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Bankruptcy Law - Matching the Historic Legal Principles of New Mexico's Exemption Laws to the Modern Identity of Annuities: Dona Ana Savings & (and) Loan Ass'n v. Dofflemeyer

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BANKRUPTCY LAW—Matching the Historic Legal Principles of New Mexico's Exemption Laws to the Modern Identity of Annuities: *Doña Ana Savings & Loan Ass'n v. Dofflemeyer*

I. INTRODUCTION

In *Doña Ana Savings & Loan Ass'n, F.A. v. Dofflemeyer (DASL)*,¹ the New Mexico Supreme Court held that statutorily exempt annuities are not automatically protected from creditor attachment.² The decision grants creditors the opportunity to challenge a debtor's transfer of nonexempt funds into annuities³ that ordinarily would be exempt.⁴ The court found that in order for a creditor to execute a judgment on annuities presumed exempt from attachment, the creditor must prove, in accordance with the Uniform Fraudulent Transfer Act (UFTA),⁵ that the debtor intended to defraud creditors.⁶

The *DASL* decision is significant for what it does not do. The court's analysis of the purposes of New Mexico's exemption statutes is cursory, inhibiting a workable construction of the statutes. Furthermore, the court confines its analysis for determining whether annuities are exempt to the subjective task of discovering the debtor's intent. As a result, the door remains open for abuse of the exemption provisions, for legal confusion, and for *ad hoc* court action regarding the validity of the transfer of nonexempt funds into exempt annuities.

This Note will examine the purposes underlying New Mexico's exemption statutes and the consequences of the court's failure to reconcile the modern

1. 115 N.M. 590, 855 P.2d 1054 (1993).

2. *Id.* at 594, 855 P.2d at 1058 (citing N.M. STAT. ANN. §§ 42-10-2 to -3 (Cum. Supp. 1993)). N.M. STAT. ANN. §§ 42-10-2 to -3 protect retirement and pension funds, annuities, and the proceeds from life, accident, and health insurance for persons supporting only themselves. Any mention in this note of "exemption statutes" or "exemption provisions" refers to N.M. STAT. ANN. §§ 42-10-2 to -3.

3. An annuity is a fund which "designates a right to receive fixed, periodic payments, either for life or for a term of years." *Moore v. O'Cheskey*, 87 N.M. 66, 66-67, 529 P.2d 292, 292-93 (Ct. App. 1974), *cert. denied*, 87 N.M. 48, 529 P.2d 274 (1974). The term "annuities" refers to all annuities, of any type and for any amount.

4. *DASL*, 115 N.M. at 594, 855 P.2d at 1058.

5. Uniform Fraudulent Transfer Act, N.M. STAT. ANN. §§ 56-10-14 to -25 (Cum. Supp. 1993). Especially pertinent to this note is § 56-10-18.

The UFTA is a revision of the Uniform Conveyance Act. UFTA replaced "conveyance" with "transfer" in recognition of the Act's applicability to transfers of personal as well as real property. Sections 56-10-18 to -19 of New Mexico's UFTA are essentially a recodification of §§ 56-10-4 & -7 of New Mexico's Uniform Fraudulent Conveyance Act. *DASL*, 115 N.M. at 593, 855 P.2d at 1057.

See generally Michael L. Cook & Richard E. Mendales, *UFTA: An Introductory Critique*, 62 AM. BANKR. L.J. 92 (1988); Frank Kennedy, *The UFTA*, 18 UCC L.J. 195 (1986); Peter A. Alces & Luther M. Dorr, Jr., *A Critical Analysis of the New Uniform Fraudulent Transfer Act*, U. ILL. L. REV. 527 (1985).

For a further analysis of the court's reference to UFTA see discussion *infra* part IV.

6. *DASL*, 115 N.M. at 593, 855 P.2d at 1057.

conditions of annuities with the historic purposes of the exemption laws.

II. STATEMENT OF THE CASE

Dofia Ana Savings and Loan (plaintiff) obtained a writ of execution against Mr. Dofflemeyer.⁷ At the time of this case, Dofflemeyer was seventy-seven years old and retired from self-employment.⁸ Dofflemeyer returned the writ to plaintiff, listing a certificate of deposit in the amount of \$54,000. However, before plaintiff could garnish this asset, Dofflemeyer liquidated the certificate of deposit and used the proceeds to purchase one annuity. Dofflemeyer then sold some real estate to his sister and purchased a second annuity with the proceeds. The record indicates that Dofflemeyer purchased the two annuities in contemplation of bankruptcy and his need for an immediate source of monthly income. Dofflemeyer named his sister as beneficiary of both annuities.

Plaintiff held deficiency judgments against Dofflemeyer and attempted to garnish Dofflemeyer's two annuities to satisfy the judgments. In state district court, Dofflemeyer claimed the two annuities were exempt from attachment under sections 42-10-2 and -3 of the New Mexico statutes. The district court agreed, dismissed plaintiff's writ of garnishment, and granted Dofflemeyer summary judgment. Plaintiff appealed. The New Mexico Supreme Court reversed the summary judgment and remanded the case to the district court to resolve whether Dofflemeyer fraudulently transferred his nonexempt funds into exempt annuities.⁹ Chief Justice Ransom dissented, concluding that there was insufficient evidence to raise a genuine issue of material fact that Dofflemeyer intended to misuse the exemption statutes. Justice Ransom reasoned that because Dofflemeyer was an elderly man and his annuities gave him a monthly income of no more than necessary for his financial independence, Dofflemeyer's annuities were for the purpose of his retirement and, therefore, properly exempt.¹⁰

III. ANALYSIS

The New Mexico Supreme Court looked beyond the plain meaning of the exemption statutes' language to the purposes of the legislation.¹¹ The court held that the objective of the exemption statutes is to protect the funds named in the statutes so long as fraud is not committed against

7. *Id.* at 591, 855 P.2d at 1055. Unless cited, all subsequent references to the facts of this case refer to this citation.

8. *Id.* at 595, 855 P.2d at 1059 (Ransom, C.J., dissenting).

9. *Id.* at 594, 855 P.2d at 1058.

10. *Id.* at 595, 855 P.2d at 1059 (Ransom, C.J., dissenting).

The case has not progressed after remand because immediately prior to the appellate issuance of the *DASL* decision, Dofflemeyer died. Because Dofflemeyer listed his sister as beneficiary of the annuities in dispute, plaintiff's attorneys brought Dofflemeyer's sister into the suit. Plaintiff has also joined the two annuity companies that issued Dofflemeyer's annuities.

11. *Id.* at 591, 855 P.2d at 1056.

creditors.¹² The *DASL* court stressed that in New Mexico it is not fraudulent *per se* for a debtor to transfer nonexempt funds into exempt annuities on the eve of bankruptcy or threatened execution by a creditor, as Dofflemeyer did.¹³ Rather, the transfer of nonexempt property to exempt funds in contemplation of bankruptcy is merely an indication of fraud.¹⁴

The court directed practitioners and courts to use UFTA to determine whether a transfer of nonexempt funds into exempt funds, specifically annuities, is voidable.¹⁵ Thus, concerned about the clash between debtors' interests and creditors' interests inherent in a combined application of the exemption statutes and UFTA, the court's goal in its statutory construction was to render a harmonious coupling of debt exemption and creditor protection.¹⁶

A. The Misplaced Focus of the Court's Statutory Interpretation

In attempting to harmonize the exemption statutes with UFTA, the *DASL* court shifted the focus of annuity-exemption analysis away from satisfying the objectives of exemption statutes. Consequently, the court overlooked the initial step of statutory interpretation which entails meshing the traditional purposes of the exemption statutes with modern financial circumstances. In the analysis of annuity-exemptions, courts should construe the statutes' historic application to annuities in light of the "modern"¹⁷ use of annuities. Such an analysis would provide guidelines that make reference to UFTA unnecessary in many annuity-exemption cases.

The language of New Mexico's exemption statutes is not ambiguous. "[A]ny interest in or proceeds from a *pension or retirement fund* of every person supporting only himself is exempt from . . . attachment, execution or foreclosure by a judgment creditor."¹⁸ Furthermore:

The cash surrender value of *any life insurance* policy . . . *annuity contract* . . . or payments of every kind from *any life, accident or health insurance* policy, annuity contract or deposit . . . issued upon the life of a citizen or resident of the state of New Mexico . . . shall in no case be liable to attachment, garnishment or legal process in favor of any creditor of the person whose life is so insured or who is protected by said contract . . .¹⁹

12. *DASL*, 115 N.M. at 592-93, 855 P.2d at 1056-57.

13. *Id.* at 594, 855 P.2d at 1058; see also *In re Zouhar*, 10 B.R. 154, 156 (Bankr. D.N.M. 1981) (transfers on the eve of bankruptcy are not *per se* fraudulent conversions).

14. *DASL*, 115 N.M. at 594, 855 P.2d at 1058.

15. *Id.*

16. "Our statutes were not meant to be construed in isolation, but in conjunction with the general body of the law as a whole." See *id.* at 593, 855 P.2d at 1057.

17. This Note will discuss how annuities in the late 20th century have broad and diverse purposes and do not always act as insurance contracts. Currently, annuities are popularly regarded as "hot" investments. See Ellen E. Schultz, *Variable Annuities Provide the Choices of Mutual Funds, Plus Some Tax Breaks*, WALL ST. J., Oct. 14, 1993, at C1.

18. N.M. STAT. ANN. § 42-10-2 (Cum. Supp. 1993) (emphasis added).

19. *Id.* § 42-10-3 (emphasis added).

Thus, when read together, sections 42-10-2 and -3 provide an unlimited amount of exemption for retirement and pension funds, payments from life, accident, and health insurance, and all annuity contracts.²⁰

Nevertheless, when the transferred funds do not comport with the underlying purposes of the exemption statutes, the public interest in preserving equitable economic relationships between debtors and creditors is transgressed.²¹ Thus, the issue *DASL* presented mandates more than the court's cursory analysis of New Mexico's exemption statutes in order to yield a workable and enduring annuity-exemption analysis.

1. Purposes of Exemption Statutes

The purpose of exemption statutes is not to grant all annuities unlimited protection from any creditor attachment; nor do the statutes purport to allow a person to shelter assets from his creditors.²² Rather, exemption statutes seek to advance five main objectives:

1. to provide the debtor with property necessary for his physical survival;
2. to protect the dignity of the debtor;
3. to enable the debtor to rehabilitate himself financially and earn income in the future;
4. to protect the debtor's family from the adverse consequences of impoverishment; and
5. to shift the burden of providing the debtor and his family with the minimal financial support from society to the debtor's creditors.²³

The New Mexico Legislature originally enacted New Mexico's exemption statutes in 1887²⁴ in order to implement humane social policy.²⁵ New

20. See also *In re Zouhar*, 10 Bankr. 154 (Bankr. D.N.M. 1981) (New Mexico case law interprets the exemptions statutes to permit unlimited exemptions with respect to insurance and to pension and retirement plans).

21. Courts have found that the legislative protection of debtors through unlimited exemptions from creditor attachment for life insurance, annuities, and pension funds, is a constitutional discrimination against the rights of creditors. See *Cooper v. Taylor*, 54 F.2d 1055 (5th Cir.), cert. denied, 286 U.S. 554 (1932) (finding it constitutional for the Florida legislature to exempt the cash surrender value from insured's creditors' claims); see also *Addiss v. Selig*, 264 N.Y.S. 816, aff'd, 266 N.Y.S. 1008, rev'd on other grounds, 190 N.E. 490 (N.Y. 1933) (the fact that an exemption statute diminished the rights of creditors does not invalidate the act).

Because all states shield debtors from potential destitution by keeping certain assets beyond the reach of creditors, the preservation of economic equity is complicated. Nonetheless, it is an economic necessity for creditors to have an effective collection method because lack of legitimate collection leads to higher rates and reduced availability of credit. See Alan N. Resnick, *Prudent Planning or Fraudulent Transfer? The Use of Nonexempt Assets to Purchase or Improve Exempt Property on the Eve of Bankruptcy*, 31 RUTGERS L. REV. 615, 615 n.2 (1978).

22. *New Mexico Nat'l Bank v. Brooks*, 9 N.M. 113, 49 P. 947 (1897) ("[I]t was never intended that these generous provisions [New Mexico's exemption statutes] should be prostituted to the encouragement of extravagance, and the evasion of just indebtedness by indulgence in luxurious living.").

23. Resnick, *supra* note 21, at 621.

24. 1887 N.M. Laws, ch. 37.

25. See, e.g., *Hewatt v. Clark*, 44 N.M. 453, 103 P.2d 646 (1940); *In re Assignment of Spitz Bros.*, 8 N.M. 622, 45 P. 1122 (1896) (Exemptions protect debtor's necessities and guard against familial destitution.); *New Mexico Nat'l Bank v. Brooks*, 9 N.M. 113, 49 P. 947 (1887); *Ruybalid*

Mexico courts have consistently found that the exemption statutes seek to "protect families from becoming destitute as the result of misfortune through common debts which are generally unforeseen . . ."²⁶ New Mexico case law has sought to construe the language of the exemption statutes in harmony with the purpose of the statutes.²⁷ Other jurisdictions also have found that the overriding purpose of exemption statutes is to insure a means of livelihood to the debtor and his family and prevent them, through the loss of basic necessities, from becoming the state's charge.²⁸ If the *DASL* court had thoroughly analyzed the social objectives of the exemption statutes when determining whether Dofflemeyer's annuities were exempt, the court might have concluded that either the annuity provisions in the exemption statutes need modernization in the form of legislative reform; or, a contemporary interpretation of the exemption statutes' purposes²⁹ would necessarily limit exempt annuities to those annuities which fulfill the social policy objectives of the exemption statutes.³⁰

B. Times Have Changed: An 1887 Annuity Is Not a 1994 Annuity

The term "annuity" appeared in the first promulgation of the life insurance exemption statute in 1887.³¹ The legislature has never amended

v. Segura, 107 N.M. 660, 666, 763 P.2d 369, 375 (Ct. App. 1988).

Although some of the terms of New Mexico's exemption statutes have evolved and been amended in response to judicial and social considerations, no alteration of the exemption provisions' underlying policy can be discovered in New Mexico case law. See *Hewatt*, 44 N.M. 453, 103 P.2d 646 (rejecting argument that legislative amendments indicated change in underlying policy of the statutes). Therefore, it is logical to conclude contemporary courts should adhere to the same purposes espoused historically.

26. *Tomson v. Lerner*, 37 N.M. 546, 549, 25 P.2d 209, 210-11 (1933); see also *D'Avignon v. Graham*, 113 N.M. 129, 137, 823 P.2d 929, 937 (1991) ("Exemption laws were enacted to protect the head of a household and his dependents from the harsh vicissitudes of poor fiscal decision-making.").

27. "The language of the [New Mexico exemption] act should be construed in harmony with its humane and remedial purpose." *Spitz Bros.*, 8 N.M. at 628, 45 P. at 1123.

28. See, e.g., *Mahone v. Mahone*, 517 P.2d 131 (Kan. 1973) (purpose and policy of Kansas exemption laws is to protect the unfortunate debtor and his family from economic destitution); *Karzina v. Kelsey*, 262 S.W.2d 844 (Mo. 1953) (the purpose of a homestead exemption is the safekeeping of the home for the householder, widow, and minor children by making it unobtainable to creditors); *Thorsby v. Babcock*, 222 P.2d 863 (Cal. 1950) (the object of homestead exemption legislation is to provide for the debtor's family and protect their home from creditors); *Poznanovic v. Maki*, 296 N.W. 415, 417 (Minn. 1941) ("the humane and enlightened purpose of an exemption statute is to protect a debtor and his family against absolute want by allowing them" some reasonable means of support); *In re Welch*, 8 F. Supp. 838 (D.N.D. 1934) (purpose of exemption statutes is to provide for care of dependents).

For a list of every state's exemption statutes see 7 WILLIAM M. COLLIER, COLLIER ON BANKRUPTCY (Lawrence P. King ed., 15th ed. 1993).

29. Although exemption statutes are generally liberally construed, see *Spitz Bros.*, 8 N.M. at 628, 45 P. 1123, liberal construction does not signal an abandonment of regard for the exemption statutes' purposes. Indeed, the *Spitz Bros.* court stated that the liberal construction is granted "so as to promote the policy on which they [exemption statutes] are based, and accomplish the purposes to which they are directed. *Id.* at 628, 45 P. at 1123. Hence, if the objectives of certain annuities do not conform to the goals of the exemption statutes, courts are not disregarding the historically liberal construction; rather, courts are acting with respect for the legislature's intent and the social objectives of the exemption statutes.

30. See *supra* note 23 and accompanying text.

31. 1887 N.M. Laws, ch. 37.

the exemption statute to define the types of annuities properly exempt nor has the legislature placed a limit on the amount of money that can be placed in an exempt annuity.³² In contrast, the use of annuities in America has changed.³³ In the one-hundred seven years since section 42-10-3 first exempted all annuity contracts, annuities have been largely transformed from insurance-type contracts into tax-sheltered investments.³⁴ Today, annuities are primarily used as tax-deferred investment vehicles.³⁵ The dramatic change in the use of annuities affects the exemption statutes' application in modern annuity-exemption cases like *DASL*.

C. Only Certain Annuities Conform to the Framework of the Exemption Statutes

Noting that the district court did not determine whether Dofflemeyer's annuities were exempt, the supreme court stated that it would decide whether the annuities were exempt under New Mexico's exemption statutes.³⁶ Nevertheless, the supreme court dodged the crux of proper annuity-exemption analysis by neglecting to ask: are Dofflemeyer's annuities the kinds of annuities the exemption statutes intend to excuse from attachment?

Although retirement/pension funds and life insurance proceeds are exempted by different statutory provisions, the historical purpose and social policy underlying sections 42-10-2 and -3 is the same.³⁷ It logically follows that annuities, included in the same exemption provisions as life insurance and retirement funds, should have the "character" of life insurance or retirement funds to be consonant with the statute's underlying policy. Exempt annuities should be restricted to exempting comparable economic necessities as retirement plans and life insurance, which prevent debtors and their families from economic dependence on the public dole.³⁸ Many present-day annuities have dubious relationships to the purposes of the exemption statutes.

32. See N.M. STAT. ANN. § 42-10-3 (Cum. Supp. 1993).

33. See Schultz, *supra* note 17.

34. *Id.* Indeed, brokerage houses advertise annuities as one of the best ways for the middle and upper classes to minimize the impact of the new taxes created by President Clinton's Omnibus Budget Reconciliation Act of 1993. See KEMPER SECURITIES, INSIGHTS 1-2 (1993) (annuities are listed as a "tax-advantaged investment strategy").

35. Schultz, *supra* note 17. Also significant to the changing role of annuities in the American financial scene is the introduction of the income tax. When the New Mexico legislature enacted the exemption provisions in 1887, there was no federal income tax. In 1913, Congress passed the Sixteenth Amendment to the United States Constitution, granting Congress the power to levy an income tax. U.S. CONST. amend. XVI. Under America's current tax structure, annuities enjoy a certain tax benefit pursuant to the exclusion ratio outlined in the Internal Revenue Code. I.R.C. § 72(b) (1986). Because annuities aid tax avoidance their character has been, in large part, transformed from insurance contracts to hot investment plans.

36. *DASL*, 115 N.M. at 592, 855 P.2d at 1056.

37. Resnick, *supra* note 21, at 621. Retirement and life insurance are exempted by different statutory provisions probably because the concept of retirement came later than life insurance and, therefore, was added to our laws as a different provision. Because the retirement and life insurance exemption statutes exist side-by-side in N.M. STAT. ANN. §§ 42-10-2 to -3, and serve similar purposes, it is reasonable to view the two statutes as akin to one another.

38. See Resnick, *supra* note 21, at 621.

1. Not All Annuities Carry the Purpose of Life Insurance

Plaintiff contended that Dofflemeyer's intent when he purchased his annuities was not to obtain life insurance, but "to shield investment income from Doña Ana Savings . . . [which] was seeking to collect its deficiency judgment."³⁹ Dofflemeyer purchased an "immediate type" annuity designed to provide him with current monthly income.⁴⁰ Based on the absence of insurance-type provisions in Dofflemeyer's annuity contracts and the selling broker's description of the annuity as an investment vehicle,⁴¹ plaintiff argued that "Dofflemeyer's resort to the exemption provisions protecting life insurance is misplaced."⁴²

Instead of taking this opportunity to apply the facts of this case to the purposes of exemption statutes, the New Mexico Supreme Court focused on discovering whether the debtor acted with fraudulent intent toward his creditors and introduced an unnecessary reference to UFTA.⁴³ Thus, the decision failed to focus on whether the character of the annuities was consonant with the life insurance exemption provisions.

2. Not All Annuities are Retirement or Pension Funds

Plaintiff contended that the classification of Dofflemeyer's annuities as retirement funds was merely "convenient nomenclature."⁴⁴ Dofflemeyer's annuities did not spring from a retirement plan or from wages arising under an employment relationship.⁴⁵ Rather, Dofflemeyer purchased his annuities with money raised through a real estate transaction and liquidating a certificate of deposit.⁴⁶ The facts suggested Dofflemeyer needed the income from the annuities to maintain his economic independence.⁴⁷ Nevertheless, unlike retirement pensions, Dofflemeyer would have been able to cash in his annuities and get his money back.

Prior to 1988, Minnesota's exemption law was similar to New Mexico's exemption law in that it did not define the type of annuity the statute exempted or the amount an annuity could exempt.⁴⁸ In *In re Raymond*,⁴⁹ the Minnesota court found that the Minnesota Legislature intended to exempt only those assets derived directly from an employment relationship or from self-employment endeavors.⁵⁰ The *Raymond* court, looking for an understanding of modern annuities, turned to federal law for guidance.⁵¹ Under federal law, terms used in retirement exemption provisions

39. Appellant's Brief-in-Chief at 12, *DASL*, 115 N.M. 590, 855 P.2d 1054 (1993) (No. 20561).

40. *Id.*

41. *Id.*

42. *Id.*

43. See *DASL*, 115 N.M. at 594, 855 P.2d at 1058. A further analysis of the court's reference to UFTA appears in the discussion *infra* part IV.

44. Appellant's Brief-in-Chief at 19, *DASL*, 115 N.M. 590, 855 P.2d 1054 (1993) (No. 20561).

45. See *DASL*, 115 N.M. at 591, 855 P.2d at 1055.

46. *Id.*

47. *Id.* at 595, 855 P.2d at 1059 (Ransom, C.J., dissenting).

48. MINN. STAT. ANN. § 550.37(24) (West 1988).

49. 71 B.R. 628 (D. Minn. 1987).

50. *Id.* at 630.

51. *Id.* (citing 29 U.S.C. § 1002(2)(A) (1988)).

"require wages to be earned to allow plan contributions by an employer and/or employee and/or self-employed person."⁵² Thus, the *Raymond* court reasoned that annuity contracts or contributions must be tied to an employment relationship before they can become exempt under Minnesota law.⁵³ Following the *Raymond* court's decision, the Minnesota Legislature, in 1988, amended Minnesota's exemption statute to limit annuity funds to earnings, and to limit the amount that can be exempted.⁵⁴

Dofflemeyer did not purchase his annuities with money directly tied to his employment wages, nor did Dofflemeyer purchase his annuities with profits directly from his self-employment.⁵⁵ Dofflemeyer never indicated that the funds he used to purchase the annuities were part of a designated, cognizable fund.⁵⁶ Rather, Dofflemeyer derived his money from two separate transactions which were wholly unrelated to his employment.

The *DASL* court chose not to recognize the importance of establishing a connection between the character of an annuity and the purpose of the exemption statutes. "We do not adopt [plaintiff's] view that Dofflemeyer's annuity funds must originate from some designated employment-related retirement or pension fund to qualify for exemption under § 42-10-2."⁵⁷ After *DASL*, the exemption statutes are applicable to all funds the *debtor* designates as retirement funds without regard for the objective character of the funds or whether the funds were derived from employment-related activities.

IV. IMPLICATIONS

The court's suggestion to use UFTA to determine if exempt annuities are valid is not necessarily helpful.⁵⁸ UFTA offers a *nonexhaustive* list of factors which are meant to help courts objectively determine if the

52. *Raymond*, 71 B.R. at 630.

53. *Id.*

54. The 1988 amendments are as follows:

(1) to the extent the plan or contract is described in section 401(a), 403, 408, or 457 of the Internal Revenue Code of 1986 [26 U.S.C.A. §§ 401, 403, 408, and 457], as amended, or payments under the plan or contract are or will be rolled over as provided in section 402(a)(5), 403(b)(8), or 408(d)(3) of the Internal Revenue Code of 1986, as amended; or

(2) to the extent of the debtor's aggregate interest under all plans and contracts up to a present value of \$30,000 and additional amounts under all the plans and contracts to the extent reasonably necessary for the support of the debtor and any spouse or dependent of the debtor.

MINN. STAT. ANN. § 550.37(24)(1)(2) (West Cum. Supp. 1993).

Such legislative revision is one route New Mexico could take to prevent abuse of and confusion about its exemption statutes. See *infra* part V.

55. *DASL*, 115 N.M. at 591, 855 P.2d at 1055.

56. See *id.*

57. *DASL*, 115 N.M. at 594, 855 P.2d at 1058.

58. See *id.* at 593, 855 P.2d at 1057.

debtor made a transfer with actual intent to defraud creditors.⁵⁹ The weight a court should give the various factors on UFTA's "intent list" is undefined. UFTA acts only as a balancing device to which the court can add its own variables and designate the importance of the variables at its discretion. Hence, UFTA may not be a well-suited test for finding fraud in the application of the exemption statutes.

Due to the myopic nature of the *DASL* opinion, questions persist: are the "funds" a debtor uses to purchase annuities on the eve of bankruptcy unrestricted by the objectives of the exemption provisions? If the debtor himself classifies these "funds" as retirement/pension plans should courts automatically recognize the funds as exempt "retirement funds"? Finally, is there any limit to the amount that an annuity can exempt from creditor attachment?

The social policy which underlies exemption statutes limits the amount that can be exempt from creditor attachment to what is necessary for the basic economic survival of the debtor and his family.⁶⁰ Yet, New Mexico's exemption provisions state no explicit value or quantity limits for annuities.⁶¹ Such generosity can lead to abuse of the statutes:

[t]he obsolescence and open-endedness of many state exemption laws enable debtors to keep property beyond the reach of creditors when no justifiable social policy is served and when creditors are thereby unduly restricted in their attempts to obtain payment of their claims.⁶²

Indeed, one bankruptcy judge noted that the unlimited exemptions with respect to insurance, retirement, and pension plans the New Mexico statutes permit "presents the potential for abuse of legitimate exemptions."⁶³

The majority opinion failed to address the amount of money Dofflemeyer transferred into exempt annuities.⁶⁴ Justice Ransom's dissenting

59. UFTA's criteria to analyze "actual intent" include:

1. the transfer or obligation was to an insider;
2. the debtor retained possession or control of the property transferred after the transfer;
3. the transfer or obligation was disclosed or concealed;
4. before the transfer was made or obligation was incurred, the debtor has been sued or threatened with suit;
5. the transfer was of substantially all the debtor's assets;
6. the debtor absconded;
7. the debtor removed or concealed assets;
8. the value of the asset transferred or the amount of the obligation incurred;
9. the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;
10. the transfer occurred shortly before or shortly after a substantial debt was incurred; and
11. the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

N.M. STAT. ANN. § 56-10-18(B) (Repl. Pamp. 1986).

60. Resnick, *supra* note 21, at 621.

61. See N.M. STAT. ANN. §§ 42-10-2 & 42-10-3 (Cum. Supp. 1993).

62. Resnick, *supra* note 21, at 628.

63. *In re Zouhar*, 10 B.R. 154, 157 (D.N.M. 1981).

64. See *DASL*, 115 N.M. 591, 855 P.2d 1055.

opinion found that the amount Dofflemeyer received from the annuities each month did not offend the social policy of the exemption provisions, and that his annuities provided him with no more money than necessary to sustain his financial independence.⁶⁵ The majority opinion formulated its holding without reference to the amount Dofflemeyer's annuities exempted, thereby overlooking the social objectives the exemption statutes are meant to protect.

A slight spin on the facts illustrates the opinion's lack of foresight: "X," the person attempting to use the exemption statutes, is an independently wealthy twenty-five-year-old with no dependents. X runs up a large debt. Upon discovering she will have to dip into her savings to pay off her debts, X purchases two annuities with most of her estate, transferring a total of one million dollars—raised from separate sources unrelated to any employment—into the annuities. X feels that these annuities will be needed to provide for her retirement. If the trial court believes X's claim that the funds are for retirement, then they are exempt. X's only concern is to avoid the prohibitions of UFTA.⁶⁶ In such a situation it becomes clear that the analysis *DASL* recommends cannot effectively prevent abuse of New Mexico's exemption provisions pursuant to annuities.

The *ad hoc* decisions *DASL* mandates and the subjective analysis it proposes will frustrate attorneys' ability to effectively counsel clients contemplating bankruptcy. Theoretically, it is logical to distinguish between situations that involve intent to defraud creditors and situations where the debtor's purpose is to acquire exempt property. However, several problems arise in using the debtor's intent as the distinguishing factor. Intent is especially difficult to discern when the debtor transfers nonexempt funds into exempt funds just prior to bankruptcy. A debtor might purchase an annuity both to protect her from economic destitution and to prevent her creditors from garnishing those assets. Thus, the likelihood for debtors to harbor multiple and overlapping motives further complicates the determination of fraud.⁶⁷ This possibility, in effect, invites the court into a potential analytical quagmire.

Lawyers and debtors should be allowed to plan for bankruptcy by appropriate resort to exempt property.⁶⁸ However, when courts use a "nebulous purpose test to determine the nature of the debtor's conduct, [the court] hampers the attorney's ability to predict with certainty when actual fraud relating to a particular conversion of nonexempt to exempt

65. *Id.* at 595, 855 P.2d at 1059 (Ransom, C.J., dissenting).

While Justice Ransom's dissent does not reach the conclusions this note advocates, the Chief Justice addresses facts relevant to analyzing whether the annuities in question comport with the purposes of the exemption statutes (i.e., Dofflemeyer's age, 77, and the way in which the income from the annuities was a reasonable amount to assist Dofflemeyer's continued financial independence).

66. See *supra* note 59 and accompanying text.

67. See Resnick, *supra* note 21, at 638.

68. "Appropriate" is used here to mean the exemption will act to fulfill the social policy of the statutes, i.e., helping the debtor establish a new start or providing the debtor with the basic economic necessities to ensure his dignity and financial independence.

property will be found.”⁶⁹ Uncertainty coupled with the risk that a court will deprive the debtor of assets can result in a “chilling effect”⁷⁰ on attorneys when advising clients. Cautious lawyers may not advise their debtor-clients to pursue questionable exemptions, thereby exposing their clients to an unnecessary loss of valuable assets. On the other hand, more imprudent lawyers may see their advice lead to the embarrassment and hardship of fraudulent transfers. Either way, the unpredictability which shrouds the legality of transfers into exempt annuities will likely increase legal malpractice suits against lawyers.

V. CONCLUSION

The *DASL* court had the opportunity to define the annuity exemption provisions in a manner that would make the statutes self-prohibitive of fraud.⁷¹ Indeed, with insightful judicial interpretation of the exemption provisions, *DASL* and similar cases might never have to turn to UFTA for answers. Yet, because the court did not limit or define the annuity provision in the statutes, evidence that an annuity is neither life insurance nor a retirement fund will not even serve to raise an inference of fraudulent intent.⁷² As a result, every annuity-exemption case will be decided on an *ad hoc* basis, with the decision's outcome turning upon the intent of the debtor. It is plausible that cases like *DASL* will be nothing more than swearing matches between a debtor and a creditor.

Perhaps, in the tradition of liberal construction of exemption provisions,⁷³ the court intended for any annuity of any amount to be exempt under section 42-10-3. In doing so, however, the New Mexico Supreme Court not only ignored the corresponding history and purpose annuities under section 42-10-3 share with retirement plans and life insurance, but also the evolution of annuities from insurance-type contracts to investment vehicles. As a result, New Mexico's generous exemption statutes remain exposed to abuse and subject to unpredictability and confusion.

69. Resnick, *supra* note 21, at 643.

70. *Id.*

71. New Mexico's appellate courts possess the power and the opportunity to recommend legislative reform and to add thoughtful definition to our historic laws through judicial construction. In a recent opinion the New Mexico Court of Appeals stated:

If, as the Water Defense Association asserts, this means that we are simply superimposing twentieth-century revisionist views onto nineteenth-century history, so be it. Legal requirements sometimes change to reflect the sensibilities of the times.

State *ex rel.* Martinez v. Lewis, 116 N.M. 194, 201-02, 861 P.2d 235, 242-43 (Ct. App. 1993) (case in continuation of the general adjudication of the Rio Hondo river system which specifically involved the water rights of the Mescalero Apache Indian Reservation). See *Schmitz v. Smentowski*, 109 N.M. 386, 396, 785 P.2d 726, 736 (1990) (law changes to recognize changing circumstances of evolving society); *Stang v. Hertz Corp.*, 83 N.M. 730, 735, 497 P.2d 732, 737 (1972) (law is dynamic and adaptable to the requirements of society at the time of its application); see also *Jones v. Harrisburg Polyclinic Hosp.*, 437 A.2d 1134, 1138 (Pa. 1981) (law must be responsive to new conditions and to sense of justice and social welfare, citing Benjamin N. Cardozo, *The Nature of the Judicial Process*, 150-51 (1921)). Thus, we apply twentieth-century notions of fairness and justice to our determination of this issue.

72. *DASL*, 115 N.M. at 594, 855 P.2d at 1058.

73. *In re Spitz Bros.*, 8 N.M. 622, 635, 45 P. 1122, 1125 (1896).

Finally, legislative action, as was done in Minnesota, can make effective changes to prevent the abuse of New Mexico's exemption statutes.⁷⁴ The legislature can, through minor amendments, make annuity exemptions less susceptible to abuse and confusion. Such revisions might include legislative amendments that would: (1) make section 42-10-3 apply only to specific types of annuities—those annuities that have a purpose and “character” consistent with the objectives of life insurance or retirement/pension plans; (2) require annuities which purport to act as retirement or pension plans be tied to employment or wages; and (3) limit the amount an annuity under section 42-10-3 can exempt to an amount that is necessary to secure the debtor's dignity and financial independence.⁷⁵ Limitation on the value annuities can exempt and definition as to what types of annuities can be exempt will establish helpful guidelines to debtors, creditors, attorneys, and courts attempting to apply the New Mexico exemption statutes.

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74. See *supra* note 54 and accompanying text.

75. Of course, the last suggestion is problematic because the amount considered reasonably necessary for financial independence will vary from person to person.