Garnishment Must Be Clarified In Pandemic Relief Laws

By **John Culhane and Lori Sommerfield** (May 27, 2020)

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In response to the growing coronavirus pandemic, Congress recently enacted two unprecedented economic stimulus laws to provide much-needed financial support for struggling individuals and families and distressed businesses, as well as hospitals and health care workers.

In its haste to enact this legislation, however, Congress appears to have overlooked an important issue: to provide exemptions from garnishment by private creditors for federal stimulus payments for individuals and Paycheck Protection Program loan proceeds for small business owners.

That legislative omission is causing additional financial pain for American families and frustration for creditors and debt collectors — while the banking industry is caught in the middle of the issue.

Banks would prefer to refrain from garnishing their customers' deposit accounts because customers desperately need access to their funds during the coronavirus crisis. Banks would also prefer to avoid the reputational risk that inevitably arises when customer funds are garnished during the severe recession that COVID-19 is causing. But yet banks are required to obey court-ordered garnishment under state laws. Clearly, legislative or regulatory clarity is needed to resolve this issue for all stakeholders involved.

The first federal stimulus law, called the Coronavirus Aid, Relief, and Economic Security, or CARES, Act of 2020, was enacted on March 27.[1] That legislation provided approximately $2.2 trillion in domestic aid to support businesses, individuals and families. Extraordinary in size and scope, the legislation is the largest economic stimulus package in American history, amounting to over 10% of total U.S. domestic product.

Among other initiatives intended to fortify the rapidly deteriorating economy, the CARES Act provided direct payments to Americans in the form of a one-time federal tax credit, known as an "economic impact payment," or EIP.[2] The act also authorized $349 billion to support a new Paycheck Protection Program for small businesses, which is 100% guaranteed by the Small Business Administration.[3]

The second law, titled the Paycheck Protection Program and Healthcare Enhancement Act, or CARES Act 2.0, was signed into law by the president on April 24. That law allocates an additional $310 billion to the PPP for small business loans, $60 billion for the SBA's Economic Injury Disaster Loan program, $75 billion for hospital and health care providers, and $25 billion for federal and state COVID-19 testing programs.

Neither of these laws contained any exemption from garnishment by private creditors for either EIPs or PPP loan proceeds. As a result, banks (at least until recently in some states) have been required by state law to garnish such funds from a recipient's deposit account when presented with a court garnishment order.

Economic Impact Payments

EIPs are authorized by Section 2201(a) of the CARES Act. While Section 2201(a) of the act does not expressly state Congress' intent for providing the EIP funds to individuals, that purpose is implied — to provide for the basic necessities of life, such as food, medicine and shelter.

Section 2201(d) of the CARES Act clearly states that EIPs cannot be offset for past-due administrative debts owed to federal agencies, past-due federal and state income tax debt, or unemployment compensation debt. EIPs may still be offset for past-due child support, however, as a matter of public policy. Despite these highly specific legislative directives concerning offset, Section 2201 is utterly silent on the issue of whether EIPs are exempt from state court-ordered garnishment to pay creditors.

Many have wondered whether the omission of exempting EIPs from garnishment by private parties was simply a legislative drafting oversight, while others have speculated that Congress intentionally chose not to confer the status of a protected federal benefit payment on EIPs as it has done in other federal laws.[4] Regardless of the reason, we believe that the U.S. Department of the Treasury has been given authority under the CARES Act to remedy it.

Section 2201(a) of the CARES Act authorizes the treasury secretary to issue guidance or a rule implementing that section. The exercise by the treasury secretary of that authority could quickly resolve the issue by making EIPs exempt from garnishment by creditors. To date, however, Treasury Secretary Steven Mnuchin — who is reported to have known about the issue since April 1 — has chosen not to exercise that authority (perhaps, as noted below, because of doubts about its scope).[5]

Since then, multiple senators, banking, payments and consumer trade groups, and state attorneys general have vigorously lobbied the Treasury through letter writing campaigns to clarify through guidance or an interim rule that EIPs are exempt from private garnishment as federally protected benefit payments.[6] So far, those efforts have yielded no fruit. Recently, the Washington Post reported that Treasury attorneys are reviewing the issue but believe that Congress would have to pass new legislation to give Treasury authority to ensure that EIPs are not garnished.[7] Therefore, this path to resolution appears unlikely.

Alternatively, Congress could provide a legislative fix by amending the CARES Act to provide clarity concerning EIPs' exemption from private garnishment. The banking trade groups have also advocated for that approach, even collaborating with various consumer groups to lobby congressional leadership for a technical amendment to the act.[8] Unfortunately, that issue fell between the cracks of Congress' priorities when it recently enacted CARES Act 2.0, so the next best hope is an amendment during a subsequent round of federal economic stimulus legislation.

In the interim, and in the absence of Treasury guidance or a legislative amendment to the CARES Act, several states have begun leaping into the federal void by taking action through their state AGs, governors, or highest courts to prohibit garnishment of EIPs. To date, 12 states have issued proclamations by governors, guidance from state AGs, or court orders that place a moratorium on garnishments during the coronavirus crisis.[9]And some of those state directives are quite aggressive.

To illustrate, on April 18, New York Attorney General Letitia James issued guidance to New York state banking institutions, creditors and debt collectors clarifying that EIPs are exempt

from garnishment under New York law.[10] New York AG James' legal analysis is based on New York City, New York state, and federal consumer protection laws and clarifies that any attempt to garnish EIPs from citizens of New York will be treated as a violation of those local, state and federal laws. For purposes of federal law, the New York AG states that she will treat garnishment of EIPs as "unfair and abusive" under the Dodd-Frank Act and will "aggressively prosecute" any such violations (although no such actions have been brought to date).

As another example, Minnesota Gov. Tim Walz issued Executive Order 20-50 on May 4, which broadly protects EIPs and any state, local and tribal government emergency funds as exempt from garnishment. Walz's executive order declares all such payments "government assistance based on need" under Minnesota Statutes Section 550.37, Subdivision 14, making such government aid exempt from all claims by creditors. Executive Order 20-50 also imposes a harsh civil penalty of $25,000 per violation against anyone who violates the order.

It is also important to note that some state directives are broader in scope and go beyond protecting only EIPs from garnishment. For example, on April 23, California Gov. Gavin Newsom issued Executive Order N-57-20 prohibiting attachment, levy, execution or garnishment of EIPs and "any other federal-, state-, or local-government financial assistance made available to individuals in express response to the COVID-19 pandemic."[11] The exemption extends to funds held in any account by an individual who received such financial assistance (to the extent such funds are traceable to that financial assistance) and applies without any further action on the part of the individual receiving the funds.

Similarly, the Illinois Supreme Court's Order M.R. 30370, issued on April 24, suspends service of any new garnishments and citations on consumer debtors through May 30, and orders a limitation on existing freezes placed on bank customers' deposit accounts by allowing a depositor to have access to at least $4,000 of his or her funds during the COVID-19 crisis.[12]

Although state action prohibiting garnishment of EIPs is generally a helpful development for the banking industry, it creates a headache for banks that operate across state lines, regional banks that conduct business in multiple states, and large nationally chartered banks that operate across the U.S. When banks operate in more than one state and garnishment procedures differ from state to state, that creates an operational nightmare. Banks will be required to review each state directive, evaluate whether they can rely upon the state directive to withhold customer funds from garnishment, and then develop a compliance strategy on a state-by-state basis.

Paycheck Protection Program Loan Proceeds

Similarly, the CARES Act does not address whether PPP loan proceeds provided to business owners can be garnished. Unlike EIPs, however, Section 1102 of the CARES Act clearly indicates how Congress intended PPP loan proceeds to be used by expressly limiting the purposes for which they may be used by an eligible recipient.

Specifically, a recipient must use such funds for payroll costs and other essential business-related expenses necessary to maintain its distressed small business.[13] The SBA's interim final rule further explains that "the non-payroll portion of the forgivable loan amount should be limited [to 25% of loan expenditures] to effectuate the core purpose of the statute and ensure finite program resources are devoted primarily to payroll."[14] The rule then goes on

to justify its requirement that at least 75% of loan proceeds be used for payroll costs on the basis of "Congress' overarching goal of keeping workers paid and employed."[15]

Section 1102 of the CARES Act, which contains specific uses for PPP loan proceeds, clearly conflicts with state laws that would subject PPP loan proceeds to garnishment. To determine whether state laws authorizing garnishment orders impermissibly conflict with Section 1102 of the CARES Act, a federal preemption analysis is required.

We believe it is appropriate to analyze this issue through the legal theory of implied conflict preemption, where express preemption language may not be present, but Congress' preemptive intent is implicit because it is either (1) impossible for a party to comply with both the federal and state laws (impossibility preemption) or (2) the state law poses an impediment to the purpose and objective of Congress (obstacle preemption).

As noted above, Section 1102 of the CARES Act and the SBA's interim final rule expressly specify that a recipient must use PPP loan proceeds for purposes of payroll costs and other business-related expenses to keep its business afloat. In our view, there is an argument that because the CARES Act limited the purposes for which a recipient may use PPP loan proceeds, a bank, by honoring a state garnishment order, would make it impossible for a recipient to avoid a violation of its CARES Act obligations. We believe there is also an argument that if a bank were to honor a court-ordered garnishment, it would impede Congress' purpose in creating the Paycheck Protection Program.

Based on this legal analysis, we find strong arguments for federal preemption that state laws authorizing a garnishment order with respect to PPP loan proceeds impermissibly conflict with the explicit requirements and purposes of the CARES Act, and therefore are preempted.

Call to Action

The lack of clarity concerning whether EIPs and PPP loan proceeds can be garnished is creating additional financial hardship for individual Americans and small business owners who are already struggling. It is also creating difficulty and complexity for bankers who are caught between their customers and private creditors in garnishment actions.

This issue could be clarified by the Department of the Treasury through issuance of guidance or an interim rule. Alternatively, Congress could adopt a technical amendment to the CARES Act clarifying that EIPs and PPP loan proceeds are exempt from garnishment (which seems more likely).

In either event, Treasury or the Congress must act expeditiously to protect these much-needed funds from garnishment before the issue is moot and consumers and small business owners experience harm.

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[1] Public Law 116-136.

[2] Section 2201(a) of the CARES Act amends Subchapter B of chapter 65 of subtitle F of the Internal Revenue Code by inserting a new section 6428 (2020 Recovery Rebates for Individuals).

[3] Section 1102 of the Act amends Section 7(a) of the Small Business Act (which is codified at 15 U.S.C. § 636(a) by adding a new subsection 36.

[4] For example, Section 207 of the Social Security Act treats social security payments as exempt under federal law from garnishment orders and the claims of judgment creditors because such payments may often constitute a major portion, and sometimes all, of an individual's income. See 42 U.S.C. § 407(a) ("…none of the moneys paid or payable or rights existing under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal process...").

[5] An article in The American Prospect dated April 15, 2020 reports that Treasury Secretary Mnuchin became aware of the omission in the CARES Act through a phone call placed by Senator Sherrod Brown (D-Ohio) to the Secretary on April 1, 2020.
See https://prospect.org/coronavirus/unsanitized-mnuchin-knew-banks-coronavirus-checks/.

https://prospect.org/coronavirus/unsanitized-mnuchin-knew-banks-coronavirus-checks/[6] Among many others, the communications to Treasury Secretary Mnuchin include a letter from Senators Sherrod Brown (D-OH), Ron Wyden (D-OR) and Elizabeth Warren (D-MA) dated April 3, 2020; a letter from Senators Sherrod Brown (D-OH) and Josh Hawley (R-MO) dated April 9, 2020; a letter issued jointly by the banking and credit union trade associations dated April 28, 2020; and a letter from 25 state attorneys general and Hawaii's Office of Consumer Protection dated April 13, 2020.

[7] See Washington Post article dated April 20, 2020 available at https://www.washingtonpost.com/business/2020/04/20/amid-bipartisan-criticism-treasury-department-attorneys-review-bank-seizures-1200-stimulus-checks.

[8] Communications to Congressional leadership include a letter from the banking trade associations (including the American Bankers Association, Consumer Bankers Association and The Clearing House) dated April 15, 2020, available at https://bpi.com/wp-content/uploads/2020/04/Joint-Trades-Letter-Exempt-Stimulus-Payments-from-Wage-Garnishments-2020.04.15.pdf, and a joint letter from the banking and consumer trade groups dated April 21, 2020, available at https://www.aba.com/-/media/documents/letters-to-congress-and-regulators/joint-trades-consumer-letter-re-garnishment-04212020.pdf?rev=238621d76d1345958d80088c61a066b3.

[9] As of the writing of this article, 12 states have issued guidance or court orders that prohibit garnishment of EIPs. Those states include California, Illinois, Indiana, Iowa, Ohio, Maryland, Minnesota, Massachusetts, Nebraska (in the form of a warning by that state's AG), New York, Rhode Island and Washington.

[10] See https://ag.ny.gov/sites/default/files/cares_act_guidance.pdf.

[11] The text of Executive Order N-57-20 is available at https://www.gov.ca.gov/wp-content/uploads/2020/04/4.23.20-EO-N-57-20-text.pdf . Although Newsom's public statements suggest that his intent was to protect the funds of individual consumers (see

concurrent press release dated April 23, 2020), the executive order might be held to protect PPP loan proceeds received by businesses that are sole proprietorships.

[12] The Illinois Supreme Court's order applies to any summons or citation directed to an Illinois depository institution that was served after March 8, 2020, or had an original return date between March 8, 2020 and "the date of termination of the Governor's Disaster Proclamations" (currently May 30, 2020 unless otherwise extended). The Court's order is available at: https://courts.illinois.gov/SupremeCourt/Announce/2020/042420.pdf

[13] See 15 U.S.C. § 636(a)(36)(F).

[14] RIN 3245-AH34 at 14.

[15] Id. at 16.