DEPARTMENT OF HEALTH AND SOCIAL SERVICES
Division of Economic Support
DES-2051 (Rev. 6/91)

50d
25

WISCONSIN

NEGATIVE NOTICE

Date: 4/7/99

Case name: ANN BUETTNER
Case number: 3106907738

☐ 1. Your application for _____ has been denied.

☐ 2. Your application for Medical Assistance has been denied because your income exceeds the legal maximum by $_____ per month. If you incur six times this amount ($_____) in medical bills, you may be eligible. Contact your worker for details.

☒ 3. Your INSTITUTIONAL M.A. benefits will be stopped effective 5/1/99. CARD SERVICES ONLY WILL BE PROVIDED.

☐ 4. Your _____ check will decrease from $_____ to $_____ effective _____.

☐ 5. _____ will no longer receive _____ benefits effective _____.

☐ 6. Your Food Stamps will decrease from $ _____ to $_____ effective _____.

☐ 7. Your application for _____ has been cancelled because you have withdrawn the application.

☐ 8. We have not yet made a decision on your _____ application.
See explanation.

References: _____ Manual:
or M.A. Handbook: APP. 11.0.0 + 14.0.0
or other (federal law or regulation, state statute, administrative rule): BWI OPERATIONS MEMO NO. 99-19.

Explanation of action:
TRANSFER OF $100,000.00 TO RONALD BUETTNER AND TRANSFE. OF $100,000.00 TO KATHLEEN BUETTNER IN EXCHANGE FOR TWO ANNUITIES THAT EACH PAY ONLY $50.00 MONTHLY FOR 71 MONTHS WITH A FINAL PAYMENT OF $100,000.00 DUE ON EACH ANNUITY IS DIVESTMENT WITH A PENALTY PERIOD OF 3/1/98 THROUGH 2/28/2001. ONLY CARD SERVICES WILL BE PROVIDED DURING THE PENALTY PERIOD.

If you have any questions, please contact:
TIM POLLARD
at 2576672

RICHARD BUSCHMANN
Director

If you do not agree with the decision, you can request a fair hearing. Please see the other side of this notice for fair hearing information as well as information about your rights and responsibilities.

Re: Fed. Register 45 CFR 205-6; 7 CFR 273; Wis. Stats. 49.04, 49.046, 49.19.

ORGINAL COPY: CLIENT CARBONS: ONE TO AGENCY FILE; ONE TO CHILD SUPPORT AGENCY

EXHIBIT A

WISCONSIN

DEPARTMENT OF WORKFORCE DEVELOPMENT
Division of Economic Support
Bureau of Welfare Initiatives

TO: **Economic Support Supervisors**
Economic Support Lead Workers
Training Staff
FSET Administrative & Provider Agencies
Child Care Coordinators
W-2 Agencies

FROM: Stephen M. Dow
Program Implementation Team
Policy Analysis & Program Implementation Section

BWI OPERATIONS MEMO
No. 99-19
File: 2730
2731
Date: 03/17/99
Non W-2 [X] W-2 [ ] CC [ ]
PRIORITY: URGENT

SUBJECT: **MEDICAL ASSISTANCE (MEDICAID) DIVESTMENT-- PROMISSORY NOTES & ANNUITIES**

CROSS REFERENCE: Medical Assistance (MA) Handbook, Appendix 11.0.0 & 14.0.0.

EFFECTIVE DATE: This memo is meant to assist county and tribal staff in understanding existing policy. Therefore there is no new effective date. The current policy has been in effect since October 1, 1993.

PURPOSE

This memo provides information from recent fair hearing decisions that interpret Medicaid divestment policy.

BACKGROUND

Many questions have come into the Department regarding the use of promissory notes and annuities to shelter assets of institutionalized and waiver applicant/recipients in order to qualify for Medical Assistance (Medicaid). For example, county and tribal departments of social/human services staff have asked whether any of the following arrangements are divestment:

1. A $20,000 promissory note from an institutionalized MA applicant to a relative that 'forgives' a portion of the debt and accrued interest each month until no portion of the $20,000 is ever repaid to the institutionalized MA recipient.

EXHIBIT B

2. A promissory note in which the institutionalized person loans $50,000 to a close relative, charges no interest, and requires only $1 each month be repaid, until a lump sum payment is made in final month of the agreement.

3. An annuity in which the institutionalized MA applicant funds an annuity with $50,000 and is repaid $15 each month until the last month of the annuity (the anticipated life expectancy month) when the rest of the annuity is repaid to the MA recipient (the former applicant). Then the recipient takes the rest of the money and funds a similar annuity with a new life expectancy date based upon his current age.

POLICY

The MA Handbook, Appendix 14.2.1, defines divestment as the "transfer of income, non-exempt assets, and homestead property, which belong to an institutionalized person or his/her spouse or both . . .for less than the fair market value of the income or asset." The determining factor in deciding whether a transfer of assets is a divestment is whether the applicant/recipient received fair market value for the transfer.

In an effort to assure uniformity in the application of current policy on the treatment of annuities and promissory notes, the Department is disseminating 2 recent fair hearing decisions: MDV 30/35331 and MDV 30/35213. These are decisions from the Department of Administration's Division of Hearings and Appeals that provide guidance to local agency staff to determine when a promissory note or annuity is divestment.

Promissory Notes

Fair hearing decisions have found that divestment has occurred with promissory notes that have inadequate interest rates, that forgive a portion of the principal or that include a "balloon" payment. The basis for these decisions is that these are not fair market transactions, at arms length, which result in a note which would have value, and be saleable, to a third party. In other words, a note with only interest payments and no payments of principal, even if the principal is due within life expectancy, would also fail the fair market value test and be divestment under this analysis.

As one fair hearing examiner states, "It strains this examiner's credulity to be told that a note for which no principal is paid for five years after the date of the note and then only if the holder is still alive, he was 73 years old at the time the note was executed, is worth its face amount"

Annuities

The document signed was not an annuity since the substance of the repayments were not to be made in fixed periodic payments.

> "In administrative code an annuity is defined as 'a written contract under which in return for payment of a premium or premiums, an individual or individuals have the right to receive ***fixed, periodic payments for life or up to a fixed point in time.***" Wisconsin Administrative Code HFS §103.065(3)(a) (emphasis added).

Something is "fixed" when it is "of an established, unchanging, or permanent character; settled; lasting; stable . . .keeping nearly the same relative position." The general use of annuities engenders fixed payments.

REVIEWS

As mentioned under "Effective Date", the policy described in this memo has existed since 10/01/93. If you are conducting a review for a case where the policy was not applied as described in this memo, apply the policy now. If, in applying the policy, you determine the recipient is no longer MA eligible, (1) provide regular timely notice of discontinuance and (2) do not pursue recoupment.

FOR YOUR INFORMATION

The decisions attached to this Operations Memo are in appeal at circuit court.

CONTACT

If you have any questions about this Operations Memo, please contact the DES Call Center:

Phone = 608-261-6317
FAX = 608-261-6968
E-mail = carpolcc@dwd.state.wi.us

Attachments

STATE OF WISCONSIN
Division of Hearings and Appeals

In the Matter of

[redacted]
Racine, WI [redacted]

DECISION

MDV-30/35331

The proposed decision of the hearing examiner dated October 28, 1998 is amended as follows, and as amended, is issued as the final order of the Department.

In the Discussion section, in the first paragraph of the first subsection on page 2, the first word of the last line, "applicable," is replaced with "application."

At the end of the section A BROADER DEFINITION OF "ANNUITY" IS NOT SUPPORTED BY OTHER CASE LAW, on page 7 the following is inserted:

> **Even if the transaction is construed to meet the formal annuity requirement of periodic fixed payments, in substance it is merely a camouflage for divestment.**
>
> The hearing examiner concludes above that the transaction is not an annuity because of its failure to meet the requirement of fixed, periodic payments. But even if it were conceded that the minimal $15 monthly payments (with the large balloon payment at the end) technically met the requirement of fixed, periodic payments, the result would not change. This transaction has no legitimate underlying economic substance, but is designed to camouflage a divestment in order to secure MA eligibility.
>
> As noted in earlier sections of this decision, courts look to the substance of an "annuity" transaction rather than its form. In one instance specifically cited above, it was noted that a transaction designed to look like an annuity with fixed, periodic payments will not be considered as such if it is designed to "merely camouflage" a loan transaction.
>
> Similarly, the transaction at issue here must be defeated because it is in substance not an annuity, but a divestment. Except to attain MA eligibility, there is no rational basis for transferring $22,000 in assets in return for $15 monthly payments and a balloon payment at the end of life expectancy.

REQUEST FOR A REHEARING

This is a final fair hearing decision. If you think this decision is based on a serious mistake in the facts or the law, you may request a new hearing. You may also ask for a new hearing if you have found new evidence which would change the decision. To ask for a new hearing, send a written request to the Division of Hearings and Appeals, P.O. Box 7875, Madison, WI 53707-7875.

Send a copy of your request to the other people named in this decision as "PARTIES IN INTEREST."

Your request must explain what mistake the examiner made and why it is important or you must describe your new evidence and tell why you did not have it at your first hearing. If you do not explain these things, your request will have to be denied.

Your request for a new hearing must be received no later than twenty (20) days after the date of this decision. Late requests cannot be granted. The process for asking for a new hearing is in sec. 227.49 of the state statutes. A cop of the statutes can found at your local library or courthouse.

APPEAL TO COURT

You may also appeal this decision to Circuit Court in the county where you live. Appeals must be filed no more than thirty (30) days after the date of this hearing decision (or 30 days after a denial of rehearing, if you ask for one). The appeal must be served on the Wisconsin Department of Health and Family Services, P.O. Box 7850, Madison, WI 53707-7850..

The appeal must also be served on the other "PARTIES IN INTEREST" named in this decision. The process for Court appeals is in sec. 227.53 of the statutes.

Given under my hand at the City of Madison, Wisconsin, this 17th day of December, 1998.

Richard Lorang, Deputy Secretary
Department of Health and Family Services

DHA-15 (R10/97)

STATE OF WISCONSIN
Division of Hearings and Appeals

In the Matter of

[redacted]

PROPOSED DECISION

MDV-30/35331

PRELIMINARY RECITALS

Pursuant to a petition filed June 18, 1998, under Wis. Stat. § 49.45(5), to review a decision by the Kenosha County Dept. of Social Services in regard to Medical Assistance (MA), a hearing was held on August 17, 1998 at Kenosha, Wisconsin. A previous hearing set for July 27, 1998, was rescheduled at petitioner's request. At petitioner's request, the record was held open for 35 days, until September 21, 1998. The county representative submitted a letter on September 14, 1998. Petitioner made additional submissions on September 7, 1998, and September 21, 1998.

The issue for determination is whether the county agency had correctly denied MA based on a divestment.

There appeared at that time and place the following persons:

PARTIES IN INTEREST:
Petitioner:

[redacted]
Racine, WI [redacted]

Wisconsin Department of Health and Family Services
Bureau of Health Care Financing
1 West Wilson Street, Room 250
P.O. Box 309
Madison, WI 53707-0309
By: Thomas Buening, ESS Supervisor and Roberta Bloner, ESS
Kenosha County Human Services Dept
8600 Sheridan Road
Kenosha WI 53140

EXAMINER:
Peter D. Kafkas, Attorney
Division of Hearings and Appeals

FINDINGS OF FACT

1. Petitioner (SSN [redacted], CARES # [redacted]) is a resident of Kenosha County.

2. In January 1998, petitioner's husband gave $22,000 to his (and petitioner's) son. The son signed a "self-canceling note." Petitioner applied for MA (nursing home daily rate), which was denied on the basis that the note had no value. The county agency concluded that the transfer of the $22,000 was a divestment. A fair hearing was held, and an examiner decided that the "purchase" of the "note" was a divestment.

2. In April 1998, the son returned the $22,000 to petitioner's husband. The parties also canceled the "self-canceling note." On April 25, 1998, petitioner's husband, once again, gave the $22,000 to his son. At the same time, the son gave the petitioner's husband a document entitled "irrevocable annuity." This document stated that petitioner's son was to pay $15 per month to petitioner's husband for 66 months. On December 31, 2003, the son was to make a final payment of $22,010 to petitioner's husband.

3. The document provided that petitioner's husband could not sell the "annuity." The payment amounts were not fixed. Nominal payments were to be made the first 66 months and a balloon payment of the substantial return amount during the last month. The payments were not to vary based on varying rate of return on an investment. Less than 5% of the repayment total was to be made the first 65 months. Over 95% of the repayment total was to be paid after 66 months.

4. The document signed on April 25, 1998, had no fair market value.

DISCUSSION

PROPERTY WAS DIVESTED SINCE IT WAS TRANSFERRED FOR LESS THAN FAIR MARKET VALUE

"'Divestment' is the transfer of income, non-exempt assets, and homestead property . . . which belong to an institutionalized person or his/her spouse or both . . . [f]or less than the fair market value of the income or asset." MA Handbook, App. 14.2.0. The "'[d]ivested amount' is the net market value minus the value received." Id. at 14.2.7. "If there was a divestment [, and no exceptions apply,] the institutionalized person must be determined ineligible for a period of time." Id. at 14.5.0. Regarding a denial of an applicable for benefits, the petitioner has the burden of establishing eligibility.

It was undisputed petitioner's husband transferred $22,000 to his son in cash on April 25, 1998. In return, he was to receive $15 monthly payments for 66 months and a $22,010 payment on December 31, 2003. Exhibit 2, page 2, Document entitled "Irrevocable Annuity." Petitioner's husband could "not sell, pledge, or otherwise use as security the amount invested or due from th[e] annuity." Id. at 1. The annuity was unsecured. Id. A cursory review of the return payment amounts reveals that the tiny yield on this contract is not even that of a simple bank account or Treasury bill, both of which have no risk. "Fair market value or full value of property is defined as: '[t]he amount it will sell for upon arms-length negotiation in the open market, between an owner willing but not obliged to sell, and a buyer willing but not obliged to buy.'" *City of West Bend v. Continental IV Fund*, 193 Wis.2d 481, 486, 535 N.W.2d 24 (Ct.App. 1995) (citations omitted). Because this transaction was between petitioner's husband and his son, the examiner can not rely on the value attributed by the family to this contract. It clearly was not "arms-length." No person of sound mind would give $22,000 to an unrelated third party in exchange for the unsecured, low yield, and non-alienable, promises in the instant document. Petitioner presented no evidence, expert or otherwise, that the contract had any "fair market value." This agreement, which could not be sold, pledged, or used as security, had no fair market value. Under a traditional analysis it is clear

a divestment occurred here. The purpose of the transaction was not an investment. It was to transfer assets to children and obtain MA eligibility.

COMPUTATION OF DIVESTMENT AMOUNTS FOR ANNUITIES IS MADE DIFFERENTLY

Petitioner argues that the examiner should find that the transfer was in return for an annuity. In general, with annuity divestments, "[t]he amount of assets that is transferred for less than fair market value [or divested] is the amount by which the transferred amount exceeds the expected value of the benefit." Wis. Stat. § 49.453(4)(b). "'Expected value of the benefit' means the amount that an irrevocable annuity will pay to the annuitant during his or her expected lifetime" which is computed according life expectancy tables. Id. at (1)(c); see also, id. at (4)(c) and MA Handbook, App. 30.10.0. Under this computation scheme, rate of return is not a factor. As long as at least payments totaling the original payment amount are scheduled to be returned during the expected lifetime of the transferor (under the life expectancy table), no divestment will be found. This computation makes some sense where fixed, periodic payments are scheduled. Even if a large amount of money is "paid" for an annuity, a certain income level and/or asset level is guaranteed per month or year. It would result in strange MA eligibility determinations were graduated or lump-sum balloon payments considered annuities; i.e., $1 per month annuity payments resulting in virtually no assets or income for MA purposes - with ineligibility only the last month of life expectancy because of a lump-sum payment. If the person would pass away before the date in the life expectancy table, no MA ineligibility will ever have occurred. If the person would pass away after the life expectancy period, MA eligibility will have been long deferred (regardless, a new "annuity" could be drafted so no ineligibility would occur). Thus, the examiner must determine whether petitioner's husband purchased an annuity from his son. If the title on a document determines whether it is an annuity, there is a financial incentive for a prospective MA recipient to title all lump-sum payment agreements, monthly payment promissory notes, and mixed lump-sum, monthly payment promissory notes as annuities.

The determination of divestment amounts discussed here may not be the exclusive way to determine an annuity divestment amount. This examiner does not need to reach this issue given the discussion infra.

THE DOCUMENT SIGNED WAS NOT AN ANNUITY SINCE THE SUBSTANCE OF THE REPAYMENTS WERE NOT TO BE MADE IN FIXED, PERIODIC PAYMENTS

Annuities have long been "described as a sum paid yearly or at other specified intervals in return for the payment of a fixed sum by the annuitant." *Bodine v. Comm. Of Internal Revenue*, 103 F.2d 982, 984 (3rd Cir.), cert. denied, 308 U.S. 576 (1939). The term has been "generally understood as an agreement to pay a specified sum to the annuitant annually during his life." *Hess v. U.S.*, 74 F.Supp 135, 138 (D.C. Minn. 1947) (citations and quotation marks omitted). "The label applied to the agreement between [what was typically an] insurer and [alleged annuitant] need not be determinative of its character. Courts have been "concerned with the substance of the transaction rather than the form." *Id.* Therefore, "[a]n examination of the authorities does not warrant the conclusion that an annuity contract is an insurance contract. It [has long been] defined as a yearly payment of a certain sum of money granted to another in fee for life or for years . . .." *Knight v. Finnegan*, 74 F.Supp 900, 902 (E.D. Mo. 1947). There has been some expansion or refining of the term over the years. For example, "[w]hen a purchaser invests in a "variable" annuity, the purchaser's money is invested in a designated way and payments to the purchaser vary with investment performance. In a classic "fixed" annuity, in contrast, payments do not vary." *NationsBank of N. C., N. A. v. Variable Annuity Life Ins. Co.*, 513 U. S. 251, 254 (1995) (emphasis added) (hybrid annuity is a mixture of the two). The long history of cases defining a basic annuity has resulted in a clear and common understanding that one of its attributes is fixed, unchanging periodic payments. See, 4 Am Jur Annuities § 1 (1998) ("An annuity is a right – bequeathed, donated, or purchased – to receive fixed or certain periodical payments, either for life or a stated period of time.") and Black's Law Dictionary 82 (5th ed. 1979) ("A right to receive fixed, periodic payments, either for life or for a term of years.")

It could be argued that the definition of an annuity should include variable annuities, which are discussed supra. See, *NationsBank of N. C., N. A.*, 513 U. S. at 254 (1995). Again, a variable annuity is:

> [a] contract calling for payments to the annuitant in varying amounts depending on the success of the investment policy of the insurance company; unlike a straight annuity which requires the payment of a fixed amount. The purpose of this type of annuity is to offset deflated value of [the] dollar caused by inflation.

Black's Law Dictionary 83(5th ed. 1979) (emphasis added). However, the use of variable annuities to avoid divestment rules contradicts the language of the relevant administrative code section, which states:

> "Annuity" means a written contract under which, in return for payment of a premium or premiums, an individual or individuals have the right to receive fixed, periodic payments for life or up to a fixed point in time.

Wis. Adm. Code, § HFS 103.065(3)(a) (emphasis added). Something is "fixed" when it is "[o]f an established, unchanging, or permanent character; settled; lasting; stable . . . [k]eeping nearly the same relative position." Funk and Wagnalls, The New International Dictionary of the English Language Vol. I, 479 (in both editions) (1967 and 1989) (emphasis added). The general use of annuities engenders fixed payments. The legislature did not add the word "variable" in front of the word annuity in the relevant statutes. See, Wis. Stat. § 49.453(4)(b). As discussed supra, courts have generally required annual or more frequent payments for an annuity definition to apply. The Wisconsin Statutes do not define "annuity" in the context of MA. However, as an analogy, the term is discussed in the context of the Wisconsin employee trust fund. See, Wis. Stat. ch. 40. In the relevant chapter, it states, "'Annuity' means a series of monthly payments payable during the life of the annuitant or during a specific period." Wis. Stat. § 40.02(5) (emphasis added) (many sections of that chapter distinguish between "annuities" and "lump sum payments." See, 1997 Wisconsin Act 149 § (enacted April 20, 1998) amending Wis. Stat. § 40.05(4)(b); Wis. Stat. § 40.24 (annuity options) versus Wis. Stat. § 40.25 (lump sum payments)). The administrative code's requirement of fixed, periodic payments is reasonable and consistent with the statutes and common understanding of the word "annuity."

The document which petitioner's husband signed was intended to look somewhat like an annuity – it contemplates titular fixed payments over 66 months. Exhibit 2, document entitled "Irrevocable Annuity," page 2. These miniscule payments of $15 a month do not make the substance of the transaction an annuity. If so, not considering other possible limitations, a party could transfer over a million dollars to a relative and, in return, the relative could make payments of $1 per month for all but the last month of life expectancy and over a million dollars during the last month of life expectancy – qualifying a person with extremely large assets immediately for MA. The annuity label is not, in itself, binding. The lump sum payment of over $22,010 near the last month of life expectancy for petitioner clearly did not qualify as a "fixed, periodic payment." Even if the administrative code and/or statutes had lumped "variable annuities" with "annuities," the document in question would not qualify. It did not envision a periodic payment based on "investment performance" as in a variable annuity. The nominal payments totaling less than 5% of the overall repayment did not change the true character of the transaction. This was essentially a payment of $22,000 in return for some diminutive monthly payments and a lump sum balloon payment of $22,010 (over 95% of the balance) after 66 months. The true essence of the agreement was the lump sum, balloon payment, not the small, token, monthly payments. The lack of an arms-length relationship, the total unsecured nature of the transaction, along with the inability of petitioner's husband to transfer or sell his interest, further mitigate against an annuity being found to truly exist here. Again, these transactions are most commonly with a business or an insurance company as an "investment." See, *Nationsbank*, 513 U.S. at 254.

THE TRANSACTION SHOULD NOT BE DIVIDED INTO A LUMP SUM PAYMENT AND ANNUITY

It could also be argued that the nominal fixed, periodic payments should be separated from the lump sum, balloon payment so that the divestment amount would be reduced. First, the 66 months of $15 payments would not affect when MA or how much MA would be received. See, MA Handbook, App. 14.5.2 (divide the divested amount by average nursing home cost ($3,334); i.e., $990/$3,334 = .296 months, with required rounding on the overall balance, no change or ($22,010 - $990)/$3334 = 6.3 round to 6 months). The county agency used an ineligibility period of six (6) months. Exhibit 3, July 10, 1998 Summary Letter. Second, it would be difficult to determine what amount was purportedly paid for these modest payments (presumably less than the $990). Third, the substance of the overall transaction makes it clear that an annuity was not created.

THE COUNTY AGENCY CORRECTLY COMPUTED THE INELIGIBILITY PERIOD

Petitioner's counsel argues that any ineligibility (divestment) period should run from the first transfer of cash for the "note," instead of the second transfer of cash for the "annuity." The following facts were undisputed by the parties. In January 1998, petitioner's husband transferred $22,000 to petitioner's and his son. Approximately the same time, the son gave petitioner's husband a "self-canceling promissory note." The county agency denied MA based on the transaction; i.e., divestment. In April 1998, petitioner's husband and the son voided the promissory note. The son returned the $22,000. On April 25, 1998, petitioner's son then signed the "irrevocable annuity." Petitioner's husband gave the son $22,000 on the same date. The annuity agreement clearly states that petitioner's husband was transferring $22,000 (in cash) to his son on April 25th, 1998. Exhibit 2, page 1, "Irrevocable Annuity." Petitioner has supplied no authority for the use of the earlier promissory note date. *Cf.*, MA Handbook, App. 14.5.0. The transfer of $22,000 in cash occurred on April 25, 1998. This is the divestment date.

PETITIONER'S *DE FACTO* ARGUMENTS DO NOT CHANGE THE RESULT IN THIS MATTER

Petitioner's engagement into this transaction was between the issuance of a Draft Operations Memo dated April 16, 1998, and an Operations Memo dated June 9, 1998. Both memos required, among other things, "payments equally distributed (by amount) over the life of the annuity." Draft Operations Memo dated April 16, 1998; Operations Memo dated June 9, 1998 (parenthesis in original).

After the transaction in this case, and after the second operations memo, an attorney, Bruce Tammi, (who is not counsel in this case) wrote to the department stating that he was the "originator of the use of private irrevocable annuities in the State of Wisconsin." He said that "welfare law is completely statutory in nature and [the] department must conform its policies and actions to the mandates of the Wisconsin Statutes." He demanded retraction of the memos or a listing of specific statutory or administrative code provisions within 10 days or he would file a mandamus action against the department. The Medicaid Eligibility Chief wrote back that the "draft Operations Memo that described" changes to MA policy on "Annuities with Balloon Payments" needed additional legal research. She said she was informing a county agency that received a preliminary draft that the policy change in that operations memo was not to be implemented at that time. Counsel in this case apparently received a copy of the attorney's letter and response (which did not deal with the current case) from the other attorney.

Although the correspondence discussed above does not deal with the current case, the examiner will consider it. It is *de facto* argument by petitioner.

The letter from the Medicaid Eligibility Chief refers to the "draft memo." It is not clear whether the Final Operations Memo dated June 9, 1998, is being referenced. The county representative in this case stated that Kenosha County never received a retraction of the Operations Memo dated June 9, 1998. The

representative said, "Kenosha County, to date has not received any form of written or verbal correspondence direction us to implement a policy change." September 10, 1998, letter. The county representative also indicated that Kenosha County had followed the same procedures before and after the operations memo. The Operations Memo dated June 9, 1998, states, "This is a clarification of an existing policy . . .." Nevertheless, as the current status of the Operations Memo dated June 9, 1998 is unclear, the examiner is not relying on it as policy of the department. The retraction of the operations memo would not delete the administrative code requirement of "fixed, periodic payments" for an annuity to exist. Moreover, Attorney Tammi's letter to the department had erred in stating that "welfare law is completely statutory." Mandatory Wisconsin case authority, persuasive case authority, and administrative code provisions may all be considered in determining, or along with, the common or legal meaning for a word such as "annuity." Petitioner can not state that she relied on the July 22, 1998, department letter since the April 25, 1998, transaction occurred prior to it. Nor does the July 22, 1998, correspondence from the department state that transactions such as the one here are not divestments under department policy. Such a policy statement would be contrary to Wis. Adm. Code § HFS 103.065(3)(a), which requires fixed, periodic payments for annuities.

A BROADER DEFINITION OF "ANNUITY" IS NOT SUPPORTED BY OTHER CASE LAW

In an attempt to determine whether any primary or secondary authority existed for a broader definition of "annuity," the examiner found a publication from a Continuing Legal Education Course (CLE). *Basic Annuities in the Medical Assistance Context* 1997 (State Bar of Wisconsin CLE Course Handbook, Special Problems of the Aging October 1997). This publication contains a subsection dealing with "Annuities at Hearing." *Id.* It states "[a]nnuities are contractual arrangements in which an individual pays a sum of money to another in return for a future stream of income or payments." *Id.* (emphasis added). "[P]ages 284 through 296 of 2 AM [sic] Jur Legal Forms 2d" is cited as supporting the broad "future stream of income or payments" definition. *Id.* The legal forms in the publication are also cited in support of the broad definition. 2A Am Jur 2d Legal Forms 2d Annuities § 21:5 (1997) states "[a] bargained-for annuity given in exchange for property is a contract in which the consideration on one side is the establishment of fixed payments for some term of years rather than immediate payment . . .." (Emphasis added). This publication notes that the title given to a document is not determinative since "a contract to pay an annuity that is merely camouflage for a loan at a usurious rate of interest may be treated by the courts as a loan within the prohibition of usury statutes." Id. (emphasis added).

The examiner did not find the term "future stream of income or payments" in various case reporters. Contrarily, the drafting record for Wis. Stat. § 49.454(4) shows a pen mark crossing out the words "nondiscretionary trust" and leaving only "irrevocable annuity" for the special treatment used in determining divestment amounts. See, drafting record for 1993 Assembly Bill 1126 (which was promulgated as 1993 Wis. Act 437 § 85). It would appear the legislature contemplated the fixed, periodic payments of an annuity and not the varying, uneven payments that can be associated with a trust.

All of the forms, except one, in 2A Am Jur Legal Forms 2d Annuities dealing with general annuities provide for fixed, periodic payments. 2A Am Jur Legal Forms 2d Annuities § 21:7 – 21:19 (1997 & Supp. June 1998 (no forms in pkt. part)). Some forms do contain provision for payment to a remainder in a real estate transaction (or to a beneficiary) upon death, but this is not a lump sum payment to the annuitant. See, eg., Id. at § 21:15. Two forms that provide for a lump sum payment at the end of a certain number of years are entitled "Annuity Trusts." Id. at § 21:17-18 (emphasis added). One form provides for a cost of living increase based on the Consumer Price Index (CPI). Id. at § 21:25. This is a protection against inflation as discussed regarding a variable annuity. See, supra, Black's Law Dictionary 83 (5th ed. 1979) (discussion of inflation protection for a variable annuity). There is no support for the broad "future stream of income or payments" definition for the generic term "annuity."

The author of the letter to the department, Attorney Bruce A. Tammi, is listed as an author or presenter relating to the "future stream of income or payments" discussion. B. Tammi, *Annuities at Hearing* a subsection of *Basic Annuities in the Medical Assistance Context* 1997 (State Bar of Wisconsin CLE Course Handbook, Special Problems of the Aging October 1997). However, another author writes, "[s]ome attorneys have considered annuities with smaller income streams and a balloon payment at the end. If these are 'actuarially sound' it should be arguable that they would be permitted. However, I believe a challenge from the Department could be expected." J. Jeager, *Advanced Planning Techniques* a subsection of *Basic Annuities in the Medical Assistance Context* 1997 (State Bar of Wisconsin CLE Course Handbook, Special Problems of the Aging October 1997). CLE materials are not typically granted great weight as secondary authority. Nevertheless, given the dearth of publications contradicting the fixed and periodic requirements for payments in annuities, it is the closest publication to supporting petitioner's position in any way. The CLE materials do not persuade in this case. If fixed, periodic payments are not required, any document entitled "annuity" will have to be treated as such. As the U.S. Supreme Court stated in *Nationsbank*, **"[i]n a classic "fixed" annuity . . . payments do not vary."** *NationsBank*, 513 U. S. at 254 (emphasis added).

A PROPOSED DECISION IS PROPER IN THIS MATTER

The Division of Hearing and Appeals has been presented with a wide variety of divestment issues concerning annuities. Such issues have involved diverse areas such as distinctions of annuities versus trusts and annuities versus promissory notes. The structure of various alleged annuities has also differed in cases presented to the Division; i.e., small payments with lump sums, graduated payments, and other varying payment schedules. County representatives are trained extensively concerning the MA Handbook. Annuities are not defined in this handbook. County workers statewide are not trained in legal interpretation of statutory authority. Different county agencies have periodically raised different issues concerning alleged annuities. The issue of the explicit definition of an annuity has apparently never been raised. Decisions of various examiners at the Division of Hearings and Appeals have differed on annuity divestment issues. See, DHA Case Nos. MED-40/##16089 and 16621 and MDV-40/##16822, 17567, and 17602 (Wis. Div. Hearings & Appeals Oct. 7, 1997 (combined cases)), on rehearing DHA Case Nos. MED-40/16089 and MDV-40/16822, 17567, and 17602 (Wis. Div. Hearings & Appeals Oct. 7, 1997 (again combined cases)) (divestment found); DHA Case No. MED-40/87846 (Wis. Div. Hearings & Appeals June 6, 1995) (no divestment found); DHA Case No. MED-40/11073) (Wis. Div. Hearings & Appeals (no divestment found, different result on promissory note issue); and DHA Case No.MDV-45/22152 (Wis. Div. Hearings & Appeals July 6, 1998) (divestment found) and on rehearing (by the same examiner) DHA Case No. MDV-45/22152 (Wis. Div. Hearings & Appeals Sept. 2, 1998) (no divestment found – discussion of Tammi letter and Department reply discussed above). Decisions of the Division of Hearings and Appeals do not serve as precedent for other hearing decisions unless issued as proposed decisions and adopted as final by the Secretary of the Department of Health and Family Services. Previous decisions did not explicitly deal with the definition of an annuity. This decision involves a new analysis of the issue. Issuing a proposed decision allows the parties to fully comment before a final decision is issued. It provides for a uniform policy in this area.

CONCLUSIONS OF LAW

1. The county agency correctly determined that the $22,000 petitioner's husband transferred to his son was divested since he did not receive fair market value in return.
2. The county agency correctly determined that petitioner's husband did not purchase an annuity since the contract did not call for fixed, periodic payments, but instead for nominal payments and a varying balloon payment.

3. The county agency correctly determined that petitioner's husband did not purchase an annuity given the other terms of the agreement in combination with the relationship between the parties.

4. The county agency correctly determined the ineligibility period relying on the April 25, 1998, transaction date since the document stated that petitioner's husband transferred at least $22,000 in cash on that date.

NOW, THEREFORE, it is **ORDERED**

That the petition for review herein be and the same is hereby dismissed.

NOTICE TO RECIPIENTS OF THIS DECISION:

This is a Proposed Decision of the Division of Hearings and Appeals. IT IS NOT A FINAL DECISION AND SHOULD NOT BE IMPLEMENTED AS SUCH.

If you wish to comment or object to this Proposed Decision, you may do so in writing. It is requested that you briefly state the reasons and authorities for each objection together with any argument you would like to make. Send your comments and objections to the Division of Hearings and Appeals, P. O. Box 7875, Madison, WI 53707-7875. Send a copy to the other parties named in the original decision as "PARTIES IN INTEREST."

All comments and objections must be received no later than 15 days after the date of this decision. Following completion of the 15 day comment period, the entire hearing record together with the Proposed Decision and the parties' objections and argument will be referred to Secretary of the Department of Health and Family Services for final decision-making.

The process relating to Proposed Decisions is described in sec. 227.46(2), Wis. Stats.

Given under my hand at the City of Madison, Wisconsin, this 28th day of October, 1998.

Peter D. Kafkas, Attorney
Division of Hearings and Appeals
1022/PDK

cc:

STATE OF WISCONSIN
Division of Hearings and Appeals

In the Matter of

[redacted]

DECISION

MDV-30/35213

The proposed decision of the hearing examiner dated October 28, 1998 is amended as follows, and as amended, is issued as the final order of the Department.

In the Discussion section, in the first paragraph of the first subsection on page 2, the first word of the last line, "applicable," is replaced with "application."

At the end of the section A BROADER DEFINITION OF "ANNUITY" IS NOT SUPPORTED BY OTHER CASE LAW, on page 7 the following is inserted:

> **Even if the transaction is construed to meet the formal annuity requirement of periodic fixed payments, in substance it is merely a camouflage for divestment.**
>
> The hearing examiner concludes above that the transaction is not an annuity because of its failure to meet the requirement of fixed, periodic payments. But even if it were conceded that the minimal $25 monthly payments (with the large balloon payment at the end) technically met the requirement of fixed, periodic payments, the result would not change. This transaction has no legitimate underlying economic substance, but is designed to camouflage a divestment in order to secure MA eligibility.
>
> As noted in earlier sections of this decision, courts look to the substance of an "annuity" transaction rather than its form. In one instance specifically cited above, it was noted that a transaction designed to look like an annuity with fixed, periodic payments will not be considered as such if it is designed to "merely camouflage" a loan transaction.
>
> Similarly, the transaction at issue here must be defeated because it is in substance not an annuity, but a divestment. Except to attain MA eligibility, there is no rational basis for transferring $103,255 in assets in return for $25 monthly payments and a balloon payment at the end of life expectancy.

REQUEST FOR A REHEARING

This is a final fair hearing decision. If you think this decision is based on a serious mistake in the facts or the law, you may request a new hearing. You may also ask for a new hearing if you have found new evidence which would change the decision. To ask for a new hearing, send a written request to the Division of Hearings and Appeals, P.O. Box 7875, Madison, WI 53707-7875.

Send a copy of your request to the other people named in this decision as "PARTIES IN INTEREST."

Your request must explain what mistake the examiner made and why it is important or you must describe your new evidence and tell why you did not have it at your first hearing. If you do not explain these things, your request will have to be denied.

Your request for a new hearing must be received no later than twenty (20) days after the date of this decision. Late requests cannot be granted. The process for asking for a new hearing is in sec. 227.49 of the state statutes. A copy of the statutes can found at your local library or courthouse.

APPEAL TO COURT

You may also appeal this decision to Circuit Court in the county where you live. Appeals must be filed no more than thirty (30) days after the date of this hearing decision (or 30 days after a denial of rehearing, if you ask for one). The appeal must be served on the Wisconsin Department of Health and Family Services, P.O. Box 7850, Madison, WI 53707-7850..

The appeal must also be served on the other "PARTIES IN INTEREST" named in this decision. The process for Court appeals is in sec. 227.53 of the statutes.

Given under my hand at the City of Madison, Wisconsin, this 17th day of December, 1998.

Richard Lorang, Deputy Secretary
Department of Health and Family Services

DHA-15 (R10/97)

STATE OF WISCONSIN
Division of Hearings and Appeals

In the Matter of

[redacted]

PROPOSED
DECISION

MDV-30/35213

PRELIMINARY RECITALS

Pursuant to a petition filed June 17, 1998, under Wis. Stat. § 49.45(5), to review a decision by the Kenosha County Dept. of Social Services in regard to Medical Assistance (MA), a hearing was held on August 17, 1998 at Kenosha, Wisconsin. At petitioner's request, the record was held open for 35 days, until September 21, 1998. The county representative submitted a letter on September 14, 1998. Petitioner made additional submissions on September 7, 1998, and September 21, 1998.

The issue for determination is whether the county agency had correctly denied MA based on a divestment.

There appeared at that time and place the following persons:

PARTIES IN INTEREST:

Petitioner:

[redacted]
Racine, WI [redacted]

Petitioner's Representative:

Attorney [redacted]
(same address)

Wisconsin Department of Health and Family Services
Bureau of Health Care Financing
1 West Wilson Street, Room 250
P.O. Box 309
Madison, WI 53707-0309
By: Thomas Buening, ESS Supervisor and Kathi Tolnai, ESS
Kenosha County Human Services Dept
8600 Sheridan Road
Kenosha WI 53140

EXAMINER:
Peter D. Kafkas, Attorney
Division of Hearings and Appeals

FINDINGS OF FACT

1. Petitioner (SSN [redacted], CARES #[redacted]) is a resident of Kenosha County. He is an applicant for MA.

2. In June 1996, petitioner transferred his home to his two sons. His home had a value of $106,800. In December 1997, his sons gave him a promissory note in exchange for the property. See, Petitioner's Brief, page 1. The promissory note provided for interest only until a lump sum payment in 2002. Exhibit C. Petitioner then applied for Title 19, which was denied.

3. On April 24, 1998, petitioner and his sons cancelled the promissory note and endorsed a document entitled "Irrevocable Annuity." The second transaction involved proceeds from the sale of the home (balance on the promissory note) and an additional $50,454 petitioner still had. The document stated that $103,255 in cash was being given to the sons on the date of execution. In return, the sons were to give petitioner $25 per month for 66 months. The document stated the total of the monthly payments would be $1,500. On the 66th month, the sons were to pay a lump sum, balloon payment, to petitioner in the amount of $106,755. Exhibit 2, "Irrevocable Annuity," page 2.

4. The document provided that petitioner could not sell the annuity. The payment amounts were not fixed. Nominal payments were to be made the first 66 months and a balloon payment of the substantial return amount during the last month. The payments were not to vary based on varying rate of return on an investment. Less than 2% of the repayment total was to be made the first 65 months. Over 98% of the repayment total was to be paid the 66th month. Id.

5. The document signed on April 24, 1998, had no fair market value.

DISCUSSION

PROPERTY WAS DIVESTED SINCE IT WAS TRANSFERRED FOR LESS THAN FAIR MARKET VALUE

"'Divestment' is the transfer of income, non-exempt assets, and homestead property . . . which belong to an institutionalized person or his/her spouse or both . . . [f]or less than the fair market value of the income or asset." MA Handbook, App. 14.2.0. The "'[d]ivested amount' is the net market value minus the value received." Id. at 14.2.7. "If there was a divestment [, and no exceptions apply,] the institutionalized person must be determined ineligible for a period of time." Id. at 14.5.0. Regarding a denial of an applicable for benefits, the petitioner has the burden of establishing eligibility.
TION

It was undisputed petitioner transferred $103,255 to his two sons in cash on April 24, 1998. In return, he was to receive $25 monthly payments for 66 months and a $106,755 payment also in the 66th month. Exhibit 2, page 2, Document entitled "Irrevocable Annuity." Petitioner could "not sell, pledge, or otherwise use as security the amount invested or due from th[e] annuity." Id. at 1. The annuity was unsecured. Id. A cursory review of the return payment amounts reveals that the tiny yield on this contract is not even that of a simple bank account or Treasury bill, both of which have no risk. "Fair market value or full value of property is defined as: '[t]he amount it will sell for upon arms-length negotiation in the open market, between an owner willing but not obliged to sell, and a buyer willing but not obliged to buy.'" *City of West Bend v. Continental IV Fund*, 193 Wis.2d 481, 486, 535 N.W.2d 24 (Ct.App. 1995) (citations omitted). Because this transaction was between petitioner and his sons, the examiner can not rely on the value attributed by the family to this contract. It clearly was not "arms-length." No person of sound mind would give $103,255 to an unrelated third party in exchange for the unsecured, low yield, and non-alienable, promises in the instant document. Petitioner presented no evidence, expert or otherwise, that the contract had any "fair market value." This agreement, which could

not be sold, pledged, or used as security, had no fair market value. Under a traditional analysis it is clear a divestment occurred here. The purpose of the transaction was not an investment. It was to transfer assets to children and obtain MA eligibility.

COMPUTATION OF DIVESTMENT AMOUNTS FOR ANNUITIES IS MADE DIFFERENTLY

Petitioner argues that the examiner should find that the transfer was in return for an annuity. In general, with annuity divestments, "[t]he amount of assets that is transferred for less than fair market value [or divested] is the amount by which the transferred amount exceeds the expected value of the benefit." Wis. Stat. § 49.453(4)(b). "'Expected value of the benefit' means the amount that an irrevocable annuity will pay to the annuitant during his or her expected lifetime" which is computed according life expectancy tables. Id. at (1)(c); see also, id. at (4)(c) and MA Handbook, App. 30.10.0. Under this computation scheme, rate of return is not a factor. As long as at least payments totaling the original payment amount are scheduled to be returned during the expected lifetime of the transferor (under the life expectancy table), no divestment will be found. This computation makes some sense where fixed, periodic payments are scheduled. Even if a large amount of money is "paid" for an annuity, a certain income level and/or asset level is guaranteed per month or year. It would result in strange MA eligibility determinations were graduated or lump-sum balloon payments considered annuities; i.e., $1 per month annuity payments resulting in virtually no assets or income for MA purposes - with ineligibility only the last month of life expectancy because of a lump-sum payment. If the person would pass away before the date in the life expectancy table, no MA ineligibility will ever have occurred. If the person would pass away after the life expectancy period, MA eligibility will have been long deferred (regardless, a new "annuity" could be drafted so no ineligibility would occur). Thus, the examiner must determine whether petitioner purchased an annuity from his sons. If the title on a document determines whether it is an annuity, there is a financial incentive for a prospective MA recipient to title all lump-sum payment agreements, monthly payment promissory notes, and mixed lump-sum, monthly payment promissory notes as annuities.

The determination of divestment amounts discussed here may not be the exclusive way to determine an annuity divestment amount. This examiner does not need to reach this issue given the discussion infra.

THE DOCUMENT SIGNED WAS NOT AN ANNUITY SINCE THE SUBSTANCE OF THE REPAYMENTS WERE NOT TO BE MADE IN FIXED, PERIODIC PAYMENTS

Annuities have long been "described as a sum paid yearly or at other specified intervals in return for the payment of a fixed sum by the annuitant." *Bodine v. Comm. Of Internal Revenue*, 103 F.2d 982, 984 (3rd Cir.), cert. denied, 308 U.S. 576 (1939). The term has been "generally understood as an agreement to pay a specified sum to the annuitant annually during his life." *Hess v. U.S.*, 74 F.Supp 135, 138 (D.C. Minn. 1947) (citations and quotation marks omitted). "The label applied to the agreement between [what was typically an] insurer and [alleged annuitant] need not be determinative of its character. Courts have been "concerned with the substance of the transaction rather than the form." *Id.* Therefore, "[a]n examination of the authorities does not warrant the conclusion that an annuity contract is an insurance contract. It [has long been] defined as a yearly payment of a certain sum of money granted to another in fee for life or for years . . .." *Knight v. Finnegan*, 74 F.Supp 900, 902 (E.D. Mo. 1947). There has been some expansion or refining of the term over the years. For example, "[w]hen a purchaser invests in a "variable" annuity, the purchaser's money is invested in a designated way and payments to the purchaser vary with investment performance. In a classic "fixed" annuity, in contrast, payments do not vary." *NationsBank of N. C., N. A. v. Variable Annuity Life Ins. Co.*, 513 U. S. 251, 254 (1995) (emphasis added) (hybrid annuity is a mixture of the two). The long history of cases defining a basic annuity has resulted in a clear and common understanding that one of its attributes is fixed, unchanging periodic payments. See, 4 Am Jur Annuities § 1 (1998) ("An annuity is a right – bequeathed, donated, or purchased – to receive fixed or certain periodical payments, either for life or a stated period of time.") and Black's Law Dictionary 82 (5th ed. 1979) ("A right to receive fixed, periodic payments, either for life or for a term of years.")

It could be argued that the definition of an annuity should include variable annuities, which are discussed supra. See, *NationsBank of N. C., N. A.*, 513 U. S. at 254 (1995). Again, a variable annuity is:

> [a] contract calling for payments to the annuitant in varying amounts depending on the success of the investment policy of the insurance company; unlike a straight annuity which requires the payment of a fixed amount. The purpose of this type of annuity is to offset deflated value of [the] dollar caused by inflation.

Black's Law Dictionary 83(5th ed. 1979) (emphasis added). However, the use of variable annuities to avoid divestment rules contradicts the language of the relevant administrative code section, which states:

> "Annuity" means a written contract under which, in return for payment of a premium or premiums, an individual or individuals have the right to receive **fixed, periodic payments for life or up to a fixed point in time.**

Wis. Adm. Code, § HFS 103.065(3)(a) (emphasis added). Something is "fixed" when it is "[o]f an established, unchanging, or permanent character; settled; lasting; stable . . . [k]eeping nearly the same relative position." Funk and Wagnalls, The New International Dictionary of the English Language Vol. I, 479 (in both editions) (1967 and 1989) (emphasis added). The general use of annuities engenders fixed payments. The legislature did not add the word "variable" in front of the word annuity in the relevant statutes. See, Wis. Stat. § 49.453(4)(b). As discussed supra, courts have generally required annual or more frequent payments for an annuity definition to apply. The administrative code's requirement of fixed, periodic payments is reasonable and consistent with the statutes and common understanding of the word "annuity."

The document which petitioner signed was intended to look somewhat like an annuity – it contemplates titular fixed payments over 66 months. Exhibit 2, document entitled "Irrevocable Annuity," page 2. These miniscule payments of $25 a month do not make the substance of the transaction an annuity. If so, not considering other possible limitations, a party could transfer over a million dollars to a relative and, in return, the relative could make payments of $1 per month for all but the last month of life expectancy and over a million dollars during the last month of life expectancy – qualifying a person with extremely large assets immediately for MA. The annuity label is not, in itself, binding. The lump sum payment of over $100,000 near the last month of life expectancy for petitioner clearly did not qualify as a "fixed, periodic payment." Even if the administrative code and/or statutes had lumped "variable annuities" with "annuities," the document in question would not qualify. It did not envision a periodic payment based on "investment performance" as in a variable annuity. The nominal payments totaling less than 2% of the overall repayment did not change the true character of the transaction. This was essentially a payment of $103,255 in return for some diminutive monthly payments and a lump sum balloon payment of $106,755 (over 98% of the balance) in 66 months. The true essence of the agreement was the lump sum, balloon payment, not the small, token, monthly payments. The lack of an arms-length relationship, the total unsecured nature of the transaction, along with the inability of petitioner to transfer or sell his interest, further mitigate against an annuity being found to truly exist here. Again, these transactions are most commonly with a business or an insurance company as an "investment." See, *Nationsbank*, 513 U.S. at 254.

THE TRANSACTION SHOULD NOT BE DIVIDED INTO A LUMP SUM PAYMENT AND ANNUITY

It could also be argued that the nominal fixed, periodic payments should be separated from the lump sum, balloon payment so that the divestment amount would be reduced. First, the 66 months of $25 payments would not affect when MA or how much MA would be received. See, MA Handbook, App. 14.5.2

(divide the divested amount by average nursing home cost ($3,334); i.e., $1,500/$3,334 = .4 months, with required rounding on the overall balance, no change). The examiner notes that 66 payments of $25 would be $1,650, not $1,500 as stated in the document. For simplicity and because of lack of clarity, $1,500 is being used in the most of the discussion here. Second, it would be difficult to determine what amount was purportedly paid for these modest payments (presumably less than the $1,500 or $1,650). Third, the county agency used a divestment period shorter than it should have been even under the most generous computations. Even if the full $1,650 were deducted, the period should be 30 months; i.e., $103,225 - $1,650 = $101,575, $101,575/3,334 = 30.46640671866 months, rounded down to 30 months. The county agency used a shorter ineligibility period of 29 months. Exhibit 3, July 27, 1998 Summary Letter. Fourth, the substance of the overall transaction makes it clear that an annuity was not created.

THE COUNTY AGENCY HAD COMPUTED THE INELIGIBILITY PERIOD WHICH WAS TOO SHORT

Petitioner's counsel argues that any ineligibility (divestment) period should run from an earlier transfer of petitioner's home. The following facts were undisputed by the parties. In June 1996, petitioner transferred a property worth $106,800 to his sons. In December 1997, the sons give petitioner a promissory note for the property. The county agency denied MA based on the transaction; i.e., divestment. On April 24, 1998, petitioner and his sons voided the promissory note, and signed the "Irrevocable Annuity" which is the issue in this case. (The "annuity" states it was signed April 29, but the examiner is relying on petitioner's brief and statements at the hearing, which delineated an April 24 transaction date.) The annuity agreement clearly states that petitioner was transferring $103,255 (in cash) to his sons on April 29th, 1998 (or April 24). Exhibit 2, page 1, "Irrevocable Annuity." It was undisputed that the $103,255 represented proceeds from the promissory note (over $50,000) and more than $50,000 petitioner still had. If, as petitioner purports, $103,255 cash was given to petitioner's sons on April 24, 1998, that is when the divestment occurred. Petitioner has supplied no authority for the use of the earlier promissory note date. *Cf.*, MA Handbook, App. 14.5.0. It is also curious how the proceeds of the promissory note would be a little over $50,000 when the note was signed less than two years earlier, was originally for over $100,000, and had provided for only interest payments until 2002. Exhibit C, page 1, "Promissory Note." On numerous occasions, even petitioner's counsel referred to over $150,000 being transferred to the sons for the "annuity." This would be an additional ground for imposition of a period of ineligibility if the annuity had "passed muster." Also, this could increase the ineligibility period. The examiner is not disturbing the county agency's computation. See, MA Handbook, App. 14.5.2 (Likely (or possible) effect would only be one month increase).

PETITIONER'S *DE FACTO* ARGUMENTS DO NOT CHANGE THE RESULT IN THIS MATTER

Petitioner's engagement into this transaction was between the issuance of a Draft Operations Memo dated April 16, 1998, and an Operations Memo dated June 9, 1998. Both memos required, among other things, "payments equally distributed (by amount) over the life of the annuity." Draft Operations Memo dated April 16, 1998; Operations Memo dated June 9, 1998 (parenthesis in original).

After the transaction in this case, and after the second operations memo, an attorney, Bruce Tammi, (who is not counsel in this case) wrote to the department stating that he was the "originator of the use of private irrevocable annuities in the State of Wisconsin." He said that "welfare law is completely statutory in nature and [the] department must comform its policies and actions to the mandates of the Wisconsin Statutes." He demanded retraction of the memos or a listing of specific statutory or administrative code provisions within 10 days or he would file a mandamus action against the department. The Medicaid Eligibility Chief wrote back that the "draft Operations Memo that described" changes to MA policy on "Annuities with Balloon Payments" needed additional legal research. She said she was informing a county agency that received a preliminary draft that the policy change in that operations memo was not to

be implemented at that time. Counsel in this case apparently received a copy of the attorney's letter and response (which did not deal with the current case) from the other attorney.

Although the correspondence discussed above does not deal with the current case, the examiner will consider it. It is *de facto* argument by petitioner.

The letter from the Medicaid Eligibility Chief refers to the "draft memo." It is not clear whether the Final Operations Memo dated June 9, 1998, is being referenced. The county representative in this case stated that Kenosha County never received a retraction of the Operations Memo dated June 9, 1998. He said although the letter "clearly says that they have [issued a withdrawal of the memo], in reality, it hasn't come out." He also stated that the policies reiterated in the operations memo were used in Kenosha County prior to issuance of the memos. He said, "Nothing has changed, that is the idea." He also stated, "Nothing has changed in Kenosha County, Nothing has changed." The Operations Memo dated June 9, 1998, states, "This is a clarification of an existing policy . . .." Nevertheless, as the current status of the Operations Memo dated June 9, 1998 is unclear, the examiner is not relying on it as policy of the department. The retraction of the operations memo would not delete the administrative code requirement of "fixed, periodic payments" for an annuity to exist. Moreover, Attorney Tammi's letter to the department had erred in stating that "welfare law is completely statutory." Mandatory Wisconsin case authority, persuasive case authority, and administrative code provisions may all be considered in determining, or along with, the common or legal meaning for a word such as "annuity." The term "annuity" is not defined in the Wisconsin Statutes. That does not mean an examiner is required to defer to the title "Irrevocable Annuity" on any particular document. Petitioner can not state that he relied on the July 22, 1998, department letter since the April 24, 1998, transaction occurred prior to it. Nor does the July 22, 1998, correspondence from the department state that transactions such as the one here are not divestments under department policy. Such a policy statement would be contrary to Wis. Adm. Code § HFS 103.065(3)(a), which requires fixed, periodic payments for annuities.

A BROADER DEFINITION OF "ANNUITY" IS NOT SUPPORTED BY OTHER CASE LAW

In an attempt to determine whether any primary or secondary authority existed for a broader definition of "annuity," the examiner found a publication from a Continuing Legal Education Course (CLE). *Basic Annuities in the Medical Assistance Context* 1997 (State Bar of Wisconsin CLE Course Handbook, Special Problems of the Aging October 1997). This publication contains a subsection dealing with "Annuities at Hearing." *Id.* It states "[a]nnuities are contractual arrangements in which an individual pays a sum of money to another in return for a future stream of income or payments." *Id.* (emphasis added). "[P]ages 284 through 296 of 2 AM [sic] Jur Legal Forms 2d" is cited as supporting the broad "future stream of income or payments" definition. *Id.* The legal forms in the publication are also cited in support of the broad definition. 2A Am Jur 2d Legal Forms 2d Annuities § 21:5 (1997) states "[a] bargained-for annuity given in exchange for property is a contract in which the consideration on one side is the establishment of fixed payments for some term of years rather than immediate payment . . .." (Emphasis added). This publication notes that the title given to a document is not determinative since "a contract to pay an annuity that is merely camouflage for a loan at a usurious rate of interest may be treated by the courts as a loan within the prohibition of usury statutes." Id. (emphasis added). U.S. Supreme Court Opinions from 1893 to present, Wisconsin Supreme Court Opinions from June 21, 1939, to present, and Wisconsin Court of Appeals Opinions from August 16, 1978, to present do not contain the phase "future stream of income or payments" as a definition of an annuity.

All of the forms, except one, in 2A Am Jur Legal Forms 2d Annuities dealing with general annuities provide for fixed, periodic payments. 2A Am Jur Legal Forms 2d Annuities § 21:7 – 21:19 (1997 & Supp. June 1998 (no forms in pkt. part)). Some forms do contain provision for payment to a remainder in a real estate transaction (or to a beneficiary) upon death, but this is not a lump sum payment to the annuitant. See, eg., Id. at § 21:15. Two forms that provide for a lump sum payment at the end of a

certain number of years are entitled "Annuity Trusts." Id. at § 21:17-18 (emphasis added). One form provides for a cost of living increase based on the Consumer Price Index (CPI). Id. at § 21:25. This is a protection against inflation as discussed regarding a variable annuity. See, supra, Black's Law Dictionary 83 (5th ed. 1979) (discussion of inflation protection for a variable annuity). There is no support for the broad "future stream of income or payments" definition for the generic term "annuity."

The author of the letter to the department, Attorney Bruce A. Tammi, is listed as an author or presenter relating to the "future stream of income or payments" discussion. B. Tammi, *Annuities at Hearing* a subsection of *Basic Annuities in the Medical Assistance Context* 1997 (State Bar of Wisconsin CLE Course Handbook, Special Problems of the Aging October 1997). However, another author writes, "[s]ome attorneys have considered annuities with smaller income streams and a balloon payment at the end. If these are 'actuarially sound' it should be arguable that they would be permitted. However, I believe a challenge from the Department could be expected." J. Jeager, *Advanced Planning Techniques* a subsection of *Basic Annuities in the Medical Assistance Context* 1997 (State Bar of Wisconsin CLE Course Handbook, Special Problems of the Aging October 1997). CLE materials are not typically granted great weight as secondary authority. Nevertheless, given the dearth of publications contradicting the fixed and periodic requirements for payments in annuities, it is the closest publication to supporting petitioner's position in any way. The CLE materials do not persuade in this case. If fixed, periodic payments are not required, any document entitled "annuity" will have to be treated as such. As the U.S. Supreme Court stated in *Nationsbank*, "[i]n a classic "fixed" annuity . . . payments do not vary." *NationsBank*, 513 U. S. at 254 (emphasis added).

A PROPOSED DECISION IS PROPER IN THIS MATTER

The Division of Hearing and Appeals has been presented with a wide variety of divestment issues concerning annuities. Such issues have involved diverse areas such as distinctions of annuities versus trusts and annuities versus promissory notes. The structure of various alleged annuities has also differed in cases presented to the Division; i.e., small payments with lump sums, graduated payments, and other varying payment schedules. County representatives are trained extensively concerning the MA Handbook. Annuities are not defined in this handbook. County workers statewide are not trained in legal interpretation of statutory authority. Different county agencies have periodically raised different issues concerning alleged annuities. The issue of the explicit definition of an annuity has apparently never been raised. Decisions of various examiners at the Division of Hearings and Appeals have differed on annuity divestment issues. See, DHA Case Nos. MED-40/##16089 and 16621 and MDV-40/##16822, 17567, and 17602 (Wis. Div. Hearings & Appeals Oct. 7, 1997 (combined cases)), on rehearing DHA Case Nos. MED-40/16089 and MDV-40/16822, 17567, and 17602 (Wis. Div. Hearings & Appeals Oct. 7, 1997 (again combined cases)) (divestment found); DHA Case No. MED-40/87846 (Wis. Div. Hearings & Appeals June 6, 1995) (no divestment found); DHA Case No. MED-40/11073) (Wis. Div. Hearings & Appeals (no divestment found, different result on promissory note issue); and DHA Case No.MDV-45/22152 (Wis. Div. Hearings & Appeals July 6, 1998) (divestment found) and on rehearing (by the same examiner) DHA Case No. MDV-45/22152 (Wis. Div. Hearings & Appeals aprox. Sept. 2, 1998) (no divestment found – discussion of Tammi letter and Department reply discussed above). Decisions of the Division of Hearings and Appeals do not serve as precedent for other hearing decisions unless issued as proposed decisions and adopted as final by the Secretary of the Department of Health and Family Services. Previous decisions did not explicitly deal with the definition of an annuity. This decision involves a new analysis of the issue. Issuing a proposed decision allows the parties to fully comment before a final decision is issued. It provides for a uniform policy in this area.

CONCLUSIONS OF LAW

1. The county agency correctly determined that the $103,255 petitioner transferred to his sons was divested since he did not receive fair market value in return.

2. The county agency correctly determined that petitioner did not purchase an annuity since the contract did not call for fixed, periodic payments, but instead for nominal payments and a varying balloon payment.

3. The county agency correctly determined that petitioner did not purchase an annuity given the other terms of the agreement in combination with the relationship between the parties.

4. The county agency correctly determined the ineligibility period relying on the April 24, 1998, transaction date since the document stated that petitioner transferred at least $103,225 in cash on that date.

NOW, THEREFORE, it is **ORDERED**

That the petition for review herein be and the same is hereby dismissed.

NOTICE TO RECIPIENTS OF THIS DECISION:

This is a Proposed Decision of the Division of Hearings and Appeals. IT IS NOT A FINAL DECISION AND SHOULD NOT BE IMPLEMENTED AS SUCH.

If you wish to comment or object to this Proposed Decision, you may do so in writing. It is requested that you briefly state the reasons and authorities for each objection together with any argument you would like to make. Send your comments and objections to the Division of Hearings and Appeals, P. O. Box 7875, Madison, WI 53707-7875. Send a copy to the other parties named in the original decision as "PARTIES IN INTEREST."

All comments and objections must be received no later than 15 days after the date of this decision. Following completion of the 15 day comment period, the entire hearing record together with the Proposed Decision and the parties' objections and argument will be referred to Secretary of the Department of Health and Family Services for final decision-making.

The process relating to Proposed Decisions is described in sec. 227.46(2), Wis. Stats.

Given under my hand at the City of Madison, Wisconsin, this 9th day of October, 1998.

Peter D. Kafkas, Attorney
Division of Hearings and Appeals
1003/PDK

cc:

STATE OF WISCONSIN CIRCUIT COURT DANE COUNTY

Spriggie Hensley,

Allen Koch,

Columbia Correctional Institution, P.O. 900, Portage, Wisconsin, 53901,

Plaintiffs,

99CV1366

Case No. _____

-vs-

SUMMONS

Wisconsin Department of Corrections, et al.,

149 East Wilson Street, Madison, Wisconsin, 53702

Classification 30701
Declaratory Judgment

Jeffrey P. Endicott,
Warden of the Columbia Correctional Institution,

2925 Columbia Drive, Portage, Wisconsin, 53901,

Defendants.

THE STATE OF WISCONSIN, To each Defendant named above:

You are hereby notified that the Plaintiffs named above have filed a declaratory action against you. The complaint, which is attached, states the nature and basis of the legal action.

Within 45 days of receiving this summons, you must respond with a written answer, as that term is used in chapter 802 of the Wisconsin Statutes, to the complaint. The Court may reject or disregard an answer that does not follow the requirements of the statutes. The answer must be sent to the Circuit Court for Dane County, Wisconsin, and to the above named Plaintiffs, at the Columbia Correctional Institution, P.O. Box 900, Portage, Wisconsin, 53901.

If you do not provide a proper answer within 45 days, the the Court may grant judgment against you for the award of legal action requested in the complaint, and you may lose your right to object to anything that is or may be incorrect in the complaint. A judgment may be enforced as provided by law.

Dated this 28th day of May, 1999, Signed:

Spriggie Hensley
Allen Koch

STATE OF WISCONSIN CIRCUIT COURT DANE COUNTY

Spriggie Hensley,

Allen Koch,
Plaintiffs,

99CV1366

Case No. _____

-vs-

Wisconsin Department of Corrections, et al.,

Classification 30701
Declaratory Judgment

Jeffrey P. Endicott,
Warden of the Columbia Correctional Institution,

Defendants.

COMPLAINT FOR DECLARATORY JUDGMENT

This is a civil action pursuant to, and consistent with, the Uniform Declaratory Judgment Act, §806.04, Wis., Stats., which has been prepared and filed by the above named plaintiffs, pro se, in accordance with §§ 801.02, and 803.04, Stats., and on behalf of all other persons similarly situated, challenging the ban and/or confiscation of inmate property currently owned by Wisconsin prisoners and the current policy prohibiting publications and/or photographs depicting nudity under the State's recent ban of pornography.

The above named plaintiffs move this Court for a declaration that the recent policies enacted by the Department of Corrections (DOC) and enforced by Warden Endicott, deprive Wisconsin prisoners of their legally purchased and legally possessed property without justification and/or compensation, and are therefore, unconstitutional and illegal due to the

violation of procedural and substantive due process, equal protection, and the principles prohibiting censorship under the First and Fourteenth Amendments of the United States Constitution.

Parties

1. Plaintiffs Spriggie Hensley and Al Koch are under the care and custody of the Wisconsin Department of Corrections, (DOC), and are currently incarcerated at the Columbia Correctional Institution, (CCI), in Portage, Wisconsin, P.O. Box 900, 53901;

2. The Wisconsin Department of Corrections, located at 149 East Wilson Street, Madison, Wisconsin, 53702, is the above named defendant, and is directly responsible for the enactment of policies, currently in effect and pending, that deprive the plaintiffs (and all other persons similarly situated), of their lawfully owned property;

3. Defendant Jeffrey P. Endicott is the Warden of CCI, located at 2925 Columbia Drive, Portage, Wisconsin, 53901, and is directly responsible for the enforcement of all DOC policies at CCI that deprive, or will deprive, the above named plaintiffs (and all other persons similarly situated), of their lawfully owned property;

4. The above named defendants are directly responsible for the enacment and enforcement of policies that deprive the above named plaintiffs (and all other persons similarly situated), of their constitutionally protected interests guaranteed under the First and Fourteenth Amendments;

FACTUAL ALLEGATIONS

5. The above named defendants are responsible for a series of property and privilege deprivations, (beginning with the ban of videos), that have been imposed against the inmate class of CCI and all prisoners currently incarcerated within the state of Wisconsin;

(The deprivations imposed do not apply to Wisconsin prisoners currently incarcerated in private prisons out-of-state by virtue of the recent "out-of-state-transfer" policy);

6. Specifically, the defendants enacted and enforced a ban of all "pornographic" material owned by Wisconsin prisoners, due to the alleged penological purpose of "rehabilitating" sexual offenders and institutional concerns related to the safety of female prison staff;

7. The state-wide ban went into effect on 12/1/1998, and called for the confiscation of all inmate owned material considered pornographic, which to date includes such material as art catalogs, personal drawings, paintings, and the swim-suit edition of Sports Illustrated magazine;

8. The ban includes the on-going confiscation of publications received by inmates through lawfully purchased subscriptions that were obtained prior to the enactment of the ban;

9. The above named defendants have not provided compensation or an opportunity for inmates to be heard, before or after, the confiscation of their property;

10. Following the ban of pornography, the defendants enacted a state-wide ban of all cassettes and cassette-tape-players currently owned by Wisconsin prisoners;

11. Specifically, on 4/21/99, the defendants posted a memo at CCI informing inmates that on June 1st, 1999, inmates would no longer be allowed to order cassettes, and on June 1st, 2000, all cassettes and cassette-tape-players currently owned by inmates would be prohibited;

12. No official justification for the ban has been provided, but the defendant (Warden Endicott) stated "unofficially" that the primary cause was offensive "rap music" and the burden of screening cassettes for content, along with concerns related to the altering and/or passing of cassettes by inmates;

13. The defendant then informed plaintiff Al Koch that inmates do not have a right to property, and therefore, compensation for the value of their property was not necessary, and further, if the inmate class decided to "do anything" the defendants would simply "take everything;"

14. Administrative Code DOC 309.20(1) specifically states that the "department" permits inmates to own personal property, and indicates that such property is specifically regulated in regards to the acquisition, possession and use of personal property owned by inmates within the particular institution;

In-fact, upon receipt of personal property, all inmates receive a "property receipt" (form DOC-237), permitting the

inmate to possess the property under specified conditions;

15. If an inmate's personal property is lost or damaged by staff, the inmate has a right to file a complaint and is entitled to compensation under DOC 309.20(3)(g);

The only provision addressing or contemplating the confiscation of inmate property is DOC 303.10, regarding property that is considered contraband; i.e., the DOC Administrative Code does not address or contemplate the "ban" or disposal of inmate property that is legally purchased and lawfully possessed;

16. In accordance with these provisions, each of the above named plaintiffs have purchased and currently own an "approved" cassette-tape-player (valued at over $100), and 15 "approved" cassette-tapes (valued at approximately $9 each);

17. Nevertheless, the policy enacted and enforced by the defendants does not provide compensation for the value of said property;

18. Furthermore, to date, the defendants have not afforded the plaintiffs an opportunity to suggest reasonable alternatives to the ban or an opportunity to be heard in opposition to the planned confiscation of their property;

19. For example, the plaintiffs would have suggested that defendants limit the number of times per year that inmates are allowed to purchase cassettes, or that defendants comprise a list of pre-approved music that inmates would be allowed to

purchase, thereby reducing or eliminating the burden of screening cassettes;

20. As for the concerns related to altering or passing cassettes, the plaintiffs would have referred the defendants to existing policies and procedures that define such conduct as property violations and/or grounds for confiscation of same as contraband;

21. The plaintiffs would have suggested that these alternatives satisfy the aforementioned concerns and render the current "take everything" mentality and systematic pattern of deprivation unnecessary and unjustified;

22. The plaintiffs would have suggested that the imposition of consecutive state-wide "bans" designed to deprive the inmate class of their lawfully possessed property is factually inconsistent with the DOC Administrative Code, and legally inconsistent with constitutional principles under the First and Fourteenth Amendments;

23. The plaintiffs believe and hereby contend that the factual allegations stated above, demonstrate that the defendants have employed an arbitrary, unreasonable and/or exaggerated response to nonexistent penological concerns, that deprive the plaintiffs (and all other persons similarly situated) of their constitutionally protected interests;

24. As a result, the above named plaintiffs, pro se, and pursuant to the Uniform Declaratory Judgment Act, and

in accordance with the statutory provisions of the state of Wisconsin, hereby move this Court for judicial intervention in the form of a declaratory judgment defining inmate rights in relation to the aforementioned policies effecting the state-wide ban of inmate property and privileges;

FIRST CAUSE OF ACTION

25. The policies enacted and enforced by the above named defendants violate principles of substantive due process, due to the arbitrary ban of legally purchased and lawfully owned property without providing compensation for the value of same;

SECOND CAUSE OF ACTION

26. Said policies violate procedural due process, due to the arbitrary ban of lawfully possessed property without providing a predeprivation hearing and/or an opportunity to be heard before or after the enactment and enforcement of same;

THIRD CAUSE OF ACTION

27. The policies as enacted violate the First Amendment due to the state-wide ban of pre-recorded music based on the lyrical content and/or "offensive" quality of a single form of music (rap music), without advancing a legitimate penological objective and/or justification;

FOURTH CAUSE OF ACTION

28. The current policy enforcing the confiscation of pornographic material owned by prisoners is in violation of the First Amendment's prohibition against censorship, due to

the overbroad definition of pornography and the confiscation of publications, photographs, and other inmate owned property that is not by any definition, pornographic or threatening to legitimate penological concerns;

FIFTH CAUSE OF ACTION

29. The policies currently enacted and enforced and those pending, violate principles of equal protection, in that, said policies apply solely to Wisconsin prisoners currently residing within the state of Wisconsin, and not to those Wisconsin prisoners currently residing in private prisons by virtue of the recent out-of-state-transfers.

ARGUMENT

30. Plaintiffs believe that this case presents a "justiciable controversy" between persons whose interests are adverse and a claim of right asserted involving an issue "ripe" for judicial determination, and is therefore properly before this Court under §806.04, Wis., Stats.; *See*, ***Loy v. Bunderson***, *107 Wis.2d 400, 320 N.W.2d 175, 181 (1982).*

31. Plaintiffs understand that Courts are not in the business of second guessing the details of prison management, but that when appropriate, Courts have said an analysis may be required to determine whether the particular prison rule or regulation is an exaggerated response to prison concerns. *See*, ***Turner v. Safley***, *___ U.S. ___, 107 S.Ct. 2254, ___ L.Ed.2d ___ (1987).*

Courts have said that for a prison regulation to pass

muster, prison officials need merely put forward a legitimate government interest and provide some evidence that the interest put forward is the actual reason for the regulation; this however, is not necessarily the end of the matter.

This is so because deference does not mean abdication; i.e., the analysis does not necessarily end at the recognition that the prison rule was adopted to serve, and actually does serve, a legitimate penological interest; where appropriate, Courts have said they must examine the logical nexus between the penological purpose served and the restriction of the prisoner's right, while balancing the importance of both; *See, e.g., Bradley v. Hall, 64 F.3d 1276, 1280-81 (9th Cir. 1995).*

32. In the instant case, the plaintiffs believe such an examination and/or determination is both appropriate and essential due to the deliberate deprivation of legally owned property and the systematic violation of prisoner rights protected under the First and Fourteenth Amendments.

33. Specifically, the Wisconsin Department of Corrections (DOC) and Warden Jeffrey Endicott have enacted and enforced a policy that calls for the complete ban of all cassettes and cassette-tape players currently owned by Wisconsin prisoners.

34. The defendants have not advanced a legitimate penological purpose and/or governmental interest served by such a ban, nor have they considered alternatives to the ban or provided inmates with an opportunity to be heard

before, or after, the enactment of the ban.

Instead, the defendants simply enacted a policy that deprives the plaintiffs (and all other persons similarly situated) of their legally purchased and lawfully owned property, without compensation or an opportunity to be heard in opposition thereto.

35. To make matters worse, this deprivation is merely the latest in a series waged against Wisconsin prisoners; i.e., prior to the attack on cassettes and cassette-tape players, the defendants imposed a state-wide ban on all pornography that actually includes art catalogs, personal drawings, and the swimsuit edition of Sports Illustrated magazine.

36. Again, the defendants did not demonstrate a tangible threat to the order, security, or rehabilitative programs of Wisconsin's prisons, nor did they attempt to fashion a reasonable, narrowly tailored response if in-fact such a threat exists.

Instead, the defendants simply enacted a state-wide ban and confiscated all inmate property depicting any form of nudity, including all material considered "sexual" in nature.

37. This pattern of deprivation is not only unfair and unjustified, it is unconstitutional and illegal under the First and Fourteenth Amendments; i.e., the Supreme Court has made clear that prisons are not beyond the reach of the Constitution, and it has insisted that prisoners be afforded

those rights that are not fundamentally inconsistent with imprisonment itself or incompatible with the objectives of incarceration. *See*, ***Wolff v. McDonnell***, *418 U.S. 539, 555, 94 S.Ct. 2963, 2974, 41 L.Ed.2d 935 (1974); and* ***Hudson v. Palmer***, *468 U.S. 517, 104 S.Ct. 3194, 3198, 82 L.Ed.2d 393 (1984).*

38. More to the point, the Court has recognized that prisoners do possess property within the meaning of the Fourteenth Amendment once that possession amounts to a legitimate claim of entitlement; a claim of entitlement is defined by existing rules or understandings that stem from an independent source such as state law; and it is well settled that once a State creates such a constitutionally protected interest, the Constitution forbids it to deprive even a prisoner of such an interest arbitrarily. ***Hudson v. Palmer***, ***supra***, *104 S.Ct. at 3210 (dissenting opinion);* ***Board of Regents v. Roth***, *408 U.S. 564, 577, 92 S.Ct. 2701, 2709, 33 L.Ed.2d 548 (1972).*

39. Likewise, the Court has recognized that prisoners have a First Amendment right to read publications of their choice as long as the publication does not pose a tangible threat to the order, security, or rehabilitative programs of the prison; *See*, ***Procunier v. Martinez***, *416 U.S. 396, 94 S.Ct. 1800, ___ L.Ed.2d ___ (1974)*; and it has barred censorship that is based solely on content that is religious, philosophical, political, social or sexual, or because the content is unpopular or repugnant. ***Thornburgh v. Abbott***, *490 S.Ct. ___, 109 S.Ct. 1874, 1882-84, ___ L.Ed.2d ___ (1989); see also,* ***Guajardo v.***

Estelle, 580 F.2d 748, 762 (5th Cir. 1978); Hardwick v. Ault, 447 F.Supp. 116, 131 (1978); Waterman v. Verniero, 12 F.Supp.2d 364 (ruling on Preliminary Injunction); 12 F.Supp.2d 378 (Permanent Injunction) (D NJ 1998).

40. In short, before prison officials may curtail or eliminate prisoner rights, the officials must advance a penological purpose and/or government interest that is legitimately served by the constraint, (such as the internal security of the institution), and it must be determined that the constraint is not an exaggerated response to the alleged prison concern. *See, Turner v. Safley, supra; Price v. Johnston, 334 U.S. 266, 285, 68 S.Ct. 1049, 1060, 92 L.Ed. 1356 (1948); Pell v. Procunier, 417 U.S. 817, 823, 94 S.Ct. 2800, 2804, 41 L.Ed.2d 495 (1974).*

41. In the instant case, as stated above, the defendants did not advance a penological purpose and/or government interest that is legitimately served by the deprivations at issue, and they did not consider available alternatives or attempt to employ a reasonable, narrowly tailored response if such interests actually exist; instead, as will be shown, the defendants ignored prisoner rights and simply deprived the inmate class of their protected property interests and eliminated the protection afforded inmates under the First Amendment.

Property

42. Wisconsin prisoners are allowed to possess "personal property" in accordance with the provisions of Administrative Code DOC 309.20; upon receipt of personal property, all inmates

receive a "property receipt" (form DOC-237), which states:

"...the Department of Corrections grants [the inmate] the privilege of possessing the above described property, specifically conditioned on [the inmate's agreement] to abide by the following: 1) [The inmate] shall not trade, loan, give, sell or otherwise exchange any of the above-described property with any other inmate without the written pre-authorization of the Warden/Superintendent. 2) [The inmate agrees] that none of the electronics or musical equipment has a value in excess of $350. 3) [The inmate agrees] that none of [the inmate's] other individual items of personal property has a value in excess of $75. 4) [The inmate] shall acquire and keep merchandise supplier's receipts for personal property. 5) If [the inmate alleges] that any of this property is lost or damaged due to the intentional act or gross negligence of a departmental employee or agent, [the inmate] may file a complaint purusant to DOC 310."

43. In other words, the DOC Administrative Code creates, by explicit rules and regulation, an "understanding" that amounts to a legitimate claim of entitlement in regards to all "personal property" that is received by inmates through officially approved channels; nowhere does the DOC Administrative Code contemplate or address the prospect of "banning" lawfully possessed "personal property."

In-fact, inmates are led to believe and literally agree to abide by specified conditions to avoid losing their "personal property" due to misconduct, and they understand that the only provision addressing the confiscation or disposal of personal property is Administrative Code DOC 303.10, pertaining to property that is considered contraband.

44. Thus, when an inmate purchases personal property and receives said property (along with a DOC property receipt), the inmate believes and understands that he is entitled to possess that property as long as he abides by the specified conditions relating to the ownership of that property; in effect, the inmate understands that he has entered into an enforceable "contractual agreement" with the DOC that is conditioned and dependent on the conduct of the inmate.

45. In the instant case, each of the above named plaintiffs purchased and currently possess an approved cassette-tape-player (valued at over $100) and the allowable limit of 15 cassette-tapes (valued at approximately $9 each); the plaintiffs have not violated any of the aformentioned conditions of ownership and they have specifically complied with all DOC Administrative rules and regulations regarding personal property.

46. As a result, the plaintiffs (and all other persons similarly situated) have a legitimate claim of entitlement to their lawfully purchased and lawfully possessed cassettes and cassette-tape-players.

47. The plaintiffs (and all other persons similarly situated) are therefore, entitled to "some kind of hearing" before the State finally deprives them of their protected property interests; i.e., the Supreme Court has said that the fundamental requirement of (procedural) Due Process is the opportunity to be heard, which is an opportunity that must be

granted at a meaningful time and in a meaningful manner. *Armstrong v. Mango, 380 U.S. 545, 552, 85 S.Ct. 1187, 1191, 14 L.Ed.2d 62 (1965); See also, Cleveland Board of Education v. Loudermill, 470 U.S. 532, 542, 105 S.Ct. 1487, 1493, 84 L.Ed.2d 494 (1985); Parham v. J.R., 442 U.S. 584, 606-607, 99 S.Ct. 2493, 61 L.Ed.2d 101 (1979); Goss v. Lopez, 419 U.S. 565, 579, 95 S.Ct. 729, 738, 42 L.Ed.2d 725 (1975); Fuentez v. Shevin, 407 U.S. 67, 80-84, 92 S.Ct. 1983, 1994-96, 32 L.Ed.2d 556 (1972).*

48. In this case, the defendants have violated this fundamental requirement of (procedural) Due Process, in that, the plaintiffs have not, and will not, be provided an opportunity to be heard at a meaningful time and in a meaningful manner; i.e., the policy enacting the state-wide ban of all cassettes and cassette-tape players has already been posted and is already in effect.

49. More importantly, the defendants have violated the substantive component of the Due Process Clause which bars certain arbitrary, wrongful government actions regardless of the fairness of the procedures used to implement them; *See, Daniels v. Williams, 747 U.S. 327, 331, 106 S.Ct. 662, 664, 68 L.Ed.2d 420 (1980); see also, Jones v. Dane Co., ___ Wis.2d ___, 537 N.W.2d 74, 82 (Wis. App. 1995).*

50. This is so because the defendants have no legitimate penological purpose at issue; in-fact, there has been no official explanation what-so-ever; instead, inmates at the Columbia Correctional Institution were told "unofficially" by Warden Endicott, that the DOC decided to ban all cassettes

because: 1) female officers found "rap music" offensive; 2) staff complain about the burden of "screening" rap tapes for lyrical content; 3) staff complain that certain inmates "alter" their cassettes; and 4) staff complain that certain inmates "pass" or "borrow" their cassettes to other inmates.

51. These "unofficial" reasons do not qualify as legitimate penological concerns, nor do they justify the complete elimination of lawfully owned property; i.e., the elimination of cassettes is not necessary, as a practical matter, to accomodate institutional needs and objectives such as the internal security of the institution; *Compare*, ***Price v. Johnston***, ***supra***, *68 S.Ct. at 1060*; ***Pell v. Procunier***, ***supra***, *94 S.Ct. at 2804*; nor is the possession of cassettes fundamentally inconsistent with imprisonment or incompatible with the objectives of incarceration. *See, e.g.*, ***Hudson v. Palmer***, ***supra***, *104 S.Ct. at 3198*.

52. The mere fact that the defendants have imposed a state-wide ban proves that it is not a matter of internal security of a particular institution, because **all** Wisconsin prisons are included, regardless of the security classification; and if the ban were justified by the considerations underlying our penal system, the defendants would not be satisfied with a ban effecting only those inmates incarcerated in Wisconsin; i.e., the ban would effect all Wisconsin inmates, including those incarcerated in private prisons out of State.

53. Furthermore, the fact that reasonable alternatives

to the ban exist, proves that the defendants have imposed an arbitrary, inherently unreasonable response to each of the aforementioned "concerns."

54. For example, if the burden of "screening" is an actual concern, the defendants could have limited the number of times per year that prisoners may order cassettes, thereby reducing the burden of screening to once or twice a year.

Or the defendants could have comprised a list of pre-approved cassettes for prisoners to choose from, thereby eliminating the need for screening altogether.

55. As for alteration, passing or borrowing cassettes, if this is an actual concern, the defendants already have existing rules and regulations defining such conduct as a punishable offense; the defendants could have simply elected to enforce these rules and regulations and punish those who violate the rules, rather than punishing the entire inmate class.

56. At any rate, these alternatives demonstrate, at the very least, that a complete state-wide ban of all cassettes and cassette-tape players is an exaggerated response to the aforementioned concerns, if in-fact those concerns actually exist.

57. Thus, for the reasons stated above, the plaintiffs believe and hereby contend that the policy, as enacted, is in violation of both procedural and substantive due process under the Fourteenth Amendment, due to the deliberate deprivation

of legally owned property without explanation, an opportunity to be heard, or compensation; accordingly, the plaintiffs request that this Court issue a declaration holding the "ban" of currently owned cassettes and cassette-tape-players unconstitutional under the Fourteenth Amendment of the United States Constitution.

Censorship

58. There is no question that imprisonment does not strip inmates of all constitutional rights, including free-speech rights protected by the First Amendment; *See*, ***Lomax v. Fielder***, ___ *Wis.2d* ___, *554 N.W.2d 841 (Wis. App. 1996)*; and music, generally, is accorded a presumption of protected speech under the First Amendment. *See*, *e.g.*, ***City of Madison v. Bauman***, *162 Wis.2d 660, 470 N.W.2d 296 (1991).*

59. The First Amendment also provides prisoners the right to read publications of their choice as long as the publication does not pose a tangible threat to the order, security, or rehabilitative programs of the prison. *See*, *e.g.*, ***Procunier v. Martinez***, ***supra***.

60. In other words, prisoners retain their First Amendment rights (and other constitutional rights) as long as they are not inconsistent with their status as prisoners or with the legitimate institutional needs and objectives of the corrections system. *See*, *e.g.*, ***Thornburgh v. Abbott***, ***supra***.

61. Thus, when a prison regulation is claimed to impermissibly interfere with prisoners' rights, the Supreme

Court has said it considers four factors in determining the reasonableness of the prison regulation: 1) whether there is a valid, rational connection between the regulation and the governmental interest justifying it; 2) whether there are alternative means of exercising the right which remain open to inmates; 3) whether accomodations of the asserted right will have an impact on guards and other inmates and prison operations generally; and 4) whether ready alternatives to the regulation or action exist. ***Turner v. Safley***, ***supra***.

62. In the instant case, the primary concern of prison officials, in regards to cassette-tapes, seems to be the lyrical content of "rap music;" in-fact, all Wisconsin prisons currently prohibit rap tapes that contain lyrics that are considered detrimental to the security of the institution; rap tapes that do not contain detrimental lyrics are allowed, along with all forms of music, such as gospel, blues, country and rock.

63. Unfortunately, the defendants have now decided to ban all cassette-tapes, regardless of the lyrical content, due to the apparent fact that female officers find rap music to be "offensive."

64. The defendants also offer the "burden" of screening cassettes, and the alteration and passing of cassettes as further justifications for the state-wide ban of cassettes.

65. However, as shown above, there are "ready alternatives" that would address the burden of screening, alteration, and passing of cassettes, which seems to indicate that the

primary concern is the offensive quality of rap music in general, which violates the First Amendment; i.e., music constitutes speech protected by the First Amendment; ***Betts v. McCaughtry, 827 F.Supp. 1400, 1406 (WD Wis. 1993)***; ***Golden v. McCaughtry, 937 F.Supp. 818, 822 (1996)***; and cannot be banned merely because the "State" finds it unpopular or repugnant; censorship is permitted if the material is "detrimental to the security, good order, or discipline of the institution or if it might facilitate criminal activity." *See, **Thornburgh, supra, 109 S.Ct. at 1877, 1882-84**; see also, **Martin v. Tyson, 845 F.2d 1451, 1454 (7th Cir. 1988)**.*

Thus, banning all cassettes because female officers find rap music offensive is not permissible under the First Amendment; furthermore, offensive or "repugnant" music does not qualify as a legitimate penological concern, because it cannot be shown that it is detrimental to the security of the institution or the objectives of the corrections system.

66. As a result, there is no "valid, rational connection" between the state-wide ban of cassettes and a legitimate governmental interest; i.e., the ban of cassettes amounts to nothing more than arbitrary censorship unrelated to legitimate penological concerns.

67. To the free citizen, and possibly this Court, such censorship may seem insignificant, but to those incarcerated, music is one of the few remaining "freedoms" available to the individual inmate.

68. If the ban on cassettes is allowed to stand, there

will be no alternative means of exercising that freedom; for example, Hispanic prisoners will be unable to listen to spanish music, inmates who prefer gospel or blues will have no viable alternative, and those who listen to classical with be left with commercial radio.

69. This unnecessary deprivation is, therefore, extremely significant to those incarcerated, particularly since music is relied upon daily by virtually all inmates.

70. If however, the ban of cassettes were not allowed to stand, the accomodation of cassettes would have virtually no "impact" on guards or prison operations generally, particularly if the defendants were to consider and implement the available alternatives.

71. As a result, it is clear that the ban of cassette-tapes and cassette-tape-players is not a "reasonable" prison regulation under the 4-prong test mentioned above, *See*, ***Turner v. Safley***, ***supra***, *at 107 S.Ct. 2254*, nor is it consistent with the First Amendment's prohibition against censorship.

72. The same is true in regards to the recent ban of pornography; i.e., the Supreme Court has explicitly held that censorship based solely on content that is religious, philosophical, political, social or sexual is prohibited. *See*, ***Thornburgh v. Abbott***, ***supra***, *109 S.Ct. at 1882-84.*

73. Furthermore, several Courts have indicated that "sweeping bans" are generally inappropriate; Courts have said that censorship of publications must be guided by narrowly

drawn regulations and that prison officials may not impose a blanket ban on a periodical; i.e., they must review each issue individually. *See, e.g.,* ***Jackson v. Ward, 458 F.Supp. 546, 563 (1978); Guajardo v. Estelle, 580 F.2d 748, 762 (5th Cir. 1978); Hardwick v. Ault, 447 F.Supp. 116, 131 (1978); McCleary v. Kelly, 376 F.Supp. 1186, 1190-91 (1974); Pepperling v. Crist, 678 F.2d 787, 791 (9th Cir. 1982);*** *See, also,* ***Kincaid v. Rusk, 670 F.2d 737 (7th Cir. 1982); Hutchings v. Corum, 501 F.Supp. 1276 (1980).***

74. More to the point, recent decisions have held that prohibiting sexually oriented materials, (even in specific sex offender institutions) is unconstitutional under the First Amendment. *See, e.g.,* ***Waterman v. Verniero, 12 F.Supp.2d 364 (D NJ 1998),*** *(ruling on Preliminary Injunction);* ***12 F.Supp 378 (D NJ 1998),*** *(permanent injunction).*

75. In the instant case, the defendants have not only imposed a ban on actual pornographic materials, they have imposed a "sweeping ban" on all material depicting any form of nudity, including art catalogs, personal drawings, paintings, and even the swimsuit edition of Sports Illustrated magazine.

76. While the defendants will no doubt claim that banning pornography is essential to the rehabilitation of sex offenders and necessary to ensure the safety of female staff, there is no "empirical evidence that sexually oriented materials have any negative effect on people." *See,* ***Waterman v. Verniero, supra.***

77. Furthermore, even if the defendants were able to demonstrate that pornography is detrimental to the security,

good order, or discipline of the institution, it would still be impossible to define the material here as pornographic; i.e., by definition, material is pornographic or obscene if the average person, applying contemporary community standards, would find that the work taken as a whole appeals to the prurient interest and if it depicts in a patently offensive way sexual conduct and if the work taken as a whole lacks serious literary, artistic, political or scientific value. *Black's Law Dictionary, 6th Ed., p. 1161, citing, Miller v. California, 413 U.S. 15, 24-25, 93 S.Ct. 2607, 2615, 37 L.Ed.2d 419.*

78. Given this definition, its difficult understanding how the defendants manage to define art catalogs or drawings as pornographic, or how the swimsuit edition of Sports Illustrated could possibly be viewed as detrimental to legitimate governmental interests.

79. More likely it seems the defendants are merely intent on imposing a regulatory scheme designed to systematically deprive Wisconsin prisoners of privileges and property, which began with the ban of videos.

80. While the ban of videos is not a cause of this action, it does tend to demonstrate the beginning of the "pattern" employed by the defendants; i.e., videos were selected by staff and shown to inmates each weekend, yet the elimination of the privilege was claimed to be necessary due to an alleged mistake made by staff when a "soft-porn-movie" was "inadvertently" shown for (3) three consecutive days at the Columbia Correc-

tional Institution in Portage, Wisconsin; the defendants, (and Governor Tommy Thompson), apparently felt the appropriate response was to ban all videos throughout the Wisconsin prison system.

81. Again, the ban of videos is not a cause of this action, but it does seem to illustrate what has become the standard practice here in Wisconsin; i.e., an "exaggerated response" to a questionable penological concern.

82. At any rate, for the reasons stated above, the plaintiffs believe and hereby contend that the ban on pornography, as enacted and enforced, is unconstitutional under the First Amendment, and further, that the ban of cassettes based on the offensive quality of rap music is both unconstitutional under the First Amendment and an exaggerated response to an unjustified penological concern.

83. Accordingly, the Plaintiffs respectfully request that this Court issue a declaration holding the ban of pornography, cassette-tapes and cassette-tape-players unconstitutional under the First Amendment of the United States Constitution.

Equal Protection

84. The plaintiffs believe and contend that the aforementioned policy enacting the state-wide ban of cassettes and cassette-tape-players, and the ban of pornography, violate principles of equal protection and/or equal treatment, due to the fact that the policies only effect those inmates currently

incarcerated within the State of Wisconsin.

85. In short, Wisconsin prisoners who currently reside in private prisons by virtue of the recent out-of-state-transfers are not effected.

86. Courts have indicated that when a party attacks a statute, policy or regulation on the grounds that it denies equal protection under the law, the party must demonstrate that the State unconstitutionally treats members of similarly situated classes differently, and that there is no rational relationship between the disparity of treatment and the legitimate governmental purpose served thereby. *See, e.g.,* ***Heller v. Doe***, ___ *U.S.* ___, *113 S.Ct. 2637 (1993).*

87. In the instant case, the difference in treatment is based solely on the location of incarceration; i.e., all Wisconsin prisoners who have been transfered to private prisons out-of-state, are not only allowed to retain their legally purchased and legally owned property, they are actually afforded additional privileges such as cable television, CDs, and the opportunity to order food from outside venders, such as Taco Bell.

88. Meanwhile, here in Wisconsin, all prisoners are continuously stripped of what few remaining rights they have by the systematic ban of their legally owned property and the enactment of "policies" that eliminate constitutional protections afforded them under the First and Fourteenth Amendments.