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SUPERIOR COURT OF THE STATE OF CALIFORNIA
COUNTY OF STANISLAUS

11 Virginia Wylie, by and through her attorney in fact
12 Kenneth Wylie, Kenneth Wylie, trustee of
13 the Wylie Living Trust, Kenneth Wylie, trustee of
14 the Wylie Survivor's Trust,

14 Plaintiffs,

15 vs.

16 Paul Fulfer, Richard Fulfer, Thomas Thorson,
17 Thorson Financial Estate Management and
18 Insurance Services, Inc., and Does 1
19 through 20,

20 Defendants.

Case No. 383525

PLAINTIFFS' MEDIATION BRIEF

Date: March 12, 2007
Time: 10:00 a.m.
Place: 1150 9th Street, Suite 1200
Modesto, CA

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20 **1. Summary of the case.**

21 Plaintiff Virginia Wylie is an 82 year old widow suffering from stage three Alzheimer's
 22 disease. In 1992, Virginia and her husband Edward executed the Living Trust of Edward G. Wylie
 23 and Virginia Lee Wylie, an AB trust. Plaintiff Kenneth Wylie is Virginia's son and is now trustee of
 24 the Wylie Living Trust and the Wylie Survivor's Trust. Plaintiffs seek damages from Modesto
 25 attorneys Paul Fulfer and Richard Fulfer and from Modesto life insurance agent Thomas Thorson,
 26 both individually and doing business through his corporate entity, Thorson Financial Estate
 27 Management and Insurance Services, Inc. The complaint alleges six causes of action: (1) Legal
 28 Malpractice; (2) Breach of Duty of Good Faith (Ins. Code § 785); (3) Violation of Senior Insurance

1 Sales Practices (Ins. Code § 789.8 *et seq.*); (4) Negligence; (5) Fraud; and (6) Elder Financial Abuse
2 (W & I § 15610.30). The action is based upon defendants’ advice and instructions to plaintiffs to
3 sell a rental property owned by plaintiffs and to invest the net proceeds of sale in a single-premium
4 fixed annuity for the purpose of qualifying Virginia for Medi-Cal benefits. Plaintiffs contend that
5 Virginia would have qualified for Medi-Cal benefits without selling this rental property and without
6 buying this annuity, and that in any event, the costs incurred in selling the property and buying the
7 annuity far outweighed any benefit derived by plaintiffs. Furthermore, plaintiffs contend that this
8 advice was given solely to generate a large commission on the sale of the annuity. Plaintiffs seek
9 compensatory damages, attorney’s fees, punitive damages, interest, and costs.

10 **2. Statement of facts.**

11 Edward and Virginia Wylie were a retired and elderly couple of modest means and were
12 long-time residents of Modesto. Virginia suffered from Alzheimer’s disease and lived in a
13 residential care facility; Edward suffered from heart disease and diabetes and lived at home. Edward
14 was concerned that Virginia’s condition would further deteriorate and that she would need to be
15 moved from the residential care facility to a skilled nursing facility; since their assets and income
16 were quite limited, Edward was also concerned about their ability to pay for such increased care.
17 Kenneth Wylie and Teri Cummins, the son and daughter of Edward and Virginia, also live in
18 Modesto. In 2005, Edward recruited Kenneth to assist him, and together they sought an elder law
19 attorney who might advise them. Kenneth looked in the Modesto SBC Yellow Pages and found a
20 display ad placed by the Law Offices of Fulfer & Fulfer. The ad announced that the firm
21 emphasizes “elder law,” and Edward and Kenneth made an appointment.

22 On July 7, 2005, Edward, accompanied by Kenneth and Teri, met with Paul Fulfer at the
23 Law Offices of Fulfer & Fulfer. The family explained to Paul Fulfer that they were concerned about
24 Virginia’s care and the family’s ability to pay for such care. They summarized the assets owned by
25 Edward and Virginia, which included a residence, a rental duplex, and some savings. Paul Fulfer
26 told them that they would have to sell the duplex and put the money into an annuity and that, in
27 such cases, he always worked together with a local life agent, Thomas Thorson. With the Wylie
28 family still seated in his office, Paul Fulfer telephoned Thorson and scheduled an appointment for

1 the Wylies to meet with Thorson on July 11, 2005.

2 On July 11, 2005, Edward, Kenneth, and Teri met with Thorson at his office. Thorson asked
3 various questions and reviewed the assets and income available to Edward and Virginia. Thorson
4 told them that he could help them and that while Virginia did not then qualify for Medi-Cal, she
5 would qualify if the Wylie Living Trust sold the duplex and put the money into an annuity which he
6 would sell them. He instructed them to sell the duplex and to “come back when the money is in the
7 bank.”

8 Shortly thereafter, Edward and Kenneth began looking for a realtor, and on September 8,
9 2005, Edward signed an exclusive listing agreement for the sale of the duplex. Various inspections
10 were ordered and a purchaser was found. On November 22, 2005, escrow closed with a sales price
11 of \$470,000. Total expenses of sale, including inspections, commissions, and escrow fees, came to
12 \$36,373. After reserving some funds for California capital gains taxes, the net proceeds of sale were
13 \$418,374. Edward deposited these funds in his checking account at CitiBank.

14 On November 28, 2005, Edward and Kenneth again met with Thorson and informed him
15 that they had followed his instructions and that the net proceeds of sale were in Edward’s bank
16 account. Thorson instructed Edward to sign various documents for the purchase of an annuity from
17 the Aviva Life Insurance Company, and Edward wrote a check for \$368,000, payable to “Aviva.”
18 On December 5, 2005, the Aviva annuity was issued.

19 In February, 2006, Edward, again assisted by Kenneth, delivered various documents to John
20 Gerbo, CPA, the tax preparer of Edward and Virginia. Shortly thereafter Mr. Gerbo informed them
21 that because of their low basis in the duplex, additional federal and state capital gains taxes would
22 have to be paid. While the annual income of Edward and Virginia was normally around \$20,000,
23 because of the sale of the duplex their income for 2005 was \$453,457. This high income exposed
24 them to the Alternative Minimum Tax, and the total amount of federal capital gains tax came to
25 \$78,128; the total amount of California capital gains tax came to \$36,019. Accordingly, the sale of
26 the duplex cost Edward and Virginia a total of \$150,520 (expenses of \$36,373 plus federal capital
27 gains tax of \$78,128 plus California capital gains tax of \$36,019).

28 The annuity sold by Thorson is a single premium fixed annuity which by its terms is “non-

1 transferable, non-assignable, non-commutable, non-surrenderable, totally and permanently
2 irrevocable, and has no cash value.” The annuity provides for monthly payments to Edward of
3 \$3,685.62 for 8.5 years (102 months), which was at the time Virginia’s life expectancy under Medi-
4 Cal regulations. Thus the single premium paid by Edward and Virginia of \$368,000 produced a total
5 payout on the annuity over its 8.5 year term of only \$375,933.24. From the sale of the annuity,
6 Thorson earned a commission of \$22,980. At this time, it is unknown whether any compensation
7 was paid by Thorson to Fulfer. On February 7, 2006, Virginia was admitted to Vintage Faire
8 Convalescent Hospital, a skilled nursing facility in Modesto. In late spring, 2006, Edward learned
9 that it was unnecessary for the duplex to have been sold nor for the annuity to have been purchased.
10 He was extremely distressed by this information became quite depressed. On August 29, 2006,
11 Edward died.

12 In order to evaluate this action, an understanding of the Medi-Cal system and the role of
13 annuities is required. The following provides a summary of this information.

14 **3. Overview of the Medi-Cal Program.**

15 Medi-Cal is the California implementation of the federal Medicaid program and was
16 designed to help pay for the medical care of people with limited assets. Federal law creates
17 Medicaid, authorizes a portion of the funding, and establishes minimum program requirements with
18 which each state must comply in implementing the program. (42 USC § 1396 *et seq.*) California’s
19 Medi-Cal program is codified at W & I Code § 14000 *et seq.* and is governed by the Department of
20 Health Services (DHS); DHS regulations are located at 22 CCR § 50000 *et seq.* Medi-Cal is
21 administered at the local level by county departments of social services (called Medi-Cal workers).
22 In addition to regulations, DHS issues “All County Welfare Directors Letters” (ACWD Letters),
23 which instruct county Medi-Cal workers on the details of administering the program. ACWD
24 Letters also sometimes include draft regulations which DHS requires counties to follow even
25 though the regulations have not yet been formally adopted. In some instances, these draft
26 regulations constitute the de facto policy of DHS for many years before the regulations may be
27 formally adopted.

1 **4. Overview of Medi-Cal Eligibility Rules.**

2 Since the purpose of Medi-Cal is to help pay for the medical care of people with limited
3 assets, eligibility is based on an applicant's assets; those who exceed minimum limits are denied
4 benefits. A denial of benefits entitles an applicant to review by an administrative law judge in a
5 procedure called a "fair hearing."

6 Where an applicant is married, competing public policies arise from both the ability of the
7 applicant to transfer property to the non-applicant spouse and from the typical desire of the non-
8 applicant spouse to provide for the care of the applicant. Until 1990, California operated under a
9 "division of assets" rule, which permitted an applicant to transfer his or her assets to the non-
10 applicant spouse until the applicant met the minimum eligibility limit; the assets of the non-
11 applicant spouse were regarded as irrelevant for purposes of eligibility. This arrangement was
12 considered unfair to taxpayers because it protected the couple's joint assets no matter what their
13 value. On the other hand, it was considered unduly harsh to require the non-applicant spouse to pay
14 for the applicant's medical care until such time as he or she too became impoverished and qualified
15 under the minimum limit. The denial of benefits on the basis of the assets of an applicant's spouse
16 also encouraged the dissolution of marriages simply to attain eligibility. To address these problems,
17 Congress enacted the "spousal impoverishment" provisions of the Medicare Catastrophic Coverage
18 Act of 1988 (MCCA – 42 USC § 1396r-5; W & I Code § 14005.12(d)(5)). The spousal
19 impoverishment rules struck a compromise between these competing policies and permitted the
20 non-applicant spouse to retain assets up to a substantially higher limit than those for the applicant.
21 These new rules resulted in an expansion of Medicaid beyond its origins as a welfare program for
22 the poor so that benefits are now available to those with modest, but not insignificant, assets.

23 Since property rights may be quite varied, the rules governing the characterization and
24 valuation of the assets of both the applicant and the non-applicant spouse are necessarily detailed
25 and complex. The following summarizes these rules for determining eligibility with regard to: (1)
26 the assets of the applicant; and (2) the assets of the non-applicant spouse.

27 **(1) Assets of the Applicant.**

28 To qualify for benefits, an applicant may have no more than \$2,000 in "countable assets."

1 (22 CCR § 50419.) Countable assets do not include assets that may be characterized as “exempt.”

2 Exempt assets include:

- 3 1. The applicant’s principle residence (22 CCR § 50425);
- 4 2. Furnishings of the residence (22 CCR § 50465);
- 5 3. The applicant’s personal effects (22 CCR § 50490.1);
- 6 4. A vehicle (22 CCR § 50461(a));
- 7 5. A family burial plot (22 CCR § 50477);
- 8 6. Qualified income producing property (22 CCR § 50485); and
- 9 7. Assets which are owned but unavailable to the applicant – this includes
- 10 retirement accounts, pensions, and annuities (22 CCR § 50402).

11 While an applicant may have no more than \$2,000 in countable assets to be eligible, he or
12 she may have any amount of property in one or more of these exempt categories. Moreover, it is not
13 improper for an applicant to “spend down” excess countable assets by converting them to exempt
14 assets. For each category of exempt asset, DHS has established detailed rules that govern whether a
15 particular asset may be characterized as exempt or must be counted. For example with regard to
16 vehicles, one vehicle is exempt, the applicant must hold title, but the applicant need not be able to
17 drive; a recreational or commercial vehicle qualifies as exempt so long as no other vehicle is
18 available to the applicant.

19 The category of assets which are owned but unavailable applies to Individual Retirement
20 Accounts, 401k accounts, and similar pension plans, as well as to some annuities sold by insurance
21 companies. The rules governing the treatment of annuities are perhaps the most complex of all of
22 the Medi-Cal rules and are found in 22 CCR § 50489 and in the 50 page guidelines issued as Medi-
23 Cal Eligibility Procedures Manual Letters No. 159, 179, and 192. They are described in paragraph
24 seven below, which follows a summary of the terminology and structure of annuities.

25 **(2) Assets of the Non-Applicant Spouse.**

26 Under the spousal impoverishment rules, the non-applicant spouse is permitted to have
27 countable assets up to a limit called the Community Spouse Resource Allowance (CSRA). (The
28 term “community spouse” here refers to the non-institutionalized spouse still living in the

1 community, also referred to as the “well-spouse.”) If the assets of the non-applicant spouse exceed
2 the CSRA then the application for benefits is denied. The CSRA is increased each year and for 2005
3 was \$95,100.

4 It is not uncommon for the assets of the non-applicant spouse to exceed the CSRA but for
5 his or her monthly income to nevertheless be very limited; this is particularly true when interest
6 rates are low. In such circumstances, the non-applicant spouse may be largely impoverished
7 notwithstanding having assets in excess of the CSRA. Because of this, Medicaid established an
8 impoverishment threshold called the Minimum Monthly Maintenance Needs Allowance
9 (MMMNA). Where the income of the non-applicant spouse is less than the MMMNA, Medi-Cal
10 benefits will be allowed even if the assets of the non-applicant spouse exceed the CSRA. The
11 MMMNA is increased each year and for 2005 was \$2,378 per month.

12 Under MCCA, income belongs to the applicant or to the non-applicant spouse based upon
13 the “name-on-the-check” rule. This rule provides that income is characterized as belonging to the
14 spouse who is actually the payee on the income check. However, states differed as to whether the
15 income of the applicant must be included in the income of the non-applicant spouse for purposes of
16 applying the MMMNA. (42 USC § 1396r-5(e)(2)(C).) In “income-first” states, the income of the
17 applicant is included in the total income available to the non-applicant spouse. In “asset-first” states,
18 it is not. California is an asset-first state, and accordingly, excludes the applicant’s income for
19 purposes of determining the income of the non-applicant spouse. (On February 8, 2006, Congress
20 passed the Deficit Reduction Act of 2005 (DRA), which requires all states to incorporate the
21 income-first rule.)

22 Medicaid also permits a non-applicant spouse to seek to increase the MMMNA itself.
23 However, such an increase may only be based upon exceptional circumstances resulting in
24 significant financial duress. (42 USC § 1396r-5(e)(2)(B).) Such claims are rarely granted.

25 Even where the income of the non-applicant spouse is well under the MMMNA, DHS rules
26 require the county Medi-Cal worker to deny the application for benefits if the non-applicant spouse
27 has assets in excess of the CSRA. The applicant then must request a fair hearing to consider
28 whether the income of the non-applicant spouse fails to meet the MMMNA. At the fair hearing, the

1 administrative law judge first includes the income of the non-applicant spouse from Social Security
2 and other pensions pursuant to the name-on-the-check rule. Then, all other income is evaluated on
3 both an “actual-yield” and “reasonable-yield” basis. For actual-yield, the income actually produced
4 by the assets is considered; for reasonable-yield, the prevailing certificate of deposit rate is used to
5 determine the amount of income which could be reasonably produced by the assets. The
6 administrative law judge then must include the income which is the lower of the actual-yield and
7 reasonable-yield calculations. (ACWD Letter No. 99-29, Q&A 7.) If the resulting income is equal
8 to or less than the MMMNA, the administrative law judge must allow Medi-Cal benefits; this
9 decision is mandatory and the administrative law judge lacks discretion to deviate from it. (42 USC
10 § 1396r-5(e)(2)(C).) The assets of the non-applicant spouse need not be actually invested nor is he
11 or she required to demonstrate any intention to reallocate investments so as to produce more
12 income.

13 As described above, Medi-Cal limits eligibility on the basis of assets and not on the basis of
14 income. With regard to the applicant’s income, Medi-Cal requires that the applicant first apply most
15 of his or her own income to expenses before Medi-Cal will contribute. If the applicant’s income is
16 inadequate to pay the allowed monthly cost of care (called the Average Private Pay Rate or
17 “APPR”), then Medi-Cal will pay the balance. The portion of the applicant’s income that must be
18 spent is called the “share of cost” (SOC). The SOC functions like a deductible on an insurance
19 policy. The SOC is determined by deducting the current “maintenance need amount” (MNA) from
20 the applicant’s monthly income; for 2005, the MNA was \$35. (22 CCR § 50605.) Thus, for an
21 applicant with monthly income of \$390, the MNA would be \$35 and the SOC would be \$355. In
22 this case, the applicant would keep the first \$35, pay the remaining \$355 to the SNF, and Medi-Cal
23 would then pay the remaining expenses of the SNF up to the APPR. However, where the applicant
24 is married and the income of the non-applicant spouse is less than the MMMNA, the MNA is not
25 paid to the SNF but rather is used for the support of the non-applicant spouse.

26 An alternate procedure to the fair hearing is provided by Medicaid and Probate Code § 3100
27 *et seq.* Such a procedure, called a “3100 petition,” authorizes a court to both approve Medi-Cal
28 benefits where the assets of the non-applicant spouse exceed the CSRA (42 USC § 1396r-5(f)(2)-

1 (3)) and where income exceeds the MMMNA (42 USC § 1396r-5(d)(5)). Unlike the administrative
2 law judge in a fair hearing, whose decision is primarily ministerial, the judge in a 3100 petition has
3 discretion to allow benefits solely upon a factual showing of the particular needs of the non-
4 applicant spouse.

5 **5. The relationship of annuities to Medi-Cal eligibility.**

6 Under DHS regulations, some annuities are characterized as exempt and are not counted in
7 the CSRA limit. In the last 20 years, insurers and their sales agents have increasingly sought to
8 exploit this preferential treatment by selling seniors various types of annuities, regardless of
9 whether the annuities are otherwise suitable. Annuities are highly complex insurance contracts
10 which may very well be beyond the capacity and experience of most laypersons to understand. Not
11 only are annuity policies filled with jargon and largely unreadable, but the costs to the senior are not
12 disclosed. These hidden costs include high commissions, low rates of return, and a loss of access to
13 the funds for a period equaling the life expectancy of the senior. Most important, agents never
14 provide seniors with a comparison of the return on the annuity to other more common investments,
15 such as treasury bills and notes, certificates of deposit, or index mutual funds. Such a comparison
16 would disclose the exceptionally poor performance of annuities compared to equally safe or safer
17 long-term investment opportunities which do not lock-up the investment for the life-expectancy of
18 the senior. When the additional layer of complexity of annuities is added to the already highly
19 complex rules governing Medi-Cal eligibility, most seniors simply have no basis for determining
20 whether the purchase of an annuity is appropriate. Accordingly, almost all seniors who purchase
21 annuities do so entirely on the urging of the agent.

22 In response to this problem, the California legislature enacted Insurance Code § 789.8 which
23 requires a statutory written disclosure from any agent seeking to sell an annuity to a senior for
24 Medi-Cal purposes. This disclosure attempts to alert seniors to some of the most basic rules
25 regarding Medi-Cal eligibility. The legislature also enacted Insurance Code § 789.9, which prohibits
26 the sale of an annuity to a senior for Medi-Cal purposes if the senior has assets equal to or less than
27 the CSRA or the senior would otherwise qualify for Medi-Cal. (Ins. Code § 789.9(a)(1).)

1 **6. Summary of the terminology and structure of annuities.**

2 In its simplest form, an annuity is an insurance contract in which the insurer agrees to make
3 periodic payments in exchange for a premium. While the specific terms of annuities vary greatly,
4 they are generally classified by (1) when payments occur, and (2) how payments are calculated.
5 With regard to when payments occur, annuities are either “immediate” or “deferred.” An immediate
6 annuity is one in which periodic payments begin upon purchase and a deferred annuity is one in
7 which a payment or payments begin at some future date. Annuities also provide for a term of
8 maturity, which may vary from a specified period of years to the life of the annuitant. In order to
9 qualify as exempt under Medi-Cal rules, the term of the annuity must be no longer than the life
10 expectancy of the applicant, as determined by Medi-Cal.

11 With regard to how payments are calculated, annuities are either “fixed” or “variable.”
12 While the term fixed suggests some set rate of return which does not change, this is not the case.
13 Rather, a fixed annuity is one in which the principal generates a return within a fixed range, that is,
14 a range with a floor and a cap. Usually, the floor is zero and the cap varies between four and eight
15 percent. Within this range, the insurer is free to set the rate of return, which is usually done at the
16 end of each year. In other words, after the insurer knows the return generated on its investments, it
17 decides what portion of this gain will be allocated to the policy and what portion it will keep; the
18 only constraint is that the return to the policy must be in the range between the floor and the cap.
19 Among fixed annuities, policies are sometimes divided between “interest-based” and “equity-
20 based” annuities. An interest-based fixed annuity merely means that the insurer will select a rate of
21 return between the floor and cap based loosely upon fluctuations in market interest rates; an equity-
22 based fixed annuity means that the insurer will select a rate of return between the floor and cap
23 based loosely upon the performance of a particular stock index such as the Standard & Poor 500.

24 A variable annuity differs from those described above in that the principal varies directly
25 with fluctuations in a specific investment, usually a mutual fund. Because variable annuities so
26 closely resemble stock investments, an agent who sells them must be licensed and registered with
27 the Securities Exchange Commission and federal rules of securities suitability apply.

28 Annuities are extremely profitable for insurers, and the agents who sell them receive very

1 large commissions. The size of the commission reflects the profitability of the policy; that is, the
2 higher the commission rate, the more profitable the policy. This motivates agents to sell the annuity
3 which pays the highest commission rather than the annuity which offers the senior the most
4 favorable terms. Because insurers pay agents such large commissions when the annuity is sold, they
5 also assess large penalties (called “surrender charges”) if a senior seeks to terminate an annuity
6 before the end of its term. Annuities typically contain a surrender charge schedule which provides
7 for penalties of between 10 and 20 percent during the first year of the annuity. Thereafter, the
8 surrender charges typically decline by one or two percent per year. The high surrender charge
9 discourages an annuitant from terminating early and reimburses an insurer for the cost of an agent’s
10 commission if the policy is terminated early. (In fact, the surrender charge and insurer earnings
11 always exceed the commission paid so that the insurer generates a profit even if the annuity is
12 terminated early.) Some annuities simply prohibit surrender altogether. Another significant
13 consequence of the purchase of an annuity is the senior’s loss of access to funds, which is almost
14 always for the senior’s life expectancy. This loss of access limits economic flexibility and the
15 ability of a senior to respond to medical or personal crises.

16 **7. Medi-Cal rules governing retirement funds and annuities.**

17 The following is a summary of the Medi-Cal rules governing retirement funds and annuities.

18 1. All work-related pensions (IRA, 401k, Keogh, etc.) are exempt so long as payments
19 are not deferred. However even if deferred, if the applicant initiates periodic payments of principal
20 and interest, the payments are considered income and the balance of the principal and interest are
21 considered unavailable and therefore exempt.

22 2. The rules relating to annuities have changed over the years. For annuities purchased
23 after August 11, 1993, the following rules apply:

- 24 • If payments are deferred, the annuity’s cash surrender value is considered available;
25 however, the undistributed balance is considered unavailable if the annuity is annuitized on
26 the life expectancy (or shorter) of either the applicant or the applicant’s spouse.
- 27 • If the annuity is annuitized for longer than life expectancy, and the annuity cannot be
28 restructured, then payments in excess of life expectancy are regarded as a disqualifying

1 transfer creating a period of ineligibility.

- 2 • Monthly payments on immediate, properly annuitized annuities must be made in
3 equal payments (or increase no more than 5 percent annually).

4 **8. The problem of unnecessary annuity sales.**

5 For 2005, an applicant would have been eligible for Medi-Cal benefits where the non-
6 applicant spouse had \$95,100 or less in countable assets (plus the \$2,000 that the applicant is
7 entitled to have). Those who had more than \$95,100 were entitled to exceed the CSRA so long as
8 the monthly income of the non-applicant spouse did not exceed the MMMNA of \$2,378. The
9 following table shows the countable assets which a non-applicant spouse could have had in 2005 for
10 each \$500 increment in monthly income using a rate of return of 3.73 percent (the six month CD
11 rate for 2005 as determined by the Federal Reserve Bank –
12 http://www.federalreserve.gov/releases/H15/data/Annual/H15_CD_M6.txt).

13 Increment in monthly income	14 Additional assets which may be kept at 3.73 % return
15 \$500	\$160,858
16 \$1,000	\$321,716
\$1,500	\$482,574
\$2,000	\$643,432

17 For example, an applicant would have been entitled to Medi-Cal benefits where the non-
18 applicant spouse had monthly social security income of \$878 and countable assets of \$482,574. In
19 addition, even if the assets of the non-applicant spouse had exceeded \$482,574, it would not have
20 been improper to “spend down” a portion of the excess into exempt assets, such as for home
21 improvements, burial plots, or a new vehicle. With current construction costs, a couple could easily
22 spend \$100,000 installing a new roof, carpets, appliances, and renovating the bathrooms and
23 kitchens. An additional \$40,000 could easily be spent on a new car. Thus, a couple with countable
24 assets in excess of \$650,000 could have qualified for Medi-Cal without purchasing an annuity.
25 Unfortunately, notwithstanding Insurance Code § 789.9 prohibiting the practice, it is a common for
26 agents to sell annuities to any senior whose assets exceed the CSRA.

27
28

1 **9. The problem of premature annuity sales.**

2 As they grow older and develop age-related disabilities, many seniors require assistance and
3 increasing levels of care. Providers of elder assistance are grouped into categories based on the level
4 of services offered. “Home Health Care Service” providers assist seniors who are able to continue
5 living independently in their own homes and only require limited or intermittent assistance.
6 “Residential Care Facilities for the Elderly” (called RCFEs) provide seniors with residential care
7 where greater assistance is needed with daily living activities. “Skilled Nursing Facilities” (called
8 SNFs) provide continuous nursing care for those who need a high level of assistance and can no
9 longer care for themselves. Medi-Cal does not provide coverage for RCFEs but does provide
10 coverage for SNFs.

11 Elderly couples often start worrying about the need for assisted care well before any long-
12 term residential admission. Foremost among these worries is the financial burden of paying for
13 long-term nursing home care. Notwithstanding these concerns, the actual likelihood of a long-term
14 stay is very low. The most recent data collected by the U.S. National Center for Health Statistics
15 show that only four percent of seniors are ever admitted to a nursing home. And even of those who
16 are admitted, 95 percent stay for less than 90 days. (<http://www.cdc.gov>.) Despite this very low risk
17 of a long-term admission, agents aggressively market annuities to seniors by emphasizing seniors’
18 fear of admission to a nursing home. Since the purchase of a Medi-Cal qualified annuity results in a
19 loss of access to funds for the life expectancy of the annuitant, the consequences of purchasing an
20 annuity before an admission can be catastrophic. First, if neither spouse is ever admitted to a SNF,
21 then the annuity locks-up the couple’s assets in an investment with a poor return. Second, agents
22 usually assume that the spouse who is exhibiting some significant health problem will be the one
23 requiring admission to a SNF. For example, where the husband is diagnosed with Parkinson’s
24 disease and requires increasing levels of assistance, the agent may sell the couple an annuity and
25 place it in the name of the wife, that is, in the name of the anticipated non-applicant spouse.
26 However, health events are notoriously unpredictable. If the husband later only requires admission
27 to an RCFE (not covered by Medi-Cal) and the wife suffers a disabling stroke requiring admission
28 to a SNF, then neither spouse would be eligible for Medi-Cal. Such a couple would be faced with

1 paying directly the cost of the husband's RCFE and the wife's SNF while their assets are
2 unavailable and locked into the poorly performing annuity.

3 Often, there are many indications that a long-term admission to a SNF is likely or imminent.
4 Typically, the condition of the applicant deteriorates to the point where he or she is admitted for
5 short in-patient stays at a hospital, followed by one or more short-term stays in a SNF. Under such
6 circumstances, Medicare pays for the hospitalization and for the first 20 days stay at the SNF. For
7 days 21 through 100, Medicare pays for a portion of the care. Even in the unlikely event that
8 Medicare does not cover the initial SNF stay, a Medi-Cal applicant may obtain retroactive coverage
9 for three months. The purchase of an annuity can be accomplished very quickly, that is in a matter
10 of days. Accordingly, even in the limited situations where purchasing an annuity to qualify for
11 Medi-Cal benefits is warranted, this should not be done prior to the commencement of a long-term
12 admission. Unfortunately, it is common practice for agents to sell annuities to any senior at any time
13 he or she will agree.

14 **10. The problem of Medi-Cal recovery rights.**

15 The Omnibus Budget Reconciliation Act of 1993 provides the basic authority for Medi-Cal
16 to recover benefits paid following the death of the applicant. (OBRA – Pub L 103-66, 107 Stat 312.)
17 Medi-Cal recovery claims are mandatory, and the DHS is required to recover benefits paid from the
18 estate of the applicant or from any recipient of the property of the applicant by distribution or
19 survival. (W & I Code § 14009.5.) Thus, while the residence of an applicant is exempt for purposes
20 of determining Medi-Cal eligibility, Medi-Cal will recover all benefits paid from the applicant's
21 share of the residence after the applicant has died. (Medi-Cal is not permitted to pursue its recovery
22 claim so long as the surviving spouse is alive – W & I Code § 14009.5(b)(2)(A); 22 CCR §
23 50961(c)(2).) However, there are a number of estate planning options which can affect the recovery
24 rights of Medi-Cal. The most common is to transfer title to the residence from the applicant to the
25 non-applicant spouse; this eliminates the recovery rights of Medi-Cal against the residence.
26 However, where the applicant lacks capacity and can no longer consensually transfer title, this may
27 only be accomplished through a 3100 petition. Since a 3100 petition is also an alternative to a fair
28 hearing for the purpose of obtaining Medi-Cal benefits where the non-applicant spouse has assets in

1 excess of the CSRA, a 3100 petition is the appropriate procedure to both obtain benefits, transfer
2 title, and to transmute the character of the property where the applicant lacks capacity. Agents
3 almost never discuss the recovery rights of Medi-Cal, the need to transfer title, and the need to
4 transmute the property through a 3100 petition where the applicant lacks capacity because agents
5 cannot prepare the petition nor appear at the hearing. This can only be done by an attorney, and an
6 experienced attorney is likely to advise the seniors against buying the annuity. Accordingly, agents
7 simply sell the couple the annuity, which results in their heirs learning years later that all Medi-Cal
8 benefits must be paid back out of the inherited property.

9 Where an applicant has substantial equity in a home and other property, qualification for
10 Medi-Cal benefits often becomes in effect only a deferral of those expenses; that is, the current cost
11 of care is borne by Medi-Cal, but eventually the expense is shifted back to the applicant following
12 the death of the applicant and the non-applicant spouse. While deferring this expense may be of
13 substantial benefit, many seniors are misled by agents into believing that by qualifying for Medi-Cal
14 benefits, they are preserving assets that will eventually be passed on to their heirs.

15 **11. Other disadvantages of receiving Medi-Cal benefits.**

16 A fully-informed couple who might otherwise qualify for Medi-Cal benefits might
17 nevertheless elect not to apply because of several important advantages of private-pay over Medi-
18 Cal coverage. First, Medi-Cal will not cover the cost of a private room; this means that a person
19 who elects private-pay over Medi-Cal benefits will almost certainly receive a higher level of
20 attention, services, and care. Similarly, superior facilities strongly prefer private-pay residents
21 because the level of compensation for services is higher; this results in easier placement and shorter
22 wait periods for private-pay patients. Conversely, placement in a SNF with Medi-Cal coverage can
23 be difficult and often requires that an applicant remain on a waiting list for several months until an
24 opening exists; this often results in substantial hardship and uncertainty during this waiting period.
25 Finally, some seniors feel that it is improper for society to pay for their support so long as they own
26 substantial assets; moreover, many people feel that they diligently saved their money over their
27 working lifetimes, at least in part, to be available during their periods of retirement. For all of these
28 reasons, and because Medi-Cal will ultimately recover the benefits paid, many seniors who have

1 sufficient assets to warrant purchasing an annuity would elect not to do so if fully informed.

2 **12. Analysis of this case.**

3 In this action, plaintiffs assert the following bases for recovery: (1) Virginia would have
4 qualified for Medi-Cal benefits without selling the duplex and purchasing the annuity; (2) The costs
5 of selling the duplex and purchasing the annuity were not justified by the Medi-Cal benefits; and (3)
6 Plaintiffs would not have followed defendants' instructions had they been fully informed. Each of
7 these bases is summarized below.

8 **(1) Virginia would have qualified for Medi-Cal benefits without selling the duplex and**
9 **purchasing the annuity.**

10 Exhibit A shows the assets of Edward and Virginia in June, 2005. Countable assets totaled
11 \$237,658. This consisted of the duplex (\$137,704), a CitiBank account (\$5,746), a Washington
12 Mutual account (\$74,542), and a CitiGroup brokerage (\$19,666). The largest countable asset was
13 the duplex. DHS regulations provide that non-exempt real property shall be valued at the "assessed
14 value determined under the most recent property tax assessment." (22 CCR § 50412(a)(1).) Exhibit
15 B is the property tax bill for the duplex for the period July 1, 2005 to June 30, 2006 showing its
16 assessed value of \$137,704. Since Edward's countable assets (\$237,658) exceeded the CSRA for
17 2005 (\$95,100), the Medi-Cal worker would have denied Virginia's application. However,
18 Edward's monthly income, measured by the actual-yield method (\$1,933) or the reasonable-yield
19 method (\$1,629), was well below the MMMNA for 2005 (\$2,378); accordingly, the administrative
20 law judge would have been required to allow benefits at a fair hearing.

21 Exhibit C shows the handwritten notes of Thorson from his interview with plaintiffs on July
22 11, 2005. These notes show that Thorson valued the duplex at \$450,000, rather than its assessed
23 value of \$137,704. However, even with the duplex valued at this higher erroneous amount,
24 Edward's countable assets only totaled \$549,954. Since Edward's monthly pension income was
25 \$890, he would have been permitted to keep sufficient assets to produce another \$1,488 in monthly
26 income. At the then prevailing rate of return of 3.73 percent, Edward would have been permitted to
27 keep a total of \$478,713 in countable assets. Thus, even under Thorson's erroneous valuation,
28 plaintiffs were only \$71,241 over this ceiling. This amount could have been spent down into home

1 improvements, household furnishings, or a new car, and thus Virginia would have been eligible for
2 Medi-Cal benefits without selling the duplex or buying the annuity. Such a course, however, was
3 inconsistent with Thorson's primary objective of earning a commission on the sale of an annuity.

4 Edward's monthly income of \$1,629 was well below the 2005 MMMNA of \$2,378. Not
5 only would Virginia have qualified for Medi-Cal benefits without selling the duplex, but from
6 Virginia's monthly income of \$390, she would have kept \$35 (the MNA), and the remaining \$355
7 (the SOC) would have been paid to Edward. By selling the duplex and buying the annuity,
8 Edward's monthly income increased to \$4,886.62 (the monthly annuity payment of \$3,685.62 + all
9 other monthly income of \$1,201). Thus, Edward's monthly income exceeded the MMMNA and
10 Virginia's SOC was paid to the SNF rather than to Edward. Accordingly, not only were the acts of
11 defendants unnecessary for qualifying Virginia for Medi-Cal, they actually caused Edward's
12 monthly income to decrease.

13 **(2) The costs of selling the duplex and purchasing the annuity were not justified by the**
14 **Medi-Cal benefits.**

15 As previously described, the immediate cost of selling the duplex was \$150,520. However,
16 plaintiffs also sustained a loss in owning the non-surrenderable annuity because they are locked into
17 an investment with a poor rate of return. One method of measuring these damages would be
18 calculated by the difference between the total value of the annuity and the total value of plaintiffs'
19 asset at the end of the annuity's term. The closest long-term rate of return for 2005 is the Federal
20 Reserve Bank 10 year certificate of deposit rate
21 (http://www.federalreserve.gov/releases/h15/data/Annual/H15_TCMNOM_Y10.txt), which was
22 4.29 percent. By its terms, the annuity pays \$3,685.62 per month for 102 months for a total return of
23 \$375,933. Since this amount is paid out over 102 months, the actual value of the total return
24 (including interest on each monthly payment beginning when it is received) would be \$454,278.
25 The total value for plaintiffs' asset (\$470,000 at 4.29% for 8.5 years) totals \$676,365. Accordingly,
26 selling the duplex and buying the annuity cost plaintiffs \$222,087.

27 The life expectancy tables used by Medi-Cal are based solely upon the age of the applicant
28 and without regard to the applicant's medical condition. In this case, Virginia was 80 years old and,

1 based solely on her age and gender, had a life expectancy of 8.5 years. However, Alzheimer's
2 disease is a degenerative condition and a person in an advanced stage three condition has a life
3 expectancy of approximately two years. Accordingly, the cost of selling the duplex and buying the
4 annuity far outweighed the value of the Medi-Cal benefits even if Virginia would not have
5 otherwise been eligible.

6 **(3) Plaintiffs would not have followed defendants' instructions had they been fully**
7 **informed.**

8 As attorneys representing themselves as elder law experts, defendants Fulfer had a duty to
9 fully, completely, and competently inform plaintiffs of the consequences of selling the duplex,
10 purchasing the annuity, applying for Medi-Cal benefits, and other related elder considerations.
11 Similarly, Thorson had a statutory duty to plaintiffs of honesty, good faith, and fair dealing pursuant
12 to Insurance Code § 785 and to advise them fully and competently with regard to purchasing an
13 annuity. Defendants breached these duties by failing to properly inform and advise plaintiffs of the
14 following important considerations: (1) They failed to inform plaintiffs that upon the sale of the
15 duplex, they would pay a large sales commission and miscellaneous expenses; (2) That plaintiffs
16 would pay a large federal and California capital gains tax; (3) That plaintiffs would pay an
17 increased federal tax because of the application of the Alternative Minimum Tax caused by the
18 unusually large income that would be reported for that tax year; (4) That plaintiffs would lose the
19 income generated on the money lost as expenses and taxes in selling the duplex; (5) That plaintiffs
20 would lose the rental income from the duplex; (6) That plaintiffs would lose the benefit of a low
21 property tax assessment; (7) That the survivor of plaintiffs and plaintiffs' heirs would lose the
22 benefit of a step-up in tax basis on the duplex upon a testamentary transfer; (8) That the financial
23 rating of an insurer is an important consideration in determining whether to purchase an annuity; (9)
24 That plaintiffs would pay a large commission on the purchase of an annuity; (10) That plaintiffs
25 would pay yearly administration expenses on the annuity; (11) That plaintiffs would be charged a
26 large surrender charge if the annuity were surrendered; (12) That plaintiffs would lose the ability to
27 affect the rate of return on the annuity; (13) That plaintiffs would lose access to these funds for
28 personal, family, or emergency purposes once the annuity was purchased; (14) That many annuities,

1 particularly those marketed to elders, provide for rates of return substantially below market rates;
2 (15) That Medi-Cal had the right to recover benefits following plaintiffs' deaths; (16) That plaintiffs
3 could have eliminated the recovery rights of Medi-Cal by transferring title to the residence from
4 Virginia to Edward but that since Virginia lacked capacity, this could only be accomplished through
5 a 3100 petition; (17) That plaintiffs would have otherwise qualified for Medi-Cal without selling the
6 duplex and buying an annuity and that Insurance Code § 789.9 prohibited such a sale; (18) That
7 plaintiffs were entitled to the statutory notice required by Insurance Code § 789.8; (19) That
8 plaintiffs were entitled to an administrative fair hearing and a 3100 petition hearing; (20) That
9 buying an annuity before admission to a SNF was imminent or had occurred could create disastrous
10 consequences; (21) That the quality of care in a SNF is often greater as a private pay resident
11 compared to that of a Medi-Cal recipient; (22) That placement in a superior nursing home is easier
12 and quicker for a private pay resident compared to a Medi-Cal recipient; and (23) That defendants
13 Fulfer acted as attorneys and agents for defendant Thorson. Had the Wylie family been fully
14 informed of these issues, they would not have sold the duplex and purchased the annuity.

15 **13. Damages.**

16 Plaintiffs seek the following damages from defendants.

Damages	Amount
Consequential damages	\$222,087
Punitive damages	\$1,000,000
Attorney's fees	\$50,000
Costs	\$1,020
Total:	\$1,273,107

21 No settlement discussions have yet occurred.

22
23 Dated: _____

Steven Riess
Attorney for Wylie