HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 451 Sufficiency of Description of Security Interests
SPONSOR(S): Robinson, W.
TIED BILLS: **IDEN./SIM. BILLS:** SB 406

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Civil Justice & Property Rights Subcommittee	17 Y, 0 N	Mawn	Jones
2) Insurance & Banking Subcommittee	15 Y, 0 N	Hinshelwood	Luczynski
3) Judiciary Committee	18 Y, 0 N	Mawn	Kramer

SUMMARY ANALYSIS

A security interest arises when, in exchange for a loan, a borrower pledges in a security agreement specified assets he or she owns that the lender may take if the borrower defaults on the loan. A security interest also assures the lender that, if the borrower enters bankruptcy, the lender may be able to recover the loan's value by taking the asset. Under Florida law, a description of an asset, whether or not the description is specific, is sufficient to pledge the asset under a security agreement if it reasonably identifies what is described. However, a description of assets in general terms, such as "all the debtor's assets," "all the debtor's personal property," or similar phrasing, does not sufficiently identify the collateral for purposes of a security interest.

Florida Law protects certain assets from legal process so that they remain out of a creditor's reach, including:

- Funds held in individual retirement accounts ("IRA") and other tax-exempt accounts.
- The cash surrender value of a life insurance policy and the proceeds of an annuity contract.
- Funds held in qualified tuition programs and medical, Coverdell education, and hurricane savings accounts.
- Disability income benefits.
- A deceased person's wages and unemployment compensation benefits.
- Homestead property and certain personal property items.
- Social security benefits; unemployment compensation, or public assistance benefits; veterans' benefits; alimony, support, or separate maintenance; and stock or pension plans under specified circumstances.

Historically, exempt assets not specifically pledged in a security agreement remained exempt from a creditor's reach. However, a recent Eleventh Circuit Court of Appeals decision broke with this rule by holding that a security agreement granting a security interest in "all assets and rights of the Pledgor" pledged the debtor's IRA as security for a loan even though the IRA was not specifically identified in the agreement. This decision may have significant federal tax consequences for Floridians, as the use of certain tax-exempt accounts as security for a loan is considered distribution of the funds to the owner, who then owes federal income tax on the money and may owe a tax penalty for early distribution.

HB 451 provides that a general description only by type of collateral is an insufficient description to pledge certain statutorily-exempt assets for the purposes of a security agreement. The bill applies retroactively.

The bill does not appear to have a fiscal impact on state or local governments.

The bill provides an effective date of upon becoming a law.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Background

Security Interests

A security interest arises when, in exchange for a loan, a borrower pledges in a security agreement[1] specified assets owned by the borrower that the lender may take if the borrower defaults on the loan.[2] A security interest also assures the lender that, if the borrower enters bankruptcy, the lender may be able to recover the loan's value by taking possession of the specified assets.[3]

Under Florida law, a description of personal or real property, whether or not it is specific, is sufficient for the purposes of a security agreement if it reasonably identifies what is described.[4] An effective description of collateral[5] in a security agreement identifies the asset by:

- Specific listing;
- Category;
- Type of collateral;
- Quantity;
- Computational or allocational formula or procedure; or
- Any method under which the identity of the collateral is objectively determinable.[6]

However, a general description of collateral as "all the debtor's assets," "all the debtor's personal property," or similar phraseology, does not sufficiently identify the collateral for purposes of creating a security interest.[7] Further, a description only by type of collateral is an insufficient description of:

- A commercial tort claim;
- In a consumer transaction, consumer goods, a security entitlement, a securities account, or a commodity account; or
- An account consisting of a right to payment of a monetary obligation for the sale of real property that is the debtor's homestead under Florida law.[8]

Asset Exemptions

Florida law protects certain assets from legal process so that they remain out of a creditor's reach, including:

- Funds held in an individual retirement account ("IRA") and other tax-exempt accounts.[9]
- A life insurance policy's proceeds.[10]
- A life insurance policy's cash surrender value and an annuity contract's proceeds.[11]
- Funds held in qualified tuition programs, medical savings accounts, Coverdell education accounts, and hurricane savings accounts.[12]
- Disability income benefits.[13]

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[1] "Security agreement" means an agreement that creates or provides for a security interest. S. 679.1021(1)(uuu), F.S.
[2] Legal Information Institute, *Secured Transactions*, https://www.law.cornell.edu/wex/secured_transactions (last visited Jan. 20, 2022).
[3] *Id.*
[4] S. 679.1081(1), F.S.
[5] "Collateral" means the property subject to a security interest. The term includes proceeds to which a security interest attaches; accounts, chattel paper, payment intangibles, and promissory notes that have been sold; and goods that are the subject of consignment. S. 679.1021(1)(*l*), F.S.
[6] S. 679.1081(2), F.S.
[7] S. 679.1081(3), F.S.
[8] S. 679.1081(5), F.S.
[9] S. 222.21, F.S.
[10] S. 222.13, F.S.
[11] S. 222.14, F.S.
[12] S. 222.22, F.S.
[13] S. 222.18, F.S.

- A deceased person's wages, travel expenses, and reemployment assistance or unemployment compensation payments.[14]
- Homestead property.[15]
- Certain personal property items.[16]
- A debtor's interest in a motor vehicle, up to $1,000 in value, and any professionally prescribed health aides.[17]
- Social security benefits; unemployment compensation, or public assistance benefits; veterans' benefits; alimony, support, or separate maintenance; and stock or pension plans under specified circumstances.[18]

Historically, exempt assets have remained exempt from a creditor's reach unless specifically pledged in a security agreement.[19]

Recent Case Law

In *Kearney Constr. Co., LLC v. Travelers Casualty & Surety Co. of America*, the federal Eleventh Circuit Court of Appeals broke with the historic tradition of maintaining asset exemptions unless the asset is specifically pledged.[20] In *Kearney*, the debtor obtained a line of credit and pledged the following collateral as a security interest:

> [A]ll assets and rights of the Pledgor, wherever located, whether now owned or hereafter acquired or arising, and all proceeds and products thereof, all goods (including inventory, equipment and any accessories thereto), instruments (including promissory notes)[,] documents, accounts, chattel paper, deposit accounts, letters of credit, rights, securities and all other investment property, supporting obligation[s], and contract or contract rights or rights to the payment of money, insurance claims, and proceeds, and general intangibles.[21]

The Court held that this language was an "unambiguous pledge" of "all assets and rights" of the debtor, including the debtor's IRA, even though the IRA was not specifically identified in the agreement.[22]

Practically speaking, the *Kearney* decision makes it possible for a borrower to inadvertently pledge as a security interest assets historically exempt from the reach of creditors under Florida law.[23] This may affect Florida consumers with security agreements containing general language similar to the language at issue in *Kearney*.

The decision could also have significant federal tax implications, as the use of certain tax-exempt accounts as security for a loan is considered a distribution of the funds in the account to the owner, who then may owe federal income tax on the distribution.[24] The Tax Code also imposes a 10 percent tax penalty for early distributions from certain tax-exempt accounts.[25]

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[14] Ss. 225.15 and 225.16, F.S.
[15] Ss. 222.01-222.05, F.S.; Art. X, Sec. 4, Fla. Const.
[16] S. 222.061, F.S.
[17] S. 222.25, F.S.
[18] Ss. 222.201 and 222.21(1), F.S.
[19] Real Property, Probate, and Trust Law Section of the Florida Bar ("RPPTL"), *White Paper* (Jan. 26, 2021); *see, e.g., Havoco of Am. Ltd. v. Hill*, 790 So. 2d 1018 (Fla. 2001); *Connor v. Seaside Nat'l Bank*, 135 So. 3d 508 (Fla. 5th DCA 2014); *Killian v. Lawson*, 387 So. 2d 960 (Fla. 1980).
[20] 795 Fed. Appx. 671 (11th Cir. 2019). The *Kearney* case is an unpublished opinion of the Federal Court of Appeals for the Eleventh Circuit. Opinions that the Eleventh Circuit's panel of judges believes to have no precedential value are not published. FED. R. APP. P. 36, Internal Operating Procedure 6; *see also* 11th Cir. R. 36-2. Although unpublished opinions may be cited as persuasive authority, they are not considered binding precedent. FED. R. APP. P. 36, Internal Operating Procedure 6; *see also* 11th Cir. R. 36-2.
[21] 795 Fed. Appx. 673-74.
[22] *Id.* at 674. The borrower testified that he did not intend to pledge the IRA; however, the lower court rejected such testimony because it was inconsistent with the borrower's earlier court filings. *Id*.
[23] The exception is homestead property, as a waiver of such rights must be "knowing, voluntary, and intelligent" to have any effect. *See* RPPTL, *supra* note 19; *see also Chames v. DeMayo*, 972 So. 2d 850 (Fla. 2007) (*citing State v. Upton*, 658 So. 2d 86 (Fla. 1995)).
[24] I.R.C. 408(e)(4) and (d)(1); I.R.C. 72(p)(1)(B).
[25] I.R.C. 72(t).

Effect of Proposed Changes

HB 451 provides that a general description only by type of collateral is an insufficient description to pledge, for the purposes of a security agreement, accounts and other entitlements set forth in ss. 222.13-222.16, 222.18, and 222.201-222.22, F.S. These include:

- Funds held in an IRA and other tax-exempt accounts.
- A life insurance policy's proceeds.
- A life insurance policy's cash surrender value and an annuity contract's proceeds.
- Funds held in qualified tuition programs, medical savings accounts, Coverdell education accounts, and hurricane savings accounts.
- Disability income benefits.
- A deceased person's wages, travel expenses, and reemployment assistance or unemployment compensation payments.
- Social security benefits; unemployment compensation, or public assistance benefits; veterans' benefits; alimony, support, or separate maintenance; and stock or pension plans under specified circumstances.

The bill provides that it is remedial in nature and applies retroactively.

The bill provides an effective date of upon becoming a law.

B. SECTION DIRECTORY:

Section 1: Amends s. 679.1081, F.S., relating to sufficiency of description.
Section 2: Provides that the bill is remedial in nature and applies retroactively.
Section 3: Provides an effective date of upon becoming a law.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   None.

2. Expenditures:

   None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   None.

2. Expenditures:

   None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill may prevent Floridians from inadvertently pledging as security specified exempt assets and suffering any related federal tax consequences.

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not Applicable. This bill does not appear to affect county or municipal governments.

2. Other:

Impairment of Contracts and Due Process

Both the Florida and the United States Constitutions prohibit the state from passing a law impairing contractual obligations.[26] However, the Legislature may provide that a non-criminal law, including one that affects existing contractual obligations, applies retroactively in certain situations.[27] In determining whether a law may be applied retroactively, courts first determine whether the law is procedural, remedial, or substantive in nature.[28] A purely procedural or remedial law may apply retroactively without offending the Constitution, but a substantive law generally may not apply retroactively absent clear legislative intent to the contrary.[29] However, even where the Legislature has expressly stated that a law will have retroactive application, a court may reject that application if the law impairs a vested right, creates a new obligation, or imposes a new penalty.[30] Further, where a law is designed to serve a remedial purpose, a court may decide not to apply the law retroactively where doing so "would attach new legal consequences to events completed before its enactment."[31]

Moreover, both the Florida and United States Constitutions prohibit the taking of life, liberty, or property without due process of law.[32] The right to contract, as long as no fraud or deception is involved and the contract is otherwise legal, is both a liberty and a property right subject to due process protections, and the impairment of contracts may, in certain instances, be viewed as the taking of property without due process.[33]

The bill contains a statement of legislative intent indicating that the bill is remedial in nature and applies retroactively. Some parties who entered into security agreements after the *Kearney* decision may have used general language to create a security interest with the understanding that such language was sufficient to pledge certain exempt assets. Whether the Legislature's retroactive modification of the meaning of such language is procedural, remedial, or substantive, and whether such modification implicates the constitutional right to contract or the constitutional right to due process, is for the courts to decide.

B. RULE-MAKING AUTHORITY:

Not applicable.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/COMMITTEE SUBSTITUTE CHANGES

[26] U.S. Const. art. I, s. 10; Art. I, s. 10, Fla. Const.
[27] U.S. Const. art. I, ss. 9 and 10; Art. 1, s. 10, Fla. Const.
[28] A procedural law merely establishes the means and methods for applying or enforcing existing duties or rights. A remedial law confers or changes a remedy, i.e., the means employed in enforcing an existing right or in redressing an injury. A substantive law creates, alters, or impairs existing substantive rights. *Windom v. State*, 656 So. 2d 432 (Fla. 1995); *St. John's Village I, Ltd. v. Dept. of State*, 497 So. 2d 990 (Fla. 5th DCA 1986); *McMillen v. State Dept. of Revenue*, 74 So. 2d 1234 (Fla. 1st DCA 1999).
[29] *State Farm Mutual Automobile Ins. Co. v. Laforet*, 658 So. 2d 55 (Fla. 1995).
[30] *Menendez v. Progressive Exp. Ins. Co., Inc.*, 35 So. 3d 873 (Fla. 2010).
[31] *L. Ross, Inc. v. R.W. Roberts Const. Co.*, 481 So. 2d 484 (Fla. 1986).
[32] U.S. Const. amends. V and XIV; Art. I, s. 21, Fla. Const.
[33] *Miles v. City of Edgewater Police Dept.*, 190 So. 3d 171 (Fla. 1st DCA 2016); s*ee, e.g., Griffin v. Sharpe*, 65 So. 2d 751 (Fla. 1953) (finding that a statute removing a specific deed restriction's expiration date both impaired contracts and constituted a taking of private property without due process).