

# A Distinction with a Difference:

A Narrow  
Reading of *Hobbs v.  
Zenderman* (10th Cir.  
Sept. 1, 2009)

BY

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*Special needs require special attorneys.*

**Introduction.** There is troubling dicta in the recent case of *Hobbs v. Zenderman*, 2009 U.S. App. LEXIS 19932 (10th Cir. Sept. 1, 2009) regarding distributions from first-party Special Needs Trusts and its very restrictive reading of the “sole benefit” requirement. However, the decision is in fact a very narrow one; the limited actual holding of the case is that there is no cause of action under 42 U.S.C. § 1983 based on two comparability statutes (§ 1396a(a)(10)(C)(i) and § 1396a(a)(17)), as well as on § 1396p(d)(4)(A).<sup>2</sup> This article will examine this aspect of the opinion and, in particular, the questionable basis for the 10th Circuit’s finding in *Hobbs* that there was no § 1396p(d)(4)(A) cause of action under § 1983.

**Review of Medicaid Rules on Comparability, Eligibility Categories, Assets and Trusts.** Before looking at the Court’s decision, it may be helpful to review the basic Medicaid rules regarding comparability, eligibility categories, assets and trusts:

**Comparability.** Medicaid is a joint federal-state program that provides financial assistance to participating States that make medical assistance available to needy persons. While States are not required to participate in the Medicaid program, if they do opt to do so, they must follow federal law.<sup>3</sup> A fundamental feature of federal Medicaid law is “comparability,” a short-hand term for the federal statutory requirement that the methodology used by States to determine Medicaid income and resource eligibility for a wide variety of programs (including the medically needy, the optionally categorically needy, and participants in Medicaid waiver programs) *may be less restrictive, but may not be more restrictive, than the methodology used by SSI.*<sup>4</sup>

**Eligibility Categories.** There are three eligibility categories for Medicaid. First are the “categorically needy,” those individuals who are eligible for SSI, TANF, and other cash assistance grants and, therefore, whose income does not exceed the federal benefit limit (\$674 in 2009). Second are the “optionally categorically needy,” those individuals who would otherwise qualify for SSI but whose income is over the SSI federal benefit limit but less than 300% of the federal benefit (\$2,022 in 2009). Third are the “medically needy,” those individuals with income more than 300% of the federal benefit limit but less than their monthly medical expenses and who qualify for Medicaid by “spending down” their excess income on their medical expenses.

All States that participate in the Medicaid program (that is, all States) are required to provide Medicaid to the categorically needy.<sup>5</sup> States have the option of providing Medicaid to the “optionally categorically needy,” and they can go further by electing to provide Medicaid to the “medically needy.” States that have elected to provide Medicaid to the “optionally categorically needy” but not to the “medically needy” will establish an income limit (typically 300% of the federal benefit, but sometimes less) as the maximum income for those individuals who may receive Medicaid; these States are known as “income-cap” States, and no “spend-down” for income is allowed as a means of qualifying for Medicaid.

**Assets and Trusts.** States are to base their assessment of financial need only on “such income and resources as are... available to the applicant or recipient.” § 1396a(a)(17)(B) (emphasis added). A fundamental Medicaid rule is that assets over which an individual has neither ownership nor control are not “available” and therefore do not count for Medicaid purposes. Thus, under this general rule, assets in an irrevocable, purely discretionary *trust* are not “available”: not to the trust Settlor because the trust is irrevocable, and not to the trust Beneficiary because the trust is purely discretionary.

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However, for self-settled trusts (that is, those in which the trust Settlor is also the trust Beneficiary), this rule was changed by the Revenue Reconciliation Act of 1993 (P.L. 103-66), (OBRA '93).

"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).

"[A]ny portion of the trust from which, or any income on the corpus from which, no payment could under any circumstances be made to the individual *shall be considered... to be assets disposed by the individual [for less than fair market value]....*"

#### 42 U.S.C. §1396p(d)(3)(B)(ii).

Thus, after OBRA '93, the Medicaid rule for irrevocable self-settled trusts—which itself represents an *exception* to the general rule that assets that are not "available" are not "countable"—is that either the funds in the trusts are "available" to the individual because the trustee has discretion to distribute these to or for the benefit of the individual, or the trust funds are "unavailable" because the trustee has no such discretion. (In the latter case, the funding of the trust which made these funds unavailable will be considered a disqualifying transfer, resulting in a period of ineligibility if the trust was funded during the look-back period.)

But this exception for self-settled trusts *is, itself, subject to three well-known exceptions under § 1396p(d)(4): "payback" or (d)(4)(A) trusts; "Miller," "qualified income," or (d)(4)(B) trusts; and "pooled" or (d)(4)(C) trusts.*

**Background of Hobbs case.** The basic facts and procedural history of *Hobbs* are as follows: As a result of an automobile accident in 2000 when he was six years old, Stefan Hobbs suffered a severe traumatic brain injury which left him disabled and eligible for both SSI and Medicaid. Following the settlement of his case in 2003, about \$275,000 was put into a d4A special needs trust for Hobbs, and \$750,000 was used to purchase a lifetime annuity for him (payable to the SNT trustee).

A year later, after reviewing this trust, the New Mexico Medicaid Agency denied Hobbs' eligibility for Medicaid waiver services based on its determination that the trust was not being administered for his "sole benefit" and was therefore a "countable resource" to Hobbs. This denial was appealed to a fair hearing in 2005, but the Administrative Law Judge affirmed the Medicaid Agency's decision. Hobbs then filed suit in federal district court under § 1983, seeking, *inter alia*, summary judgment that the trust was not a countable resource. But in 2008 the District Court also affirmed the Medicaid denial, finding that the State Medicaid Agency could review the manner in which trust was administered. It was the appeal of this decision that was the basis for the September 1, 2009 10th Circuit opinion upholding the denial.

While the 10th Circuit's opinion in *Hobbs* considered a number of issues, because it found the statutory provisions upon which Hobbs relied did not confer private rights enforceable under § 1983, *everything else in its opinion is merely non-precedential dicta.*

**Analysis of Hobbs decision.** Hobbs alleged a private right of action under § 1983 based on three

provisions of the Social Security Act: § 1396p(d)(4)(A) and two "comparability" statutes—42 U.S.C. § 1396a(a)(10)(C)(i), which requires a State's methodology for determining Medicaid eligibility to "be no more restrictive than the methodology which would be employed under the [SSI] program"; and § 1396a(a)(17), which requires a State's methodology to take into account "only such income and resources as... would not be disregarded... in determining [the applicant's] eligibility for [SSI]."

As the *Hobbs* Court found, "the primary question in determining whether a statute will support a claim under § 1983 is whether 'Congress intended to confer individual rights upon a class of beneficiaries.' [*Gonzaga Univ. v. Doe*, 536 U.S. 273 (2002)] at 285." This determination is made by examining the statute under the three-prong test set forth in *Blessing v. Freestone*, 520 U.S. 329, 329-330 (1997). Under *Blessing* the questions are: 1) whether the plaintiff is an intended beneficiary of the statute; 2) whether the plaintiff's asserted interests are not so vague and amorphous as to be beyond the competence of the judiciary to enforce; and 3) whether the statute imposes a binding obligation on the State.

In *Hobbs*, the 10th Circuit found that neither of the two comparability statutes would support a claim under § 1983 because they failed the first prong of the *Blessing* test:

"Unlike some subsections of § 1396a(a) [such as "§ 1396a(a)(10)(A)(i), which requires States to make Medicaid available to 'all individuals' who meet certain criteria"], the methodology provisions [contained in § 1396a(a)(10)(C)(i) and (a)(17)] do not phrase their directions to program administrators in

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terms of the persons benefited. Their ‘focus is... removed from the interests of individual [applicants] and [they] clearly do not confer the sort of “individual entitlement” that is enforceable under § 1983.’ *Gonzaga Univ.*, 536 U.S. at 287 (quoting *Blessing*, 520 U.S. at 343).”

*Hobbs*, p. 18.

More troubling, though, was the Court’s finding that § 1396p(d)(4)(A), the section of the Medicaid Act that authorized Stefan Hobbs’ special needs trust, would not support a claim under § 1983 because it failed the third prong of the *Blessing* test – that is, “it [did] not ‘unambiguously impose a binding obligation on the State[ ],’” *Blessing*, 520 U.S. at 341.” *Hobbs*, p. 13. Indeed, the Court went further, concluding that “Congress left the States free to decide whether and under what conditions to recognize [§ 1396p(d)(4)] trusts.” *Id.* at 14. In justifying its conclusion, the Court stated it was bound by its prior decision in *Keith v. Rizzuto*, 212 F.3d 1190 (10th Cir. 2000) that not only all “income trusts” under § 1396p(d)(4)(B) but all d4 trusts are *optional*—States are free to treat them as exempt assets or not as they see fit. <sup>6</sup>

“[T]his court concluded in *Keith* that “Congress required that States generally count trust assets and income for purposes of determining Medicaid eligibility [§ 1396p(d)(3)], but exempted trusts from that requirement [§ 1396p(d)(4)]. Thus [sic], Congress left the States free to decide whether and under what conditions to recognize such trusts.” 212 F.3d at 1193. We thus held that States “need not count [§ 1396p(d)(4)] trusts for eligibility purposes, but nevertheless

may... opt to do so.” *Id.* Although the statute might have been read in the first instance to require States to exempt special needs trusts, that construction is foreclosed by our opinion in *Keith*.”

*Hobbs*, p. 14. (Underscoring in original; emphasis added.)

Given the pivotal importance accorded *Keith* by the *Hobbs* court, it is necessary to digress and examine *Keith* to see just what it held and how persuasive its reasoning was for its holding.

**Analysis of *Keith* decision.** The facts of *Keith* can be stated briefly: Clancy Keith had Alzheimer’s disease and resided in a community care facility. He had executed an income trust in order to prevent his pension income from disqualifying him from Medicaid eligibility. Colorado recognized “income trusts” under 42 U.S.C. § 1396p(d)(4)(B), and it had also established an income diversion limit for those who could use such trusts of \$3,034 a month, being the average cost of nursing home care in Keith’s region.<sup>7</sup> Because Keith’s total gross monthly income was \$4,867, he was over the limit and therefore did not qualify to use an income trust.

Keith filed suit against the Secretary of the New Mexico Dept. of Human Services, et al., in federal court, arguing that while 42 U.S.C. § 1396p(d)(3) “allows” States to count trust income and assets, § 1396p(d)(4) exempts (d)(4)(B) income trusts from this requirement. Therefore, States are not allowed to count any income in such trusts in determining Medicaid eligibility. That is, Keith was arguing that (d)(4)(B) income trusts were *mandatory* for States like Colorado that had not elected to extend Medicaid eligibility to the “medically needy.”

The Court disagreed, saying that § 1396p(d)(3) doesn’t “allow”

States to count trusts but *requires* them to do so, and § 1396p(d)(4) “therefore provides an exception to a requirement.” The Court then concluded, illogically, that “[s]tates accordingly [sic] need not count income trusts for eligibility purposes, but nevertheless may, like Colorado, opt to do so. Appellant’s first argument is therefore without merit.” *Keith*, 212 F.3d at 1193 (underscoring added; emphasis in original).<sup>8</sup>

The better reasoning is that Congress intended *all* of § 1396p(d)(4)—indeed, all of § 1396p—to be *mandatory* on the States. The argument for this is as follows: <sup>9</sup>

- 1) As noted above, while States are not required to participate in the Medicaid program, if they do opt to participate, they are required to follow federal law in order to receive federal Medicaid dollars.<sup>10</sup>
- 2) The comparability requirements for state plans are found in § 1396a (at (a)(10)(C)(iii) for the medically needy and at 42 USC § 1396a(r)(2) for all categories of eligibility).
- 3) In general, § 1396a says a state plan “*must* (1) *provide* that it shall be in effect in all political subdivisions of the State, and, if administered by them, *be mandatory upon them*,” and the plan “*must* (2) *provide* for financial participation by the State... for carrying out the State plan...”
- 4) With respect to trusts, § 1396a says that the state plan *must* “(18) *comply* with the provisions of § 1396p of this title with respect to liens, adjustments and recoveries of medical assistance correctly paid, transfers of assets, and treatment of certain trusts.” (Note that state plans *must comply* with *all* of § 1396p, not everything *except* § 1396p(d)(4).)
- 5) Section 1396p(c) concerns “Taking into account certain transfers of assets,” and § 1396p(c)(2)(B)(iv) uses the same mandatory language—

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“An individual *shall not* be ineligible for medical assistance by reason of paragraph (1) [concerning transfers of assets for less than fair market value within the look-back period] to the extent that the assets were transferred to a trust (including a trust described in subsection (d)(4) of this section) established solely for the benefit of an individual under 65 years of age who is disabled...”

- 6) Section 1396p(d)(1), concerning “Treatment of trust amounts,” is also expressed in mandatory terms:

For purposes of determining an individual’s eligibility for, or amount of, benefits under a State plan under this subchapter [Title XIX, Medicaid], subject to paragraph (4), the rules specified in paragraph (3) *shall apply* to a trust established by such individual.

- 7) As noted above, § 1396p(d)(3) operates to deem as “available resources” trusts that are not actually available and therefore would not otherwise count as resources.<sup>11</sup> Section 1396p(d) *requires* States to deem as available certain trusts, but only those trust to which it applies.
- 8) And finally, § 1396p(d)(4) itself says: “This subsection [i.e., subsection d] *shall not* apply to any of the following trusts:” What could be more *mandatory* than the words “shall not”?

Thus, by the use of such language, Congress evidenced its intent that § 1396p(d)(4)(A) be mandatory on the States. Section 1396p(d)(4)(A) thus satisfies the third-prong of the *Blessing* test, because it “imposes a binding obligation on the State” that would support a cause of action under § 1983.

### Keith distinguished from Hobbs.

However, *Keith* can be distinguished from *Hobbs* because these cases involved different types of (d)(4) trusts: in *Keith* the issue was whether the State of Colorado (an “income-cap” state) had the option under federal law to set an income limit on those individuals who could use income trusts established under § 1396p(d)(4)(B), while the pivotal issue in *Hobbs* was whether the State of New Mexico was prohibited by federal law from counting for Medicaid eligibility purposes the assets in a payback trust established under § 1396p(d)(4)(A).

The court in *Hobbs* noted this difference in the type of trusts involved in the two cases but found “no principled distinction” between the two:

*Keith* considered “income trusts” established pursuant to § 1396p(d)(4)(B). Because the same statutory language in § 1396p(d)(4) exempts both special needs and income trusts from the operation of § 1396p(d)(3), *we see no principled distinction that would allow us to read § 1396p(d)(4)(A) as a mandatory exclusion when we have read § 1396p(d)(4)(B) as a discretionary exclusion.*

*Hobbs*, pp. 14-15, footnote 3. (Emphasis added.)

But there *is* a principled distinction, found in the federal statute. Colorado made Medicaid available to the optionally categorically needy but, being an income-cap state, did not extend Medicaid to the medically needy. While Colorado was therefore required under § 1396p(d)(4) to recognize income trusts under § 1396p(d)(4)(B), it was free to *add restrictions to them because, unlike* (d)(4)(A) payback trusts and (d)(4)(C) pooled trusts, these (d)(4)(B) income trusts *were not subject to comparability*. Here is why:

- 1) Section 1382b(e) sets forth the SSI resource rules for trusts. It

states that in determining the resources of an individual, the rules in paragraph (3) apply to all self-settled trusts except those described in paragraph (5).

- a. The rules in paragraph (3) are nearly identical to those in § 1396p(d)(3)(B); that is, funds in a self-settled trust will be considered “available resources” to the individual if either the trust is revocable, or if it is irrevocable, then if “there are any circumstances under which payment from the trust could be made to or for the benefit of the individual (or of the individual’s spouse).” § 1382b(e)(3).
- b. But paragraph (5), which is the exception to paragraph (3), states that § 1382b(e) “shall not apply to a trust described in subparagraph (A) or (C) of section 1396p(d)(4) of this title.”
- i. Note that § 1382b governs resources for SSI purposes. Under comparability any resource excluded by § 1382b does not count as a resource for Medicaid purposes in an SSI state. Thus, if (d)(4)(A) and (d)(4)(C) trusts are SSI resource exclusions under § 1382b(e)(5), then comparability *requires* that Medicaid agencies in SSI States apply them just like any other resource exclusion listed in § 1382b (the home, personal property, trade & business property, life insurance with face value of \$1,500, etc.).
- ii. Note also that income trusts under § 1396p(d)(4)(B) are not excluded under § 1382b(e)(5).
- 2) Section 1396a(a)(10)(G), part of the 1999 SSI Anti-Fraud Act, mandates that States are to disregard § 1382b(c) regarding transfers and § 1382b(e) regarding trusts when applying SSI criteria to determine Medicaid eligibility for individuals who are not receiving SSI. Thus, by enacting this provision Congress made it very clear that

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comparability would continue for (d)(4)(A) and (d)(4)(C) trusts because (G) does not apply to those trusts.<sup>12</sup>

- 3) Thus there is comparability under § 1396a(r)(2) for trusts SSI says meet the § (d)(4)(A) or (C) requirements, but *no* comparability for any other self-settled trusts, including § (d)(4)(B) trusts, for individuals not receiving SSI.

Furthermore, as stated in footnote 8 above, it appears that the income trust applicable to *Keith* was a variation of a § 1396p(d)(4)(B) trust created by a waiver. Both the SSI “state-wideness” requirement for income tests and the comparability requirement can be overridden by a waiver. But the *Keith* opinion does not mention this distinction, which may have misled the Court into

concluding that § 1396(d)(4)(B) is optional in the absence of a waiver, which is not the case.

## Conclusion

The 10th Circuit’s recent opinion in *Hobbs v. Zenderman* contains troubling remarks regarding the limits on distributions from special needs trusts and a narrow reading of the “sole benefit” requirement. However, the *Hobbs* decision is actually a very narrow one because it is based on the Court’s finding that appellant had no cause of action under 42 U.S.C. § 1983, and therefore these troubling remarks are only dicta with no precedential value.

Of much more concern is the Court’s finding, based on its prior decision in *Keith v. Rizzuto*, 212 F.3d 1190 (10th Cir. 2000), that “Congress left the States free

to decide whether and under what conditions to recognize [§ 1396p(d)(4)] trusts.” *Hobbs*, p. 14. In fact, all of 42 U.S.C. § 1396p is binding on the States, including all three (d)(4) trusts. But *Keith* can be distinguished from *Hobbs* because the former involved an income trust under § 1396p(d)(4)(B)—and apparently an income trust established pursuant to a waiver—while the latter involved a payback trust under § 1396p(d)(4)(A), and under § 1382b(e) income trusts are not subject to the strict comparability requirements that apply to payback and pooled trusts. By recognizing this distinction, the *Hobbs* Court could distinguish *Keith* on its facts and find, as have courts in the Second and Third Circuits, that § 1396p(d)(4)(A) does, indeed, impose a “binding obligation” on the States that supports a private cause of action under § 1983.

## Endnotes

- 1 This article is based largely on material, analysis and unflagging support graciously supplied to the author by Wisconsin attorneys Angela Canellos and Sara Buscher.
- 2 For brevity, the “42 U.S.C.” is omitted; all statutory cites hereafter are to sections of 42 U.S.C. unless otherwise noted.
- 3 *Ramey v. Reinertson*, 268 F.3d 955, 957 (10th Cir. 2001), citing *Schweiker v. Gray Panthers*, 453 U.S. at 36-37 (1981).
- 4 The original comparability statute, at 42 U.S.C. §1396a(a)(10)(C)(i)(III), covered only the medically needy. Later, as part of the Medicare Catastrophic Coverage Act of 1988 (P.L. 100-360), Congress reaffirmed its commitment to comparability by re-enacting and expanding it at §1396a(r)(2) to cover additional categories of individuals, including participants in waiver programs and the optionally categorically needy.
- 5 *Ramey*, supra, 268 F.3d at 960, citing *Herweg v. Ray*, 455 U.S. 265, 268 (1982).
- 6 One gets the impression from reading the opinion that the Court had doubts about the soundness of the *Keith* holding; at times, indeed, it sounds almost apologetic in finding itself bound by this prior decision: “*Although the statute might have been read in the first instance to require States to exempt special needs trusts, that construction is foreclosed by our opinion in Keith.*” *Hobbs*, at 14. “*Given this circuit’s prior holding that States have discretion to count § 1396p(d)(4) trusts as resources, Keith, 212 F.3d at 1193, we are not free to adopt the reasoning contained in Wong or Lewis even if we were to agree with that approach.*” *Id.* at 16. (Underscoring added.) (Both *Wong v. Daines*, 582 F. Supp. 2d 475 (S.D.N.Y. 2008) and *Lewis v. Rendell*, 501 F. Supp. 2d 671 (E.D. Pa. 2007), found that § 1396p(d)(4)(A) conferred a private right of action under § 1983: *Wong* because “the district court concluded that § 1396p(d)(4)(A) unambiguously exempted all statutorily-compliant special needs trusts from eligibility determinations,” and *Lewis* because the district court found that § 1396p(d)(4)(A) “refers to the eligibility for Medicaid and provides that eligibility will not be affected by the existence of a [special] needs trust.” *Hobbs*, p. 15.)
- 7 Although the opinion doesn’t say so, the income trust applicable to *Keith* was apparently a variation of a § 1396p(d)(4)(B) trust created by a waiver. The Medicaid statute does not permit an income cap greater than 300% of the federal benefit rate (which the Colorado cap of \$3,034 clearly was), nor does it permit income tests to vary geographically within a state for the categorically Medicaid eligible (that is, those who are SSI-related for Medicaid purposes), unless overridden by a waiver. § 1396b(f)(4)(C); § 1396n(c)(3).

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- 8 How does it follow that an “exception to a requirement” must therefore be an option?
- 9 Nota bene: This argument for the mandatory effect of all of § 1396p(d) is taken almost verbatim from an email to the author by Wisconsin attorney Sara Buscher, who has managed to tease out of the mammoth Social Security Act (deemed “almost unintelligible to the uninitiated” by the U.S. Supreme Court) the relevant provisions cited here to form this step-by-step analysis.
- 10 This is based on the Spending Clause of the U.S. Constitution and 42 U.S.C. § 1396, entitled “Appropriations” (which statute includes the basic requirement that States may receive federal payments only if they have State plans approved by the Secretary). See *Mowbray v. Kozlowski*, 914 F.2d 593 (4th Cir. 1990) regarding the linkage between the Spending Clause and Medicaid and the States’ right to be put on notice when Congress changes the conditions which they must follow in exchange to their receipt of federal funds for Medicaid.
- 11 See *Schweiker v. Gray Panthers*, 453 U.S. 34 (1981), for an explanation of the concept of “actual availability” and the rule that States are not allowed to deem as available resources that are not actually available except as otherwise provided in § 1396a(a)(17).
- 12 Note: *Keith* was decided after these changes in the SSI law but on facts that resulted in the Court deciding the case under the law in effect before the end of 1999 when SSI law changed and (G) was enacted.