

Limiting the Florida Homestead Exemption by Broadening the Application of the Fraud or Egregious Conduct Exception

Since 1868, the Florida Constitution has expressly shielded homestead property from forced sale except in certain delineated circumstances.¹ In 2001, in response to a certified question from the 11th Circuit Court of Appeals, the Florida Supreme Court, in the case *Havoco of America, Ltd. v. Hill*, 790 So. 2d 1018 (Fla. 2001), reviewed over 100 years of jurisprudence to explain the historical and legal contours of the Florida Constitution's homestead exemption and its intersection, if any, with the Florida Uniform Fraudulent Transfer Act (FUFTA). As noted by the Florida Supreme Court, for over 150 years, the purpose of the homestead exemption has been to prevent absolute pauperism by protecting people of limited means from the consequences of "ill-advised promises," which they make due to their own poor judgment or due to inducement by others.² By guaranteeing the security of the home against the demands of general creditors, the homestead exemption promotes the stability and welfare of the state.³ Although the exemption clearly benefits the homeowner and his or her family, it also serves "the public welfare and social benefit which accrues to the state by having families secure in their homes."⁴ The Florida Supreme Court has described the exemption as the "bulwark of our social system," observing that "[t]he history of this law has clearly demonstrated that preservation of a domestic roof...against the demands of creditors has contributed immeasurably to the happiness and solidarity of family life...."⁵ It is the express intent of the Florida Constitution to place the security of families in their homes be-

fore the interests of unsecured creditors.

The Homestead Exemptions and its Exceptions

In *Havoco*, the creditor obtained a judgment against the debtor for \$15 million based upon fraud, conspiracy, tortious interference with contractual relations, and breach of fiduciary duty.⁶ Within two weeks of entry of the judgment, the debtor, previously a Tennessee resident, bought a \$650,000 home in Florida using nonexempt assets.⁷ The debtor subsequently filed for bankruptcy and claimed his Florida home was exempt from forced sale.⁸ The creditor asserted it would be inequitable to apply the homestead exemption because the debtor acquired the homestead with the specific intent to hinder, delay, or defraud creditors.⁹ The issue before the Florida Supreme Court was whether Fla. Const. art. X, §4, still protects a Florida homestead where the debtor acquired the homestead using nonexempt funds with the specific intent of hindering, delaying, or defrauding creditors in violation of F.S. §726.105.¹⁰

Fla. Const. art. X, §4(a)(1), provides, in relevant part:

There shall be exempt from forced sale under process of any court, and no judgment, decree or execution shall be a lien thereon, except for the payment of taxes and assessments thereon, obligations contracted for the purchase, improvement or repair thereof, or obligations contracted for house, field or other labor performed on the realty, the following property owned by a natural person: 1) a homestead....¹¹

The Florida Supreme Court, noting the policy of liberal construction of the homestead exemption and the rule of strict construction as applied to these exceptions, analyzed the intersection of the FUFTA and the homestead

exemption in the context of civil and criminal forfeitures, and equitable lien cases. With respect to civil and criminal forfeiture cases, the Florida Supreme Court, citing *Butterworth v. Caggiano*, 605 So. 2d 56 (Fla. 1992), and *Tramel v. Stewart*, 697 So. 2d 821 (Fla. 1997), reasoned that art. X, §4, expressly provides for only three exceptions to the homestead exemption and forfeiture is not one of them.¹² The Florida Supreme Court held that according to the plain and unambiguous wording of art. X, §4, a homestead is only subject to forced sale for 1) the payment of taxes and assessments thereon; 2) obligations contracted for the purchase, improvement, or repair thereof; or 3) obligations contracted for house, field, or other labor performed on the realty.¹³ "[F]orfeitures are not excluded from the homestead exemption because they are not mentioned, either expressly or by reasonable implication, in the three exceptions that are expressly stated."¹⁴ The Florida Supreme Court found it irrelevant that the homestead was being used in the course of criminal activity or was purchased with funds derived from criminal activity.¹⁵

However, the Florida Supreme Court did recognize that with respect to the equitable lien cases,¹⁶ the court has strayed from the literal language of the exemption where the equities have demanded it, albeit rarely, and always with due regard to the exceptions provided in art. X, §4.¹⁷ The equitable lien cases are primarily based upon the doctrines of equitable subrogation and/or unjust enrichment. In *Palm Beach Savings & Loan Ass'n v. Fishbein*, 619 So. 2d 267 (Fla. 1993), the Florida Supreme Court granted an equitable lien against

homestead property in favor of a lender, where the debtor husband fraudulently obtained a loan by forging his wife's signature on the mortgage and used the loan to satisfy three preexisting mortgages on the property.¹⁸ The Florida Supreme Court employed the doctrine of equitable subrogation¹⁹ and imposed an equitable lien to allow the defrauded mortgagee to stand in the shoes of the prior mortgagees, who would have been able to proceed against the homestead under the express terms of art. X, §4.²⁰ The Florida Supreme Court also relied upon the doctrine of equitable subrogation in *Jones v. Carpenter*, 90 Fla. 407, 106 So. 127 (1925). In *Jones*, the court granted the trustee of a debtor an equitable lien against the homestead of the debtor's former president where the former president embezzled corporate funds to make improvements on his homestead.²¹ The court concluded that the claims fell within the express exceptions to the homestead exemption because the embezzled funds were used for the improvement of the homestead.²² The Florida Supreme Court has also utilized the doctrine of unjust enrichment to impose an equitable lien on homestead.²³ In *LaMar v. Lechliden*, 185 So. 833 (1939), the court imposed an equitable lien where the plaintiffs made valuable improvements to the defendant's homestead with the belief that they were acquiring an interest in the homestead.²⁴ The court held that since the plaintiffs placed permanent and valuable improvements on the homestead, it would be inequitable for the defendant to retain the improvements without compensating the plaintiffs.²⁵

However, the Florida Supreme Court was clear that the aforementioned jurisprudence has not created "a fourth exception to the homestead exemption excepting homesteads claimed in furtherance of fraud from the protection of [a]rticle X, §4."²⁶ The court noted that its equitable lien jurisprudence should not be read too broadly:

Virtually all of the relevant cases involve situations that fell within one of the three stated exceptions to the homestead provision. Most of those cases involve equitable liens that were imposed where proceeds from fraud or reprehensible conduct were used to invest in, purchase, or improve the homestead. See, e.g., *Jones v. Carpenter*, 90 Fla. 407, 106 So. 127, 130 (1925); *La Mar*, 135 Fla. 703, 711, 185 So. 833, 836. Other

relevant cases cited involve situations where an equitable lien was necessary to secure to an owner the benefit of his or her interest in the property...The [court in *Bessemer v. Gersten*] specifically did not address the issue of whether the lien came within one of the stated exceptions to the homestead exemption. 381 So. 2d [1344] at 1347 n. 1 [Fla. 1980].²⁷

The Florida Supreme Court held that the fraudulent transfer of non-exempt assets to purchase an exempt homestead did not fall within the court's equitable lien jurisprudence. The court explained that equitable principles could not justify reaching beyond the literal language of the exceptions unless the funds were obtained through fraud or egregious conduct and were used to invest in, purchase, or improve the homestead.²⁸ Even though the court was "loathe to provide constitutional sanction to the conduct alleged," it found itself "powerless to depart from the plain language of article X, section 4."²⁹ The debtor, with the actual intent to hinder, delay, or defraud any of his creditors, was free to transfer his nonexempt property into an exempt

homestead because the nonexempt property was not obtained through fraud or egregious conduct.³⁰

FUFTA, Fraud, and the Homestead Exemption

FUFTA provides two theories of recovery from recipients of fraudulent transfers, actual fraud, and constructive fraud. Under F.S. §726.105(1)(a), an actual fraudulent transfer is a transfer made or obligation incurred by a debtor, if the debtor made the transfer or incurred the obligation with the actual intent to hinder, delay, or defraud any creditor of the debtor.³¹ Pursuant to F.S. §§726.105(1)(b) and 726.106(1), a transfer is fraudulent under a theory of constructive fraud if the debtor does not receive reasonable value in exchange, and the debtor either 1) was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; 2) intended to, believed, or reasonably should have believed that he or she would incur debts beyond

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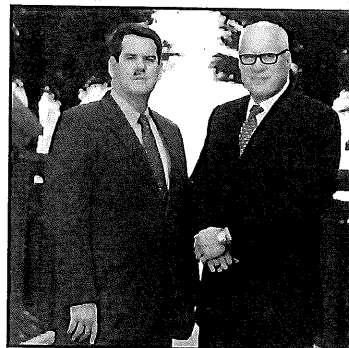
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his or her ability to pay them as they became due; or 3) was insolvent at the time of the transfer.³² The fraudulent intent belongs to the transferor, not the transferee.³³

Subsequent to *Havoco*, several courts have considered whether an exception to homestead exists if the funds derived from a fraudulent transfer were then used to invest in, purchase, or improve the homestead. In the case *Willis v. Red Reef, Inc.*, 921 So. 2d 681,682 (Fla. 4th DCA 2006), *rev. denied*, No. SC06-809 (Fla. Jun. 26, 2006), the creditor had a pending lawsuit for specific performance and breach of contract against the defendants' company when the defendants sold the company's sole asset and transferred the proceeds from the sale to pay off their mortgage. Ultimately, the creditor prevailed on the pending lawsuit and was awarded damages in the amount of \$1.5 million against the company.³⁴ Subsequently, the creditor brought a second action against the defendants for fraudulent transfers of corporate assets, alter ego liability, and tortious civil conspiracy.³⁵ The trial court entered a judgment against the defendants for the receipt of actual and constructive fraudulent transfers and imposed an equitable lien and/or constructive trust on the homestead property of two of the defendants.³⁶ The issue before the appellate court was whether the diversion of corporate assets for the purpose of paying off the mortgage on their homestead constituted fraud or egregious conduct to warrant the imposition of an equitable lien.³⁷ Relying on *Havoco*, the appellate court focused on the source of the funds used to pay off the defendants' mortgage, not on the fact that the funds had been fraudulently diverted from the corporation.³⁸ Since the defendants did not fraudulently obtain funds from the creditor to pay off their mortgage, the creditor could not be awarded an equitable lien and/or constructive trust on their homestead.³⁹

In addition to Florida state courts, bankruptcy courts have also weighed in on the application of the exceptions to the homestead exemption. In the most recent case on this issue, *In re Lee*, 574 B.R. 286 (Bankr. M.D. Fla. 2017), the protection of the homestead defined in *Havoco* seems to be shrinking. In *Lee*,

a court-appointed receiver for entities involved in a Ponzi scheme sought an equitable lien and constructive trust on the homestead of the Ch. 7 debtor and his nondebtor spouse for the debtor's receipt of false profits from the scheme.⁴⁰ Neither the debtor nor his spouse had been accused of any wrong doing associated with the Ponzi scheme, only that the debtor was the recipient of fraudulent transfers consisting of false profit derived from the scheme and that the debtor used a portion of the false profits to purchase his homestead.⁴¹

The issue before the bankruptcy court was whether the exceptions to the homestead exemption required that the fraud or the egregious conduct be committed by the homeowner claiming the exemption.⁴² "In this case, the [d]ebtor passively received the fraudulent transfers and used them to buy the house. It is not alleged that he or his wife engaged in any kind of fraud or egregious conduct."⁴³ The bankruptcy court focused on the reasoning set forth in *Fishbein* and *In re Financial Federated Title & Trust, Inc.*, 273 B.R. 706 (Bankr. S.D. Fla. 2001), and concluded that the underlying fraud of the Ponzi scheme was not relevant to the determination of imposing an equitable lien on homestead, but rather, the prevention of unjust enrichment and the homeowner receiving a windfall.⁴⁴ As stated by the bankruptcy court, "[t]he focus is not on the [d]efendants' culpability, but on the necessity of preventing or mitigating their unjust enrichment by permitting fraudulent transfers to be sheltered in their homestead."⁴⁵

However, in both *Fishbein* and *Financial Federated*, fraud had been committed to procure the funds used to acquire or pay off the mortgage on the homestead. In *Fishbein*, the Florida Supreme Court allowed the bank an equitable lien against the homestead under the doctrine of equitable subrogation since the bank's mortgage, which had been obtained by fraud, had been used to satisfy the prior liens against the home.⁴⁶ Moreover, there was competent and substantial evidence to support the finding that Mrs. Fishbein stood in no worse position than she stood before the execution of the mortgage.⁴⁷ When the bank made its loan, one of the prior mortgages was already overdue.⁴⁸ Mr.

Fishbein testified that by that time he had no other assets that could be used to pay off the preexisting liens, and Mrs. Fishbein testified that she had no funds with which to pay them.⁴⁹

In addition, in *Financial Federated*, the funds used to purchase the debtor and nondebtor's homestead were broker commissions derived from the procurement of investors in a Ponzi scheme.⁵⁰ The debtor was adjudicated guilty on conspiracy to commit mail fraud and conspiracy to commit money laundering regarding his personal role in the Ponzi scheme.⁵¹ The funds used to purchase the homestead were procured through fraud. The court utilized the doctrine of unjust enrichment to address the spouse's interest in the homestead and to prevent her from receiving a windfall.⁵² The court imposed an equitable lien and a constructive trust over the homestead. As stated by the court, "[t]his is a case involving the investment of fraudulently obtained funds directly to the homestead."⁵³

Neither *Fishbein* nor *Financial Federated* considered the question of whether a debtor that passively receives fraudulent transfers and uses them to invest in, purchase, or improve the homestead constitutes the required fraud or the egregious conduct sufficient to impose an equitable lien or constructive trust on the homestead. In both of these cases, the homeowner participated in the underlying fraudulent conduct. Nonetheless, the court in *Lee*, in what amounts to an apparent expansion of the exceptions to the homestead exemption, focused solely on the windfall the parties would receive due to the fraud committed by the third-party running the Ponzi scheme. The bankruptcy court concluded the doctrine of unjust enrichment, without any fraud committed by the homeowner, is all that is required to invoke the exceptions to the homestead exemption.

FUFTA and Fraud/Egregious Conduct

In *Havoco*, the Florida Supreme Court made clear that the imposition of an equitable lien or constructive trust on the homestead requires that the funds be obtained through fraud or egregious conduct and be used to invest in, purchase, or improve the homestead.

The homeowner in *Havoco*, used his own funds, which were otherwise subject to the claims of creditors, and converted these "nonexempt" funds into an exempt homestead. While the transfer to the homestead was clearly a transfer to hinder, delay, and defraud creditors avoidable under FUFTA, *Havoco* ruled that the statutory scheme of FUFTA could not overcome the protections of the Florida Constitution and, because the funds were not derived from fraud or other egregious conduct, the equitable lien exception to homestead could not apply. Subsequent to *Havoco*, several courts have considered whether funds that ultimately were derived from a fraud, but not a fraud directly perpetrated to obtain or pay down a homestead, may give rise to an equitable lien. In *Lee*, the bankruptcy court, in what appears to be a case of first impression, determined that so long as the funds originated with a fraud, even if the homeowner was otherwise innocent, the homestead was subject to an equitable lien. The *Lee* case allowed such results despite the fact that victims of the Ponzi scheme could not trace their funds directly into the homestead and the homeowner took no action to obtain the funds. The holding in *Lee* appears to widen the scope of the doctrine of unjust enrichment to a type of per se liability, which seems beyond the initial rationale for equitable liens. Recently, the *Lee* case settled prior to the 11th Circuit Court of Appeals (or a referral to the Florida Supreme Court) rendering a decision on the underlying merits of the opinion, so legal practitioners and homeowners will have to wait to see if the perceived expansion is, in fact, a reality.⁵⁴□

¹ FLA. CONST. art. IX, §1 (1868).

² *Carter's Adm'rs v. Carter*, 20 Fla. 558, 563 (Fla. 1884).

³ *Public Health Trust v. Lopez*, 531 So. 2d 946, 948 (Fla. 1988). See also *Bigelow v. Dunphe*, 143 Fla. 603, 608 (Fla. 1940) (quoting 26 AM. JUR. 10) (the purpose of the homestead laws is to promote stability and welfare of the state by encouraging property ownership and independence of the citizens).

⁴ *Butterworth v. Caggiano*, 605 So. 2d 56, 59 (Fla. 1992) (quoting *In re Bly*, 456 N.W.2d 195, 199 (Iowa 1990)).

⁵ *Olesky v. Nicholas*, 82 So. 2d 510, 512 (Fla. 1955).

⁶ *Havoco*, 790 So. 2d at 1019.

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ FLA. CONST. art. X, §4(a)(1) (1968).

¹² *Havoco*, 790 So. 2d at 1021-1022.

¹³ *Id.* at 1022.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ The predominant view in Florida is that equitable liens may be founded upon two bases: 1) a written contract that indicates an intention to charge a particular party with a debt or obligation; or 2) a declaration by a court out of general considerations of right or justice as applied to the particular circumstances of a case. See *In re Tsiolas*, 236 B.R. 85, 88 (Bankr. M.D. Fla. 1999).

¹⁷ *Havoco*, 790 So. 2d at 1023-24.

¹⁸ *Id.* at 1024.

¹⁹ Greta K. Kolcon, *Common Law Equity Defeats Florida's Homestead Exemption*, 68 FLA. B. J. 54, 55 (Nov. 1994) ("Equitable subrogation, a sister remedy to the equitable lien, places one party to whom a particular right does not legally belong in the position of the right's legal owner.").

²⁰ *Havoco*, 790 So. 2d at 1024.

²¹ *Id.* at 1025.

²² *Id.*

²³ "The elements of a cause of action for unjust enrichment are: (1) plaintiff has conferred a benefit on the defendant, who has knowledge thereof; (2) defendant voluntarily accepts and retains the benefit conferred; and (3) the circumstances are such that it would be inequitable for the defendant to retain the benefit without first paying the value thereof to the plaintiff." *Agritrade, LP v. Quercia*, 253 So. 3d 28, 33, 42 Fla. L. Weekly D2514, D2516 (Fla. 3d DCA Nov. 29, 2017) (quoting *Peoples Nat'l Bank of Commerce v. First Union Nat'l Bank of Fla.*, 667 So. 2d 876, 879 (Fla. 3d DCA 1996)), *rev. denied*, No. SC17-2294, 2018 WL 1256501 (Fla. Mar. 12, 2018). The basis of the remedy of unjust enrichment is to provide restitution where one person has been unjustly enriched at the expense of another. See *id.*; *Circle Fin. Co. v. Peacock*, 399 So. 2d 81, 84 (Fla. 1st DCA 1981) ("Unjust enrichment is characterized as the effect of a failure to make restitution for property received by one under such circumstances as to give rise to a legal or equitable obligation, thereby requiring such person to account for his retention of the property.").

²⁴ *Havoco*, 790 So. 2d at 1026.

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.* at 1027 (quoting *Caggiano*, 605 So. 2d at 60 n.5).

²⁸ *Id.* at 1028. See also *id.* at 1028 n.12. ("We recognize that several [d]istrict [c]ourts have allowed equitable liens beyond the exceptions provided under article X, [§]4 where a husband has used the homestead exemption to avoid his alimony and child support obligations. See *Brose v. Brose*, 750 So. 2d 717 (Fla. 2d DCA 2000); *Rosenblatt v. Rosenblatt*, 635 So. 2d 132 (Fla. 3d DCA 1994); *Radin v. Radin*, 593 So. 2d 1231 (Fla. 3d DCA 1992); *Gepfrich v. Gepfrich*, 582

So. 2d 743 (Fla. 4th DCA 1991); cf. *Smith v. Smith*, 761 So. 2d 370 (Fla. 5th DCA 2000); *Isaacson v. Isaacson*, 504 So. 2d 1309 (Fla. 1st DCA 1987). We express no opinion as to the validity of this approach.").

²⁹ *Id.* at 1021.

³⁰ *Id.*

³¹ FLA. STAT. §726.105 (1997).

³² FLA. STAT. §§726.105 and 726.106 (1997).

³³ FLA. STAT. §726.105 (1997).

³⁴ *Willis*, 921 So. 2d at 683.

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.* at 684.

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ *In re Lee*, 574 B.R. at 289. False profits are considered to be the distributions received by the investors in the Ponzi scheme above the amount invested in the scheme.

⁴¹ *Id.* 290.

⁴² *Id.* at 291.

⁴³ *Id.*

⁴⁴ *Id.* at 292-294.

⁴⁵ *Id.* at 293.

⁴⁶ *Fishbein*, 619 So. 2d at 269-270.

⁴⁷ *Id.* at 270-271.

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ *In re Financial Federated Title & Trust, Inc.*, 273 B.R. at 709.

⁵¹ *Id.* at 710.

⁵² *Id.* at 717.

⁵³ *Id.* at 719.

⁵⁴ See *Vernon M. Lee, et al. v. Burton Wiand*, No. 8:18-13156-FF (11th Cir. Apr. 1, 2019) (order dismissing appeal).

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This column is submitted on behalf of the Business Law Section, Jacob A. Brown, chair, and Paige Greenlee, editor.