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Bankruptcy

by the Honorable John T. Laney, III *
and Victoria Barbino Grantham **

This year's Bankruptcy Law Article surveys include both notable cases and legislation that will have an impact on the practice of bankruptcy law in the United States Court of Appeals for the Eleventh Circuit.¹ It will address one Supreme Court of the United States case² argued in October 2020, which was decided early in 2021, and three Eleventh Circuit Court of Appeals cases³ decided in 2020. This Article will also include a follow up on the Small Business Reorganization Act of 2019⁴ and a glimpse into the CARES Act,⁵ the most groundbreaking legislation of its kind, and its provisions that directly and indirectly affect the insolvency industry.

In a year not seen for a generation, the bankruptcy industry was deeply affected by the economic shutdowns of 2020. Industries, such as retail, suffered extraordinary hardships and sought relief through Chapter 11 bankruptcies and creditor restructuring,⁶ and, overall,

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¹ For a discussion on opinions from 2019 that impacted bankruptcy law, see John T. Laney, III and Nicholas Greer, *Bankruptcy, 2019 Eleventh Circuit Survey*, 71 MERCER L. REV. 937 (2020).

² *City of Chi. v. Fulton*, 141 S. Ct. 585 (2021).

³ *Law Sols. of Chi. LLC v. Corbett*, 971 F.3d 1299 (11th Cir. 2020); *Whaley v. Guillen (In re Guillen)*, 972 F.3d 1221 (11th Cir. 2020); *Feshbach v. Dep't of Treasury IRS (In re Feshbach)*, 974 F.3d 1320 (11th Cir. 2020).

⁴ Small Business Reorganization Act of 2019, 116 P.L. 54, 133 Stat. 1079.

⁵ Coronavirus Aid, Relief, and Economic Security Act, 116 P.L. 136, 134 Stat. 281.

⁶ Tonya Garcia, *Retail bankruptcies in 2020 hit the highest levels in more than a decade, and experts say there are more to come*, MarketWatch (Dec. 28, 2020, 1:25 PM),

business bankruptcies reached their highest levels since 2013.⁷ Because of the effect of Covid-19, however, aggregate bankruptcy filings, including personal bankruptcies, decreased roughly thirty percent from 2019 to 2020.⁸ Bankruptcy professionals, and nearly everyone worldwide, have faced a world with uncertainties, financial and otherwise, instigated by this new virus.

I. NOTABLE CASES

A. *Supreme Court Opinion: City of Chicago, Illinois v. Fulton*⁹ Defines a Violation of the Automatic Stay

On October 13, 2020, the Supreme Court heard arguments on *City of Chicago, Illinois v. Fulton* after the arguments were postponed in April due to COVID-19 restrictions.¹⁰ The case delved into the bounds of the automatic stay in addressing rightful possession during a debtor's bankruptcy.¹¹ In this case, the City of Chicago impounded the cars of three named Respondents, Robbin L. Fulton, George Peake, and Timothy Shannon, as well as Jason Howard.¹² Subsequently, they filed for Chapter 13 bankruptcy.¹³ The Respondents and City of Chicago disagreed as to which entity should rightfully possess the vehicles.¹⁴

As Respondents, the Debtors argued, under § 362(a)¹⁵, the City of Chicago's continued possession of the vehicles after the debtors' notice of bankruptcy filings violated the automatic stay.¹⁶ The automatic stay prohibits, "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the

<https://www.marketwatch.com/story/retail-bankruptcies-in-2020-hit-the-highest-levels-in-more-than-a-decade-and-experts-say-there-are-more-to-come-11608151350>.

⁷ Ed Flynn, *Weekly Bankruptcy Analysis December 14–20, 2020*, ABI (Feb. 25, 2021), https://abi-org.s3.amazonaws.com/Covid19/stats/Weekly_Update_Dec_14-20-2020.pdf.

⁸ Maria Chutchian, *Chapter 11s soared, but overall bankruptcies hit historic low in 2020*, Westlaw News (Jan. 5, 2021), <https://www.reuters.com/article/bankruptcy-2020-stats/chapter-11s-soared-but-overall-bankruptcies-hit-historic-low-in-2020-idUSL1N2JG1SQ>.

⁹ 141 S. Ct. 585 (2021).

¹⁰ *City of Chicago, Illinois v. Fulton*, SCOTUSBlog, <https://www.scotusblog.com/case-files/cases/city-of-chicago-illinois-v-fulton/>.

¹¹ *Fulton*, 208 L.Ed.2d at 387.

¹² Brief for the Respondents at 10, *Fulton*, 208 L. Ed. 2d 384 (2021). (No. 19-357).

¹³ *Id.*

¹⁴ *Id.* at 20.

¹⁵ 11 U.S.C. § 362.

¹⁶ Brief for the Respondents, *supra* note 11, at 28–31.

estate[.]”¹⁷ The Seventh Circuit previously held that a creditor’s retention of collateral repossessed pre-petition violates the automatic stay.¹⁸

In its response, the City of Chicago as Petitioner first addressed § 362(a)(3), stating the statute’s text does not require a creditor in lawful possession of property to surrender it to a debtor in bankruptcy.¹⁹ Then, the Petitioner argued that § 542(a)²⁰ controls.²¹ Section § 542(a) reads, “an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell . . . shall deliver to the trustee, and account for, such property or the value of such property[.]”²² The City claimed that the property should be transferred to the Trustee, not to the debtors.²³ However, the City also argued that the transfer of property to the trustee is not, “self-executing,” triggered only by the filing of a petition.²⁴ The City agreed to transfer the property after the Trustee demonstrated that the requirements of § 542(a) are met, and the possessing creditor has no defenses to turnover.²⁵

On January 14, 2021, the Court ruled unanimously that the, “mere retention of estate property after the filing of a bankruptcy petition does not violate § 362(a)(3).”²⁶ The Court held that the automatic stay prohibits, “affirmative acts” that would “disturb the status quo of [the] estate[.]” but an act, “implies . . . something more” than continued possession of already held property.²⁷ The Court added that this interpretation creates a “[more] natural reading” of the relationship between § 362(a)(3) and § 542(a): § 362(a)(3), “prohibits collection efforts outside the bankruptcy proceeding that would change the status quo” and § 542(a), “works within the bankruptcy process to draw far-flung estate property back into the hands of the debtor or trustee.”²⁸

¹⁷ 11 U.S.C. § 362(a)(3).

¹⁸ *Thompson v. GMAC, LLC*, 566 F.3d 699 (7th Cir. 2009). The Eleventh Circuit also accepted this understanding of § 362(a)(3) in *Rozier v. Motors Acceptance Corp. (In re Rozier)*, 376 F.3d 1323, 1324 (11th Cir. 2004).

¹⁹ Brief for the Petitioners at 5, *City of Chi, Illinois v. Fulton*, 208 L. Ed. 2d 384 (2021) (No. 19-357).

²⁰ 11 U.S.C. § 542(a).

²¹ Brief for the Petitioners, *supra* note 11, at 7–8.

²² 11 U.S.C. § 542(a).

²³ Brief for the Petitioners, *supra* note 11, at 48–49.

²⁴ *Id.* at 53.

²⁵ *Id.* at 50.

²⁶ *Fulton*, 208 L. Ed. 2d at 391.

²⁷ *Id.* at 387, 389.

²⁸ *Id.* at 387, 390.

B. Eleventh Circuit Opinions

The Eleventh Circuit issued three bankruptcy opinions this year: *Law Solutions of Chicago, LLC v. Corbett*, *Whaley v. Guillen (In re Guillen)*, and *In re Feshbach*.

1. *Law Solutions of Chicago, LLC v. Corbett* Affirms the Bankruptcy Court's Power to Sanction

The Eleventh Circuit addressed the bankruptcy court's jurisdiction and sanctioning power in *Law Solutions of Chicago, LLC v. Corbett*. Law Solutions of Chicago LLC and UpRight Law LLC joined to create "The UpRight Law Firm" (UpRight), an internet-based debt relief agency based in Chicago.²⁹ It operates by referring consumer bankruptcy cases to a national network of local lawyers who represent the debtors in bankruptcy courts.³⁰ The contract that a debtor signs for representation comes directly from UpRight Law Firm, not the local attorneys.³¹

In April 2016, the Bankruptcy Administrator ("BA") for the Northern District of Alabama filed two adversary proceedings regarding UpRight's involvement in a repossession scheme that deprived creditors of secured collateral.³² The BA and UpRight settled the cases in October, presenting the bankruptcy court with a settlement agreement.³³ At the time, the UpRight contract for the clients in the Northern District of Alabama included a provision that limited the services UpRight would provide for its clients included in the "flat fee" paid by the debtor to UpRight; other services that exceeded the contractual bounds were excluded from the representation or would cost the debtor more. The settlement agreement between the BA and UpRight included a provision that stated UpRight could no longer use the service-limiting language in its contract with clients in the Northern District of Alabama. The bankruptcy court, without reiterating the settlement agreement's contents, signed an order approving the agreement.³⁴

Roughly seven months after the settlement agreement and subsequent court approval, the BA audited UpRight's cases and found three open cases in which UpRight used the old contractual language, in violation of

²⁹ *Corbett*, 971 F.3d at 1304.

³⁰ *Id.* at 1306.

³¹ *See id.* The bankruptcy court found UpRight, not the local attorney "partner," responsible for the wording of the firm's "Retention Agreements."

³² *Id.* at 1307.

³³ *Id.* at 1307–08.

³⁴ *Id.* at 1308.

the settlement agreement between the BA and UpRight.³⁵ The BA filed a motion to examine, which the court heard in July 2017.³⁶ During the hearing, the BA asserted that UpRight violated § 707,³⁷ § 526,³⁸ and Rule 2016,³⁹ and UpRight admitted it made mistakes in the three cases.⁴⁰ The BA also made the court aware of three additional closed cases in which UpRight had used the old contractual language. At the end of the hearing, the bankruptcy court remarked that more testimony and review was needed to determine whether UpRight violated the settlement agreement and the proper recourse if so.⁴¹ The bankruptcy court entered an “Order to Appear and Show Cause” and scheduled an evidentiary hearing.⁴²

During the evidentiary hearing, the BA put forth evidence that UpRight used contractual language that violated the settlement agreement in at least six cases. UpRight’s representative testified that it made mistakes in the contested filings and, in those cases, UpRight did not charge the debtors for additional services; however, UpRight also admitted that the debtors had not asked for those services and, if they had, UpRight would have charged the debtors extra for those services.⁴³ After the hearing, the BA and UpRight briefed the issues, including whether UpRight had violated §§ 526 and 707.⁴⁴

The bankruptcy court determined that UpRight violated Rule 9011⁴⁵, and §§ 526 and 707.⁴⁶ It imposed sanctions of \$150,000 and suspended UpRight’s ability to file cases in the Northern District of Alabama for eighteen months.⁴⁷ UpRight appealed to the district court, and the district court affirmed. UpRight then appealed to the Eleventh Circuit.⁴⁸

³⁵ *Id.* at 1308–09.

³⁶ *Id.* at 1309.

³⁷ 11 U.S.C. § 707.

³⁸ 11 U.S.C. § 526.

³⁹ USC Bankruptcy R 2016. Rule 2016 requires attorneys file detailed disclosure documents when applying for compensation.

⁴⁰ *Law Sols. of Chi. LLC*, 971 F.3d at 1309.

⁴¹ *Id.* at 1310.

⁴² *Id.* at 1310–11.

⁴³ *Id.* at 1311.

⁴⁴ *Id.* at 1313.

⁴⁵ USC Bankruptcy R 9011.

⁴⁶ *Corbett*, 971 F.3d at 1314.

⁴⁷ *Id.*

⁴⁸ *Id.* at 1304.

The Eleventh Circuit first addressed whether the bankruptcy court had the authority to impose sanctions under § 526(a)(2).⁴⁹ Section 526(a)(2) prohibits debt relief agencies from making statements in bankruptcy courts that they know or should have known were untrue or misleading.⁵⁰ The bankruptcy court can impose sanctions if it finds the agency violated § 526(a)(2) or, “engaged in a ‘clear and consistent pattern or practice’ of doing so[.]”⁵¹ The Eleventh Circuit found the language used in the contracts with clients, which allowed UpRight to charge for additional services, misleading and in violation of § 526(a)(2).⁵²

UpRight argued that the bankruptcy court did not have subject matter jurisdiction to impose sanctions. UpRight posited that the bankruptcy court sanctioned UpRight for three closed cases and, because the cases were not reopened, the court had no jurisdiction over the cases.⁵³ The Eleventh Circuit quickly disposed of that argument, stating a court’s jurisdiction to sanction does not end when a case is closed.⁵⁴

UpRight also claimed that because the bankruptcy court’s order did not expressly incorporate the terms of the settlement agreement, the court could not enforce the agreement.⁵⁵ UpRight relied on *Kokkonen v. Guardian Life Insurance Co. of America*,⁵⁶ which found that an order approving a settlement is not sufficient to establish jurisdiction to enforce the settlement.⁵⁷ However, the Eleventh Circuit held that the bankruptcy court relied on Rule 9011 and §§ 526 and 707 of the Bankruptcy Code to impose sanctions, providing the bankruptcy court independent grounds for jurisdiction.⁵⁸ Further, the Eleventh Circuit added that the settlement agreement and order were drafted to comply with the federal Bankruptcy Code and rules and affected UpRight’s filings in the bankruptcy court upon the settlement agreement’s effectuation.⁵⁹ Therefore, the bankruptcy court must have jurisdiction to address UpRight’s future filings, including the prohibition of such filings, in its court.

⁴⁹ *Id.* at 1315.

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.* at 1315–16.

⁵³ *Id.* at 1316.

⁵⁴ *Id.*

⁵⁵ *Id.* at 1317.

⁵⁶ 511 U.S. 375 (1994).

⁵⁷ *Corbett*, 971 F.3d at 1317.

⁵⁸ *Id.*

⁵⁹ *Id.*

UpRight argued that the bankruptcy court violated its due process rights when imposing sanctions under §§ 526 and 707 and Rule 2016 because UpRight was not given notice that “those particular sources were in play.”⁶⁰ Upright contended that the Order to Show Cause and evidentiary hearing only addressed sanctions for violating the settlement agreement and not statutory sanctions.⁶¹ However, transcripts from the evidentiary hearing include references to §§ 526 and 707 as well as Rule 2016.⁶² Further, the Eleventh Circuit noted five different times in the proceedings that the BA or the bankruptcy court provided UpRight notice of the potential for statutory sanctions.⁶³

UpRight then claimed that the bankruptcy court used the wrong standard in imposing sanctions.⁶⁴ Because the suspension had already run at the time of arguments, the court dismissed this argument as moot.⁶⁵

Lastly, UpRight argued that its errors were inadvertent, and the sanctions imposed were “grossly excessive.”⁶⁶ While the Eleventh Circuit stated the bankruptcy court’s condemnations of UpRight as “strong,” the court believed, “serious sanctions were appropriate” based on UpRight’s conduct.⁶⁷

2. *Whaley v. Guillen (In re Guillen)* and the Bounds of Modification Under § 1329

The Eleventh Circuit addressed a question of first impression regarding the circumstances in which modification is permitted by § 1329.⁶⁸ The court heard this appeal directly from the bankruptcy court, given the current circuit split stemming from this question.⁶⁹ The Eleventh Circuit agreed with the bankruptcy court that § 1329 does not require a change of circumstances for the court to grant modification.⁷⁰

This case arose when Rachel Capeloto Guillen, the debtor, moved for the bankruptcy court’s permission to modify her Chapter 13 plan. Guillen

⁶⁰ *Id.* at 1318.

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.* at 1319.

⁶⁴ *Id.*

⁶⁵ *Id.*

⁶⁶ *Id.* at 1320.

⁶⁷ *Id.*

⁶⁸ 11 U.S.C. § 1329.

⁶⁹ *In re Guillen*, 972 F.3d at 1223.

⁷⁰ *Id.* at 1223–24.

had two secured creditors in this case and commenced an action against one of the secured creditors to avoid its lien. The parties entered into a consent judgment agreeing that the lien was not perfected and that the creditor held an unsecured claim.⁷¹

The bankruptcy court subsequently confirmed the debtor's original Chapter 13 plan. The original plan called for \$4,900 in attorney's fees plus approved fees incurred from the adversary proceeding.⁷² After confirmation, the debtor's counsel applied for \$8,295 for post-petition legal fees stemming from the adversary proceeding and filed a modified Chapter 13 plan to address the new fees.⁷³

Under § 1329(a), a Chapter 13 plan can be modified under four circumstances: (1) increasing or reducing payments to a class of creditors in the plan; (2) extending or reducing time to make payments; (3) altering distributions to a creditor to account for payments made other than under the plan; and (4) reducing the amounts to be paid under the plan to account for the debtor's purchase of health insurance.⁷⁴ The debtor's modified plan fell under § 1329(a)(1); she requested to reduce the available funds for unsecured creditors from \$20,172 to \$11,877 to pay the additional \$8,295 in attorney's fees.⁷⁵ The Chapter 13 Trustee for the Northern District of Georgia (the "Trustee") objected to modification claiming the modification violated the best interests of the creditors' test in § 1325⁷⁶ and that *res judicata* barred the debtor's modification.⁷⁷ The bankruptcy court confirmed the plan, finding that § 1329 creates an exception to the finality of a plan and the proposed modified plan complied with § 1329.⁷⁸

The Eleventh Circuit first addressed the relationship between *res judicata*, § 1327, and § 1329.⁷⁹ Section 1327 treats the confirmation of a Chapter 13 plan as a final judgment, preventing parties from relitigating the issues necessarily decided during confirmation.⁸⁰ However, § 1329 explicitly creates an exception to a plan's finality if the modified plan meets its statutory requirements.⁸¹ The Trustee argued that § 1329

⁷¹ *Id.* at 1224.

⁷² *Id.*

⁷³ *Id.* at 1224–25.

⁷⁴ *Id.* at 1225 (citing 11 U.S.C. § 1329(a)(1)–(4)).

⁷⁵ *In re Guillen*, 972 F.3d at 1225.

⁷⁶ 11 U.S.C. § 1325.

⁷⁷ *In re Guillen*, 972 F.3d at 1225.

⁷⁸ *Id.*

⁷⁹ *Id.* at 1225–26.

⁸⁰ *Id.*

⁸¹ *Id.* at 1226.

requires a change of circumstance for modification; otherwise, modification disregards the finality of confirmation orders under § 1327.⁸² The Eleventh Circuit disagreed.⁸³

The court held that the language of § 1329 does not require a change of circumstances to allow modification.⁸⁴ The court determined Congress's omission of a requirement of a debtor's change of circumstances within the statute itself was persuasive.⁸⁵ The court cited similar provisions elsewhere in the Bankruptcy Code, namely § 1127(b),⁸⁶ where Congress included a requirement for a change in circumstances for debtors in Chapter 11, and § 1127(e), where Congress omitted the requirement for individual debtors in Chapter 11.⁸⁷ Quoting *Sandoz Inc. v. Amgen Inc.*,⁸⁸ the court stated, "[h]ad Congress intended to 'oblige individual debtors to show some change in circumstances before modifying confirmed plans, 'it presumably would have done so expressly'—just as it did in § 1127(b)."⁸⁹

The court then addressed its sister circuits' interpretations of § 1329.⁹⁰ The First, Fifth, and Seventh Circuits agree with the Eleventh Circuit's reading of § 1329.⁹¹ However, the Fourth Circuit in *In re Arnold*⁹² disagreed and held that res judicata barred modification without a change in circumstance of the debtor's financial condition.⁹³ The Fourth Circuit feared debtors would overwhelm the system with modifications after minor financial changes undermining the finality of confirmations.⁹⁴ The Eleventh Circuit addressed these concerns, stating that it would not read policy into the statute where the statute was clear.⁹⁵ Further, the Eleventh Circuit added that the provisions of § 1329 provided safeguards from all debtors' requesting frivolous

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ 11 U.S.C. § 1127.

⁸⁷ *In re Guillen*, 972 F.3d at 1227.

⁸⁸ 1327 S. Ct. 1664 (2017).

⁸⁹ *In re Guillen*, 972 F.3d at 1227 (quoting *Sandoz Inc.*, 137 S. Ct. at 1677).

⁹⁰ *Id.* at 1227–28.

⁹¹ *Id.* at 1228. See *In re Witkowski* 16 F.3d 739, 742 (7th Cir. 1994); *In re Meza* 467 F.3d 874, 877–78 (5th Cir. 2006); *Barbosa v. Solomon*, 235 F.3d 31, 41 (1st Cir. 2000).

⁹² *In re Guillen*, 972 F.3d at 1228. See *Arnold v. Weast (In re Arnold)*, 869 F.2d 240 (4th Cir.1989).

⁹³ *In re Arnold*, 869 F.2d at 243.

⁹⁴ *In re Guillen*, 972 F.3d at 1228 (citing *In re Murphy*, 474 F.3d 143, 150 (4th Cir. 2007)).

⁹⁵ *In re Guillen*, 972 F.3d at 1228.

modifications—only certain parties can request modification and only in the specific listed circumstances: the modified plan must still comply with §§ 1325(a),⁹⁶ 1322(a),⁹⁷ (b), and (c) and, under § 1329, the bankruptcy court also has the discretion of whether plan modification is appropriate in the circumstances, unlike confirmation required under § 1325.⁹⁸

Finally, the court addressed the Trustee's assertion that *In re Hogle*⁹⁹ already resolved this legal question.¹⁰⁰ In *Hogle*, the Court analyzed § 1322(b)(5) and its relationship to § 1329.¹⁰¹ In that case, the court allowed three debtors to modify their Chapter 13 plans to cure post-confirmation defaults saying, "Congress designed § 1329 to permit modification of a plan due to changed circumstances of the debtor unforeseen at the time of confirmation."¹⁰² However, in *Guillen*, when addressing *Hogle*, the Eleventh Circuit made it clear that, while an unforeseen change of circumstance does permit modification, the modification under § 1329 is not limited to only those situations.¹⁰³ The court said:

When a bankruptcy court faces a modified plan that satisfies the requirements of § 1329, it may properly consider whether there had been some changes in circumstances when deciding whether to confirm the plan as modified. But it is free to confirm the modified plan even where it has not found any change of circumstance.¹⁰⁴

In this case, the Eleventh Circuit held that the circumstances of this debtor and the parties' interests were best suited by modification.¹⁰⁵

Lastly, the Eleventh Circuit addressed the Trustee's assertion that the bankruptcy court included the debtor's attorney's fees in the § 1325 best interest of the creditor's calculation.¹⁰⁶ The court held that the

⁹⁶ 11 U.S.C. § 1325. By using the wording "the court shall confirm a plan," the court interpreted 11 U.S.C. § 1325 to require courts to confirm a plan that meets the section's enumerated requirements.

⁹⁷ 11 U.S.C. § 1322.

⁹⁸ *In re Guillen*, 972 F.3d at 1228–29.

⁹⁹ 12 F.3d 1008 (11th Cir. 1994).

¹⁰⁰ *In re Guillen*, 972 F.3d at 1229.

¹⁰¹ *In re Hogle*, 12 F.3d at 1010.

¹⁰² *Id.* at 1011.

¹⁰³ *In re Guillen*, 972 F.3d at 1229.

¹⁰⁴ *Id.* at 1229–30.

¹⁰⁵ *Id.* at 1230.

¹⁰⁶ *Id.*

Trustee failed to address this contention in the initial brief and only in the reply brief, waiving those claims for the court's consideration.¹⁰⁷

3. *In re Feshbach*: Misbehaved Debtors Cannot Evade the IRS

The Eleventh Circuit addressed § 523(a)(1)¹⁰⁸ in this fact-intensive case. This case arose from the Chapter 7 bankruptcy case of Matthew and Kathleen Feshbach.¹⁰⁹ The bankruptcy court found that the Feshbachs violated § 523(a)(1)(C) of the Bankruptcy Code,¹¹⁰ which exempts tax debts from discharge when, “the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax.”¹¹¹ The Eleventh Circuit agreed.¹¹²

The court first laid out the case's substantial factual background. Matthew Feshbach worked as an investment professional and formerly managed a hedge fund. In 1999, the Feshbachs incurred a tax liability of \$1,950,827 and did not submit payment with their return. In June 2001, to settle their tax liability, the Feshbachs submitted an offer-in-compromise to the IRS for about \$1 million to settle what was owed, offering to immediately pay \$200,000, sell their home in Bellaire, Florida and pay \$300,000, and pay the remaining balance over the next five years. Along with the offer-in-compromise, the Feshbachs included a \$200,000 payment.¹¹³ “Looking at the Feshbachs' income and allowable expenses, the IRS believed the offer was a non-starter.”¹¹⁴ The documentation the Feshbachs submitted with their offer showed the Feshbachs', “collection potential was not only greater than their offer but also greater than the entire debt.” The Feshbachs withdrew their offer before it was rejected and agreed instead to make monthly payments of \$1,000 to the IRS during their negotiations.¹¹⁵

However, to make the original \$200,000 payment, the Feshbachs had to liquidate securities, which led to their incurrence of capital gains tax included in their 2001 tax liability, totaling \$3,245,839. Including interest and their previous unpaid debt, the Feshbachs then owed over \$6 million to the IRS. The Feshbachs again approached the IRS with a

¹⁰⁷ *Id.*

¹⁰⁸ 11 U.S.C. § 523.

¹⁰⁹ *In re Feshbach*, 974 F.3d at 1323.

¹¹⁰ *Id.*

¹¹¹ 11 U.S.C. § 523(a)(1)(C).

¹¹² *In re Feshbach*, 974 F.3d at 1323.

¹¹³ *Id.*

¹¹⁴ *Id.* at 1324.

¹¹⁵ *Id.*

second offer-in-compromise, offering \$1.25 million—a higher dollar amount, but a lower percentage of their tax liability covered. On their Form 433-A, the financial disclosure document which accompanied their offer, the Feshbachs claimed they earned roughly \$180,000 annually; on their 2002 tax return, the Feshbachs reported an income of \$611,413 and the following year earned \$738,608.¹¹⁶ The Feshbachs also failed to sell their Florida residence, a part of the original offer to the IRS.¹¹⁷ The IRS rejected the Feshbachs' offer, finding that the Feshbachs had the ability to pay their tax liability fully and settlement was inappropriate.¹¹⁸

After two failed settlement offers, the Feshbachs approached the IRS about creating an installment plan to pay off their liabilities. The IRS conditionally agreed only if the Feshbachs first fully paid their 1999 tax debt. After the Feshbachs paid two installments of \$50,000 and took out a loan to pay the rest of the 1999 tax, the IRS approved their installment plan.¹¹⁹

The Feshbachs remained current on their installment plan from late 2005 until 2008 when they began missing payments. In September 2008, the Feshbachs made a third offer-in-compromise of \$120,000 for their remaining \$3.6 million debt. With this offer, their Form 433-A stated the couple had a monthly income of \$833 and their household expenses totaled over \$12,000. However, their tax return claimed an income of \$193,205. After fully investigating the Feshbachs' financial position, the IRS determined the Feshbachs were able to pay \$15,000 per month. The Feshbachs made four such payments but failed to make any beyond May of 2011. The couple filed for Chapter 7 bankruptcy soon after.¹²⁰

In their Chapter 7 case, the Feshbachs initiated an adversary proceeding against the IRS, claiming their 2001 tax liability was dischargeable.¹²¹ The government claimed that the Feshbachs violated § 523(a)(1)(C) by willfully attempting to evade and defeat their tax liability.¹²² The IRS relied on the Feshbachs reported income, actual income, and spending habits. The government also argued that Feshbachs purposefully lowballed the IRS to stall making payments.¹²³

¹¹⁶ *Id.*

¹¹⁷ *Id.* 1324–25.

¹¹⁸ *Id.* at 1325.

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² *Id.* at 1325–26.

¹²³ *Id.* at 1326.

The bankruptcy court held a bench trial and concluded that the Feshbachs willfully attempted to evade or defeat their 2001 tax liability. The court found that the Feshbachs' lavish spending wrongfully inhibited the Feshbachs from paying back their tax debts in full when they had the capacity to do so. The court also found that the Feshbachs intentionally used the settlement process to delay the IRS's collection efforts while willfully redirecting their funds to pay for their lavish lifestyle.¹²⁴ The court also asked the parties to brief whether a partial discharge of debts would be appropriate if the Feshbachs could not repay their debts, but later found that partial discharge is not allowed under 523(a)(1)(C).¹²⁵ The Feshbachs appealed.¹²⁶

The Eleventh Circuit first affirmed the bankruptcy court's determination that the Feshbachs' debt was nondischargeable under 523(a)(1)(C).¹²⁷ The Eleventh Circuit established a test for dischargeability under § 523(a)(1)(C): the government must prove by a preponderance of the evidence that the debtor engaged in affirmative acts constituting a willful attempt to evade or defeat payment of taxes.¹²⁸ To demonstrate willfulness under § 523(a)(1)(C), the "government must demonstrate that '(1) the debtor had a duty under the law, (2) the debtor knew of that duty, and (3) the debtor voluntarily and intentionally violated that duty.'"¹²⁹ Holding that no facts at issue existed for the first two prongs of the willfulness test, the Eleventh Circuit focused on the third criteria.¹³⁰

The Feshbachs argued that the bankruptcy court erred in finding their spending habits alone justified finding their conduct willful.¹³¹ The Eleventh Circuit opted not to decide the issue because the evidence of the Feshbachs' other conduct, together with their spending, supported the bankruptcy court's conclusions.¹³² The court then addressed the Feshbachs' behavior in the offer-in-compromise process.¹³³ First, the Eleventh Circuit quickly noted that the offer-in-compromise process was an important settlement tool and, by using that process, debtors can

¹²⁴ *Id.*

¹²⁵ *Id.* at 1326–27.

¹²⁶ *Id.* at 1327.

¹²⁷ *Id.*

¹²⁸ *Id.* at 1331. See *In re Griffith*, 206 F.3d 1389, 1396–97 (11th Cir. 2000).

¹²⁹ *In re Feshbach*, 974 F.3d at 1237 (quoting *In re Griffith*, 206 F.3d at 1396).

¹³⁰ *Id.* at 1237.

¹³¹ *Id.* at 1328.

¹³² *Id.*

¹³³ *Id.*

settle their cases with the IRS in a productive manner.¹³⁴ However, the court determined that the Feshbachs abused the offer-in-compromise system by submitting offers that were, “inadequate and unrealistic . . . given their income and spending” and, “they used the offer-in-compromise process to delay their payment of taxes.”¹³⁵ While they had pending offers-in-compromise with the IRS, the Feshbachs paid only \$1,000 monthly to the IRS but continued spending on expensive personal luxuries.¹³⁶ The Feshbachs claimed the expenses were for business, but the bankruptcy court found many expenses had no business purpose.¹³⁷

The court also addressed the disparity between the Feshbachs’ self-reported income on their Form 433-A and their actual income for those years.¹³⁸ IRS officials believed that the Feshbachs underreported their income while the IRS considered their offers-to-compromise, especially given bank records showing the Feshbachs unexplainedly deposited \$50,000 into their bank accounts monthly.¹³⁹ The Eleventh Circuit agreed, adding that individuals who had the reported income from their Form 433-A would not continue to spend at the rate of the Feshbachs, especially on luxuries such as, “the personal chef, the dining-out, [and] the expensive private schooling.”¹⁴⁰ The court noted, “after reporting an income of \$180,000 on a Form 433-A, the Feshbachs spent \$1.5 million on themselves.”¹⁴¹ And when they submitted their 2008 offer of \$120,000—just 3.3% of their total debt—the Feshbachs were spending, “over \$12,000 per month on household goods and services.”¹⁴² The Feshbachs claimed the \$180,000 income was based on their average income of the past four years taking into account, “phantom income” received in 1999 and 2001.¹⁴³ However, the Feshbachs still made \$700,000 in income in 1998, meaning they would have to make, “less than \$20,000 over the next three years” to have an average income of \$180,000.¹⁴⁴ Instead, the Feshbachs made over \$13.5 million, leading the

¹³⁴ *Id.* at 1328–29.

¹³⁵ *Id.* at 1329.

¹³⁶ *Id.*

¹³⁷ *Id.*

¹³⁸ *Id.* at 1330.

¹³⁹ *Id.*

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

¹⁴² *Id.*

¹⁴³ *Id.*

¹⁴⁴ *Id.*

Eleventh Circuit to dispute all their earnings were entirely, “phantom income.”¹⁴⁵

The Eleventh Circuit then addressed the *mens rea* element of § 523(a)(1)(C).¹⁴⁶ The Feshbachs argued the bankruptcy court applied the wrong standard, and the government had to prove that their spending was directly undertaken in order to evade taxes.¹⁴⁷ The Eleventh Circuit disagreed.¹⁴⁸ First, the court ruled that the bankruptcy court applied the correct standard of civil willfulness.¹⁴⁹ It held § 523(a)(1)(C), “requires only a ‘voluntary, conscious, and intentional’ attempt to violate a known duty to pay taxes,” not the Feshbachs’ preferred standard of criminal fraudulent intent.¹⁵⁰ Then, the court reviewed the bankruptcy court’s finding that the Feshbachs met the civil willfulness standard for evidence of the court’s clear error.¹⁵¹ In reviewing the bankruptcy court’s findings, the Eleventh Circuit did not determine that the bankruptcy court committed clear error.¹⁵² There was evidence that the bankruptcy court appropriately reviewed the evidence and found the IRS’s arguments and evidence more persuasive.¹⁵³

Finally, the Eleventh Circuit acknowledged the bankruptcy court’s finding that partial discharge is not available under § 523(a)(1)(C) but declined to examine the issue.¹⁵⁴ The Feshbachs earned more than double their owed debt over the nine years in question, making partial discharge, even if available, inappropriate.¹⁵⁵

II. RELEVANT LEGISLATION

Legislation heavily impacted the insolvency industry in 2020 with the enactment of the Small Business Reorganization Act (“SBRA”) and the passage of the Coronavirus Aid, Relief, and Economic Security Act (“CARES” Act).

¹⁴⁵ *Id.*

¹⁴⁶ *Id.* at 1331.

¹⁴⁷ *Id.*

¹⁴⁸ *Id.*

¹⁴⁹ *Id.*

¹⁵⁰ *Id.* (quoting *In re Fegeley*, 118 F.3d 979, 984 (3d Cir. 1997)).

¹⁵¹ *Id.*

¹⁵² *Id.*

¹⁵³ *Id.* at 1331–32.

¹⁵⁴ *Id.* at 1332.

¹⁵⁵ *Id.*

A. *Small Business Reorganization Act*

Congress passed SBRA at the end of 2019, which created subchapter V of Chapter 11 for small businesses to reorganize.¹⁵⁶ Small business debtors could begin filing under subchapter V as of February 19, 2020.¹⁵⁷ Congress primarily hoped SBRA would expedite the plan confirmation timeline and reduce expenses for small business owners to take advantage of the bankruptcy process.¹⁵⁸ In 2020, over 1,300 subchapter V cases were filed, including approximately 250 cases in the Eleventh Circuit.¹⁵⁹

These cases filed under subchapter V have met the Congressional goals for SBRA's implementation. As of September 2020, twenty percent of the cases filed had plans confirmed, which is six times the rate of confirmations for non-subchapter V cases filed in the same timeframe.¹⁶⁰ Twenty of the subchapter V cases had plans confirmed within 120 days of filing; comparatively, only ten non-subchapter V cases had plans confirmed within 120 days over the past three years.¹⁶¹ Under SBRA, subchapter V trustees are empowered to oversee the viability of plans and negotiate with parties in an effort for cases to be resolved more efficiently.¹⁶² Thus far, more than sixty percent of plan confirmations were consensual, suggesting subchapter V trustees have addressed disputes preconfirmation, avoiding additional time and court costs.¹⁶³

B. *The CARES Act*

In its initial response to the coronavirus crisis, Congress passed the CARES Act, which was signed into law on March 27, 2020.¹⁶⁴ The CARES Act includes provisions that increased the debt threshold for filing under subchapter V, addressed changes to Chapter 7 and 13 debtors' circumstances, and created the Payroll Protection Program ("PPP")

¹⁵⁶ For a more thorough analysis of the provisions of SBRA, see *supra* note 1 at 531.

¹⁵⁷ Clifford J. White III, *Small Business Reorganization Act: Implementation and Trends*, ABI J., Vol. XL, No. 1, (January 2020).

¹⁵⁸ *Id.*

¹⁵⁹ ABI, <https://app.powerbi.com/view?r=eyJrIjoiNzJmYWJlNDQzMGNIMy00MDA5LTlmZWVtODU5YTQyMDRjYWVjIiwidCI6ImI0NDhOWMyLThjNmYtNGNlYS1iYzI1LWYzZTI0MGJjNGI1ZCIsImMiOiF9>.

¹⁶⁰ Clifford J. White III, *supra* note 189.

¹⁶¹ *Id.*

¹⁶² *Id.*

¹⁶³ *Id.*

¹⁶⁴ Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, 134 Stat. 281 (2020).

affecting current debtors in bankruptcy and the financial options for considering filing.

1. Subchapter V Debt Threshold

As part of the CARES Act, Congress increased the availability of subchapter V for small business debtors. Originally, in order to file for subchapter V, businesses must have accumulated less than \$2,725,625 in debt.¹⁶⁵ Congress temporarily increased the debt ceiling for small businesses to file under subchapter V to \$7.5 million.¹⁶⁶ However, if a debtor had filed for Chapter 11 before March 27, 2020, and now qualified for subchapter V, the debtor cannot convert its case.¹⁶⁷ This temporary increase is set to expire on March 27, 2022, without additional Congressional action to extend.¹⁶⁸

C. Consumer Bankruptcy Changes

The CARES Act also included specific provisions under Chapter 7 and Chapter 13 to ease the burden on consumer debtors. Under Chapter 7, the calculation of a debtor's income excludes any federal stimulus payments distributed to individuals because of the COVID-19 pandemic.¹⁶⁹ In Chapter 13, a debtor's disposable income also excludes those federal stimulus payments.¹⁷⁰ The CARES Act also permits Chapter 13 debtors who confirmed plans before March 27, 2020, to seek plan modification if the debtor experienced a direct or indirect, "material financial hardship" due to the pandemic.¹⁷¹ A modified plan can extend payments to seven years after the initial payment under the debtor's

¹⁶⁵ Gary McIntosh et. al., *CARES Act Temporarily Expands Bankruptcy Rules*, WEAVER INSIGHTS & RESOURCES (Apr. 16, 2020), <https://weaver.com/blog/cares-act-temporarily-expands-bankruptcy-rules>.

¹⁶⁶ Jason Ayres et. al., *(Not-So) Small Business Reorganization Act: CARES Act Expands SBRA Eligibility*, FOSTER GARVEY LEGAL ALERT (Apr. 6, 2020), <https://www.foster.com/newsroom-alerts-small-business-reorganization-act-cares-act-expands-sbra-eligibility>.

¹⁶⁷ *Id.*

¹⁶⁸ Michele Sabo Assayag and Joshua Partington, *Debt Limit Increase of Subchapter V of Chapter 11 of Bankruptcy Code Extended*, Snell & Wilmer Legal Alerts (Apr. 5, 2021), <https://www.swlaw.com/publications/legal-alerts/2933>.

¹⁶⁹ Phoebe S. Winder et. al., *Covid-19: How the Cares Act Will Impact Chapter 7 and Chapter 13 Consumer Bankruptcies*, NAT. L. REV. (Mar. 31, 2020), <https://www.natlawreview.com/article/covid-19-how-cares-act-will-impact-chapter-7-and-chapter-13-consumer-bankruptcies>.

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

original plan became due.¹⁷² These protections sought to ease the burden on individual consumer debtors and prevent pandemic-related defaults in otherwise successful cases.

1. PPP Loans and Bankruptcy-related Litigation

The CARES Act also instituted the Payroll Protection Program, which created loans for companies to use on rent, wages, utilities, etc.¹⁷³ Congress granted the Small Business Administration (SBA) with the power to grant these loans.¹⁷⁴ The loans can be completely forgiven if the company meets certain guidelines, such as maintaining their entire workforce for the required time after the loan's disbursement and proof the loan was used for eligible expenses.¹⁷⁵

In the CARES Act's language and initial guidance from the SBA, no mention was made as to whether businesses in bankruptcy could apply for PPP loans.¹⁷⁶ However, on April 24, 2020, the SBA released guidance that barred debtors currently in bankruptcy from receiving PPP loans.¹⁷⁷

In the Fifth Circuit, debtors barred from receiving funds through the PPP challenged the SBA's authority to discriminate against bankrupt companies under § 525(a)¹⁷⁸ of the Bankruptcy Code and claimed that the SBA's denial of the debtor's loan violated the arbitrary and capricious standard¹⁷⁹ under 5 U.S.C. § 706(2)(C).¹⁸⁰ In June, the Fifth Circuit addressed an appeal from the bankruptcy court which had imposed a preliminary injunction against the SBA that would require the SBA to

¹⁷² *Id.*

¹⁷³ Office of Capital Access, *Top-line Overview of First Draw PPP*, U.S. SMALL BUSINESS ADMINISTRATION (Mar. 31, 2020), <https://www.sba.gov/sites/default/files/2021-01/Top-line%20Overview%20of%20First%20Draw%20PPP%20%281.8.2021%29-508.pdf>.

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

¹⁷⁶ Evan M. Jones et al., *Bankruptcy Courts Are Split on Whether a Chapter 11 Debtor Is Eligible for a PPP Loan Under the CARES Act*, O'MELVENY ALERTS & PUBLICATIONS, (May 12, 2020), <https://www.omm.com/resources/alerts-and-publications/alerts/bankruptcy-courts-are-split-on-whether-a-bankruptcy-debtor-is-eligible-for-a-ppp-loan/>. On the initial application for a PPP loan, debtors were required to indicate whether they were currently in bankruptcy, but there was no indication that the debtor's status would affect their eligibility for the loan.

¹⁷⁷ *Id.*

¹⁷⁸ 11 U.S.C. § 525.

¹⁷⁹ *Hidalgo Cty. Emergency Serv. Found. v. Carranza (In re Hidalgo Cty. Emergency Serv. Found.)*, 962 F.3d 838, 840 (5th Cir. 2020).

¹⁸⁰ 5 U.S.C. § 706.

grant PPP funding to a bankrupt company.¹⁸¹ The court sided with the SBA and vacated the injunction because 15 U.S.C. § 634(b)(1)¹⁸² prohibits injunctive relief against the SBA.¹⁸³ The court did not address the debtor's § 525(a) or 5 U.S.C. § 706(2)(C) arguments.¹⁸⁴

On December 22, 2020, the Eleventh Circuit addressed the same issue and decided the case under administrative law. The court applied the *Chevron*¹⁸⁵ framework in addressing whether an administrative agency overstepped its statutory authority.¹⁸⁶ *Chevron* created a two-step analysis to address agency overreach: whether Congress directly spoke on the issue and whether the agency's interpretation of the statute is reasonable.¹⁸⁷ In addressing the first step, the court held that the CARES Act directly folded the PPP program into the SBA's previously existing statutory authority and explicitly gave the SBA emergency authority to issue regulations for distributing PPP funds.¹⁸⁸ In addressing the second step, the court determined that the SBA expedited the regulatory timeline to quickly disburse needed loans and the PPP's to help struggling small businesses avoid financial distress, not to relieve already financially distressed businesses.¹⁸⁹ Given those considerations, the court held the SBA's bar on bankrupt companies' receipt of PPP funding reasonable.¹⁹⁰ Finally, on the claim that the SBA's rule was arbitrary and capricious, violating 5 U.S.C. § 706(2)(C), the court also sided with the SBA.¹⁹¹

¹⁸¹ *Hidalgo*, 962 F.3d at 840.

¹⁸² 15 U.S.C. § 634.

¹⁸³ *Hidalgo*, 962 F.3d at 840.

¹⁸⁴ *Id.* at 841.

¹⁸⁵ *Chevron, U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837 (1984).

¹⁸⁶ *USF Fed. Credit Union v. Gateway Radiology Consultants, P.A. (In re Gateway Radiology Consultants, P.A.)*, 983 F.3d 1239 (11th Cir. 2020) (citing *Animal Legal Def. Fund v. USDA*, 789 F.3d 1206, 1215 (11th Cir. 2015)).

¹⁸⁷ *Gateway*, 983 F.3d at 1261–62. *See also* *Friends of the Everglades v. S. Fla. Water Mgmt. Dist.*, 570 F.3d 1210, 1222–23 (11th Cir. 2009).

¹⁸⁸ *Id.* at 9–10.

¹⁸⁹ *Id.* at 40–41.

¹⁹⁰ *Id.* at 41.

¹⁹¹ *Id.* at 41–42, 44–46.