MEMORANDUM

To: Drafting Committee
Uniform Wage Garnishment Act
From: Steve Willborn
Date: March 2, 2015
Re: Issues

A. Definition of "Earnings." This definition is intended to use two factors to delineate the dividing line between earnings and non-earnings: (1) the money must be owed by an employer and (2) it must be for personal services. This would mean for example:

(1) A pension payment from an independent trust separate from the employer would not be earnings under the Act. The definition includes periodic pension and disability payments, but only if they come directly from the employee's employer. But see U.S. v. Lee, 659 F.3d 619 (7th Cir. 2011)(401K payments are earnings under CCPA); U.S. v. DeCay, 620 F.3d 534 (5th Cir. 2010)(same).

(2) An income tax refund would not be earnings because they also do not come directly from the employer. See Kokoszka v. Belford, 417 U.S. 642 (1974)(holding that income tax refund is not earnings under CCPA).

(3) A severance payment would be earnings even though there would be an argument that it was not due to personal services, but rather as a reward for ceasing personal services. (This is clarified by the list.) See Shah v. City of Farmington Hills, 748 N.W.2d 592 (Mich. Ct. App. 2008)(severance payments are earnings under CCPA because for personal services; rejects periodicity as relevant; dissent says not for personal services but rather for agreement not to perform personal services).

(4) Tips would be earnings if they were collected by the employer and paid out, but not if they were paid directly to the employee. Only in the former case would the compensation be owed by the employer to the employee. This is the Department of Labor's rule under the CCPA, but the cases are mixed. See, e.g., Erlanger Medical Center v. Strong, 382 S.W.2d 349 (Tenn. Ct. App. 2012)(tips that do not pass through employer are not earnings); Shanks v. Lowe, 364 Md. 538 (Md. Ct. App. 2001)(tips paid directly to employee are earnings).

(5) A distribution from an LLC or partnership would be earnings if it were treated as compensation under applicable state law, but not if it constituted a payment for a member or partner's transferable interest in the entity. In the former case, the

distribution would be for personal services; in the latter case, it would not be. See Uniform Limited Liability Company Act, § 102(4)(a distribution from an LLC can be compensation or distribution of a transferable interest); In Re Dewey & LeBoeuf, LLC, 518 B.R. 766, 785-90 (S.D.N.Y. 2014)(under New York's "no compensation" rule, no part of the distribution from the partnership is treated as compensation).

(6) Payments for profit-sharing or recognition awards are earnings even though they are not periodic. Periodicity is relevant only to distinguish between lump-sum and periodic pension and disability payments coming from an employer. See U.S. v. Lee, 659 F.3d 619 (7th Cir. 2011).

(7) Allowances (payments) for benefits such as housing or automobiles would count as earnings – they come from an employer and are for personal services. This would raise the issue of valuation, but that is an issue that would generally have to be resolved for other purposes anyway (such as taxation).

(8) Reimbursement for employment-related expenses are a close call. They do come from the employer, but arguably they present a close call on whether the reimbursement is for personal services (vs. as mere re-payment of expenses paid). Despite the close call, intuitively, it seems that this type of payment should be protected, so the suggestion is to include it explicitly in the list of covered items. This avoids the ambiguity. (Intuitively, these types of payments seem as if they should be entitled to even more protection than provided to the other categories; but creating a super-protected category does not seem advisable.)

(9) Workers' compensation payments. [I have some cases to cite here and some discussion to insert.]

In thinking about this, it's important to keep a couple things in mind. First, the definition cannot be narrower than the one in the Consumer Credit Protection Act because state law must be at least as protective as the CCPA. This is not a simple criterion to meet as the cases under the CCPA are not entirely consistent.

Second, this definition defines the scope of the consumer protections under the CCPA. If a particular payment does not fit within the definition of "earnings," an employee would not be able to take advantage of the exemptions and limits of Section 7, which apply only to "earnings." Consequently, for non-earnings, a creditor could access the total amount of a payment and would not be limited by the exemptions and limits.

At the end of the day, I expect it will be impossible to fit every type of payment with absolute precision into either earnings or non-earnings. The issue here is whether this definition does a good enough job of covering most of the possible situations.

B. Definition of "Employee." Distinguishing employees from other categories of workers (independent contractors, volunteers, interns, students) has proven to be exceedingly difficult. I could, but will not, cite you to hundreds of cases that wrestle with the issue in dozens of contexts (whether workers can unionize, whether they are entitled to overtime premiums, whether they are covered by workers' compensation, etc.).

The current language defers to the employer's classification as an employee for federal tax purposes. This has several advantages: (1) it's a bright line rule which will be very easy for employers to apply and, hence, contribute to the efficiency of the garnishment system; (2) it will largely remove debates (and litigation) about proper classification from garnishment proceedings; (3) it avoids the need to analyze how workers who are not treated as employees by an employer would have been compensated had they been treated as employees (e.g., to determine their disposable earnings); and (4) it should not skew employer classification decisions as they are likely to be driven by issues other than garnishment.

The downside of this approach is that it is a narrow approach to who is protected by the consumer protections of the garnishment laws. For example, misclassified workers and workers who, although properly classified, seem to fit within the policy of garnishment protections would not be protected under this approach. In *In Re Pruss*, 235 B.R. 430 (D. Neb. 1999)(later vacated for mootness), for example, the court found that a lawyer's accounts receivable were earnings subject to the protections of the Nebraska garnishment statute. The Court held that the policy of the Act was to protect "periodic payments needed to support the wage earner and his family on a week-to-week, month-to-month basis." Id. at 436 (quoting Kokoszka v. Belford, 417 U.S. 642 (1974)). That policy meant that these amounts should be protected even though the attorney was not an employee.

Having said that, *In Re Pruss* is an outlier. The general approach of the CCPA and state garnishment laws is not to extend protections to the earnings of independent contractors and other non-employees. *See, e.g., In Re Galvez*, 115 Nev. 417 (Nev. Sup. Ct. 1999)(real estate commission earned by independent contractor was not earnings under state garnishment law); *Coward v. Smith*, 6 Kan. App.2d 863 (1981)(amounts due an independent contractor under a construction contract were not earnings).

If we were to attempt to cover more workers, the probable approach would be to dispense with definitions of employer and employee (since they would not be relevant narrowing concepts anymore) and to place more weight on the definition of earnings – something like "periodic payments necessary for day-to-day living expenses" or something like that. The basic issue would be whether the expansion of the scope of the Act would be worth the complications, confusions, and inefficiencies that would result.

In the Issues Memo for our fall, 2014, meeting, I discussed ways in which we could define "employee" should we decide we wanted to include a definition in the Act (instead of deferring to the employer's classification). Models are available from the Model Employment Termination Act (META)

and from the recent Restatement of Employment Law. I will not repeat that discussion here, but it's available in that earlier Issues Memo.

C. Choice of Law. We have reserved Section 4(c) to deal with the issue of choice of law in cases in which the employer cannot be sued in the State in which the employee works (the situation contemplated by subsection (b)). So let's say the debtor is in State A, but the case is filed in State B. The issue is what law should State B apply. Bill and I have talked about this briefly, but without much resolution. On the one hand, State B will know its own law best so that's a reason to lean in favor of State B's law and, in addition, one would think our law would not (maybe could not) require State B to follow State A's procedural rules. On the other hand, State A's garnishment laws were constructed to provide its citizens the level of protection chosen by the legislature (or Unicameral, as the case may be). And even if both States have adopted the Uniform Act, the Act will provide several areas where choices can be made about the level of protection. It is also possible, of course, that State A has not adopted the Uniform Act, which would mean that the differences between State A and B are likely to be bigger. The issue for us is what we want the choice of law rule to be. If you can give me guidance on that, I will probably be able to draft a provision that will reflect that policy decision.

D. Notice Form. Section 6 contains a notice form. Bill and I have had some discussions about the word "wages" that is used in the form. Bill has suggested that perhaps we should use the word "earnings" instead, as that is a defined term in the Act. There are two overlapping issues here.

A. To what extent do we need to use the defined terms within the forms? I think Bill and I both agree that strict adherence to the defined terms is not necessary in the forms, as the forms are intended for a different audience.

B. What is our intuition about whether "wages" would be a better understood term than "earnings" for the intended audience of the Notice Form? On this, I think Bill and I have somewhat different intuitions. As we will discuss at the meeting in Chicago, we are hoping to have expert advice on this issue.

E. Multiple Levies. Several issues are raised by the current draft of Section 11 on multiple levies.

A. Although I think we agreed to the following policy at our last meeting, I wanted to mention it again in case it merits further discussion. The basic allocation of Subsection (a)(2) is that when there are multiple garnishments (or other levies with the same priority), each levy should be paid the same amount. The other major possibilities are: (1) to weight the levies in the same priority level by their amounts and allocate the available amounts in proportion to the total amounts due on each levy (this option is a lot more complicated to describe and implement) or (2) to provide that the first-in-time levy should be paid in full before the next levy in line (first-in-time is a common approach in garnishment statutes and, indeed, a common legal response to priority issues in the law generally[1]).

[1] See Lawrence Berger, An Analysis of the Doctrine That "First in Time is First in Right, 64 Neb. L. Rev. 349 (1985)(you can look at this article if you want, but I include it mostly as a nod to the author, one of my main mentors at Nebraska).

B. The federal Consumer Credit Protection Act does not deal with priorities. As a result, the issue has to be determined by federal or state law. For us, state law is pretty easy; since we're drafting a state law, we can say what the priorities are. Federal law, on the other hand, presents complications. For example, the priority of federal tax levies is uncertain; but both options conflict with a proportional-payment rule.[2] You'll see that I try to deal with this in subsections (b)(3) and (c)(2) by adopting one of the two possible approaches of the IRS. But I'm quite uncertain about that. We may need to have a conversation with the IRS about it.

C. Some states provide higher priority for their own claims, e.g., for taxes owed to the State. You'll see that my solution to this is to leave a blank for states to insert their own special priorities. If we adopt this approach, we would need to provide a note with some direction for state legislative drafters to let them know that we are permitting – but probably discouraging in the name of uniformity – individual state priorities.

F. Interaction with the Uniform Interstate Family Support Act (UIFSA). At our last meeting, we agreed to exclude support orders covered by UIFSA from our Act. This draft's implementation of that leaves three traces of UIFSA in the Act: (1) In Section 2, the definition of "support order;" (2) in Section 3, excluding "support orders" from the Act's coverage; and (3) in Section 11, including "support orders" as the highest level priority when there are multiple levies.

G. Exemptions and Limits When There Are Two Employers. Jack Davies wonders whether we should consider employees with two jobs. Assume a worker with two low-paid jobs neither of which produce disposable earnings each week of 30 times the federal minimum wage, but which together exceed that amount by quite a bit. If we do nothing, the current structure of the Act would permit that employee to have the benefit of two exemptions and have no wages garnished. Even at higher wage levels, workers with two jobs would have the advantage of two exemptions. (If both jobs pay a lot, the advantage would disappear as both would be limited only by the 25% limitation.)

IRS levies do take account of such situations. It provides that its exemptions can apply to only one source of income; if there are two sources of income, the IRS provides a letter to the second employer telling that employer not to allow any exemptions. This would provide a model for thinking about our limit and exemption structure, but it would be an awkward and complicated one. A garnishee/employer would not have notice that another employer was being garnished. As a result, some sort of notice of double garnishment would probably have to come from the creditor. But the creditor would not know ahead of time how the exemptions and limits would apply since it would not know the wage levels at the two employers, so after the creditor notice of two garnishments, the system would probably have to provide for some sort of exchange of information between the two garnishees/employers. So, again, it would be complicated.

My intuition is to permit a debtor/employee with two jobs to take advantage of two sets of exemptions and limits. The advantage of this – which I think is a significant one – is that it avoids the complications

[2] Amy's Complete Guide reports that IRS regulations give federal tax levies priority over other garnishments, but IRS policy follows a first-in-time principle.

of setting up a system to deal with the situation. It has the side "benefit" of increasing the consumer protections of the Act for that subset of workers. The downside is that it treats an employee with two incomes better than a similarly situated employee with one job.

H. Penalties for Creditors. The issue here is whether to have something in the Act that discourages creditors from filing garnishment actions without paying any attention to whether an individual actually is an employee of the employer.[3] Or stated the other way around, should there be a penalty to encourage creditors to do some due diligence to determine whether debtors are employees before they file a garnishment action.

In general, three types of penalties could be relied on to encourage due diligence:

1. ***The court filing fee itself***. If high enough, this would discourage frivolous, fishing filings. An advantage of adopting this approach is that it would require nothing in our statute; it's a part of the background rules. On the other hand, (a) it will vary by state and (b) it may not be enough of a discouragement.

2. ***An administration fee***. Option 2 in subsection E above would create an incentive in the right direction and, as indicated, would be fairly easy to implement. On the other hand, (a) it's hard to know what the proper amount of the fee should be for this purpose[4] and (b) as indicated above, it may raise enactability problems.

3. ***An explicit penalty***. The Act could provide an explicit penalty for creditors who file garnishment actions willy-nilly. This would be the most targeted way to encourage due diligence. But (a) it would require some sort of standard for when the penalty would apply that would probably be hard to apply ("penalty for filing without reason to believe the debtor is an employee…", or something mushy like that); (b) it would apply only rarely and be expensive to enforce when it was invoked; (c) it would need to have a higher penalty than either of the other options because creditors will properly discount the face amount of the penalty by the low probability that it will ever be applied to them no matter how they act; and (d) because the amount of the penalty will have to be significant (see (c) above), it will probably create enactability problems.

At this point, I've not included any creditor penalties in the Act. My intuition is that they would create more trouble than they're worth. But my intuitions have often been wrong in the past.

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[3] Similarly, we may want to think about having a penalty for a failure of a creditor to comply with Section 5(b) and 5(i) which require the creditor to petition for dismissal of the action in certain circumstances.

[4] Note that the purpose here is ***not*** to compensate the employer for its costs, but rather to encourage due diligence by the creditor. There is little reason to think that the "proper" amount for those two purposes would be the same and there will be precious little empirical guidance about what the proper amount should be for the latter purpose.

I. Responses to Employee Debt Other than Wage Garnishment. At our first meeting, we talked briefly about alternatives that creditors might pursue if wage garnishment became burdensome or impracticable. The main worry (voiced by Jack, among others) was that creditors would begin to garnish bank accounts rather than wages. We didn't make much progress on this at our second meeting. I did not deal with it in the current draft, but I wanted to have this note in the Issues Memo to ensure that it is still on our radar screen.

This problem with a statute restricted to wage garnishment is aggravated because most existing garnishment statutes encompass garnishment from entities other than employers. Some statutes are explicitly very broad,[5] while others use the word "employer" but define the term broadly enough to encompass many non-employment relationships.[6] Although I've not done a complete survey, I expect only a few garnishment statutes are strictly limited to "wage" garnishment from "employers."

This leaves us with difficult choices. Some options:

(1) We could limit our statute to wage garnishment from employers. This would require states to either amend our statute to broaden it to include garnishment from other types of entities and relationships, or to draft a separate statute for other types of garnishments.

(2) We could limit our statute to wage garnishment, but define wages expansively to encompass situations where the "wages" are being held by entities other than employers. For example, if wages included monies received for personal services within the preceding 30 days, then whatever restrictions that might apply to an employer directly would also apply to others that were holding such "wages" (such as a bank which had received the monies through a direct deposit from an employer).

(3) We could draft a statute that explicitly extended beyond wage garnishment to encompass garnishments from other types of entities and relationships. This would probably require permission from the Scope and Program Committee.

(4) We could provide States with options about what kinds of entities and relationships they want the statute to cover. This again may require permission from Scope and Program.

J. Administrative Fee. In this draft, as in the last draft, I have not included any provision for an administrative fee to be paid to the employer. At our last meeting, we discussed the issue, but only very briefly and without coming to any conclusion. Again, I am including the issue here to keep it on our radar screen. Currently, about a dozen states do not provide for any administrative fees. Of the others, most

[5] See, e.g., Del. Code Ann. tit. 10, § 9588(b)(plaintiff may seek garnishment from anyone who has "in his or her hands, or possession, any attachable goods, or chattels, rights, credits, money, or effects of the defendant").
[6] See, e.g., Conn. Gen. Stat. § 52-362(a)(4)(employer defined to include any person "who owes earnings to an obligator"); Ariz. Rev. Stat. § 12-1598.03(4)(permits garnishment if garnishee is "believed to be the employer of the judgment debtor or otherwise owes or will owe to the debtor disposable earnings"). On their face, these statutes permit garnishment from entities that have independent contractor and other non-employment relationships with debtors.

require the payment to be paid by the creditor rather than by the debtor. So these are the three general options on administrative fees:

1) No fee, as in the current draft.

2) A fee to be paid by the creditor. This would be fairly simple to implement. The main issues would be (a) how much and (b) when does it have to be paid. Both issues could cause enactability problems, especially in states that do not now require such fees to be paid.

3) A fee to be paid by the debtor. This is possible and occurs currently in some states, but it's a little bit more complicated to insert into the statute as it would affect things like the forms, the limits, and the priorities.