Act, dealing with irrevocable trusts:

In the case of an irrevocable trust, if there are any circumstances under which payment from the trust could be made to or for the benefit of the individual, the portion of the corpus from which, or the income on the corpus from which, payment to the individual could be made shall be considered resources available to the individual...

42 U.S.C. §1396p(d)(3)(B)(I). Based upon the foregoing, the Court concluded easily that the payments from such trusts were comprised of both corpus and income and that the corpus of such trusts were countable.

Noting that commercial annuities such as that purchased by Mrs. Geston were not before it, the Court expressly declined to consider whether they are countable under the Medicaid Act. The similarity between CSATs and commercial annuities, however, did not escape its notice:

Like CSATs, commercial annuities provide a stream of payments (in this context, to the community spouse) for a fixed term of years. However, they are administered differently from CSATs. Whereas the corpus of a CSAT is administered by a trustee, who is often related to the elderly couple, the “corpus” of a commercial annuity is paid to an unrelated third party (typically an insurance company) to purchase the annuity. The annuity company then makes payments to the community spouse from a combination of principal and income from that corpus.

*Johnson*, 357 F.3d at 406 n. 3.

Nothing in the minor distinctions between a “CSAT” and a commercial annuity even begins to justify the completely opposing results reached by the *Johnson* Court and the District Court in the instant case. Indeed, there is nothing

in the District Court or similar cases to prevent a community spouse from structuring an annuity like a CSAT, as a private arrangement with children or other family members.

Ironically, the *James v. Richman* case concerning a commercial annuity and relied upon by the District Court and others in reaching a result opposite to *Johnson*, was also decided by the Court of Appeals for the Third Circuit. This Court should decline to perpetuate that Court's lapse in *James* and overturn the decision of the District Court.

NDDHS determined the Geston annuity was a resource with a value equal to the corpus of the total of all of the outstanding payments due. That determination is consistent with the trust provisions of the Medicaid Act and the underlying intent of Congress. The District Court's holding to the contrary was error.

**IV. THE DISTRICT COURT ERRED BY FAILING TO RECOGNIZE A NON-QUALIFIED ANNUITY IS A RESOURCE AND THAT THE PAYMENTS ARE COMPRISED ALMOST ENTIRELY OF THE RETURN OF THE ORIGINAL PREMIUM COMPRISED OF COUNTABLE RESOURCES**

“In assessing the appellant's argument, we are guided by the fundamental principle that – put bluntly – the law is not an ass.”

*Donahoe v. Donahoe*, No. 91-C-2163, slip op. at 4 (W.Va. May 12, 2006) (citing George Chapman, *Revenge for Honor*, Act III, Scene ii (1654) and Charles Dickens, *Oliver Twist*, ch. 51 (1837) in declining

to hold appellee in contempt for failing to make payments on a non-existent debt).

The Geston annuity was purchased with \$400,000 of non-qualified, countable resources. It pays \$2,734.65 monthly for 13 years, for a total of \$426,605.40. In holding that the annuity was not a resource, the Court ignored the fact the payments themselves were cash, which could be used to pay for Mr. Geston's support and care in the nursing facility and were, in reality, comprised almost entirely of a return of the original premium, which itself was comprised of countable resources.

Section 72 of the Internal Revenue Code, 26 U.S.C. §72, establishes comprehensive rules which govern the treatment of annuities for purposes of determining what portion of an annuity is to be included in a taxpayer's gross income for tax purposes. The statute defines an "exclusion ratio" which describes that portion of an annuity which is considered to be income for tax purposes, and the portion which is considered to be a return of the original investment. It provides, "Gross income does not include that part of any amount received as an annuity under an annuity ...contract which bears the same ratio to such amount as the investment in the contract (as of the annuity starting date) bears to the expected return under the contract (as of such date). 26 U.S.C. §72(b).

Similarly, “interest,” which is considered to be unearned income under the Medicaid Act, is defined under the regulations as a return on capital investments such as stocks, bonds, or savings accounts. 20 C.F.R. §416.1121(c). Performing the basic arithmetic on the terms of the Geston contract under the IRS formula, the annuity pays an average annual internal rate of return of 0.5% simple interest on the original investment and nearly 94% of the payments are excluded from gross income.

The return on the investment, by itself, calls into question the legitimacy of the entire transaction, even in this current low interest rate environment, and makes crystal clear that the transaction served no investment purpose other than to shield a portion of the original corpus of the Gestons’ estate. *See, e.g.*, SMM §3258.9(B) (When determining whether an annuity is a transfer for less than fair consideration, “in order to avoid penalizing annuities validly purchased as part of a retirement plan but to capture those annuities which abusively shelter assets, a determination must be made with regard to the ultimate purpose of the annuity”).

Thus, under the Internal Revenue Code, under our commonly accepted principles of accounting, our common understanding of economics, and under the Medicaid Act, an average of \$2,564.10 of the monthly payments Mrs. Geston receives over the term of the contract is the return of her initial investment of

countable resources. Only an average of \$170.55 per month over the term of the contract, representing the average internal rate of return on the original investment, can be considered “interest” income of Carolyn Geston. 20 C.F.R. §416.1121(c). There is no principled reason under the Medicaid Act why determinations of what constitutes “income” should be divorced from reality.

At the time Mr. Geston applied for Medicaid, the total of the payments remaining on the contract equaled \$383,592.10. At most, \$23,922.87 may be considered income, the balance, \$359,670, represents the original investment. This amount exceeds the resource limits established by Congress under MCCA. The District Court erred in holding otherwise.

**V. THE DISTRICT COURT ERRED BY FAILING TO RECOGNIZE THAT THE ANTI-ASSIGNMENT PROVISIONS IN THE ANNUITY ARE UNENFORCEABLE AS CONTRARY TO PUBLIC POLICY UNDER NORTH DAKOTA LAW**

Citing 20 CFR §416.1201(a)(1), POMS §SI 01110.115, and *James v. Richman, id.* the District Court held that a community spouse’s annuity can be a resource, and thus countable, if and only if the spouse has the “legal right, authority, or power,” and not solely the de facto ability, to sell the annuity.<sup>8</sup>

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<sup>8</sup> Although the POMS section requires the spouse to have a “legal right” to liquidate, this flatly contradicts the federal regulation which controls.

*Geston*, 2012 WL 1409344 at \*13. It is SSA policy, continued the court, to look at the terms of the annuity itself to determine whether they curtail the spouse's legal wherewithal. *Id.* at \*12. Finding several terms in Mrs. Geston's annuity requiring her to retain the annuity in her own name, the court concluded that Mrs. Geston lacked the requisite legal right, authority or power to liquidate it such that the annuity could not be a resource. *Id.* at \*15.

Under the court's analysis, then, cash – an incontrovertibly countable resource – used to purchase an otherwise freely marketable annuity – also a countable resource – ceases to be a resource at all as long as the annuity declares itself unmarketable. Despite the Court's protestation that "Federal law controls under the[se] circumstances," *id.* its analysis exalts an anti-assignment clause above Congress' complex scheme to reserve taxpayer funded long term care for the truly needy while preventing the impoverishment of the spouse remaining in the community. Perhaps recognizing this absurdity, the District Court threw up its hands, concluding resignedly that "if there is a 'loophole,' the closing of that 'loophole' is best left for Congress to address." *Id.* at \*18. (Quotations in original)

In so doing, however, the District Court wholly ignored the role of state law – a role Congress not only tolerates in light of the nature of Medicaid as a federal-state

cooperative program, but expects will be fully operational when it enacts provisions of Medicaid law that implicate matters traditionally regulated by the state. “After all,” as the Court of Appeals for the Third Circuit recently observed in overturning a district court order striking down a provision of Pennsylvania law, “Congress did not pass a federal body of trust law, estate law, or property law when enacting Medicaid. It relied and continues to rely on state laws governing such issues.” *Lewis v. Alexander*, 2012 WL 2334322 at \*15. Federal law may govern how certain financial instruments are treated for purposes of determining eligibility for Medicaid, but it does not resemble some sort of “diplomatic immunity” that shields them from any and all obligation to comply with ordinary state laws. Instead, “States retain their traditional regulatory authority” over such matters. *Lewis v. Alexander, id.*

Accordingly, the status of the anti-assignment provisions in the annuity contract under North Dakota law is essential to the question whether Mrs. Geston truly lacked the “legal right, authority, or power” to turn it into a liquid asset. North Dakota statutes, codes, and case law make it abundantly clear that these provisions would not effectively bar Mrs. Geston from turning her annuity into a liquid asset.

Indeed, the issue presented by the instant case – whether a North Dakota court would find anti-assignment provisions in an annuity contract sufficient to defeat Mrs. Geston’s ability to lawfully generate liquid assets from it – has been definitively

answered in the negative by the North Dakota Supreme Court. In *Estate of Gross v. North Dakota Department of Human Services*, the Supreme Court ratified the Department's denial of the institutionalized George Gross's application for Medicaid on the ground that a non-assignable annuity in the name of Mrs. Gross, a community spouse, constituted excess resources. *Gross*, 687 N.W.2d at 466. Defining an annuity as "a 'payment of a fixed sum of money at regular intervals of time,'" *id.* (citation omitted), the Court relied upon a North Dakota law that establishes "a presumption that a holder's interest in a contractual right to receive money payments is saleable." *Id.* (citing N.D. Admin Code §75-02-02.1-30(1)). The holder can defeat this presumption by showing that she has made a good faith effort to sell and has found no buyer willing to pay at least 75 percent of the fair market value of the payment stream. *Id.* (citing N.D. Admin Code §§75-02-02.1-01(13), 75-02-02.1-01(24), 75-02-02.1-30). Citing evidence of a "factors market" for such payments and of a lack of good faith effort on Mrs. Gross's part, the Court held that "the annuity was a countable asset for purposes of George Gross's medicaid eligibility." *Id.*

In so doing, the Court rejected the contention of Mr. Gross's Estate that "because the annuity was not assignable, the income stream from the annuity could not be sold" and the annuity was not a countable asset. *Id.* The Gross case demonstrates, therefore, that under North Dakota law, the anti-assignment provisions

in an annuity – such as Mrs. Geston’s – are insufficient to shield the annuity from being considered a countable asset. *See id.*

Furthermore, under North Dakota law, the anti-assignment provisions of the annuity would be unenforceable on the basis of public policy. A North Dakota statute provides that a contract provision is unlawful if it is (1) contrary to an express provision of law; (2) contrary to the policy of express law, though not expressly prohibited; or (3) otherwise contrary to good morals. N.D.C.C. §9-08-01. Elucidating upon the second category, “contrary to public policy,” the Supreme Court of North Dakota defined “public policy” as “a principle of law whereby contracts will not be enforced if they have a tendency to be injurious to the public or against the public good.” *Meyer v. Hawkinson*, 626 N.W.2d 262, 267 (N.D. 2001). A contract is against public policy in North Dakota if a state statute or the constitution so provides, *see, e.g.*, N.D.C.C. §9-08-02 (“contracts that have for their object exemption of persons from responsibility for willful violation of the law are against public policy”), or when it “is inconsistent with fair and honorable dealing, contrary to sound policy, and offensive to good morals.” *Meyer*, 626 N.W.2d at 267.

In *Meyer v. Hawkinson*, the Supreme Court invalidated an agreement among former friends to split the proceeds of one friend’s winning lottery ticket on the ground that although the agreement itself was not unlawful, having been made

outside of the state, “public policy in North Dakota runs consistently against lotteries.” *Id.* at 268. The Supreme Court noted further that it had “refused to enforce a contract, as against public policy, when the contract defeated the express purposes of a statute.” *Id.* (citing *Schollmeyer v. Saxowsky*, 211 N.W.2d 377, 386 (N.D. 1973)). In *Schollmeyer*, the court “on the basis of public policy . . . refused to enforce [a] contractual provision because it was contrary to the spirit of [a state consumer protection statute] and defeated the statute’s purposes. . . .” 211 N.W.2d at 386.

It is clearly the public policy of North Dakota that taxpayer-funded long-term care be reserved for the truly needy and not provided to persons who have sufficient assets to pay for such care under state and federal law, but have chosen instead to purchase a financial instrument like a purportedly resource-hiding annuity and reap its benefits throughout the years. The North Dakota Legislative Assembly has enacted legislation expressing the intent that “medical assistance be paid for any [financially eligible] person who . . . [h]as not at any time before or after making application for medical assistance made an assignment or transfer of property for the purpose of rendering that person eligible for assistance under this chapter.” N.D.C.C. § 50-24.1-02. Moreover, the legislature has defined the

“phrase ‘assignment or transfer’ [to] include actions or failures to act which effect a renunciation or disclaimer of any interest which the applicant or recipient might otherwise assert or have asserted, or which serve to reduce the

amounts which an applicant or recipient might otherwise claim from a decedent's estate, a trust or similar device, or a person obligated by law to furnish support to the applicant or recipient.”

*Id.*

Further evidence of North Dakota’s public policy includes the regulations interpreted by the North Dakota Supreme Court in the *Gross* case, as discussed above, as well as by the statute at issue in the instant case, NDCC §50-24.1-02.8(7), which treats annuities purchased by higher income couples as resources available to help pay for long-term care. It is almost by definition that in purportedly redistributing private costs from those who can afford to bear them onto the taxpayers of North Dakota, the anti-assignment provisions in Mrs. Geston’s and similar annuities are “injurious to the public” and “against the public good.”

Accordingly, Mrs. Geston had the power to liquidate the annuity under North Dakota law and the District Court’s failure to treat the annuity as a resource under N.D.C.C. §50-24.1-02.8(7) was reversible error.

## VI. CONCLUSION

For all the forgoing reasons, the District Court's judgment should be reversed.

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## **CERTIFICATE OF COMPLIANCE**

I certify that the original Brief complies with the type-volume limitation provided in Fed. R. App. P. 32(a)(7)(B) and 8th Cir. R. 28(A). This brief contains 12,402 words in Times New Roman 14 point proportional type. The word processing software used to prepare this brief was Corel WordPerfect with Windows XP as the operating system. The brief and addendum have been scanned for and are free of virus.

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**IN THE UNITED STATES COURT OF APPEALS  
FOR THE EIGHTH CIRCUIT**

|                                       |   |                  |
|---------------------------------------|---|------------------|
| CAROL K. OLSON, in her official       | : |                  |
| capacity as Executive Director of the | : |                  |
| North Dakota Department of            | : |                  |
| Human Services                        | : |                  |
| Appellant,                            | : |                  |
|                                       | : | Case No. 12-2224 |
| vs.                                   | : |                  |
|                                       | : |                  |
| JOHN AND CAROLYN GESTON               | : |                  |
| Appellees.                            | : |                  |

**CERTIFICATE OF SERVICE**

I certify that the original Brief was filed electronically with the Clerk of the Court using the ECF system on July 12, 2012 and electronic notice of the filing will be emailed to the attorneys for the appellees as follows:

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