

**California Department of Health Care Services  
Proposed Trailer Bill Legislation**

**Special Needs Trust Recovery**

**FACT SHEET**

**Background on the topic (prior legislation, previous budget action, and related matters).**

The Third Party Liability and Recovery Division of the Department of Health Care Services (DHCS) is responsible for recovery of Medi-Cal expenditures where a Medi-Cal beneficiary has a claim against a liable third party.

Existing law authorizes courts to establish a special needs trust (SNT) for minors and disabled individuals using the proceeds from a personal injury settlement, judgment, or award. (See Prob. Code, § 3600 et seq.). SNT beneficiaries tend to be gravely disabled and they often recover multi-million dollar settlements. During the existence of these trusts, Medi-Cal, in many instances, continues to pay for the majority of the beneficiary's care. Trust assets are to be used only to meet the beneficiary's special needs, which are items and services that public benefit programs, such as Medi-Cal, do not cover.

Federal law is clear that the trust corpus shall be considered an available resource for purposes of Medicaid eligibility (42 U.S.C. §1396p(d)). However, Section 1396p(d)(4)(A) creates an exception to this rule by allowing a disabled individual under age 65 to remain eligible for Medicaid benefits, despite having considerable resources that would otherwise render the individual ineligible for such benefits. The Congressional intent behind Section 1396p(d)(4)(A) is to permit continued Medicaid eligibility as long as the state is reimbursed, upon the individual's death and from any remaining trust assets, for Medicaid expenditures made on behalf of the individual.

Existing law requires DHCS to seek recovery of Medi-Cal expenditures from the estates of deceased Medi-Cal beneficiaries. Estate recovery (ER) is limited to services paid on or after the beneficiary's 55<sup>th</sup> birthday, unless the beneficiary was an inpatient in a nursing facility prior to age 55. When the decedent is survived by a spouse, recovery is deferred until after the spouse's death. Recovery is altogether exempt when the decedent is survived by a child under age 21, or a child of any age who is blind or disabled according to federal law.

In *Shewry v. Arnold* (2004) 125 Cal.App.4th 186 (*Arnold*), the Department of Health Services (DHS - now known as DHCS) asserted a claim for Medi-Cal reimbursement against a decedent's SNT. The Medi-Cal decedent's disabled daughter invoked Welfare and Institutions Code Section 14009.5, which governs ER, and argued that DHS was barred from recovering against the SNT because she fell within the "surviving disabled child" exemption of Section 14009.5. By focusing on the language in Probate Code Section 3605(b) that provides that the trust property, upon trust termination, is considered "part of the beneficiary's estate," the court saw no reason why SNT recovery

should be treated any differently than ER. Consequently, the court agreed with the daughter's argument and denied DHS's recovery.

Prior to *Arnold*, SNT recovery and ER were always treated differently, i.e., governed by separate and distinct law. However, since the issuance of the *Arnold* decision, attorneys have successfully defeated DHCS's SNT claims by persuading superior courts in California to extend *Arnold* to all of the ER exemptions listed in Section 14009.5. (Federal ER law also provides for these exemptions. See 42 U.S.C. § 1396p(b)). DHCS is currently losing approximately 90 percent of its SNT claims because courts are applying ER law to SNT recovery. In fiscal year 2009-10, DHCS estimates that this will result in lost revenue of approximately \$3.5 million total funds.

Recently, attorneys have attempted to apply ER regulations to further defeat SNT recovery. For example, ER excludes In-Home Supportive Services (IHSS) from its claims. Attorneys are now challenging the inclusion of IHSS in SNT claims. The majority of SNT claims include IHSS. If courts allow ER regulations to govern SNT recovery, in addition to the ER statutory exemptions, there will continue to be a significant loss of revenue to the state.

Because state law (Prob. Code, § 3605 – effective January 1, 1993) was enacted prior to the federal statute (42 U.S.C. § 1396p(d)(4)(A) – effective October 1993), state law does not follow federal law nearly as well as it could. Although neither statute contains any provisions barring SNT recovery, the *Arnold* decision has caused California law to conflict with federal law by allowing ER law and its claims exemption provisions to govern SNT recovery. Since federal law mandates that the state be reimbursed at trust termination from any remaining trust assets, failure to comply with federal law could make DHCS, and the General Fund (GF), liable to the Centers for Medicare and Medicaid Services (CMS) for lost reimbursement.

In 1997, the federal court in *Dalzin v. Belshe* (N.D. Cal. 1997) 993 F.Supp. 732 (*Dalzin*) determined that the provisions of Section 14009.5(b)(3), regarding "proportionate share" recovery, violated federal law. Prior to *Dalzin*, only the portion of an estate related to a minor, blind, or permanently disabled heir was exempted by DHCS. The *Dalzin* injunction exempted the entire estate regardless of other heirs' exempt status. Although DHCS has complied with the *Dalzin* order since its issuance in 1997, subdivision (b)(3) of Section 14009.5 was never formally eliminated from the statute. In light of the proposed amendments to state law to address the problem with SNTs, it is an appropriate opportunity to also delete the invalid provisions of subdivision (b)(3).

**Why is this change needed (i.e., what problem is the language trying to address)?** Attorneys are successfully invoking ER statutes and exemptions to circumvent Medi-Cal recovery from SNTs. State and federal law authorize the creation of an SNT, but federal law also explicitly requires that the state be reimbursed from all remaining trust assets upon trust termination. Under current state law, when an SNT is terminated, the trust property becomes part of the beneficiary's estate. Following *Arnold*, California courts have allowed, and are continuing to allow, ER statutes to govern SNT recovery, and in those instances where an ER exemption is found to exist, SNT recovery has

been completely defeated. The *Arnold* case has caused state law to conflict with the mandate in federal law that the State be reimbursed at trust termination. In addition, per *Dalzin*, state statutory provisions regarding proportionate share recovery were determined to violate federal law. In both respects, this proposed legislation will conform state law to federal law.

A legislative remedy is necessary to clarify that SNT recovery is not governed by ER provisions, which will prevent future lost SNT recoveries. Legislation will also delete invalid provisions of current law regarding proportionate share recovery.

### **Summary of arguments in support.**

- Federal law mandates that the state be reimbursed at trust termination (from any remaining trust assets). Legislation is needed to bring state law into compliance with federal law regarding SNT recovery. A statutory change is the only solution to remove the conflict between state and federal law.
- Failure to comply with federal law could make DHCS, and the GF, liable to CMS for lost SNT recoveries.
- *Arnold* is based on existing language in Probate Code Section 3605(b). There are no other alternative solutions that will conform state law to federal law and prevent the application of ER exemptions, listed in Section 14009.5, to SNT recovery.
- Attorneys are applying ER statutory exemptions and regulations to SNT recovery. Statutory amendments are necessary to protect the state from lost recoveries and potential liabilities.
- No additional resources are needed to implement this legislation. An increase to the GF is expected once SNT recovery is restored.
- Current state law regarding proportionate share recoveries is invalid and inconsistent with DHCS practices that conform to federal law and the *Dalzin* order.

### **Potential for opposition, if yes, why.**

Unknown. This trailer bill language was proposed last year. At that time, DHCS met with advocate groups, who did not express either support or strong opposition; however, they acknowledged DHCS's concerns with the *Arnold* decision, and expressed interest in reviewing the proposed language when released. The California Advocates for Nursing Home Reform (CANHR) voiced concerns with portions of the proposal and suggested that the issue be addressed in a policy bill. CANHR requested that, in accordance with *Dalzin*, DHCS eliminate subdivision (b)(3) of Section 14009.5 regarding proportionate share recovery. DHCS has included deletion of subdivision (b)(3) as part of this proposal. Other requested modifications exceeded DHCS's original proposal.

Attorneys representing estate heirs will likely oppose this proposal. In the absence of statute that resolves the problem of courts' application of *Arnold* in recovery from SNTs, attorneys will continue to benefit from successfully defeating DHCS's recovery claims.

**Is there a BCP associated with this language (yes or no)?**  
No