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ERISA Advisory

SIMPLE Retirement Account Held to be Protected by State Anti-Garnishment Law

A new district court case, *VFS Financing, Inc. v. Elias-Savion-Fox LLC*, 2014 U.S. Dist. LEXIS 166240 (S.D.N.Y. Dec. 1, 2014), has ruled that Section 514(a) of ERISA does not preempt application of a state anti-garnishment statute to a SIMPLE retirement account. The case not only adopts a narrow view of ERISA's preemptive scope, but also highlights a seeming anomaly in the law. Unlike other types of IRAs, simplified employee pensions (SEPs) and SIMPLE retirement accounts (SIMPLEs) that receive employer contributions are generally considered to be "employee benefit plans" subject to ERISA (including ERISA's preemption of state laws that "relate to" such plans), but the anti-alienation creditor protection generally extended to ERISA-covered pension plans is inapplicable to SEPs, SIMPLEs and other types of IRA arrangements under IRC § 408. See ERISA §§ 201(6) & 206(d)(1).

The case grew out of a bad loan to a limited liability corporation (LLC) for the purchase of a private jet. The borrower defaulted, the lender sued, and the parties settled for $2.4 million, which the lender then sought to collect. The LLC had only $200,000 in assets, but its members had guaranteed the loan, and one of them, Richard Fox, had a $600,000 IRA. The lender applied for a turnover order garnishing the IRA. Mr. Fox resisted on the ground that New York law, which the court held applied to the loan agreement, exempts IRAs from garnishment by judgment creditors (except for contributions made later than 90 days before the lawsuit was filed). Mr. Fox had to rely entirely on the state anti-garnishment law because ERISA's prohibition against assignment or alienation of benefits does not extend to IRAs.

The state anti-garnishment law would unquestionably protect a run-of-the-mill IRA. The creditor contended that this IRA was different, because; (1) it was the funding vehicle for a SIMPLE (IRC § 408(p)); (2) SIMPLEs are employee benefit plans subject to ERISA; and (3) the state anti-garnishment law was therefore preempted by ERISA. The court agreed that the SIMPLE funded by the IRA was an ERISA-covered plan. Department of Labor regulations exclude individual retirement accounts (IRAs) from the definition of "employee benefit plan" only if, *inter alia*, "[n]o contributions are made by the employer," and participation by employees is completely voluntary. 29 C.F.R. § 2510.3-2(d). While participation in a SIMPLE plan is voluntary, the employer is required to match any employee contributions (or to make non-elective contributions instead), so that the account is, under a strict reading of the DOL regulation, an employee benefit plan subject to ERISA.

The court then turned to the creditor's preemption argument. Mr. Fox's SIMPLE was ERISA-covered, and therefore, state laws that "relate to" it were preempted by Section 514(a) of ERISA, with exceptions for insurance, banking, securities, criminal, and some other laws that were not pertinent here. The creditor could, in fact, cite a US Supreme Court decision almost exactly on point. In *Mackey v. Lanier Collection Agency & Service, Inc*., 486 U.S. 825 (1988), the Court held that a Georgia law forbidding the garnishment of welfare plan benefits (also not protected by ERISA against assignment or alienation) was preempted. It would be difficult to draw a coherent distinction between the Georgia anti-garnishment statute and New York's.

How, then, did the court in *VFS Financing* reach the conclusion that ERISA did *not* preempt the New York law, particularly after agreeing with the creditor's argument that the defendant's account was indeed an ERISA plan? The district court recognized ERISA preempts state laws that single out ERISA-covered plans for special treatment, even if their impact is minimal, quoting the Supreme Court for the proposition that: "Where a State's law acts immediately and exclusively upon ERISA plans, as in *Mackey*, or where the existence of ERISA plans is essential to the law's operation, as in *Greater Washington Bd. of Trade*

and *Ingersoll-Rand*, that 'reference' will result in pre-emption." *California Division of Labor Standards Enforcement v. Dillingham Construction, N.A., Inc*., 519 U.S. 316, 325 (1997). Given that the New York law identified individual retirement accounts, including SIMPLEs covered by ERISA, as exempt from its generally applicable garnishment statute, it might appear to fall squarely within the Supreme Court's concept of "reference," though the court thought otherwise:

> It blocks creditors from reaching a wide range of assets, including, among others, religious texts, family pictures, domestic animals, a wedding ring, clothing, a car, and – relevant here– retirement funds provided for under IRC § 408 [citation omitted]. Such retirement funds are not, therefore, the exclusive focus of New York's statute, unlike the Georgia law struck down in *Mackey*, which explicitly referred – and solely applied – to ERISA plan benefits.

That analysis leans heavily on the word "exclusively." What was important in *Mackey* was that the Georgia garnishment law was a generally applicable creditors' rights statute from which ERISA-covered plans were specifically exempted. The Supreme Court did not ask whether there were any other exemptions. It seems rather tenuous to suggest that a law does not "refer to" ERISA plans simply because it explicitly refers to them *and* to some other entities. Certainly *Mackey*'s reasoning would, on its face, apply just as well if Georgia had also placed religious texts, family pictures, domestic animals, etc. beyond the grasp of creditors.

So far as we can determine, *VFS Financing* is only the third case to consider whether IRAs established pursuant to SEPs or SIMPLEs can receive the benefit of state anti-garnishment laws. Both of the earlier cases concluded that they cannot. *Lampkins v. Golden*, 28 Fed. Appx. 409 (6th Cir. 2002) (not for publication); *Ducana Windows & Doors, Ltd. v. Sunrise Windows Ltd., L.L.C.*, 2012 U.S. Dist. LEXIS 185505 (E.D. Mich. 2012), *magistrate's report adopted by* 2013 U.S. Dist. LEXIS 12872 (2013). The *VFS Financing* opinion criticized *Lampkins* for its failure to recognize the alleged revolutionizing of preemption doctrine brought about by *Travelers* and its progeny. A *Lampkins* advocate might respond that it is not the business of lower courts to overrule Supreme Court precedents.

On the whole, the reasoning of *VFS Financing* is open to challenge, although its outcome – the consistent application of a state anti-garnishment law to all IRAs, regardless of their origin – has the effect of closing an apparent "gap" in anti-alienation creditor protection for SEPs and SIMPLEs. This issue is of interest to IRA vendors, most of which handle IRAs of all species. Since they must deal with different states' garnishment rules for most of their accounts, these vendors may be happier with *VFS Financing*, which makes it unnecessary to look into IRA subspecies, than with the conclusion reached in *Lampkins*.