Exemptions And Waivers: Kearney Construction – A Whole New Ball Game

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Kearney Construction Company, LLC v. Travelers Casualty and Surety Company of America is a befuddling opinion that appears to contradict longstanding precedent under Florida law, legislative intent and public policy underlying the state's expansive and generous exemptions which favor the protection and preservation of certain assets from attachment or seizure by creditors. While a disturbing opinion, the holding is nevertheless an anomaly deserving of a fair amount of skepticism and suspicion by practitioners.

In *Kearney*, the debtor ("Debtor") obtained a line of credit ("LOC") from Moose Investments ("Moose") and pledged collateral as security for the LOC pursuant to a security agreement executed on March 1, 2012 (the "Agreement"). The Agreement provided in relevant part:

> As security for any and all Indebtedness (as defined below), the Pledgor hereby irrevocably and unconditionally grants a security interest in the collateral described in the following properties[:] all assets and rights of the Pledgor, wherever located, whether now owned or hereafter acquired or arising, and all proceeds and products thereof, all goods (including inventory, equipment and any accessories thereto), instruments (including promissory notes)[,] documents, accounts, chattel paper, deposit accounts, letters of credit, rights, securities and all other investment property, supporting obligation[s], any contract or contract rights or rights to the payment of money, insurance claims, and proceeds, and general intangibles.[2]

The property subject to the collateral under the Agreement was at issue of the case. The Eleventh Circuit considered whether the Debtor's pledge included the assets held in his Individual Retirement Account ("IRA") sufficient to constitute a genuine issue of material fact for purposes of summary judgment.[3]

Observing that the Agreement appeared to constitute an "unambiguous pledge" of *all assets* and rights of the Debtor, the court considered the Debtor's intent to include the IRA on his affidavit in connection with the Agreement.[4] The Debtor argued that the IRA should not have been included based on affidavits previously submitted by both the Debtor and the manager of Moose, respectively. Relying upon the trial court's findings of inconsistencies, contradictions and "self-serving" tendencies regarding the affidavits, the court rejected this argument along with the Debtor's assertion that the IRA had not been perfected as a security interest because it had never been delivered to Moose.[5] Only with an oblique reference to Florida's statutory protection for IRAs, the court held that the trial court had correctly included the IRA as part of the Debtor's security.

Florida law affords generous protections to cash and other property payable to an owner, a participant, or a beneficiary from, and any interest of any such individual in a retirement or profit-sharing plan qualified under §§ 401(a), 403(a), 403(b), 408 (that is, an IRA), 408A (that is, a Roth IRA), or 409 of the Internal Revenue Code (the "Code") by exempting such assets from the claims of creditors of the beneficiary or participant.[6] The exemption applies if the retirement account qualifies as a qualified plan or IRA under the Code. The exemption also applies to governmental and church plans that qualify for tax-exempt status under §§ 414, 457, and 501(a) of the Code.[7] This exemption is in addition to any other exemption from process provided by state or federal law, such as ERISA, which notably does not apply to assets held in an IRA.[8] Beyond a potential fraudulent conversion or fraudulent transfer claim, intent appears to have little relevancy to the application of this exemption.

Exemptions such as the foregoing have historically been liberally construed in favor of protecting the subject interest holder.[9] For example, Florida's homestead protection, a paramount exemption which is engrained in both the state's constitution and statutes, has been consistently interpreted generously by courts in favor of protecting the family home.[10]

This liberal construction standard extends to other Florida exemptions analyzed by courts. To illustrate, in *Chase Bank USA, N.A. v. Alfie*,[11] the defendant ("D") testified that she lived with her elderly parents and provided more than one-half (1/2) of their

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economic support. Thus, D argued she was eligible to claim the head of family exemption under the Florida wage exemption pursuant to former Fla. Stat. § 222.12 (2012).[12] D claimed her parents were "other dependents" under Fla. Stat. § 222.11 (2014). The Court relied on the interpretation of the term "head of family" test[13] where the debtor may show either of the: (1) existence of a legal duty to support arising out of the family relationship at law known as a "family in law"; or (2) continuing communal living by at least two (2) individuals under such circumstances that one is recognized as in charge, known as "family in fact." The court held that D did not qualify under the "*family in law test*" since she had no legal obligation to support her mother and father. Nonetheless, the court found that D did satisfy the "*family in fact test*" as she is the person "in charge" and possessed "a moral obligation to provide support for her elderly, unemployed parents whose sole source of income is a combined $600 per month from social security."[14] Finally, the court also recognized that exemption statutes should be construed liberally in favor of a debtor.[15] Thus, the court held that the term "other dependent"[16] should apply to D's elderly and unemployed parents.

Public policy motivations constitute an important factor for courts weighing the rights of creditors against the potential burden a debtor may place upon the taxpayer. It is also significant that the definition of "asset" contained within Florida's version of the Uniform Fraudulent Transfer Act ("FUFTA") omits from its scope any asset which is generally exempt under nonbankruptcy law.[17] As previously noted, beyond the application of the FUFTA, the intent of the parties in litigation appears to be irrelevant to the application of the exemption, particularly where the application of a waiver is concerned.

Interpreting Florida's statutory protections for wages earned by heads of family, the court in *Killian v. Lawson*[18] emphasized the public policy ramifications of such protections in that they "should be liberally construed in favor of a debtor so that he and his family will not become public charges."[19] Notwithstanding the substantial latitude granted to "honest debtors,"[20] courts are also careful to ensure that such protections do not encourage or enable fraud upon creditors.[21]

Despite substantial precedent which reliably applies Florida's exemption protections in favor of debtors, the *Kearney* court disregarded this authority. Instead, the court construed the statutory IRA exemption narrowly and rigidly against the Debtor. Such an interpretation contradicts the enduring legislative objective in Florida of ensuring that debtors avoid becoming public charges of the state.

Further, the holding in *Kearney* that the Debtor waived the protections of Florida's exemption for IRAs pursuant to the Agreement demonstrates a tremendous disservice to Florida precedent concerning exemption waivers. The language from the Agreement cited in *Kearney* and reproduced above exemplifies the type of "boilerplate" language from which courts have historically attempted to shield the layman debtor.[22] Instead, an effective waiver must be "knowing, voluntary, and intelligent."[23] A "knowing, voluntary, and intelligent" waiver did not seem a reasonable possibility under the record in *Kearney*.

Merely having entered into the Agreement would not appear to satisfy the foregoing stringent standard. Instead, the Debtor would have had to demonstrate a thorough understanding of the rights being surrendered. That does not seem a standard that can be proven under the facts in *Kearney*. This procedural hurdle implemented by courts is intended to discourage routine waivers of important rights provided to Florida residents where public policy concerns are pervasive.

Moreover, it is important to recognize that federal law forbids the use of any portion of an IRA as security for a loan.[24] If such a pledge occurs, the portion (or whole) of the IRA will cease to be treated as an IRA and will instead be deemed a taxable distribution.[25] The court in *Kearney* overlooked the broad consequences of facilitating waivers in this manner notwithstanding existing case law that cautions against general tacit contractual waivers and federal statutes which prohibit such pledges.

Procedurally, the decision in *Kearney* is also faulty because the issues raised were deserving of an *en banc* review.[26] Cases which are of exceptional importance merit the *en banc* standard rather than the three judge panel presiding in the *Kearney* case. Finally, the public policy considerations seem worthy of review by the Florida Supreme Court as a question of great public importance.[27]

Another recent decision, *Castro v. Mercantil Commercebank, N.A.*,[28] issued by the Florida Third District Court of Appeal illustrates the difficulties facing courts attempting to effectively balance the generous exemptions afforded to debtors under Florida law with the rights of creditors. Unlike the "boilerplate" language found in the IRA waiver in *Kearney*, the plain language in the *Castro* waiver presented a greater challenge to the court in its analysis of what constituted a valid and knowing waiver of the Florida wage exemption under the statute in force and effect at the time. Although such language would not pass muster under the current version of Florida's wage exemption statute, the *Castro* case makes for a highly troubling outcome to debtors and practitioners alike if a stale waiver suddenly becomes relevant years later. Ultimately, the court's holding is another reminder of why the current version of Fla. Stat. § 222.11 (2019) more effectively protects debtors from unknowingly waiving their rights under Florida law with respect to garnishment of wages.

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In *Castro*, Halmac Development, Inc. ("Halmac") executed a promissory note in the principal amount of $250,000.00 payable in installments to Mercantil Commercebank, N.A. ("Mercantil"). Hector Castro ("Castro") personally guaranteed payment of the note and pledged certain collateral to secure it. Under the terms of the guaranty, upon a default Mercantil was entitled to "collect any deficiency balance with or without resorting to legal process."[29] Less than a year after executing the note, Halmac defaulted and Mercantil filed suit. In 2015, Mercantil obtained summary judgment against Castro as the guarantor and Halmac as the borrower.

In 2019, Mercantil filed a motion for a continuing writ of garnishment against Castro's wages. The trial court issued the writ that was served on Castro's employer. Castro subsequently filed a motion to dissolve arguing that his wages were exempt from garnishment because he was the "head of family" as defined in Fla. Stat. § 222.11 (2019). The lower court had determined that Castro waived his right to avoid garnishment of his wages. Castro appealed and posited that the contractual language was insufficient to effectuate a waiver of his claim of exemption. The version of Fla. Stat. § 222.11(2)(b) (2009) then in effect provided:

> Disposable earnings of a head of a family, which are greater than $500 a week, may not be attached or garnished unless such person has agreed otherwise in writing. In no event shall the amount attached or garnished exceed the amount allowed under the Consumer Credit Protection Act, 15 U.S.C. s. 1673.[30]

The language of Fla. Stat. § 222.11(2)(b) (2009) has since been amended to include several requirements, including capitalized 14-point type language informing debtors of their rights and the method by which a waiver may be effectuated within a contract or agreement.[31]

Neither party disputed that Castro qualified as the "head of family." Mercantil argued that Castro consented to garnishment of any earnings in excess of $500 per week. Castro, on the other hand, maintained that he only provided his consent to a court issuing a writ of garnishment. Further, he argued that Fla. Stat. § 222.11 (2019) was applicable to the waiver in question.

The guaranty executed by Castro included the following capitalized provision: "GUARANTOR HEREBY CONSENTS TO THE ATTACHMENT OR GARNISHMENT OF HIS/HER/ITS EARNINGS."[32] Additionally, it provided that the "[o]bligations [hereunder] . . . shall not be affected or impaired [by] . . .[a]ny present or future law . . . purporting to reduce, amend or otherwise affect the indebtedness . . . or any other terms of payment."[33]

Affirming the lower court's holding, the court found that the consent to garnishment in the guaranty was clear in its intent and expansive in its reach. In essence, Castro consented to the garnishment of his wages. The court also noted that Fla. Stat. § 77.01 (2019) provided Mercantil with the right to a writ of garnishment regardless of the terms of the guaranty.[34]

In the footnotes, the court dismissed Castro's argument that the 2019 version of the statute applied by invoking Article I, Section 10 of the Florida Constitution ("No bill of attainder, ex post facto law or law impairing obligation of contracts shall be passed.")[35] The court found that the guaranty's clause providing that the "[o]bligations [hereunder] . . . shall not be affected or impaired [by] . . . [a]ny present or future law . . . purporting to reduce, amend or otherwise affect the indebtedness . . . or any other terms of payment" prevented Castro from advancing his argument concerning the applicability of Fla. Stat. § 222.11 (2019).

The *Kearney* decision is flawed due to its indifference to established case law, legislative pronouncements and public policy concerns which together form the basis for creditor protection for IRAs. Contrast *Kearney* with *Castro* where the court's decision rests on a far stronger predicate. While the holding in *Kearney* is the exception rather than the rule among courts interpreting exemption statutes, it appears prudent to cautiously proceed with planning in *this* area until the issue is clarified by the Florida Supreme Court or by amendment to Florida law.

Endnotes

1 *Kearney Construction Company, LLC v. Travelers Casualty and Surety Company of America*, 2019 WL 5957361 (Fla. 11th Cir. Nov. 13, 2019).

2 *Id.* at *1.

3 The other issue presented to the court involved the argument that only the Debtor's *pro rata* portion of the IRA was subject to garnishment. However, the court concluded that this issue had not been preserved on appeal.

4 *Id.* at *2.

5 *Id.*

6 Fla. Stat. § 222.21(2)(a) (2019).

7 *Id.*

8 29 U.S.C. § 1051. A qualified plan must contain an anti-alienation provision. 29 U.S.C. § 1056(d)(1).

9 *See e.g. Slatcoff v. Dezen*, 76 So.2d 792 (Fla. 1954) (insurance); *Havoco of Am. Ltd. v. Hill*, 790 So.2d 1018 (Fla. 2001) (homestead); *Connor v. Seaside National Bank*, 135 So.3d 508 (Fla. 5th DCA 2014) (annuities).

10 *See e.g.*, *Milton v. Milton*, 58 So. 718, 719 (1912); *Edward Leasing Corp. v. Uhlig*, 652 F. Supp. 1409 (S.D. Fla. 1987)).

11 *Chase Bank USA, N.A. v. Alfie*, 22 Fla. L. Weekly Supp. 1101b (Fla. Broward Cty. Ct. Mar. 16, 2015).

12 Fla. Stat. § 222.12 (2012). Although cited in this 2015 decision, Fla. Stat. § 222.12, "Proceedings for exemption", was repealed effective July 1, 2013.

13 *Mazzella v. Boinis*, 617 So.2d 1156 (Fla. 4th DCA 1993) (citing *Killian v. Lawson*, 387 So.2d 960, 962 (Fla. 1980) and *Holden v. Estate of Gardner*, 420 So.2d 1082, 1083 (Fla. 1982)).

14 *See Nationwide Fin. Corp. v. Thompson*, 400 So.2d 559 (Fla. 1st DCA 1981).

15 *Mazzella v. Boinis*, 617 So.2d 1156 (*citing Patten Package Co. v. Houser*, 102 Fla. 603, 136 So. 353 (1931); *Farland Loan & Savings Co. v. Pittman*, 108 Fla. 442, 146 So. 554 (1933); *Slatcoff v. Dezen*, 76 So.2d 792 (Fla. 1954)).

16 Fla. Stat. § 222.11 (2014).

17 Fla. Stat. § 726.102(2)(b) (2019).

18 *Killian v. Lawson*, 387 So.2d 960 (Fla. 1980).

19 *Id.* at 962 (citing *Patten Package Co. v. Houser*, 102 Fla. 603, 136 So. 353 (1931); *Elvine v. Public Finance Co.*, 196 So.2d 25 (Fla. 3d DCA 1967)).

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20 "[E]xemption laws were 'designed for the honest debtor'[.]" *Slatcoff v. Dezen*, 76 So.2d 792, 793 (Fla. 1954) (citing 22 Am.Jur., Exemptions, Section 140).
21 *Pasco v. Harley*, 75 So. 30 (Fla. 1917).
22 *See e.g. Chames v. DeMayo*, 972 So.2d 850 (Fla. 2007).
23 *Id.* at 861 (citing *State v. Upton*, 658 So.2d 86, 87 (Fla.1995)).
24 I.R.C. § 408(e)(4).
25 *Id.*
26 Rule 9.331, Fla. R. App. P. (2018).
27 Fla. Const. art. 5, § 3(b)(4).
28 *Castro v. Mercantil Commercebank, N.A.*, 2020 WL 2049100 (Fla. 3rd DCA 2020).
29 *Castro v. Mercantil Commercebank, N.A.*, 2020 WL 2049100, at *1.
30 Fla. Stat. § 222.11(2)(b) (2009).
31 Fla Stat. § 222.11(2)(b) (2019).
32 *Castro v. Mercantil Commercebank, N.A.*, 2020 WL 2049100, at *1.
33 *Id.*
34 *Id.* at *2 (citing Fla. Stat. § 77.01 (2019)).
35 *Id.* at n. 2.

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