

# A tale about a promissory note journey

## *How the Florida Elder Law Bar successfully resolved a DRA implementation issue*

by Howard S. Krooks



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We've all been there. Waiting to see how our state would implement the DRA. In some cases, implementation was accomplished quickly. In others, this was not the case until very recently. Still other states await implementation, even to this day. In my case, the journey was even more interesting since I practice in two states, New York and Florida. The similarities and differences between New York and Florida mark a poignant contrast in how different states can approach the very same issue, with a federal statute purportedly providing uniformity and a federal agency, CMS, purportedly doing the same. This article details the journey the Florida Elder Law Bar traveled in relation to the treatment of promissory notes in a post-DRA world. The story of Florida's treatment of promissory notes is compelling, not only because it has a happy ending from an advocacy standpoint, but because it could serve as a useful model that we hope will be replicated in other states.

The story begins in December 2004, when the Florida Department of Children and Families (our Medicaid agency) issued a transmittal (Transmittal No. P-04-10-0017), as amended by Transmittal No. 04-12-0020, rendering all promissory notes countable resources, the effective date of which was delayed from Dec. 22, 2004, through Feb. 28, 2005. A statement made in the transmittal made it clear that this was intended to constitute a total prohibition on the use of promissory notes in Florida: "They will be countable assets to the individual (lender) in the amount of their equity value. The liquidity

of a promissory note, loan or mortgage will have no effect on the asset's countability." The use of promissory notes came to a screeching halt in Florida long-term care planning on Mar. 1, 2005.

Then along came the federal DRA statute on Feb. 8, 2006. Among many other things (some not so clearly stated), the DRA delineated clear parameters setting forth the requirements for how a promissory note was to be structured in order for the note not to be considered an uncompensated transfer of assets resulting in a penalty period (i.e., level payments, actuarially sound, no deferred payments, no self-canceling notes, etc.). The Florida Elder Law Bar thought at the time that these new parameters would supersede the prior transmittal treating all notes as countable resources. Much to our surprise (or maybe it should have come as no surprise), the Medicaid agency stated in informal discussions that even a so-called DRA compliant note would be considered a countable resource for Medicaid eligibility purposes. Thus, we were left with the possibility of having a DRA compliant note, so no transfer of assets penalty would apply, but the entire value of the note would be considered an available resource. Thus, the use of notes in long-term care planning remained nonexistent in Florida.

While this was going on in Florida, New York had implemented the DRA effective Aug. 1, 2006, and the use of notes was subsequently challenged in numerous fair hearing decisions. A similar issue was raised in at least some of these cases regarding the question of whether a note was a countable resource. The appellants argued that it was not, while the New York State Department of Social Services argued, among other things, that there was a secondary

market for the notes and, therefore, the note should be countable as a resource for Medicaid purposes. This argument was struck down in the various published decisions, so DRA compliant notes could be used in New York, and the value of the note would not constitute an available resource for Medicaid purposes. This was of particular importance in New York, where a partial return of funds was not allowed per the administrative directive (06 OMM/ADM-5) issued by the Department of Social Services implementing the DRA.<sup>1</sup>

About a year ago, I was asked to chair the DRA Task Force for NAELA to address some of the implementation issues being experienced around the country and to work with CMS in securing a clarifying pronouncement regarding certain issues that remained unclear post DRA. This work is ongoing, and I am sure you will hear more about the work of the task force since a meeting with CMS is being planned as I write this piece. As part of the work of the DRA Task Force, we looked at the question of how promissory notes should be treated post DRA and the varying experiences of the states on this issue.<sup>2</sup> I was convinced that Florida's treatment of notes was not correct in light of the New York experience, the SSI POMS and the *James v. Richman* line of cases from the Third Circuit.

So, with this backdrop, let's return to Florida and see what happened to cause a change in Medicaid's treatment of notes. The Florida Elder Law Bar comprises primarily the Academy of Florida Elder Law Attorneys (AFELA)<sup>3</sup> and The Florida Bar Elder Law Section.<sup>4</sup> These two groups have worked side by side for about six years through their Joint Public Policy Task Force, a collection of elder law attorneys from both

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## Promissory note journey

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groups that work toward achieving positive change regarding a broad range of policy issues throughout the state.<sup>5</sup> The task force also works with a lobbyist, an administrative law attorney, a governmental consultant and a public relations specialist, all of whom are paid individuals through funding that is contributed by AFE-LA and Elder Law Section members. Needless to say, DRA implementation is one of many issues the task force has been working on since Feb. 8, 2006. There is a phone call of task force members every Thursday to discuss progress and strategy. Florida implemented the DRA through formal adoption of two rules (Nov. 1, 2007, and Dec. 24, 2009), the publication of one transmittal (Oct. 31, 2007) and through various changes to its Medicaid Manual (April 2009, July 2009, October 2009 and January 2010). Many issues were addressed in these various rules, transmittals, etc. But one issue remained unresolved, and that is the way Florida Medicaid treated DRA compliant promissory notes. Although Florida allows for a partial return of funds to reduce a penalty period, the question about the

countability of DRA compliant notes continued to weigh on the minds of the task force members since it did not seem consistent with federal SSI law, which provides for a rebuttable presumption that the note could be sold.

There were other issues as well that required our attention. For example, we were working on a variety of challenges to Medicaid's implementation of the DRA outside of the promissory note issue. In particular, Florida's attempted retroactive implementation of a 60-month lookback period was the cause of great concern. Through discussions with the assistant general counsel at the Department of Children and Families and others, the task force was successful in having the 60-month lookback period applied prospectively only, and this was one of the major changes contained in the recently adopted Dec. 24, 2009, rule. We are also challenging Medicaid's casual approach to effectuating change through Medicaid Manual revisions, none of which followed basic principles of administrative law (i.e., publication, public comment, hearing, etc.) before being implemented. In fact, our administrative law attorney has submitted to Medicaid a draft of a petition challenging the Medicaid Manual revisions as a violation of

the state's Administrative Procedure Act. The task force is waiting to hear back from Medicaid as to whether it will publish such changes as a rule, allowing a comment period and conducting a hearing, or if we will need to proceed with litigation over these issues.

Meanwhile, I was asked to join some informal discussions with Medicaid policymakers that were initially designed to address customer service issues for the consumer in dealing with Medicaid.<sup>6</sup> This began about nine months ago. Once all of the customer service issues were addressed, I suggested that we tackle some of the more substantive issues that remained post DRA, and the Medicaid policymakers were receptive to this. All they asked was that I outline in memo format the nature of the issue, the law and our interpretation of the law. There were a number of sub-issues that the task force identified as being appropriate for discussion in this forum, and one of them was the promissory note issue. The task force appointed a sub-committee consisting of Lauchlin Waldoch, Esq., Ellen Morris, Esq., and me to work on various memoranda outlining our position on promissory notes and certain other issues. The promissory note memo outlined federal law and Florida law on the treatment of promissory notes, and I had previously forwarded *James v. Richman*, the Third Circuit case holding that no secondary market existed for a non-assignable, non-transferable annuity income stream. I submitted the promissory note memo in August 2009 and was told that Medicaid would review our position and let us know what action, if any, would be taken in response. Several months passed, and in October 2009, I was told that Medicaid had considered our position and that a policy statement would be forthcoming in the near future. I was told that a final decision had not yet been made as to whether this change would occur in the form of a rule, a transmittal or a Medicaid Manual change. From September through December 2009, no action was taken, and I began to wonder if this would end up in the agency black hole where so many things land, never to be heard from again.

The Florida Bar Certification Review Course was scheduled for Jan. 14-15, 2010 (a course designed to prepare Elder Law Section members to become board certified in elder law), and I was scheduled to cover the topic of Planning After the DRA. I thought it prudent to check to see if there were any revisions to the Medicaid Manual before giving the presentation since these changes are never announced to us, and if anything had changed I should know about it so that I could pass it along to the attendees. Up until this point in time, the Medicaid Manual had a provision stating:

If the note, loan or mortgage is not bona fide or not negotiable, the instrument cannot be converted to cash (sold) and is not an asset but is a potential transfer.

This is confusing language to deal with because Medicaid's position in our discussions was always that a DRA compliant note would not result in a penalty, but would be considered an available resource, yet the language of the manual suggests it would be considered a potential transfer. One could only imagine that the manual should have read "... is not an asset but is a countable resource."

In any event, when I looked at the January 2010 changes to the Medicaid Manual, the table of contents referred to a change in the treatment of promissory notes. So, I looked at the new provision, which read as follows:

If the note, loan or mortgage is not bona fide or not negotiable, the instrument cannot be converted to cash (sold) and is not an asset.

Could it be? The elimination of five words in the Medicaid Manual seemed to reflect our understanding that a DRA compliant note would neither be a transfer nor a countable asset. I spoke the next day with my contact at Medicaid, and he confirmed that indeed the department was satisfied that our reading of federal law on this issue was correct! Thus, effective with the January 2010 Medicaid Manual change referenced above, DRA compliant promissory notes can now be used in Florida as part of long-term care planning, and such notes will not be considered countable assets.

The moral of the story is, of course,

at least in our experience, it is worthwhile to pursue an ongoing relationship with Medicaid, one that spans the test of time and not just an occasional contact. It may not resolve every issue, and litigation will remain an option for some issues that cannot be resolved in this way. Having said that, ongoing communication could provide an extremely useful and powerful way to effectuate change in Medicaid policy and, at a minimum, will reveal to the Elder Law Bar (and vice versa) the thinking of the Medicaid agency on important policy issues.

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#### Endnotes:

1. Partial return of funds has been allowed in various counties throughout the state due to an ambiguity in the directive.
2. New Jersey has vacillated between allowing them and then not allowing them several times. New York allows the use of DRA compliant notes, and they will neither be considered an uncompensated transfer of assets nor be counted as an available resource. Ohio considers notes to be a transfer of assets, even so-called DRA compliant notes. NAELA Past President Bill Browning is presently arguing a case in the Sixth Circuit challenging Ohio's treatment of notes, but this case is presently hung up on some procedural issues, so it may be some time before the Ohio position is resolved. The use of notes has been upheld in Massachusetts as well.
3. Randy Bryan, Esq., of Oviedo, Fla., is the current president of AFELA.
4. Babette Bach, Esq., of Sarasota, Fla., is the current chair of the Elder Law Section.
5. Task force members include: Randy Bryan and Steve Kotler, co-chairs; Mark Mazzeo, AFELA president-elect; Steve Quinnell, AFELA treasurer; Babette Bach, ELS chair; Len Mondschein, ELS chair-elect; Twyla Sketchly, ELS substantive chair; Enrique Zamora, ELS administrative chair; Ellen S. Morris, legislative chair; Lauchlin Waldoch, at large member; Howard S. Krooks, at large member; Beth Prather, at large member; and Jack Rosenkranz, at large member.
6. Many thanks to Elder Law Section member Scott Selis for arranging these informal calls.