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GOVERNOR EXEMPTS CARES ACT ASSISTANCE PAYMENTS FROM LEVY

On April 23, 2020, California Governor Gavin Newsom signed Executive Order N-57-20 ("Order") which exempts from garnishment federal, state or local government financial assistance payments received by individuals in response to the COVID-19 pandemic. This includes recovery rebates under the CARES Act (Coronavirus Aid, Relief, and Economic Security Act) whereby certain individuals are entitled to an advanced tax credit of up to $1,200, depending on their income level. Stated simply, the Order prevents debt collectors from garnishing federal stimulus funds from most Californians. Unfortunately, due to the broad and vague language used in the Order there are quite a number of unanswered questions that remain.

If you have any questions regarding Governor Newsom's Order, contact Keith Forrester at 800-742-3600 or email him at KForrester@ABLawyers.com.

Scope of Exemption. The exemption for federal stimulus funds under the Order does not appear to be limited to the direct deposit of financial assistance payments (such as via ACH), as the exemption applies to any funds that are "traceable to the financial assistance received by that individual." Therefore, financial institutions may need to attempt to implement a process to enable them to identify customer deposits of government checks for financial assistance under the CARES Act.

Impacted Levies. The Order states that the financial assistance payments "shall be exempt from any attachment, levy, execution, or garnishment" but excludes from the exemption any legal process for "any child support, spousal support, or family support, or any criminal restitution payable to victims." Due to this exclusion, orders to withhold from the Department of Child Support Services (DCSS) are not subject to the exemption under the Order. Additionally, while the language in the Order is broad enough to include virtually any levy that may be served on financial institutions in California, it is highly doubtful that the Order would or could legally apply to the IRS as an IRS levy would likely benefit from federal preemption.

Amounts Owed to Financial Institutions. Financial institutions are also limited in their ability to apply financial assistance payments to amounts owed by a customer to the institution itself. "No financial institutions shall have any lien upon, or any right of setoff against, any financial assistance" funds as described in the Order. This also includes "any such setoff in connection with fees." Based on this language, financial institutions should not unilaterally apply any of the assistance funds to cover amounts owed to the institution, including for fees. For example, if a customer has a negative balance of $500 in an account and receives a deposit of covered financial assistance in the amount of $1,200, the Order likely prohibits the institution from applying any of those funds to the negative balance (which would have left an account balance of $700). The Order appears to require that the customer be provided access to the full $1,200, without regard to the account balance.

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PPP Loan Proceeds. What is even more confusing about the Order is the extent to which it applies, if at all, to the Small Business Administration's Paycheck Protection Program ("PPP") loan proceeds. While the Order specifically refers to "[f]inancial assistance under section 2201 of the Cares Act (concerning 2020 Recovery Rebates for Individuals)," the Order also includes as exempt "any other federal-, state-, or local-government financial assistance made available to individuals in express response to the COVID-19 pandemic."

There are two considerations here. First, if a PPP loan is made to a sole proprietor, it may be difficult to argue that the loan proceeds do not consist of financial assistance made available to an individual in response to the pandemic. Second, what about PPP loan proceeds that are ultimately paid by a small business to its employees (even when the borrower is not an individual, such as a corporation)? Would those payments be considered financial assistance made available to individuals in response to the pandemic?

It likely would not be too difficult for a financial institution to trace the proceeds of a PPP loan it makes to an individual sole proprietor. On the other hand, it would be extremely difficult, if not impossible, to trace the payment of those PPP loan proceeds to small business employees consistent with the PPP loan program. Without clarification from the governor's office, it remains unclear whether the proceeds of PPP loans should be considered exempt under the Order under either scenario described above.

Refund of Money Already Collected. The Order also quite explicitly states that any money covered by the Order which was already collected is required to be refunded. The Order makes it illegal for anyone to "retain" any financial assistance money so collected. This obviously means that any individuals who had their financial assistance funds levied are entitled to a return of those funds. However, it is unclear how this is to be accomplished. Creditors are unlikely to even know that they levied against financial assistance payments and there is no mechanism for that determination to be made. Of course, the debtor could provide proof to the creditor that the levy proceeds consisted of assistance payments but that seems to go against the language in the Order which states that the funds are to be refunded "without any further action . . . by the individual entitled to that money . . .."

What about an obligation of the financial institution to provide assistance to its customer to obtain a refund? The Order does not provide any guidance here. Even more troubling is that the Order does not specifically state that the "creditor" is the one that must refund the funds that were levied upon. This could be interpreted to mean that the financial institution that debited the account in response to a levy must refund the funds since the institution "collected" the funds (before remitting them pursuant to the levy). Of assistance here may be the additional language in the Order which states that it is unlawful "to retain" the funds collected. If the funds have already been remitted to the levying officer, the institution does not "retain" the funds. Therefore, it may be reasonable to take the position that the creditor, as the person that actually "retains" the funds, has the obligation to provide the "refund."

For a financial institution that previously remitted financial assistance payments in response to a levy, what should the institution do? To the extent the institution can determine that these protected funds were levied upon it may want to consider providing a notice to the levying officer and/or the creditor that the levied funds consisted of financial assistance payments. On the other hand, to the extent the institution receives a demand from its customer that the institution, rather than the creditor, is obligated to refund the payments to the customer, please immediately contact legal counsel.