BURR ALERT

Garnishee Bank's "Defenses" Trumped?

By W. Patrick Ayers and Madison L. Mitchell *February 2016*

Cases decided recently in Florida and Illinois call into question one legal rule that some might have thought well-settled: a first-perfected security interest in collateral beats a later-perfected lien creditor's interest in that same collateral. Seems simple enough. Except this rule might not be followed in every State.

In Am. Home Assur. Co. v. Weaver Aggregate Transp., Inc., 84 F. Supp. 3d 1314 (M.D. Fla. 2015)[1], a Florida court held (interpreting Illinois law) that a garnishing lien creditor's interest in funds held in a depository account defeats the depository bank's UCC security interest and setoff rights, at least when the bank had not declared the loans in default and set off the funds BEFORE the bank's receipt of the writ of garnishment. American Home relied in part upon S.E.I.U. Local No. 4 Pension Fund v. Pinnacle Health Care of Berwyn LLC, 560 F. Supp. 2d 647 (N.D. Ill. 2008)[2], which essentially decided the same thing - also under Illinois law - in favor of another garnishing judgment creditor. A third Illinois case, One CW, LLC v. Cartridge World N. Am., LLC, 661 F. Supp. 2d 931 (N.D. Ill. 2009)[3], similarly ruled in favor of a garnishment creditor and against the depository bank (senior UCC creditor), importantly, because the bank's security agreement was read to grant the bank the rights of a secured part ONLY UPON DEFAULT and not before.

American Home, S.E.I.U., and One CW should serve as an ominous warning to secured creditor depository banks seeking to protect "secured" rights and remedies PRIOR TO DEFAULT. Because this disturbing line of cases appears to rely upon limiting language in the loan documents themselves that the secured party's rights and remedies somehow do not even exist unless and until an affirmative "default" exists and is called, then secured creditor depository banks might amend form loan documents to trigger a default automatically, without any notice or cure/grace rights, immediately upon receipt of any information (including but not limited to a writ of garnishment, attachment, notice of a lawsuit or judgment or lis pendens, etc.) that causes it to feel insecure or otherwise threatens to impair its collateral. Loan documents should be written to expressly and automatically authorize a secured creditor's actions to protect its collateral in "non-default" situations.

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[1] See http://www.leagle.com/decision/In%20FDCO%2020150203B45/American%20Home%20Assurance%20Company%20v.%20Weaver%20Aggregate%20Transport,%20Inc., visited February 15, 2016.

[2] See http://www.leagle.com/decision/20081207560FSupp2d647_11145/S.E.I.U.%20LOCAL%20NO.%204%20PENSION%20v.%20PINNACLE%20HEALTH, visited February 15, 2016.

[3] See http://www.leagle.com/decision/20091592661bofsupp2d931_11526/ONE%20CW,%20LLC%20v.%20CARTRIDGE%20WORLD%20NORTH%20AMERICA,%20LLC, visited February 15, 2016.

In deciding priority disputes between a garnishee bank with setoff rights and a garnishing judgment creditor, Florida courts have also held that a garnishee bank prevails over a judgment creditor when the bank's setoff rights had accrued BEFORE the bank received service of the writ of garnishment. The timing of the accrual of such setoff rights is crucial and, like Illinois law, is tied to the existence of a "default." See Coyle v. Pan Am. Bank of Miami, 377 So. 2d 213 (Fla. 3d DCA 1979); Barsco, Inc. v. H.W.W., Inc., 346 So. 2d 134 (Fla. 1st DCA 1977) (finding non-payment default under bank's security agreement sufficient to trigger maturity of obligation justifying setoff right); see also In re T & B General Contracting Co., 13 B.R. 686 (Bankr. M.D. Fla. 1981). Thus, a garnishee bank may not set off unmatured debts due from the judgment debtor-depositor against the amount claimed in a writ of garnishment. See Bostic v. Bostic, 678 So. 2d 366 (Fla. 2d DCA 1996). Only matured debts may be set off. See Am. Alternative Ins. Corp. v. South Florida Glazing, Inc., 904 So. 2d 656 (Fla. 4th DCA 2005) (finding garnishee bank had superior right to funds in account sought to be garnished because promissory note from judgment debtor was **in *default*, even though bank had not taken affirmative action on default**); see also Ebsary Foundation Co. v. Barnett Bank of South Florida, N.A., 569 So. 2d 806 (Fla. 3d DCA 1990) (finding garnishee bank's setoff right not defeated even though bank had collateral for matured debt). In short, if the judgment debtor's obligation to the bank has not matured or the judgment debtor has not defaulted, the ability of a bank in Florida to set off against a judgment debtor's account may be limited by another creditor's garnishment of the account.

Absent documentary and protective actions being taken BEFORE receipt of a garnishment notice, all hope still might not be lost – but it will entail litigation expense in the garnishment proceeding. Because the garnishing judgment creditor has no greater rights against the garnishee than the judgment debtor has and may recover only whatever the judgment debtor could recover from the garnishee, Florida law recognizes certain defenses the garnishee may raise in the answer to a writ of garnishment, including:

> (i) "any defenses" that the garnishee may have had in a suit by the judgment debtor, see Un. Presidential Life Ins. Co. v. King, 361 So. 2d 710, 712 (Fla. 1978), Bank of Winter Park v. Resolution Trust Corp., 633 So. 2d 53 (Fla. 5th DCA 1994), Florida Public Service Commission v. Pruitt, Humphress, Powers & Munroe Advertising Agency, Inc., 587 So. 2d 561 (Fla. 1st DCA 1991), and Blatch v. Wesley, 238 So. 2d 308 (Fla. 3d DCA 1970) (finding that garnishee may attack validity of judgment against judgment debtor); and
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> (ii) any right of setoff against the indebtedness due the judgment debtor, see Coyle, 377 So. 2d at 215-16 and Baxter Healthcare Corp. v. Universal Medical Labs, Inc., 760 So. 2d 1126 (Fla. 5th DCA 2000) (finding that bank may set off fee charged when writ served before responding to writ).

If the garnishee bank raises a defense of setoff, the issue becomes who has priority to the funds in the account. And such priority, again, will depend upon the timing of the "default" that triggers the setoff rights.

If you would like more information, please contact:

Madison L. Mitchell in Nashville at (615) 724-3242 or mlmitchell@burr.com;

W. Patrick Ayers in Tampa at (813) 367-5701 or payers@burr.com

Or the Burr & Forman attorney with whom you regularly work.