STETSON BUSINESS LAW REVIEW

Volume 1, No. 1 | Spring 2022

Articles

Catching a Negligence Case:
A Framework of Business Negligence Liability for COVID-19
Thomas Miller
Terrence Dwyer

To Give or Not to Give?
Examining Whether the Small Business Administration
has the Authority to Exclude Bankruptcy Debtors from
the Paycheck Protection Program
Nicolaos Soulellis

Narrowing the Road to Recovery:
A Proposal to Tighten the Reins on the
Doctrine of Piercing the Corporate Veil
Lauren Douglas

City of Chicago, Illinois v. Fulton:
Maintaining the Status Quo After the Tow
Robert T. Reeder

STETSON BUSINESS LAW REVIEW

VOLUME 1	SPRING 2022	ISSUE 1

INAUGURAL PUBLICATION
Articles

Catching a Negligence Case: A Framework of Business Negligence Liability for COVID-19 — Thomas Miller, Terrence Dwyer — 1

This article examines a business' potential liability for the negligent transmission of the novel coronavirus on its premises. This article concludes that courts will likely impose a duty on businesses not to unreasonably spread the novel coronavirus on their premises as well as a duty to follow government health regulations. However, this article concludes that plaintiffs will have difficulty proving factual causation and breach of duty given the omnipresence of the novel coronavirus. This article concludes by examining the potential damages a plaintiff may recover if they are able to prove breach of duty and factual causation.

To Give or Not to Give? Examining Whether the Small Business Administration has the Authority to Exclude Bankruptcy Debtors from the Paycheck Protection Program — Nicolaos Soulellis — 24

In this Article, the author explores the notable court split on the Small Business Administration's ("SBA") interim final rule that bankruptcy debtors are not eligible for the Paycheck Protection Program ("PPP"). The Article first focuses on the parameters of an administrative agency's rulemaking authority under the Administrative Procedure Act and the United States Bankruptcy Codes protections afforded to debtors. From there, the Author delves into the most notable cases on each side of the split to better illustrate the respective arguments being made. Finally, the Article considers whether the SBA had the authority, under both the Administrative Procedure Act and the United States Bankruptcy Codes, to exclude bankruptcy debtors from the PPP, and provides a potential solution for the prejudiced debtor.

Narrowing the Road to Recovery: A Proposal to Tighten the Reins on The Doctrine of Piercing the Corporate Veil — Lauren Douglas — 43

Limited liability is the touchstone of the corporate form and aims to protect individual and corporate investors in the name of societal growth and economic prosperity. However, corporate actors sometimes stretch limited liability beyond its intended form and exploit their limited liability status to conduct shady or illegitimate business practices in an effort to make a quick buck or avoid repaying corporate debts. In such instances, courts may invoke the doctrine of piercing the corporate veil to hold corporate actors liable for the debts of the enterprise. Unfortunately, the piercing doctrine is one of the most muddled and incalculable doctrines in corporate law and remains a topic of great unrest in legal scholarship.

This Article aims to add some structure to the unstable piercing doctrine by offering a seemingly new way to categorize victims of corporate wrongdoing. Specifically, this Article argues that the two preexisting categories of plaintiffs–"voluntary contract creditors" and "involuntary tort creditors"–are insufficient to allow courts to assign corporate liability adequately and fairly, and that, to resolve this insufficiency, courts should break down the traditional category of "contract creditors" into "ordinary creditors" and "sophisticated creditors." Such a change would further account for the ability of well-equipped entities to protect themselves from risk prior to forming a relationship with the corporation and would further safeguard the policy considerations that surround limited liability. This Article also offers an alternate, less convoluted route of recovery for sophisticated creditors that avoids invoking the piercing doctrine altogether.

City of Chicago, Illinois v. Fulton:
Maintaining the Status Quo After the Tow — Robert T. Reeder — 62

In response to the challenges of a global pandemic, the United States Supreme Court heard telephonic arguments throughout the October 2020 Term. Among the cases heard was *City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585 (2021), decided on January 14, 2021. In *Fulton*, the Supreme Court addressed a controversial circuit split by conclusively outlining the function of the automatic stay in bankruptcy cases, as set forth in 11 U.S.C. § 362. This Case Note addresses the background and development of *Fulton* and the relevance of the Supreme Court's holding in the context of bankruptcy practice. Specifically, *Fulton* established certain boundaries on judicially creative interpretations of 11 U.S.C. § 362, precluding any future court from entering an order requiring turnover of estate property based solely on the filing of a bankruptcy petition. Instead, the Supreme Court, in *Fulton*, directs courts to address these issues in a turnover proceeding under 11 U.S.C. § 542. This Case Note also addresses Justice Sotomayor's Concurrence, which concludes by calling upon Congress to address identified concerns and provide a resolution in the best interest of a debtor who needs immediate access to their vehicle to effectively reorganize.

STETSON BUSINESS LAW REVIEW

VOLUME 1 | SPRING 2022 | ISSUE 1

The Mission of Stetson University College of Law

Stetson University College of Law provides a dynamic and supportive scholarly community in which students learn, in and outside the classroom and by example, to become outstanding lawyers and leaders who serve the profession and society.

College of Law Faculty & Deans

Kristen David Adams, *Wm. Reece Smith, Jr. Distinguished Professor of Law and Director of Dispute Resolution*

Michèle Alexandre, *Dean and Professor of Law*

Linda Anderson, *Professor of Law*

Andrew Appleby, *Assistant Professor of Law*

Roy Balleste, *Assistant Professor of Law and Director of the Dolly & Homer Hand Law Library*

Mark D. Bauer, *Professor of Law*

Jason R. Bent, *Associate Dean for Academic Affairs and Professor of Law*

Elizabeth Berenguer, *Associate Professor of Law*

Elizabeth Ippolito Boals, *Assistant Professor of Law and Director, Center for Excellence in Advocacy*

Paul Boudreaux, *Professor of Law*

Brooke J. Bowman, *Professor of Law; Director of Finances, Advocacy Boards; and Director, Moot Court Board*

Catherine J. Cameron, *Professor of Law*

Christine E. Cerniglia, *Associate Professor of Law and Director of Clinical and Experiential Education*

Grant Christensen, *Assistant Professor of Law*

Kirsten K. Davis, *Professor of Law and Director of the Institute for Advancement of Legal Communication, Director of Online Legal Education Strategies and Director, Stetson Law Honors Program*

Kelly M. Feeley, *Professor of Law*

Michael S. Finch, *Professor of Law*

Roberta K. Flowers, *Professor of Law and Director, Center for Excellence in Elder Law*

James W. Fox Jr., *Professor of Law*

Royal C. Gardner, *Professor of Law and Director, Institute for Biodiversity Law and Policy*

James Hart, *Visiting Professor of Law*

Cynthia G. Hawkins, *Professor of Law*

Alicia Jackson, *Assistant Professor of Law and Director of Academic Success and Bar Preparation*

Marco J. Jimenez, *Professor of Law*

Timothy S. Kaye, *Professor of Law*

Peter F. Lake, *Professor of Law, Charles A. Dana Chair and Director, Center for Excellence in Higher Education Law and Policy*

Lance N. Long, *Professor of Law and Coordinator of Legal Research and Writing*

Rebecca C. Morgan, *Professor of Law, Boston Asset Management Chair in Elder Law and Director, M.J. in Healthcare Compliance*

Joseph F. Morrissey, *Professor of Law and Leroy Highbaugh Sr. Research Chair*

Anne E. Mullins, *Professor of Law*

Luz Estella Nagle, *Professor of Law*

Erin Okuno, *Visiting Professor of Law*

Jason Palmer, *Professor of Law*

Ann M. Piccard, *Professor of Law*

Ellen S. Podgor, *Gary R. Trombley Family White-Collar Crime Research Professor*

Robyn Powell, *Bruce R. Jacob Visiting Assistant Professor*

Theresa J. Pulley Radwan, *Transitional Business Administrator and Professor of Law*

Susan D. Rozelle, *Professor of Law*

Judith A.M. Scully, *Professor of Law*

James A. Sheehan, *Distinguished Practitioner in Residence*

Stacey-Rae Simcox, *Professor of Law, Director, Veterans Law Institute, and Director, Veterans Advocacy Clinic*

Tomer Stein, *Bruce R. Jacob Visiting Assistant Professor of Law*

Mary Strubbe, *Visiting Professor of Law*

Charles J. Tabb, *Distinguished Visiting Lecturer*

Ciara Torres-Spelliscy, *Professor of Law*

Stephanie A. Vaughan, *Professor of Law*

Louis J. Virelli III, *Professor of Law*

Darryl C. Wilson, *Associate Dean for Faculty and Strategic Initiatives, Attorneys' Title Fund Professor of Law and Director, Institute of Caribbean Law and Policy*

Karen Woody, *Visiting Professor of Law*

Candace Zierdt, *Professor of Law*

Full-text versions of the Stetson Business Law Review are available online at https://www.stetson.edu/law/business-law-review/

The Stetson Business Law Review is printed up to two times per year by Sheridan PA and is mailed from Hanover, Pennsylvania. Annual subscriptions and individual copies are available by request at buslawreview@law.stetson.edu.

Please inform the Stetson Business Law Review promptly of any address change by sending the new address and a mailing label with the former address. Unless a claim is made for nonreceipt of a Stetson Business Law Review issue within six months of the mailing date, Stetson Business Law Review nor Stetson University College of Law are not responsible for supplying the issues without charge.

The Stetson Business Law Review will process subscription requests via email: busIawreview@law.stetson.edu. Any other business communications may be addressed to Editor in Chief via e-mail: busIawreview@law.stetson.edu.

The Executive Board welcomes the submission of articles of substantial legal merit. Authors seeking publication in the Stetson Business Law Review should submit manuscripts with footnotes originating in a MS Word document. Authors may submit manuscripts either electronically on Scholastica (preferred) or to buslawreview@law.stetson.edu. Footnotes should follow the most recent version The Bluebook: A Uniform System of Citation, published by the Harvard Law Review Association. The Stetson Business Law Review will conform all manuscripts selected for publication to The Redbook: A Manual on Legal Style, published by West.

The Stetson Business Law Review assumes no responsibility for the return of manuscripts. Although the Stetson Business Law Review generally grants great deference to an author's work, the Review retains the right to determine the final published form of every article. As a matter of policy, the Stetson Business Law Review encourages the use of gender- and race-neutral language. Student works generally appear in alphabetical order according to last name.

Catching a Negligence Case: A Framework of Business Negligence Liability for COVID-19

By: Thomas Miller* & Terrence Dwyer**

COVID-19, the disease caused by the novel coronavirus, has become the most prominent health issue facing this country. The disease has led to an economic recession, [1] almost 500 million infections worldwide, and almost eighty million infections in the United States alone.[2] COVID-19 has impacted nearly every aspect of American life, and litigation will be no exception. In fact, barely a month after the disease's first documented appearance in the United States, litigation related to the spread of the novel coronavirus had already begun.[3]

This Article will address the degree to which businesses will be liable for negligence due to the spread of the coronavirus to its customers. It will also analyze circumstances where the spread of coronavirus may result in liability for the tort of negligence.[4] Further, it will examine the extent to which businesses owe a duty to their customers and how businesses might breach that duty. The Article will also address issues related to proving causation, which could be exceedingly difficult given the prevalence of the coronavirus and the ease with which it spreads. Finally, the Article will address potential damage awards plaintiffs may receive if they

---

* Thomas Miller, Assistant Professor, Division of Justice & Law Administration, Western Connecticut State University. B.A. Western Connecticut State University; J.D. Regent University School of Law.

** Terrence P. Dwyer, Professor, Division of Justice & Law Administration, Western Connecticut State University. B.A. Fordham University; J.D. Pace University School of Law.

1. Ceri Parker, *World Vs Virus Podcast: An economist explains what COVID-19 has done to the global economy*, WORLD ECONOMIC FORUM (Sep. 25, 2020), https://www.weforum.org/agenda/2020/09/an-economist-explains-what-covid-19-has-done-to-the-global-economy/?msclkid=7d45cd76a7bf11ec8683c3c23383a0a1.

2. *WHO Coronavirus (COVID-19) Dashboard*, WORLD HEALTH ORGANIZATION, https://covid19.who.int/ (last visited Apr. 10, 2022).

3. Greg Allen, *Even With COVID-19 Cases, Suing Cruise Lines Is Extraordinarily Difficult*, NPR (Apr. 22, 2020, 8:00 AM), https://www.npr.org/sections/coronavirus-live-updates/2020/04/22/840525310/even-with-covid-19-cases-suing-cruise-lines-is-extraordinarily-difficult.

4. The classic elements of negligence are duty, breach of duty, causation, and damages. 57A AM. JUR. 2d *Negligence* § 71 (2022).

can prove they became infected with the novel coronavirus on a business' premises.

I. POSSIBLE NEGLIGENCE DUTIES BUSINESS OWNERS MAY OWE TO THEIR CUSTOMERS

The first element of negligence is duty.[5] This element makes negligence a flexible tort that can provide plaintiffs with relief in almost any situation. At a base level, every person owes every other person a duty to behave reasonably under the circumstances.[6] What this means varies greatly based on the circumstances.[7] In some cases, the duty a person owes may be quite high. For example, when giving legal advice, attorneys have a duty to provide advice that a reasonably competent attorney would give, which should be much better advice than a reasonable layperson would give.[8] Conversely, the duty a person owes another person could be comparatively low. For example, children are usually held to only owe the duty to act as a child of similar age, intelligence, and experience would.[9] What the average twelve-year-old may do is certainly different than what a typical adult would do.

The varying duties that may be owed warrants a thorough examination of the potential duties a business owner might owe his or her customers. In addition to the general duty to prevent the spread of an infectious disease, business owners may run into more specific duties, especially ones resulting from premises liability and negligence per se.

---

5. *Id.* at § 73.
6. *Id.* at § 75.
7. *Id.* at § 138 ("'Due care' is a relative term and much depends upon the facts of the particular case . . . Accordingly, while the rule that requires ordinary care prevails at all times, ordinary care may be a high degree of care under some circumstances but a slight degree of care under other circumstances. Thus, what may be deemed ordinary care in one case may, under different surroundings and circumstances, be negligence.").
8. *See, e.g.*, Dawson v. Toledano, 109 Cal. App. 4th 387, 389 (Cal. Ct. App. 2003) (laying out the elements for a malpractice claim against an attorney).
9. RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR PHYSICAL AND EMOTIONAL HARM § 10 (2010).

A. The General Duty Not to Spread Infectious Disease

Courts have long held that people have a duty to not unreasonably spread communicable diseases to others.[10] As the Pennsylvania Supreme Court stated, "[t]o be stricken with disease through another's negligence is in legal contemplation as it often is in the seriousness of consequences, no different from being struck with an automobile through another's negligence."[11] Courts have held parties responsible for the negligent spread of a significant number of diseases, including valley fever,[12] whooping cough,[13] salmonella,[14] tuberculosis,[15] smallpox,[16] diphtheria,[17] and typhoid.[18] Unless legislative acts intervene,[19] there is no reason to believe that the spread of the novel coronavirus will be treated differently than any other disease when it comes to negligence law.

When departing from specific common law or statutory duty rules, courts usually consider a series of factors.[20] Although the details of the lists vary from state to state, many of the same factors appear in each state.[21] When applied, these factors typically ask whether the defendant had a duty to act in a particular way in a certain situation.[22]

The most commonly used list was laid out by the California Supreme Court in *Rowland v. Christian*, which included the following factors: (1) whether harm is foreseeable to the plaintiff;

---

10. Berner v. Caldwell, 543 So. 2d 686, 688 (Ala. 1989) (overruled on other grounds) ("For over a century, liability has been imposed on individuals who have transmitted communicable diseases that have harmed others.").

11. Billo v. Allegheny Steel Co., 328 Pa. 97, 105 (Pa. 1937).

12. Crim v. International Harvester Co., 646 F.2d 161, 162–63 (5th Cir. 1981).

13. Smith v. Baker, 20 F. 709, 709–10 (C.C.S.D.N.Y. 1884).

14. Capelouto v. Kaiser Found. Hosp., 7 Cal. 3d 899, 891 (Cal. 1972).

15. Hofmann v. Blackmon, 241 So. 2d 752, 753 (Fla. 4th DCA 1970); Earle v. Kuklo, 98 A.2d 107, 109 (N.J. Super. Ct. App. Div. 1953).

16. Minor v. Sharon, 112 Mass. 477, 487 (Mass. 1873); Franklin v. Butcher, 129 S.W. 428, 430 (Mo. Ct. App. 1910); Jones v. Stanko, 160 N.E. 456, 457–58 (Ohio 1928).

17. Hewett v. Woman's Hospital Aid Ass'n, 64 A. 190, 193–94 (N.H. 1906).

18. Kliegel v. Aitken, 69 N.W. 67, 68 (Wis. 1896).

19. A handful of states have passed laws limiting a business' liability for the spread of the novel coronavirus, and Congress may pass a similar law nationally. Chris Marr, *Covid-19 Shield Laws Proliferate Even as Liability Suits Do Not*, BLOOMBERG LAW (June 8, 2021, 5:31AM), https://news.bloomberglaw.com/daily-labor-report/covid-19-shield-laws-proliferate-even-as-liability-suits-do-not.

20. *See* W. Jonathan Cardi, *The Hidden Legacy of Palsgraf: Modern Duty Law in Microcosm*, 91 B.U.L. REV. 1873, 1878 (2011).

21. *Id.* at 1878–79.

22. *Id.* at 1896–97.

(2) the degree to which it is certain harm will come to the plaintiff; (3) the closeness of the connection between the defendant's injury and the plaintiff's conduct; (4) the defendant's moral blameworthiness; (5) the likelihood liability would prevent future harm; (6) the burden placed on the defendant and the community; and (7) the insurability of defendant's conduct.[23] This list is far from exhaustive. At least thirty states have added factors to California's test, and, between the fifty states, at least twenty-two distinct factors are considered.[24]

Courts are not likely to engage in this kind of in-depth analysis given the fact that, as discussed above, courts have long held there is a duty not to spread communicable diseases.[25] However, a brief discussion of these factors as they relate to the spread of the novel coronavirus demonstrates that courts will not likely depart from the traditional duty rules regarding infectious diseases.

i. Whether Harm is Foreseeable to the Plaintiff

Foreseeability is arguably the most crucial factor upon which courts rely. However, courts disagree on the meaning of this factor. Most courts describe foreseeability as whether the type of harm suffered by the plaintiff was reasonably foreseeable or specifically foreseeable to the plaintiff.[26] There is little question that harm from contracting COVID-19 is foreseeable to the plaintiff. Although many people infected with the novel coronavirus are asymptomatic, the disease has killed almost one million people in the United States alone.[27] Further, thousands of others have suffered long hospital stays and horrific body aches, fevers, delirium, and an inability to breathe.[28]

In determining the foreseeability of harm, courts have also considered whether the defendant should have had knowledge of the danger.[29] Unless a business owner has been living under an

23. 443 P.2d 561, 564 (Cal. 1968) (rev'd on other grounds).
24. *See* Cardi, *supra* note 20, at 1878–79.
25. *See, e.g.*, *supra* text accompanying notes 12–18.
26. *See* Cardi, *supra* note 20, at 1884–85.
27. *Supra* note 2.
28. Ed Yong, *COVID-19 Can Last for Several Months*, THE ATLANTIC (June 4, 2020), https://www.theatlantic.com/health/archive/2020/06/covid-19-coronavirus-longterm-symptoms-months/612679/?msclkid=6f0922c5a7bb11eca675163ab6ee1047.
29. *See* 57A AM. JUR. 2d *Negligence* § 148 (2022).

unfathomably large rock, it is highly unlikely that they are unaware of the ease with which the novel coronavirus is spread. If a court also looks at whether the risk itself was foreseeable (and not just the harm), the question may become slightly closer, but probably not by much. The novel coronavirus has become omnipresent in American society and is spread in the air whenever a person coughs, sneezes, or speaks.[30] Thus, the risk of spread is obvious.

Foreseeability could be affected by a variety of elements, including the local prevalence of the disease at the time of the alleged infection and whether the business owner had reason to know an employee or customer was infected with the disease. Absent this, and given the considerable number of asymptomatic cases, it is hard to imagine a scenario where a patron potentially spreading the disease is not foreseeable.

ii. The Degree to Which Harm is Certain to the Plaintiff

The degree to which harm is certain to a plaintiff will vary based on activities engaged in by the business owner and the employee, as well as local conditions. The more precautions a business takes, including precautions that go beyond local government regulation, the less certain harm becomes. In addition, an employer that requires customers and employees to wash their hands, wear masks, and socially distance whenever possible decreases the likelihood of harm. For example, in Missouri, two mildly symptomatic hairdressers interacted closely with 139 clients while wearing a cloth mask and did not infect any clients with coronavirus.[31]

30. *Frequently Asked Questions*, CENTERS FOR DISEASE CONTROL AND PREVENTION, https://www.cdc.gov/coronavirus/2019-ncov/faq.html#Spread (last visited Apr. 9, 2020).

31. M. Joshua Hendrix et al., *Absence of Apparent Transmission of SARS-CoV-2 from Two Stylists After Exposure at a Hair Salon with a Universal Face Covering Policy — Springfield, Missouri, May 2020*, CENTERS FOR DISEASE CONTROL AND PREVENTION (July 14, 2020), https://www.cdc.gov/mmwr/volumes/69/wr/mm6928e2.htm.

iii. The Closeness of the Connection Between the Defendant's Injury and the Plaintiff's Conduct

A plaintiff's injuries from contracting COVID-19 can vary significantly. There is a broad spectrum of symptoms between asymptomatic and mortality. Symptoms of COVID-19 include body aches, fevers, delirium, nausea, diarrhea, loss of taste, loss of smell, and an inability to breathe.[32] Further, patients with common underlying conditions like obesity, diabetes, cancer, chronic kidney disease, chronic obstructive pulmonary disease, and asthma are at risk for having more severe COVID-19 symptoms.[33]

These underlying conditions can make the true causes of the plaintiff's symptoms unclear. However, the coronavirus has become so common that it is evident that, if a plaintiff has contracted COVID-19, there is likely a close relationship between the plaintiff's injuries and the disease itself, as most of these symptoms would not have been caused, or at least would not have reached their significant extent, but for the plaintiff contracting COVID-19.[34]

iv. The Defendant's Moral Blameworthiness

A defendant's moral blameworthiness will vary based upon the situation. On the one hand, most people would agree that business owners are valuable to the economy and have a right to make a living. On the other hand, as the old saying goes, "[y]our right to swing your arms ends just where the other man's nose begins."[35] This means that one's legal right to engage in business activities does not include the right to injure others.

---

32. *Symptoms of Coronavirus*, CENTERS FOR DISEASE CONTROL AND PREVENTION, https://www.cdc.gov/coronavirus/2019-ncov/symptoms-testing/symptoms.html (last visited Mar. 19, 2022).

33. *People with Certain Medical Conditions*, CENTERS FOR DISEASE CONTROL AND PREVENTION, https://www.cdc.gov/coronavirus/2019-ncov/need-extra-precautions/people-with-medical-conditions.html (last updated Feb. 25, 2022).

34. *Supra* note 30.

35. This quote has been attributed to both Abraham Lincoln and Chief Justice Oliver Wendell Holmes without support and likely comes from a 1919 Harvard Law Review article. *See* John William Draper, *Preserving Life by Ranking Rights*, 82 ALB. L. REV. 157, n. 420 (2018) (citing Zechariah Chafee, Jr., Freedom of Speech in War Time, 32 HARV. L. REV. 932, 957 (1919)).

To assess moral blameworthiness, courts have looked to whether there were steps the defendant could have taken to avoid the injury and whether the defendant was more powerful and sophisticated than the plaintiff.[36] However, courts have noted that "the moral blame that attends ordinary negligence is generally not sufficient to tip the balance . . . in favor of liability."[37] For example, it is more likely that the moral blame sufficient to trigger a duty would attach if the defendant knew or should have known that an employee had tested positive for COVID-19.[38] Moreover, given that the novel coronavirus is extremely contagious and has deeply interrupted American society, juries may well impute knowledge on behalf of business owners.

v. The Likelihood Liability Would Prevent Future Harm

Assessing liability against a party likely decreases future harm from the coronavirus. People are less inclined to do something if there is a cost attached to it, especially profit-minded business owners. Though the novel coronavirus is so contagious that even the most reasonable precautions are not guaranteed to prevent all transmissions, the emerging scientific consensus has demonstrated that individuals can take reasonable steps to prevent its spread.[39] These precautions include wearing face masks, frequently washing ones hands, staying six feet away from others, and frequently cleaning touched surfaces.[40] Businesses can also reduce future harm by limiting both the number of customers allowed in a single space and in-person contact with employees.[41] There is little doubt that businesses can prevent future harm taking these precautions.

---

36. *See, e.g.*, Vasilenko v. Grace Family Church, 3 Cal. 5th 1077, 1091 (Cal. 2017).

37. Day v. Lupo Vine Street L.P., 22 Cal. App. 5th 62, 75, 231 (Cal. App. 2d Dist. Apr. 11, 2018).

38. *See* Butcher v. Gay, 29 Cal. App. 4th 388, 403 (Cal. Ct. App. 1994) (considering whether Defendant knew or should have known about the spread of Lyme disease on his property in determining whether Defendant was morally blameworthy).

39. *How to Protect Yourself and Others*, CENTERS FOR DISEASE CONTROL AND PREVENTION, https://www.cdc.gov/coronavirus/2019-ncov/prevent-getting-sick/prevention.html (last visited July 31, 2020).

40. *Id.*

41. *Id.*

vi. The Burden Placed on the Defendant Compared to the Consequences to the Community

There is no question that COVID-19 has significantly burdened businesses.[42] The U.S. economy gross domestic product contracted an annual rate of 32.9% in the second quarter of 2020, which was largely due to the coronavirus.[43] Although there was some growth in the fourth quarter of 2020, the U.S. economy still shrank overall for the year.[44] The more businesses are required to do to prevent COVID-19, the less profitable they become in the short term. Reductions in customer capacity are especially likely to burden businesses. However, many measures, such as mask mandates, temperature checks, and frequent cleaning of surfaces with disinfectants are far less costly than the profit loss businesses will incur by employing these additional preventive measures.

Further, over 900,000 people have been killed by COVID-19 in the United States, and countless more have been hospitalized.[45] In several communities, hospitals have been pushed to the brink of capacity. For example, Miami-Dade intensive care units were at 146% of their designed capacity in July 2020,[46] and hospitals in Texas were forced to send patients as far as 120 miles away to receive care because their facilities were full.[47] Additionally, hospitals in Los Angeles County in January 2021 were operating at as high as 320% of their designed capacity.[48]

While there are certainly public health consequences to economic contraction, the burden of increased COVID-19 spread in

---

42. Harriet Torry, *U.S. Economy Contracted at Record Rate Last Quarter; Jobless Claims Rise to 1.43 Million*, WALL STREET JOURNAL (July 30, 2020), https://www.wsj.com/articles/us-economy-gdp-report-second-quarter-coronavirus-11596061406.

43. *Id.*

44. *Id.*

45. *Supra* note 2.

46. Alexander Nazaryan, *Miami-Dade ICUs at 146% capacity with coronavirus patients, according to federal document*, YAHOO NEWS (July 30, 2020), https://news.yahoo.com/miami-dade-ic-us-at-146-percent-capacity-with-coronavirus-patients-151222876.html.

47. Edgar Walters et al., *Texas Hospitals Are Running Out of Drugs, Beds, Ventilators and Even Staff*, TEXAS TRIBUNE (July 14, 2020), https://www.texastribune.org/2020/07/14/texas-hospitals-coronavirus/.

48. Hayley Smith et al., *One L.A. County hospital ICU is operating at triple its capacity amid COVID-19 surge*, LOS ANGELES TIMES (Jan. 13, 2021), https://www.latimes.com/california/story/2021-01-13/covid-19-surge-pushes-la-hospital-320-percent-occupancy.

the community is greater than the one placed on individual businesses. Businesses will also benefit in the long run by taking measures to control the spread of the novel coronavirus. The faster the virus is controlled, the safer it will be for customers to return to businesses at pre-pandemic levels of capacity.

vii. Insurability of Defendant's Conduct

Business owners usually carry premises liability insurance to protect themselves in case a customer is injured on the premises. However, in the years leading up to the pandemic, insurance companies began significantly limiting disease coverage in their premises liability policies.[49] There is no reason to believe insurance companies will broaden the number of diseases that they insure in the middle of a pandemic.[50] This means many businesses are not, and may not be able to be, insured against the risk of the spread of the novel coronavirus on their premises, especially if significant liability is imposed.[51] Nevertheless, courts have determined that, despite the potential lack of insurance, businesses may still have a duty to not allow transmission of diseases.[52] For example, in *Kesner v. Superior Court*, the California Supreme Court held that a business had a duty to prevent the transmission of asbestos-related diseases even though imposing such liability may increase the cost of insurance or make it unavailable entirely.[53]

viii. Courts Are Unlikely to Deviate from the Rule that Businesses Owe a General Duty Not to Unreasonably Transmit Infectious Disease

Based on the factors discussed above, courts are unlikely to deviate from the rule establishing a general duty to not unreasonably transmit an infectious disease. In certain cases, the costs to take reasonable actions to prevent the spread of COVID-19 could be significant, such as limiting customer capacity. However, many actions such as mask mandates, temperature

49. David F. Klein, *Insuring Against the Business Risks of Coronavirus*, PILLSBURY LAW, https://www.pillsburylaw.com/en/news-and-insights/insuring-against-the-business-risks-of-coronavirus.html (last visited July 31, 2020).
50. *Id.*
51. *Id.*
52. *See* Kesner v. Superior Court, 1 Cal. 5th 1132, 1153 (Cal. 2016).
53. *Id.* at 1156.

checks, and frequent cleaning are not as costly. There are also significant community consequences from the spread of the novel coronavirus that range well beyond even the deaths of more than 900,000 Americans. The harms from coronavirus are also easily foreseeable. Without statutory intervention, there is little that separates the coronavirus from other viruses with regards to negligence liability.

B. Premises Liability Duties

In all fifty states, businesses owe customers on their premises the duty to protect them from dangerous conditions that may injure them.[54] This is known as "premises liability."[55] Although some states recognize premises liability as a separate cause of action from negligence, most courts consider it an extension of specialized duties under negligence law.[56] There are two distinct approaches to premises liability law that are used by courts in the United States. The first, and most common, is the common law approach.[57] The second approach is sometimes called the "modern" approach.[58]

i. Common Law Approach

Under the common law approach to premises liability, the duties owed by the defendant to the plaintiff depend on the status of the plaintiff.[59] Plaintiffs are classified into three broad groups: trespassers, invitees, and licensees.[60]

Trespassers are those who enter the premises without authorization or other right.[61] Business owners only owe the duty not to engage in willful or wanton conduct toward trespassers.[62] This is a high bar that is unlikely to lead to a recovery for the plaintiff.

54. 62 AM. JUR. 2D *Premises Liability* § 1 (2022).
55. *Id.*
56. *Id.*
57. *Id.* at § 70.
58. *Id.* at § 73.
59. *Id.* at § 70.
60. *Id.* at § 70.
61. *Id.* at § 119.
62. *Id.* at § 203.

Invitees are people who enter the premises at the invitation of the owner for the owner's benefit.[63] Importantly, this group includes a business' customers and employees.[64] Businesses owe invitees the highest duties under common law: the duty to use ordinary care to keep the premises in a safe condition.[65] Business owners must also warn invitees about dangerous conditions on the property about which the business owner should be aware of.[66] Since customers are considered invitees, business owners should be most concerned with this category relating to the potential transmission of COVID-19.

Licensees are a catchall category and encompass everything in between trespasser and invitee.[67] The licensee status usually includes people who enter the premises for their own purposes rather than for the benefit of the owner.[68] For example, in *French v. Sunburst Properties, Inc.*, the Indiana Court of Appeals held that a man injured while visiting an apartment complex in search of his dog was a licensee.[69] Businesses owe licensees similar duties to trespassers in traditional common law states. Business owners owe the duty not to engage in willful or wanton misconduct but have no duty to make the premises safe.[70] Business owners also owe licensees a duty to warn them of unsafe conditions they have no reason to be aware of.[71]

ii. The Modern Approach

Under the modern approach to premises liability, there is no distinction between trespassers, licensees, and invitees.[72] Instead, the same standard applies to everyone on the premises.[73] That standard is "reasonable care under the circumstances," which is the same standard used in general negligence cases.[74]

63. *Id.* at § 83.
64. *See, e.g.*, Nivens v. 7-11 Hoagy's Corner, 943 P.2d 286, 291 (Wash. 1997) (noting that customers were invitees of a business at Common Law).
65. *Id.*
66. *Id.*
67. *Id.* at § 109.
68. *Id.*
69. 521 N.E.2d 1355 (Ind. Ct. App. 1988).
70. 62 AM. JUR. 2D *Premises Liability* § 184 (2022).
71. *Id.* at § 192.
72. *Id.* at § 73.
73. *Id.*
74. *Id.* at § 73.

In states that follow the modern approach, the foreseeability of the injury becomes a key factor in determining whether the business owner is liable for injuries upon their premises.[75] Business owners in these states are not likely to be treated much differently than those in common law jurisdictions.[76] The standard for invitees under common law is essentially the same as the modern approach standard for all people on the premises.[77] Invitees include customers and employees, individuals most likely to be on a business' premises.[78]

iii. Possibility of a Premises Liability Case

Though a premises liability claim is theoretically possible, general negligence claims are more commonly brought, as the claims are redundant to one another. Courts have, however, allowed cases to proceed under this theory. For example, in *Tynes v. Buccaneers Ltd. P'shp*, the Middle District of Florida allowed an NFL player's premises liability claim to proceed against the Tampa Bay Buccaneers on the theory that the team did not adequately protect him against the spread of methicillin-resistant staphylococcus aureus (MRSA).[79] As an employee of the team, the plaintiff was considered an invitee.[80] The presence of the novel coronavirus is a dangerous condition for premises liability law.

C. Negligence Per Se

The category of duty that businesses should be most concerned about is negligence per se. Under the doctrine of negligence per se, plaintiffs can use a statute, ordinance, or regulation to serve as the basis for a duty.[81]

Under the Restatement (Second) of Torts approach to negligence per se, a statute, regulation, or ordinance will become the duty the plaintiff owes the defendant when the statute, ordinance, or regulation is designed:

---

75. *Id.* at § 79.
76. *Id.*
77. *Id.* at § 73.
78. *Nivens*, 943 P.2d at 291.
79. F. Supp. 3d 1351, 1354 (M.D. Fla. 2015).
80. *Id.* at 1356.
81. 57A AM. JUR. 2D *Negligence* § 685 (2022).

(a) to protect a class of persons which includes the one whose interest is invaded, and

(b) to protect the particular interest which is invaded, and

(c) to protect that interest against the kind of harm which has resulted, and

(d) to protect that interest against the particular hazard from which the harm results.[82]

There has been extensive regulation on what businesses can and cannot do by regulators at the state and local level due to the novel coronavirus.[83] Because of this extensive and often specific regulation, business owners have more to worry about. It will be relatively easy for plaintiffs' lawyers to discover whether businesses have been following regulations. Pre-trial investigation, disclosure, and subsequent deposition testimony should yield whether mask mandates, cleaning requirements, and capacity restrictions were followed.

Failing to follow government regulations will likely lead to liability if the novel coronavirus is transmitted on a business owner's premises. The government designed these regulations to prevent the spread of coronavirus to everyone, so it is hard to imagine a person who these regulations are not meant to protect.

Moving back to the Restatement approach, the interest invaded, and the harm and hazards incurred when a plaintiff is infected with the novel coronavirus is a person's interest in not having the coronavirus. Someone contracting the novel coronavirus is the very thing government regulations are attempting to prevent. In *Diretto v. Country Inn & Suites by Carlson*, the Eastern District of Virginia denied a defendant hotel's motion to dismiss a plaintiff customer's negligence per se claim.[84] In that case, the plaintiff (the customer's estate) alleged that the customer contracted legionnaires' disease and died as a result of

82. RESTATEMENT (SECOND), TORTS § 286 (AM. L. INST. 1965).

83. *Guidance for Businesses and Employers Responding to Coronavirus Disease 2019 (COVID-19)*, CENTERS FOR DISEASE CONTROL AND PREVENTION (Mar. 8, 2021), https://www.cdc.gov/coronavirus/2019-ncov/community/guidance-business-response.html.

84. No. 1:16cv1037(JCC/IDD), 2017 U.S. Dist. LEXIS 15043, at *10–12 (E.D. Va. Feb. 2, 2017).

the hotel failing to comply with Virginia's administrative regulations about water supply facilities.[85]

Similarly, in *Casas v. Laquinta Holdings, Inc.*, the Western District of Tennessee denied defendant hotel's motions to dismiss several of plaintiffs' complaints regarding the negligent transmission of Legionnaires' disease, including one plaintiff's negligence per se claim.[86] As with Legionnaires' disease, COVID-19 can cause coughing, shortness of breath, fever, muscle aches, headaches, and death.[87]

II. BREACH

Assuming a diligent plaintiff's counsel can prove a business owner had a duty to prevent the spread of a communicable disease to customers and employees, the next hurdle is proving the business owner breached that duty. Overcoming this hurdle rests on plaintiff's counsel proving a causal connection between the duty owed and the alleged resulting harm. The novel coronavirus is unlike other communicable diseases, such as HIV and herpes, wherein plaintiffs have been successful in establishing a breach of the duty of care owed by a defendant to the plaintiff. In cases involving HIV and herpes, there is generally little mystery in attributing the source of transmission.[88] There have been an abundance of successful claims made nationwide for negligent transmission of HIV and herpes[89], in addition to claims based on intentional infliction of emotional distress and claims of fraud in the transmission between unmarried individuals.[90]

---

85. *Id.*

86. No. 2: 16-cv-2951-JTF-dkv, 2018 U.S. Dist. LEXIS 222089, at *9–13 (W.D. Tenn. Sept. 26, 2018).

87. *Legionella (Legionnaires' Disease and Pontiac Fever)*, CENTERS FOR DISEASE CONTROL AND PREVENTION, https://www.cdc.gov/legionella/about/signs-symptoms.html (last visited Apr. 10, 2022).

88. *Sexually Transmitted Diseases, Diseases & Related Conditions*, CENTERS FOR DISEASE CONTROL AND PREVENTION, https://www.cdc.gov/std/general/default.htm (last visited Apr. 10, 2022).

89. *See, e.g.*, Behr v. Redmond, 123 Cal. Rptr. 3d 97 (Cal. App. 4th Dist. 2011); Doe v. Dilling, 888 N.E.2d 24 (2008); Ray v. Wisdom, 166 S.W.3d 592 (Mo. App. E. Dist., 2005); Meany v. Meany, 639 So. 2d 229 (La. 1994); *see also* Deana A. Pollard, *Sex Torts*, 91 MINN. L. REV. 769 (2007); Louis A. Alexander, *Liability in Tort for the Sexual Transmission of Disease: Genital Herpes and the Law*, 70 CORNELL L. REV. 101 (Nov. 1984)

90. Claims between married couples for infection stemming from extramarital affairs have also been successful based on a theory of negligent transmission and battery. *See, e.g.*, Lori C. v. David C., 2012 Dolan Media Jury Verdicts, June 14, 2012, LEXIS 26312 (resulting in a $215,000 award after trial for the plaintiff wife).

Case precedent in the United States has held that infection from a communicable disease by another can lead to liability.[91] Of course, liability hinges on the ability to prove a defendant breached a duty of care owed to the plaintiff.[92] Breach in the HIV and herpes cases has been premised upon a defendant's knowledge of their infection and the risk inherent in their exposing others to the illness through sexual contact.[93] Knowledge comes from either testing positive for, or experiencing any of, the symptoms of either HIV or herpes.[94] Imputing knowledge, the legal requirement of scienter, to a potential defendant in a case of negligent transmission of COVID-19 would rely on the same basis: a positive test or signs of the well-documented symptoms of the coronavirus, which therefore places the potential defendant in breach for failure to avoid other individuals.[95]

The extent of a potential defendant's knowledge may vary across jurisdictions.[96] Actual notice is clearly present when an individual is diagnosed with a particular communicable disease and is thereby placed on notice of their infection and the inherent risk in its spread to others.[97] However, there can be constructive notice when an infected individual "consciously avoid[s] knowledge of infection even when suffering visible symptoms of a disease."[98] Some courts have eased this standard even further by applying a "reason to know" test.[99] In a case involving the negligent transmission of HIV, a California court imputed knowledge under the standard that an infected person "has information from which a person of reasonable intelligence . . . would infer that the fact in question exists."[100] The issue of a defendant's constructive notice

91. *See, e.g.*, Earle v. Kuklo, 98 A.2d 107 (N.J. Super. Ct. App. Div. 1953) (tuberculosis); Skillings v. Allen, 173 N.W. 663 (Minn. 1919) (scarlet fever).

92. *Earle*, 98 A.2d. at 109.

93. Endres v. Endres, 968 A.2d 336, 338 (Vt. 2008).

94. *Id.* at 339.

95. *See, e.g.*, Deuschle v. Jobe, 30 S.W.3d 215, 219 (Mo. Ct. App. 2000); Hendricks v. Butcher, 129 S.W. 431, 432 (Mo. Ct. App. 1910); Meany v. Meany, 639 So. 2d 229, 235–36 (La. 1994); M.M.D. v. B.L.G., 467 N.W.2d 645, 647 (Minn. Ct. App. 1991).

96. *Id.* at 342.

97. *Endres*, 968 A.2d at 342.

98. *Id.* at 341.

99. *See* John B. v. Superior Court, 137 P.3d. 153, 161 (Cal. 2006) (quoting RESTATEMENT (SECOND) OF TORTS §12, subd. (1) (1965)).

100. *Id.*

of infection is ultimately one to be left for the jury in a negligent transmission case.[101]

The relative ease in the spread of COVID-19 makes it all but certain that an infected person will transmit the disease to others. No better example is the national fool's parade of COVID-19 parties and the resulting infection rate of attendees witnessed throughout 2020.[102] A more tragic outcome occurred in San Antonio, Texas where a thirty-year-old man attended a COVID-19 party believing the disease was a hoax and subsequently died in a hospital from the virus.[103] Stories like this continued in the national media during the second half of the year, and one study found partisan differences in health outcomes relating to physical distancing.[104]

The difficulty linked to the contagion's spread is tracing the infection locus. Aside from COVID-19 parties, the ability of the coronavirus to spread airborne over a wide range and to last in aerosol form for three hours while airborne complicates tracing.[105] However, the unique aspects of the novel coronavirus and the potential difficulty in tracing an infection locus do not necessarily forestall inventive plaintiffs' counsel from initiating a claim. Contagion clusters, or "hot spots," can be useful in tracing infection if a plaintiff has been at the location or in contact with someone who has been there.[106] Additionally, federal, and individual state health agency contact tracing can be of assistance.[107] Unfortunately, a contagion contact point may be hard to determine.

101. William S. Donnell, *You Wouldn't Give Me Anything, Would You? Tort Liability for Genital Herpes*, 20 CAL. WEST. L. REV. 60, 70 (2016).

102. Karin Brulliard, *At Dinner Parties and Game Nights, Casual American Life is Fueling the Coronavirus Surge as Daily Cases Exceed 150,000*, THE WASHINGTON POST (Nov. 12, 2020), https://www.washingtonpost.com/ health/2020/11/12/covid-social-gatherings/.

103. Robert Glutter, M.D., *Here's Why You Shouldn't Go to A 'Covid Party'*, FORBES (July 12, 2020, 7:48 PM), https://www.forbes.com/sites/robertglatter/2020/07/12/covid-parties-should-you-go-to-one/?sh=4e4fa3c92249.

104. Anton Gollwitzer et al., *Partisan differences in physical distancing are linked to health outcomes during the COVID-19 pandemic*, 4 NAT'L HUM. BEHAV. 1186 (Nov. 2, 2020), https://doi.org/10.1038/s41562-020-00977-7.

105. *Aerosol and Surface Stability of SARS-CoV-2 as Compared with SARS-CoV-1*, N382 NEW ENG. J. Med., 1564, 1564 (2020).

106. *Contact Tracing*, CENTERS FOR DISEASE CONTROL AND PREVENTION (Jan. 11, 2022), https://www.cdc.gov/ coronavirus/ 2019-ncov/daily-life-coping/contact-tracing.html.

107. *Id*; *State Approaches to Contact Tracing during the COVID-19 Pandemic*, NASHP (Feb. 2, 2022), https://www.nashp.org/state-approaches-to-contact-tracing-covid-19/.

A severe acute respiratory syndrome (SARS) outbreak in 2003 was linked to a Chinese doctor who treated infected patients and then flew on a commercial airline.[108] This led to nearly 8,500 SARS cases worldwide and over 900 deaths.[109] In this case, there was the identification of an initial contact point and subsequent tracing.[110] However, when the H1N1 swine flu pandemic of 2009, lasting nineteen months from January 2009 to August 10, 2010, was first discovered in the United States on April 15, 2009, its infection of a second patient two days later was more problematic in tracing.[111] The second patient infected with the H1N1 virus lived 130 miles away and had no known contact with the first patient.[112] On April 23, two additional cases were reported in Texas, and the Center for Disease Control (CDC) declared a multi-state outbreak and response.[113] This type of initial outbreak is hard to trace and attribute blame. The inability to impute knowledge on the part of a potential defendant is a death knell for a negligent transmission claim. Of course, circumstances shift once the medical and scientific communities can provide more information from research and tracing.

By the time the H1N1 virus peaked in May and June 2009, there was a different standard of care owed.[114] On May 1, the CDC provided interim guidance on closing schools and childcare facilities and by mid-June all fifty states, the District of Columbia, the U.S. Virgin Islands, and Puerto Rico had reported outbreaks.[115] By June 19, over thirty summer camps in the United States experienced H1N1 flu outbreaks, and by early July, the reported cases nearly doubled since the prior month.[116] A second wave of the virus began in the United States in late August.[117] The first approved vaccine was not administered until October 5, 2009, with

108. Courtney Clegg, *The Aviation Industry and the Transmission of Communicable Disease: The Case of H1N1 Swine Influenza,* 75 J. AIR L. & COM. 437, 440 (2010).

109. *Id.*

110. *Id.*

111. *The 2009 H1N1 Pandemic: Summary Highlights, April 2009-April 2010*, CENTERS FOR DISEASE CONTROL AND PREVENTION, https://www.cdc.gov/h1n1flu/cdcresponse.htm (last visited Apr. 12, 2022).

112. *2009 H1N1 Pandemic Timeline*, CENTERS FOR DISEASE CONTROL AND PREVENTION, https://www.cdc.gov/flu/pandemic-resources/2009-pandemic-timeline.html (last updated May 8, 2019).

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.*

the peak of the second wave of the virus occurring in late October.[118] Finally, on August 11, 2010, the World Health Organization (WHO) announced the end of the 2009 H1N1 influenza pandemic.[119] The H1N1 flu virus mostly impacted children and middle-aged adults.[120] Furthermore, it did not result in massive self-isolation and ordering non-essential businesses to shut down.

The worldwide mortality rate for the 2009 H1N1 virus was 0.0001 to 0.0007% of the world's population during the first year.[121] When the United States approached the one-year mark of the pandemic, the worldwide mortality rate for coronavirus was 0.0325% of the world's population.[122] The world population mortality rate during the 1968 H3N2 influenza pandemic was 0.03% of the population and during the Spanish Flu Pandemic of 1918 it was 1% to 3%.[123] While there is little solace to be taken from comparative mortality rates, the numbers do provide adequate evidence of the potential seriousness of infection. However, what further distinguishes coronavirus from its predecessors are the potential long-term health effects survivors of the illness may encounter.[124] This factor can impact potential damages in a negligent transmission case.

Proving breach of duty is imperative to successful litigation of a negligent transmission of a communicable disease case. The prevailing caselaw in the litany of HIV/AIDS cases from the 1980s and 1990s is instructive for COVID-19 litigants.[125] The element of scienter, implicit in a defendant's actions, can depend on many

---

118. *Id.*
119. *Id.*
120. *2009 H1N1 Pandemic (H1N1pdm09 virus)*, CENTERS FOR DISEASE CONTROL AND PREVENTION, https://www.cdc.gov/flu/pandemic-resources/2009-h1n1-pandemic.html (last updated June 11, 2019).
121. *Id.*
122. *Mortality Analyses*, JOHN HOPKINS UNIVERSITY OF MEDICINE, https://coronavirus.jhu.edu/data/mortality (last visited Apr. 5, 2022).
123. *The global impact of the largest influenza pandemic in history*, OUR WORLD IN DATA (Mar. 4, 2020), https://ourworldindata.org/spanish-flu-largest-influenza-pandemic-in-history.
124. For further information on the potential long-term health effects of coronavirus *see infra* note 223 in the Damages section below.
125. See*, e.g.*, Bonnie E. Elber, *Negligence as a Cause of Action for Sexual Transmission of Aids*, 19 U. TOL. L. REV. 923, 937 (1987); Regina DelaRosa, *Viability of Negligence Actions for Sexual Transmission of the Acquired Immune Deficiency Syndrome Virus,* 17 CAP. U. L. REV. 101, 111 (1989); Matthew Seth Sarelson, *Toward a More Balanced Treatment of the Negligent Transmission of Sexually Transmitted Diseases and AIDS,* 12 GEO. MASON L. REV. 481, 485 (2003).

factors. The unique circumstances of each case drive the viability of the potential claim. A business owner who exhibits reckless and wanton conduct in ensuring proper safety precautions for customers and employees presents less of a breach barrier than an employer who has taken adequate precautions. The overriding question in any future litigation involving negligent transmission of coronavirus involves the exact nature of the adequate precautions a business owner is expected to take.

The changing nature of health protocols and warnings related to individual states re-opening created confusion and doubt regarding proper safety precautions. In late June 2020, twelve states had to pause or reverse their re-opening plans due to a surge in coronavirus cases.[126] Florida and Texas, two states that re-opened ahead of northeast states like Connecticut, Massachusetts, New Jersey, and New York, were experiencing sharp increases in daily infections by mid-July 2020, with Dallas County, Texas reporting its deadliest day on July 17.[127] Local health department guidance to businesses may vary from state to state, thereby creating different standards of care. At a minimum, however, a business' failure to enforce mask policies may create a definite line of attack where illness can be traced to that business.

While much of the discussion regarding breach is speculative, one should consider the first wrongful death case filed in the United States. In this case, the family of a deceased Walmart employee filed a wrongful death action against the company and the retail shopping center's management company in an Illinois court.[128] The civil complaint outlined causes of action for negligence and wanton and willful misconduct against the Evergreen Park store.[129] The negligence claims were based on allegations that the defendants failed to implement, promote, and enforce social distancing guidelines; failed to clean and sanitize the store to prevent the spread of the coronavirus; and failed to

126. Nicole Chavez & Madeline Holcombe, *12 states are pausing reopening over the surge in US coronavirus cases*, CNN (June 27, 2020, 6:10 PM), https://www.cnn.com/2020/06/27/health/us-coronavirus-saturday/index.html.

127. Tasha Tsiaperas, *COVID-19 updates: Texas reports its deadliest day with 174 new deaths*, WFAA (July 17, 2020, 5:21 PM), https://www.wfaa.com/article/news/health/coronavirus/coronavirus-updates-july-17-in-dallas-fort-worth/287-f53a00dd-52a6-4a8c-b3ec-b053aca07cff.

128. *See* Complaint, Toney Evans, Special Administrator of the Est. of Wando Evans v. Walmart, Inc., et al., No. 2020L003938 (Cir. Ct. Cook Cnty, Ill. Apr. 6, 2020).

129. *Id.*

monitor and prevent symptomatic employees from working.[130] A failure of the store to provide personal protective equipment—masks, latex gloves, antibacterial soaps—was also alleged.[131] It remains to be seen the extent to which the plaintiff's case is limited by workers' compensation insurance which the employer paid. The pleading alleged conduct rising to more than negligence with its wanton and willful misconduct claims, which may move the case outside the limits of workers' compensation.[132] While employee claims may be limited under state workers' compensation provisions, the success of customer claims will be limited by their ability to prove a breach.[133] A further limitation to customer claims will be specific state laws that do not recognize a cause of action for negligent transmission of a contagious or infectious disease.[134]

III. CAUSATION

The single, most significant hurdle to plaintiffs in a COVID-19 negligence lawsuit will be the causation element of negligence. To hold a defendant liable for negligence, a plaintiff must show that the defendant's breach of duty was both the factual cause and the proximate cause of a plaintiff's injuries.[135]

Though definitions and usage of these terms vary across jurisdictions, generally, factual cause is the requirement that, but for the defendant's breach of duty, the plaintiff's injuries would not have occurred.[136] Proximate causation evades a straight forward definition,[137] but it essentially means that the defendant's breach

130. *Id.* at 3–5.

131. *Id.* at 3–4, 8.

132. For different approaches to the "intentional harm exception" to workers compensation, *see* Acevedo v. Consolidated Edison Co. of N.Y., Inc., 189 A.D.2d 497, 500-01 (1st Dept. 1993) (requiring an employer's actual intent to harm); *see also* Millison v. E.I. du Pont de Nemours & Co., 101 N.J. 161, 177–79 (1985) (two-part test requiring employee to show 1) substantial certainty of injury or death resulting from employer's conduct, and 2) the circumstances under which injury or death arose were not an ordinary fact of industrial life).

133. *See generally id.*

134. Florida is a state who does not recognize this tort. *See* Quezada v. Circle K Stores, Inc., No. 2:04-cv-190-FtM-33DNF, 2005 U.S. Dist. LEXIS 20217, at *4–5 (M.D. Fla. July 7, 2005).

135. *See* Hiltgen v. Sumrall, 47 F.3d 695, 700 (5th Cir. 1995) ("The element of causation may be broken down into two parts: factual or "but-for" causation and legal or proximate causation.").

136. *Id.* ("Factual causation, or 'but for' causation, asks whether the complained of injury or damage would have occurred but for the act or omission of the party in question.").

137. 57A AM. JUR. 2D *Negligence* § 411 (2022).

of duty is closely related enough to the plaintiff's injuries that the law will consider it the legal cause and impose liability.[138] Many courts will focus on whether the defendant's breach of duty was a foreseeable cause of the plaintiff's injuries in a proximate cause analysis, a view famously expounded by Justice Cardozo in *Palsgraf v. Long Island Railroad Co.*[139]

i. Factual Causation

Factual causation is likely to be a plaintiff's most significant hurdle in proving a claim against a business for the negligent transmission of the novel coronavirus. Quite simply, the novel coronavirus is everywhere in the United States, and no part of the country has been unaffected. There were an estimated 26 million cases of COVID-19 in the United States between August 2020 and February 2021.[140] Comparable diseases like norovirus and legionnaires' disease were never nearly as widespread at once.[141]

Causation may be easier to prove in environments where plaintiffs were confined to close spaces for an extended span of several days, such as on cruise ships or in nursing homes. This type of confinement coextensive to an incubation period could ease the plaintiff's burden of proof. Even this, however, is not a guarantee. For example, in *Davis v. Cruise Operator, Inc.*, the Southern District of Florida granted a defendant cruise ship operator's motion for summary judgment.[142] In that case, the plaintiff contracted norovirus while on the defendant's cruise, but she had eaten at several places shortly before the cruise and had disembarked from the ship shortly before she began showing

---

138. *Id.*

139. 248 N.Y. 339, 344-45 (N.Y. 1928).

140. *COVID Data Tracker*, CENTERS FOR DISEASE CONTROL AND PREVENTION, https://covid.cdc.gov/covid-data-tracker/#datatracker-home (last visited Apr. 5, 2021).

141. *Trends and Outbreaks*, CENTERS FOR DISEASE CONTROL AND PREVENTION, https://www.cdc.gov/ norovirus/trends-outbreaks/burden-us.html (last visited Apr. 5, 2021); *What Owners and Managers of Buildings and Healthcare Facilities Need to Know about the Growth and Spread of Legionella*, CENTERS FOR DISEASE CONTROL AND PREVENTION, https://www.cdc.gov/legionella/wmp/overview/growth-and-spread.html (last updated Apr. 30, 2018).

142. No. 16-cv-62391-BLOOM/Valle, 2017 U.S. Dist. LEXIS 111860 (S.D. Fla. July 19, 2017).

symptoms of the norovirus.[143] Most importantly, there were no other outbreaks on board the cruise ship.[144]

A plaintiff's case for causation can be aided by proven outbreaks. For example, if the plaintiff can show that several people who visited the defendant's business location in the same time period as the plaintiff also contracted coronavirus, the case can become easier to prove. Similarly, if the plaintiff can show that employees were sick when plaintiff was present on defendant's premises, the plaintiff will have an easier time showing causation.

Nonetheless, in most cases, it will likely take expert epidemiological evidence to prove a business was the source of the plaintiff's infection, given the widespread nature of the coronavirus. Epidemiologists will then have to engage in an analysis that satisfies the standards of expert witness testimony, such as the federal rules standard laid out in *Daubert v. Merrell Dow Pharmaceuticals*.[145]

Satisfying *Daubert* can be challenging for plaintiffs. For example, in *Foster v. Legal Sea Foods, Inc.*, the District of Maryland refused to admit the expert testimony of two doctors who would have testified that plaintiffs likely contracted hepatitis by eating contaminated mussels at the defendant's restaurant.[146] The court held that even though the doctors had extensively reviewed the plaintiff's medical files and the defendant's sanitation practices, their testimony was not admissible because it did not sufficiently "minimize" other causes.[147] The court stated, "[e]ven if [the proposed expert] adequately ruled out alternative sources of the [plaintiff's hepatitis] as part of a reliable differential diagnosis, the available evidence was not sufficiently probative for [the expert] to have ruled *in*, from the universe of possible causes, [defendant's] mussels."[148]

This case is illustrative of how plaintiffs will have to ensure that their epidemiological experts can significantly narrow, if not eliminate, other sources of transmission. This was hard enough in cases like *Davis* and *Foster* that involved far less widespread diseases.

143. *Id.* at 14–17.
144. *Id.* at 16.
145. 509 U.S. 579 (1993).
146. No. CCB-03-2512, 2008 U.S. Dist. LEXIS 57117 (D. Md. July 25, 2008).
147. *Id.* at *31, *35–36.
148. *Id.* at *36.

An analogy can also be drawn to toxic tort cases. In a toxic tort case, causation is often at issue because it becomes incredibly difficult to prove that plaintiff's injuries were caused by the defendant's products.[149] Those cases are different because, in a toxic-tort case, plaintiffs often must prove that the defendant's product is capable of causing injury in the first place.[150] That will not be as big an issue in novel coronavirus cases because coronavirus is so omnipresent, and its means of transmission are understood reasonably well.[151]

However, the novel coronavirus' relative omnipresence is what will make it ultimately hard to show causation. In toxic-tort cases, it is not enough to simply show that the plaintiff was exposed to the defendant's product.[152] It is also not enough to merely show a temporal connection between the onset of the plaintiff's symptoms and exposure to the defendant's product. There must be an actual scientific link between the plaintiff's condition and the defendant's product.[153]

Similarly, in coronavirus cases, showing a temporal connection between the plaintiff's symptoms and the plaintiff's visit(s) to the business' premises will not likely be enough. There are so many places where the novel coronavirus can be transmitted. Courts will likely lean on expert witness testimony from epidemiologists especially when determining whether a novel coronavirus case can even pass summary judgment.

ii. Proximate Causation

Even if a plaintiff can prove factual causation, the plaintiff will still have to prove proximate causation.[154] This task may be difficult. If a court focuses solely on whether the plaintiff's injuries were foreseeable, a plaintiff can likely overcome this hurdle. However, in many states, courts will also take policy considerations into account when determining whether proximate cause exists.[155]

149. 57A AM. JUR. 2D *Negligence* § 513 (2022).
150. *Supra* note 105.
151. *Supra* note 107.
152. *See* James v. Bessemer Processing Co., Inc., 714 A.2d 898, 907 (N.J. 1998).
153. 57A AM. JUR. 2D *Negligence* § 513 (2022).
154. *Id.* at § 417.
155. Curtis v. M&S Petroleum, Inc., 174 F.3d 661, 664 (5th Cir. 1999).

Foreseeability is an easy bar to meet. Most members of society are aware of the possibility of transmitting the novel coronavirus just about everywhere they go. Everyone from celebrities,[156] to government officials,[157] to average citizens on social media platforms,[158] have discussed the need to take common sense precautions against the spread of the novel coronavirus such as mask wearing, handwashing, and social distancing. Just about anyone can foresee getting COVID-19 from a business.

Some states, however, may choose to use proximate causation to require specific proof of causation as a policy matter. There has not been a pandemic on the scale of the novel coronavirus since the Spanish Influenza of 1918, which was ten years before the New York Court of Appeals decided the famous *Palsgraf v. Long Island Railroad Company* case in 1928.[159] Courts may well decide, given the economic difficulties caused by COVID-19, that, as a policy matter, it is best to hold plaintiffs to a higher standard of causation.

For example, a court could hold that a plaintiff can only show injuries are foreseeable when the defendant knew or was reckless as to the presence of the novel coronavirus on the business premises. This is similar to current standards for negligence. Negligence cases often require juries to determine whether the defendant should have been aware of a risk. For example, in *John B. v. Superior Court¸* the California Supreme Court focused its inquiry on a negligent transmission of HIV case on whether the defendant knew or had reason to know he was HIV positive.[160]

This is only one step below recklessness, which usually requires knowledge of a risk and a disregard of the risk. Instead of asking, "should the defendant business have been aware of the risk," courts could use proximate causation to ask the question "did the defendant actually know there was novel coronavirus on the property or did the defendant make itself willfully blind to the risk

156. *See, e.g.*, Johnni Macke, *How Celebs Like Reese Witherspoon, Kim Kardashian and More Are Staying Safe with Masks and More Amid Coronavirus Pandemic*, US MAGAZINE (Mar. 15, 2021), https://www.usmagazine.com/celebrity-news/pictures/celebrities-take-precautions-during-coronavirus-outbreak-pics/.

157. Even President Trump begrudgingly praised mask wearing. Kevin Breuninger, *Trump says face masks are 'patriotic' after months of largely resisting wearing one*, CNBC (July 20, 2020, 6:40 PM), https://www.cnbc.com/2020/07/20/trump-says-coronavirus-masks-are-patriotic-after-months-of-largely-resisting-wearing-one.html.

158. As anyone with a mother can attest.

159. 248 N.Y. 339, 339 (N.Y. 1928).

160. 137 P.3d 153, 156 (Cal. 2006).

of coronavirus on the property?" Courts could also take the opposite approach and find that defendant businesses should be and often are more sophisticated than their customers. Thus, businesses should not be held to a lower standard for the spread of novel coronavirus than any other infectious disease. Courts' approach to proximate causation could differ wildly because policy considerations can become involved in proximate causation analyses.

IV. DAMAGES

Money damages are the *sine qua non* of negligence claims. In the case where "a person who negligently exposes another to an infection or contagious disease, which such other thereby contracts," the infected person passing the disease is liable in damages.[161] The issue thus becomes—after proving the necessary elements of duty, breach, and resulting harm—one of proving damages. However, an injury alone will not lead to damages.[162] Courts have tried many cases wherein jury verdicts leave plaintiffs with nothing.[163] Even if a plaintiff can prove a duty and breach of that duty, a failure to establish a causal connection between the breach and the resulting harm will defeat the damages element of a claim.[164] The recent COVID-19 pandemic presents some unique challenges for plaintiffs' counsel in proving damages through a causal connection showing a business owner's actions caused the negligent transmission of the virus.[165] These challenges are especially complicated by the nature of the coronavirus and its spread. As soon as medical science announced it had isolated an aspect of the nature of the virus and how it was spread, new and sometimes conflicting information was released, and any prior certainty was questioned. Presently, renewed concerns pertaining

161. 39 AM. JUR. 2D *Health* § 101 (2022).

162. 57A AM. JUR. 2D *Negligence* § 71 (2022). *See* Baltimore City Pass. Ry. Co. v. Nugent, 38 A. 779, 781 (Md. 1897); Morril v. Morril, 142 A. 337, 339 (N.J. 1928).

163. *See* Alexia Brunet Marks, Check Please: Using Legal Liability to Inform Food Safety Regulation, 50 HOUS. L. REV. 723, 768 (Winter 2013). Dr. Marks' study of the verdicts and settlements in 320 foodborne illness cases from 2000-2011 indicated a significant advantage to defendants whose cases went to verdict resulting in no recovery for the plaintiff.

164. 57A AM. JUR. 2D *Negligence* § 71 (2022).

165. Russel W. Hartigan & Sarah Norkus, *Workers' Comp, Negligence, and COVID-19*, 108 ILL. B.J. 28, 29 (2020). *See also* Kantrow v. Celebrity Cruises Inc., 553 F. Supp. 3d 1203, 1222 (S.D. Fla. 2021) (holding that the plaintiffs sufficiently alleged causation at the motion to dismiss stage).

to aerosol spread of the coronavirus have dispelled earlier scientific community assertions that droplet spread was the main source of transmission.[166] Reduced concerns of surface spread through fomites has lessened the importance of disinfecting objects and packages, while the necessity for cleaning common surfaces and thorough handwashing remain.[167] The lack of certainty in the actual spread of the virus and its specific pathway to infecting a potential plaintiff provide little assurance to plaintiffs' counsel, though it does permit a formidable line of defense for opposing counsel. In addition, a plaintiff's behavior and lifestyle leading up to the time of infection can be another factor in mitigating or preventing damages.[168] An assumption of risk defense places the plaintiff equally on trial for a negligence of their own doing.[169] However, these issues aside, the question of damages for a COVID-19 lawsuit cannot be ignored. Cases have already been filed and more will follow as the scientific community learns more about the virus.[170] Treatments and vaccines will follow, and the mystery of coronavirus will subside, yet those attorneys who were the first to wade into the murky waters of litigation will have provided a template for future litigants.

The extent of potential damages for business owners due to COVID-19 related negligent transmission claims must be compared to past damage awards for communicable and infectious diseases. These types of claims fall into one of two distinct categories—cases wherein direct causality can be isolated and proven, and those wherein direct causation is specious and

---

166. Amanda D'Ambrosio, *Droplets vs Aerosols: What's More Important in COVID-19 Spread?*, MEDPAGE TODAY (May 13, 2021), https://www.medpagetoday.com/special-reports/exclusives/92564.

167. *See* Colleen R. Newey et al., *Presence and stability of SARS-CoV-2 on environmental currency and money cards in Utah reveals a lack of live virus* (Etsuro Ito ed. 2022); *compare with*, *Science Brief: SARS-CoV-2 and Surface (Fomite) Transmission for Indoor Community Environments*, CENTERS FOR DISEASE CONTROL AND PREVENTION (Apr. 5, 2021), https://www.cdc.gov/coronavirus/2019-ncov/more/science-and-research/surface-transmission.html.

168. Michele L. Mekel, *Kiss and Tell: Making the Case for the Tortious Transmission of Herpes and Human Papillomavirus*, 66 MO. L. REV. 929, 954 (2001) ("[T]he case could be vulnerable to attack if the victim had prior or subsequent sexual partners.").

169. 57B AM. JUR. 2D *Negligence* § 759 (2022).

170. *COVID-19 Employment Litigation Tracker and Insights*, FISHER PHILLIPS, https://www.fisherphillips.com/innovations-center/covid-19-employment-litigation-tracker-and-insights/index.html (last visited Apr. 13, 2022); Tom Hals, *U.S. business fears never ending liability from 'take-home' COVID-19 lawsuits*, REUTERS (Jan. 12, 2022, 11:14 AM), https://www.reuters.com/world/us/us-business-fears-never-ending-liability-take-home-covid-19-lawsuits-2022-01-12/.

vague.[171] An additional factor impacting both categories are pre-existing conditions of the plaintiff which complicate the alleged injury.[172] In insurance parlance, a pre-existing condition is any condition from which the insured is already suffering before applying for insurance, and where there has been a prior diagnosis or treatment.[173] For litigation purposes, the definition is expanded to include a diagnosis or treatment of a condition or illness preceding the injury and harm alleged in the negligence complaint.[174]

A pre-existing condition is a significant factor for a jury denying damages.[175] For instance, in a 2009 jury trial out of Michigan, a plaintiff, who was one of 450 people contracting norovirus at a Carrabba's Italian Grill in Lansing, sought $6 million in damages as a result of a colon removal, a future permanent colostomy bag, and diminished life expectancy.[176] The defendant restaurant admitted liability for the spread of norovirus to its patrons, but contested the plaintiff's claim that the virus led to the removal of his colon.[177] Plaintiff had an underlying, untreated case of ulcerative colitis which the defendant argued was the reason for his colon removal.[178] The jury, after three hours of deliberation, returned a verdict in favor of the defendant restaurant.[179]

In a more recent 2019 case involving a food-based infection claim, the plaintiff became ill after eating a taco at a Del Taco

---

171. *See* Struve v. GMRI, Inc., d/b/a Olive Garden, 1:09-cv-00637-LJM-JMS, 2010 Jury Verdicts LEXIS 51426 (S.D. Ind. Jan. 20, 2010); Kamell v. Del Taco, LLC, 30-2016-00891419-CU-PO-CJC, 2019 Jury Verdicts LEXIS 13015 (Cal. Super. Ct., Jan. 22, 2019).

172. Stevens v. Bangor & Aroostook R.R., 97 F.3d 594, 601 (1st Cir. 1996) ("[A]s a general matter, when a defendant's negligence aggravates a plaintiff's pre-existing health condition, the defendant is liable only for the additional increment caused by the negligence and not for the pain and impairment that the plaintiff would have suffered even if the accident had never occurred.").

173. *What is a Pre-Existing Condition?*, CIGNA (July 2018), https://www.cigna.com/individuals-families/understanding-insurance/what-is-a-pre-existing-condition; *see also What is PREEXISTING CONDITION*, THE LAW DICTIONARY, https://thelawdictionary.org/preexisting-condition/ (last visited Apr. 13, 2022).

174. *See* Sauer v. Burlington Northern R. Co., 106 F.3d 1490, 1492-93 (10th Cir. 1996); Harris v. ShopKo Stores, Inc., 308 P.3d 449, 456-57 (Utah 2013); Komlodi v. Picciano, 89 A.3d 1234, 1249 (N.J. 2014).

175. *Stevens*, 97 F. 3d at 601.

176. Wininger, et al. v. Carrabba's Italian Grill, Inc., 08-000225-NO, 2009 Jury Verdicts LEXIS 425932 (Mich. Cir. Ct. Oct. 6, 2009).

177. *Id.*

178. *Id.*

179. *Id.*

restaurant in La Habra, California.[180] Extensive vomiting led to a tear in his esophagus.[181] The plaintiff claimed he was sickened by the bacteria infected food he consumed at the restaurant.[182] His epidemiological expert testified that staphylococcus bacteria in his food is the only type of bacteria that could have made him sick within hours of eating.[183] Plaintiff argued that an employee at the restaurant handling the food must have had a staph infection and passed it on when preparing the food.[184] Defense counsel noted that hospital tests of the plaintiff did not show any signs of a staph infection.[185] The defense attributed plaintiff's vomiting to acid reflux and presented an expert gastroenterologist who testified that people with acid reflux disease do experience bouts of vomiting.[186] The plaintiff's purchase of medications to reduce acid reflux, as well as plaintiff's complaint of indigestion and heartburn in the hours leading up to the vomiting attack, were also introduced into evidence.[187] In a final rebuttal to the plaintiff's claim, defense counsel said the vomiting could have been the result of norovirus, which is more prevalent in the winter, and the symptoms of norovirus can appear several days after exposure, thus reducing the likelihood plaintiff's illness was attributable to his meal at Del Taco.[188] After three days of trial and a twenty-minute deliberation, the jury returned a verdict for the defendant.[189] A novel aspect of the defense in this case was the introduction of a symptomatic disease, the norovirus, to explain the plaintiff's condition and the assertion that causally connecting the plaintiff's injuries to that disease was too remote.[190] This is a marked contrast to the *Wininger* case, where the defendant admitted liability for the norovirus outbreak, but denied a causal connection between the food service and the plaintiff's colon removal, as the defense in this case never conceded liability for the infection.

---

180. *Kamell*, 2019 Jury Verdicts LEXIS 13015.
181. *Id.*
182. *Id.*
183. *Id.*
184. *Id.*
185. *Id.*
186. *Kamell*, 2019 Jury Verdicts LEXIS 13015.
187. *Id.*
188. *Id.*
189. *Id.*
190. *Id.*

While norovirus is not a perfect comparator for coronavirus, there are some shared characteristics that make it a reasonable subject for comparison. Norovirus is an extremely contagious virus that attacks the gastrointestinal system, causing vomiting and diarrhea.[191] It is spread easily and people with norovirus "can shed billions of norovirus particles" and "only a few virus particles can make other people sick."[192] A virus spreads through contact with infected people, consuming contaminated food, and or touching contaminated surfaces.[193] There is no vaccine for norovirus, but preventive measures include handwashing, safe handling and preparation of food, cleansing and disinfecting surfaces, and distancing from infected persons.[194] A key difference between norovirus and coronavirus, in terms of assessing damages, is the fact that norovirus is spread through contaminated food and symptoms appear within twelve to forty-eight hours after exposure.[195] Also, the commonality of settings where the norovirus is spread, as reported by the Center for Disease Control, lends itself to a narrower tracing of viral contagion than coronavirus.[196]

A case in point is the 2010 Federal District Court, Southern District of Indiana matter of *Struve v. GMRI, Inc.*[197] Heath and Cherie Struve ate dinner at an Olive Garden restaurant with their minor child, and within twelve hours, the child began vomiting and experiencing nausea, dehydration, and diarrhea.[198] The minor child was treated at a local emergency room and released, but a few days later, he returned with continuing symptoms and was hospitalized for one week.[199] A report was made to the county health department and an investigation revealed two employees who were infected with norovirus were working at the restaurant

191. *About Norovirus*, CENTERS FOR DISEASE CONTROL AND PREVENTION, https://www.cdc.gov/norovirus/about/index.html (last visited Mar. 5, 2021).
192. *Id.*
193. *Id.*
194. *Preventing Norovirus*, CENTERS FOR DISEASE CONTROL AND PREVENTION, https://www.cdc.gov/norovirus/about/prevention.html (last visited Oct. 20, 2021).
195. *The Symptoms of Norovirus*, CENTERS FOR DISEASE CONTROL AND PREVENTION, https://www.cdc.gov/norovirus/about/symptoms.html (last visited Mar. 5, 2021).
196. *Common Settings of Norovirus Outbreaks*, CENTERS FOR DISEASE CONTROL AND PREVENTION, https://www.cdc.gov/norovirus/trends-outbreaks/outbreaks.html (last visited Mar. 5, 2021).
197. Struve v. GMRI, Inc., No. 1:09-cv-00637, 2010 Jury Verdicts LEXIS 51426 (S.D. Ind. Dist. Ct., Jan. 20, 2010).
198. *Id.*
199. *Id.*

at the time the Struves' dined there.[200] The plaintiffs alleged negligence on the part of the restaurant for providing an unreasonably dangerous environment and for breach of warranty of fitness for a particular purpose.[201] They also included a res ipsa loquitur claim predicated on the fact of the presence of the illness as proof of negligence.[202] Among the defendant's defenses were that superseding acts or omissions by persons over whom they had no control caused the injuries, that it acted reasonably under the customs and usage in the food service industry, and that the plaintiffs were at least 50% at fault.[203] This latter defense was not further explained in the reporter, but it is a standard assumption of the risk defense inserted into many negligence defenses. The case did not go to trial; it settled for $65,000.00.[204] Other than a resulting illness that was prolonged beyond the usual one-to-three-day period for norovirus infection, there were no other damages.[205] The settlement amount was reasonable based on the facts. Causation was easily established through the county health department's investigation.[206]

A 2013 case from New York State represents the upper limits of norovirus damages. In *Baker v. SF HWP Mgt., LLC*, 600 guests stayed at the Six Flags Great Escape Lodge and Indoor Waterpark in March 2008 and contracted norovirus.[207] The property management was aware many guests were sick but did not close the park or warn guests of the outbreak.[208] A state health department investigation subsequently found that several employees at the park's restaurants were sick when the norovirus outbreak began.[209] The park was instructed to undertake infection control measures and disinfect the property.[210] Five guests who became sick initiated a class action lawsuit.[211] The class was limited to guests who experienced gastrointestinal illness within

200. *Id.*
201. *Id.*
202. *Struve*, 2010 Jury Verdicts LEXIS 51426, at 2.
203. *Id.* at 3.
204. *Id.*
205. *See id.* at 2.
206. *Id.*
207. Baker v. SF HWP Mgt., LLC, No. 50564, 2013 Jury Verdicts LEXIS 14774 (N.Y. Sup. Ct., May 7, 2013).
208. *Id.*
209. *Id.*
210. *Id.*
211. *Id.*

seventy-two hours of leaving the park and reported their illness to the state health department.[212] Plaintiffs' complaint alleged failure to implement, monitor, and ensure proper sanitary conditions and safeguards; failure to properly train employees in infection control; failure to send ill workers home; and failure to warn guests.[213] The case settled for $1.3 million.[214] The number of plaintiffs in the class, coupled with the obvious neglect of guest health and safety, was a significant factor in the settlement amount.[215]

Unlike coronavirus, the mortality rate from norovirus is low. Of the reported average of 109,000 norovirus hospitalizations each year, there is an average of 900 deaths.[216] This is a little over 0.8% of hospitalized illnesses. The death rate is 0.04% when one factors in 2,270,000 overall norovirus outpatient visits.[217] Monetary damages from norovirus for physical injury do not present a significant recovery model due to low litigation rates,[218] the commonality of the disease,[219] and the inability to connect it to a source.[220] Conversely, coronavirus infection rates in the United States are more than seventy-nine million cases with more than 972,000 deaths.[221] This is slightly over a 1.2% U.S. mortality rate for coronavirus.[222] While coronavirus mortality remains a remote possibility, it is significantly higher than norovirus. The impact on damages from coronavirus infection exposure is a higher possibility of wrongful death claims for business owners. Absent death, there remains the long-term effect on health from

212. *Id.*

213. *See Baker*, 2013 Jury Verdicts LEXIS 14774, at 1.

214. *Id.* at 2.

215. *Id.*

216. *Burden of Norovirus Illness in the U.S.*, CENTERS FOR DISEASE CONTROL AND PREVENTION, https://www.cdc.gov/norovirus/trends-outbreaks/burden-US.html (last visited Mar. 5, 2021).

217. *Id.*

218. *See* John Aloysius Cogan, Jr., *The Uneasy Case for Food Safety Liability Insurance*, 81 BROOKLYN L. REV. 1495, 1538 & n. 245 (2016).

219. Sandra Hoffman, Bryan Maculloch & Michael Batz, *Economic Burden of Major Foodborne Illnesses Acquired in the United States*, ECONOMIC INFORMATION BULLETIN NO. 140 (U.S. Department of Agriculture, May 2015), at 30 ("Norovirus causes 58 percent of foodborne illnesses in the United States that can be linked to a specific pathogen, 5.5 million cases in a typical year."]; *see also*, L. Barclay, et al., *Infection Control for Norovirus,* 20 CLINICAL MICROBIOLOGY AND INFECTION, 731, 732 (2014) (citing the high probability of shedding by infected persons, the low infectious dose, and environmental stability of the virus).

220. Cogan, *supra* note 220.

221. *Supra* note 2.

222. *Id.*

coronavirus exposure and illness. While medical evidence is still being gathered, the long-term effects can range from heart damage to lung damage to neurological symptoms.[223] Blood-clotting, strokes, and embolisms found in hospitalized patients also present significant coronavirus-related physical injuries that could be compensable in a lawsuit for negligent exposure. [224]

One might wonder how damages for more serious physical injuries or health effects resulting from negligent exposure to a communicable disease can be assessed. Even though comparisons are hard to make at the present stage of the COVID-19 pandemic, other communicable disease outbreaks provide a guide for what might be expected if a claim for negligent exposure is brought against a business and the elements of causation can be proven. Sample cases indicate that the monetary damages can be in the low six-figure to seven-figure range.[225] In 2009, a worker's compensation trial resulted in a $226,000 settlement for a female correction officer who claimed she was infected with methicillin-resistant Staphylococcus aureus (MRSA) while working at a state prison.[226] The MRSA infection caused permanent scarring on her face, arms, and legs.[227] The plaintiff's attorney claimed the prison failed to maintain a sanitary facility.[228] The defendant prison countered that MRSA is found everywhere—in homes, cars, stores, and in the soil—thereby challenging her assertion that she contracted the infection while at work.[229] The defendant also relied on the overall low MRSA infection rate of its staff and the training it provides to staff relating to MRSA and infection control.[230] Plaintiff's counsel countered with an infectious disease expert who opined that plaintiff officer contracted the disease from her daily exposure to the unsanitary conditions of the prison and estimated

---

223. *Looking Forward: Understanding the Long-Term Effects of COVID-19*, NATIONAL HEART, LUNG, AND BLOOD INSTITUTE (June 3, 2020), https://www.nhlbi.nih.gov/news/2020/looking-forward-understanding-long-term-effects-covid-19.

224. *What we know (so far) about the long-term health effects of Covid-19*, ADVISORY BOARD (June 2, 2020), https://www.advisory.com/daily-briefing/2020/06/02/covid-health-effects.

225. *See, e.g.*, Snyder v. Dept. of Corr. (Graterford), 3100315, 2008 Jury Verdicts LEXIS 32380 (Pa. Bureau of Workers' Comp., Dec. 8, 2008).

226. Snyder v. Dept. of Corr. (Graterford), 3100315, 2008 Jury Verdicts LEXIS 32380 (Pa. Bureau of Workers' Comp., Dec. 8, 2008).

227. *Id.*

228. *Id.*

229. *Id.*

230. *Id.*

that over 100 prisoners were infected.[231] MRSA would seem to present similar problems with isolating infection to a specific location; however, the unique set of facts and occupation of the plaintiff contributed to a monetary recovery.[232]

Cases involving E-coli transmission appear to result in the upper range of monetary damage settlements or verdicts. Two cases are illustrative.[233] In *Almquist v. Finley School District #53*, eleven grade school children in Kennewick, Washington became ill after eating school lunch tacos.[234] Their symptoms were related to E-coli infection and included severe stomach pains, cramping, vomiting, and bloody diarrhea.[235] All of the children received emergency medical care, and four had to be hospitalized for critical care relating to a potentially deadly complication due to the E-coli infection.[236] One victim had signs of permanent kidney damage that would require a transplant.[237] After several years of litigation, the case settled before trial for $4,750,000.[238]

In *Mayfield v. The Learning Vine, LLC*, a two-year-old contracted E-coli from a teacher at his daycare who was allowed to work despite their infection.[239] The day care center did not require the teacher to be tested, nor did it take any action to improve sanitary conditions once it became aware of the teacher's illness.[240] The exposed two-year-old began to first experience loose stools on and off for two weeks, then more severe symptoms of stomach pains, cramping, and severe diarrhea.[241] His parents took him to the emergency room where he was diagnosed with hemolytic uremic syndrome, a complication from E-coli found in young children.[242] His kidneys began to shut down, and he was admitted to the pediatric intensive care unit, where he was placed on

231. *Id.*
232. *Snyder*, 2008 Jury Verdicts LEXIS 32380.
233. Almquist v. Finley School District #53, 99-2-01123-3, 2009 Jury Verdicts LEXIS 48121 (Wash. Super. Ct., Feb. 2001).
234. *Id.*
235. *Id.*
236. *Id.*
237. *Id.*
238. *Id.*
239. Mayfield v. The Learning Vine, LLC, 015-CP-24-00794, 2016 LexisNexis Jury Verdicts & Settlements 125 (S.C. Comm. Pls., 8th Jud. Cir., Mar. 21, 2016).
240. *Id.*
241. *Id.*
242. *Id.*

dialysis and a ventilator.[243] The child died five days later.[244] A state health department investigation found there were fourteen cases of E-coli involving individuals connected to the day care center the victim toddler attended.[245] Under South Carolina law, anyone infected with a communicable disease is not allowed to work around children.[246] The day care center failed to notify the department of health of the teacher's exposure.[247] In a deposition, the owner of the day care center testified that she was unaware of the dangers of E-coli to children at the time they became sick.[248] The case settled for $1 million.[249]

The deceased child in *Mayfield* case suffered the same complication from E-coli as the toddler in the *Almquist* case, hemolytic uremic syndrome.[250] This is a syndrome anyone can get, but it is more common in children exposed to E-coli infection.[251] Untreated, it can cause death, although it is treatable with early detection and medication.[252] However, in its severe form it can cause lasting kidney damage.[253] The variables leading to seven-figure settlements in each of these two cases are child victims and severe complications causally related to E-coli infections. These cases present sobering considerations for similar businesses seeking to re-open amid the ongoing COVID-19 pandemic. Even for those businesses in states where there is a reduction in reported cases and mortality, the heightened precaution mandated by most states must be scrupulously followed since contact tracing is more readily available and pinpointed in these environments. This portends trouble for any business not strictly adhering to minimum state mandated health and safety protocols.

The potential for courts to award money damages in a successfully litigated case pertaining to the negligent transmission of coronavirus can be significant. Minimum adherence to state

---

243. *Id.*
244. *Id.*
245. *Mayfield*, Jury Verdicts LEXIS 125.
246. *Id.*
247. *Id.*
248. *Id.*
249. *Id.*
250. *Id.*
251. *Hemolytic Uremic Syndrome (HUS)*, MAYO CLINIC (July 22, 2021), https://www.mayoclinic.org/diseases-conditions/hemolytic-uremic-syndrome/symptoms-causes/syc-20352399.
252. *Id.*
253. *Id.*

guidelines may not be enough in defending against a negligent transmission claim, especially if those guidelines are followed in a perfunctory manner. In an often-quoted line from Justice Byron White's 1986 U.S. Supreme Court opinion in *Malley v. Briggs,* he wrote that qualified immunity is a form of sovereign immunity, less strict than absolute immunity, protecting "all but the plainly incompetent or those who knowingly violate the law."[254] To paraphrase Justice White and apply his observation to business owners potentially courting a coronavirus negligent transmission claim, it can be said that the underlying common-law principles required to plead a successful case and the high bar a plaintiff's counsel must meet will protect all except for the plainly incompetent or those who knowingly violate the law.

254. 475 U.S. 335, 341 (1986).

TO GIVE OR NOT TO GIVE? EXAMINING WHETHER THE SMALL BUSINESS ADMINISTRATION HAS THE AUTHORITY TO EXCLUDE BANKRUPTCY DEBTORS FROM THE PAYCHECK PROTECTION PROGRAM

By Nicolaos Soulellis*

I. INTRODUCTION

According to a survey conducted by CBIZ, Inc., over 43% of small to mid-sized businesses "report[ed] a significant to severe impact" from the Coronavirus pandemic ("COVID-19"), while "84% . . . of businesses surveyed realized some impact from the pandemic."[1] To help businesses combat their economic hardships, Congress enacted the "Coronavirus Aid, Relief, and Economic Security Act," also known as the "CARES Act."[2] Within the CARES Act is the "Paycheck Protection Program" ("PPP").[3] The PPP provides small businesses[4] with funds to pay payroll costs and other allowable expenses.[5] PPP funds are eligible for loan forgiveness if the applicant meets specific requirements enumerated under the CARES Act.[6] As of this Article, the Small Business

---

* J.D., Stetson University College of Law, 2021; B.A., University of South Florida, 2017. Nicolaos Soulellis is an attorney at Brundage Law, P A., focusing his practice on commercial litigation and corporate and business transactions. The opinions expressed in this article are his alone and do not reflect the opinions and beliefs of his affiliates. Much thanks is owed to the many individuals that helped make this article a reality, including Michael P. Brundage, Ronald Espinal, Jace D. Williams, and the staff of the *Stetson Business Law Review*.

1. *Small Businesses Feel Biggest Impact of Coronavirus Pandemic*, BUSINESS WIRE (Oct. 8, 2020, 9:30 AM), https://www.businesswire.com/news/home/20201008005232/en/Small-Businesses-Feel-Biggest-Impact-of-Coronavirus-Pandemic.

2. Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116–36, § 1101, 134 Stat. 281, 281 (2020) [hereinafter CARES Act].

3. *Id.* § 1102, 134 Stat. at 286.

4. The PPP defines a small business as a business that does not employ more than 500 employees. *Id.* at 288.

5. *Small Business Paycheck Protection Program*, U.S. DEP'T. OF THE TREAS., https://home.treasury.gov/policy-issues/coronavirus/assistance-for-small-businesses (last visited Mar. 7, 2022).

6. The SBA will forgive a PPP loan if: (1) the "[e]mployee and compensation levels are maintained" by the applicant; (2) "[t]he loan proceeds are spent on payroll costs and other eligible

Administration ("SBA") dispersed $522 billion in the PPP's first draw and $284.45 billion in the second draw.[7]

But what if an applicant files for bankruptcy before receiving its PPP funds? Is the SBA required to distribute PPP funds to the bankruptcy debtor? The SBA does not believe so. After consulting the Secretary of the Treasury, the SBA issued an interim final rule ("IFR") on the PPP.[8] The IFR provided that applicants are ineligible to receive PPP funding if they are bankruptcy debtors or file for bankruptcy before applying.[9] Further, the IFR states that "[i]f the applicant or the owner of the applicant becomes the debtor in a bankruptcy proceeding after submitting a PPP application," but before the SBA disburses the loan, the applicant must notify their respective lender and "request cancellation of the [PPP] application."[10] The SBA justified its decision by stating that "providing PPP loans to debtors in bankruptcy would present an unacceptably high risk of an unauthorized use of funds or nonrepayment of unforgiven loans."[11]

While the SBA took a firm position on whether entities filing for bankruptcy before the disbursement of PPP funds are eligible to receive the PPP funds, the courts have not. As it currently

---

expenses"; and (3) "[a]t least 60 percent of the proceeds are spent on payroll costs." *PPP Loan Forgiveness*, U.S. SMALL BUSINESS ADMINISTRATION, https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program/ppp-loan-forgiveness (last visited Mar. 7, 2022).

7. Emily Hamann, *A New Round of PPP is Coming. Here's What's Changed, and What's the Same in the Program*, SACRAMENTO BUSINESS JOURNAL (Dec. 22, 2020), https://www.bizjournals.com/sacramento/news/2020/12/22/whats-the-same-whats-changed-ppp.html.

8. Business Loan Program Temporary Changes; Paycheck Protection Program—Requirements—Promissory Notes, Authorizations, Affiliation, and Eligibility, 85 Fed. Reg. 23,450, 23,451 (Apr. 28, 2020) (to be codified at 13 C.F.R. pt. 120-21). The IFR in question is the fourth regulation the SBA issued on the PPP/CARES Act. *See* Business Loan Program Temporary Changes; Paycheck Protection Program, 85 Fed. Reg. 20,811 (Apr. 15, 2020) (first regulation); Business Loan Program Temporary Changes; Paycheck Protection Program, 85 Fed. Reg. 20,817 (Apr. 15, 2020) (second regulation); Requirements for Certain Pledges of Loans, 85 Fed. Reg. 21,747 (Apr. 20, 2020) (third regulation). Yet only the fourth regulation—the IFR—is of relevance here. *Infra* note 12.

9. Business Loan Program Temporary Changes; Paycheck Protection Program—Requirements—Promissory Notes, Authorizations, Affiliation, and Eligibility, 85 Fed. Reg. at 23,451 ("If the applicant or the owner of the applicant is the debtor in a bankruptcy proceeding, either at the time it submits the application or at any time before the loan is disbursed, the applicant is ineligible to receive a PPP loan.").

10. *Id.* The SBA notes that "[f]ailure by the applicant to do so will be regarded as a use of PPP funds for unauthorized purposes." *Id.*

11. *Id.*

stands, there is a split between courts on whether the IFR violates the Administrative Procedure Act ("APA") and 11 U.S.C. § 525.[12]

Part II of this Article will explore the relevant sections of the APA and 11 U.S.C. § 525 to understand the issues at hand better. Part III of this Article will then highlight the legal arguments each side advanced on this issue. Finally, Part IV of this Article will suggest that while SBA had both the constitutional and statutory authority to exclude bankruptcy debtors from the PPP program, there is a potential solution to the debtors' problem.

II. A DISCUSSION OF THE APA AND 11 U.S.C. § 525

Most debtors challenging the SBA's IFR have argued the IFR violates the APA because (1) the IFR exceeds statutory authority under 5 U.S.C. § 706(2)(C), and (2) it was arbitrary and capricious—and 11 U.S.C. § 525's prohibition against discriminatory treatment of bankruptcy debtors.[13] To better understand the legal arguments advanced on each side,[14] a deeper dive into the APA and 11 U.S.C. § 525 is required.

A. The Administrative Procedure Act

The APA is found within Title 5 of the United States Code ("U.S.C.").[15] The APA "governs the process by which federal agencies develop and issue regulations."[16] While agencies can create rules, whether formal[17] or informal,[18] these rules face, when

---

12. *Compare*, *e.g.*, Alaska Urological Inst., P.C. v. U.S. Small Bus. Admin., 619 B.R. 689, 710 (D. Alaska 2020) (ruling for the debtor); In re Skefos, 2020 WL 2893413, at *15 (Bankr. W.D. Tenn. June 2, 2020) (same); In re Roman Catholic Church of Archdiocese of Santa Fe, 615 B.R. 644, 657 (Bankr. D.N.M. 2020) (same), *with*, *e.g.*, In re Gateway Radiology Consultants, P.A., 983 F.3d 1239, 1262 (11th Cir. 2020) (ruling for the SBA) [hereinafter *Gateway II*]; Tradeways, Ltd. v. U.S. Dep't. of the Treas., CV ELH-20-1324, 2020 WL 3447767, at *7 (D. Md. June 24, 2020) (same); Diocese of Rochester v. U.S. Small Bus. Admin., 466 F. Supp. 3d 363, 378, 380 (W.D.N.Y. 2020) (same).

13. *See Gateway II*, 983 F.3d at 1246–47 (only discussing the violations under the APA); *Tradeways, Ltd.*, 2020 WL 3447767, at *1; *Diocese of Rochester*, 466 F. Supp. 3d at 369; *Alaska Urological Inst.*, 619 B.R. at 696; *In re Skefos*, 2020 WL 2893413, at *1; *Roman Catholic Church*, 615 B.R. at 652–56.

14. *Infra* Pt. II.

15. 5 U.S.C. § 551 et seq. (2018).

16. *Summary of the Administrative Procedure Act*, EPA, https://www.epa.gov/laws-regulations/summary-administrative-procedure-act (last visited Mar. 7, 2022).

17. 5 U.S.C. §§ 556, 557.

18. *Id.* § 553(b)–(c).

challenged, what is known as "judicial review."[19] The APA is clear that any person adversely affected or aggrieved by an agency's action is entitled to judicial review.[20] As for the scope of a judicial review, a court can "hold unlawful and set aside agency action, findings, and conclusions found to be . . . arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law,"[21] or "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right."[22]

Motor Veh. Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co. best explains the arbitrary and capricious standard.[23] Generally, an agency rule is arbitrary and capricious under four circumstances: (1) if "the agency [relies] on factors" which Congress did not intend for the agency to consider; (2) if the agency "entirely failed to consider an important aspect of the problem"; (3) if the agency "offered an explanation for its decision that runs counter to the evidence before the agency"; or (4) if the rule "is so implausible that it could not be ascribed to a difference in view or the product of agency expertise."[24]

The Supreme Court noted that the scope of review to determine if an administrative act is arbitrary and capricious is narrow and that a court cannot "substitute its judgment for that of the agency."[25] Instead, "the agency must examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'"[26] When reviewing the agency's explanation, the court must determine whether the agency based its decision on relevant factors and whether the agency committed "a clear error of judgment."[27] Yet a reviewing court cannot make up for an agency's shortcomings or deficiencies.[28] Rather, a reviewing court should

19. *Id.* § 701 et seq. (2018). Judicial review is the review of an agency's legislation by a reviewing court. *Id.*

20. *Id.* § 702.

21. *Id.* § 706(2)(A).

22. *Id.* § 706(2)(C).

23. 463 U.S. 29 (1983).

24. *Id.* at 43.

25. *Id.*

26. *Id.* (citing *Burlington Truck Lines v. United States,* 371 U.S. 156, 168 (1962)).

27. *Id.* (quotations in original) (citing Bowman Transp., Inc. v. Arkansas-Best Freight Sys., Inc., 419 U.S. 281, 285 (1974); Citizens to Pres. Overton Park, Inc. v. Volpe, 401 U.S. 402, 416 (1971)).

28. *Id.* (citing SEC v. Chenery Corp., 332 U.S. 194, 196 (1947)).

uphold the agency's decision, even if it is "of less than ideal clarity," if the court can reasonably discern the agency's reasoning.[29]

Concerning whether an agency exceeded its statutory jurisdiction, authority, or limitations,[30] the standard comes from *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*[31] In *Chevron*, the Supreme Court focused on whether the Environmental Protection Agency exceeded its statutory authority by creating a regulation allowing States to group all pollution-emitting devices "as though they were encased within a single bubble."[32] The Supreme Court applied a two-step framework for evaluating agency actions under § 706(2)(C).[33] The first step of the test looks at "whether Congress has directly spoken [on] the precise question at issue."[34] If Congress has indeed spoken on the issue, and it's intent is clear, then the reviewing court and agency must adhere to Congress' interpretation.[35]

If Congress has not addressed the precise issue, "[a reviewing] court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation."[36] Instead, the question becomes whether the agency based its answer "on a permissible construction of the statute."[37] This analysis hinges on whether Congress' decision to leave an ambiguity or failure to include express language was explicit or implicit.[38] If the decision was explicit, the agency's regulations "are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute."[39] On the other hand, if the decision is implicit, "a court may not substitute its own construction of a statutory provision for a reasonable

29. *Id.* (citing Bowman Transp., 419 U.S. at 286; Camp v. Pitts, 411 U.S. 138, 142–43 (1973) (per curiam)).

30. 5 U.S.C. § 706(2)(C).

31. 467 U.S. 837, 844, 863 (1984).

32. *Id.* at 840 (internal quotations omitted).

33. *Id.* at 842–43.

34. *Id.* at 842.

35. *Id.* at 842–43 ("[a reviewing] court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.").

36. *Id.* at 843 (citing R. POUND, THE SPIRIT OF THE COMMON LAW 174–75 (1921)).

37. *Id.*

38. *Id.* at 843 (citing Morton v. Ruiz, 415 U.S. 199, 231 (1974)).

39. *Id.* at 843–44 (citing United States v. Morton, 467 U.S. 822, 834 (1984); Schweiker v. Gray Panthers, 453 U.S. 34, 44 (1981); Batterton v. Francis, 432 U.S. 416, 424–26 (1977); Am. Tel. & Tel. Co. v. United States, 299 U.S. 232, 235–37 (1936)).

interpretation made by the administrator of an agency."[40]

B. 11 U.S.C. § 525

11 U.S.C. § 525 protects bankruptcy debtors against discriminatory treatment based on whether the person is or has been a bankruptcy debtor.[41] While Congress enacted § 525 in 1978,[42] its protections precede its codification.[43]

In *Perez*, the Supreme Court faced whether Arizona Rev. Stat. § 28–1163(B) of the Arizona Motor Safety Responsibility Act ("Arizona Act") "was in direct conflict with the Bankruptcy Act" and in violation of the Supremacy Clause.[44] While the Supreme Court respected the Arizona Act's principal purpose,[45] it contrasted the purpose of the Arizona Act to the purpose of the Bankruptcy Act.[46] The Bankruptcy Act gave debtors "a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt."[47] The Supreme Court noted Congress intended for the Bankruptcy Act to provide a "'new opportunity' to include freedom from most kinds of preexisting tort judgments."[48] As a result, the Supreme Court reasoned that the state law, like the Arizona Act, could not "frustrate the operation of federal law," such as the Bankruptcy Act, "as long as the state legislature . . . had some purpose in mind other than one of

40. *Id.* at 844 (citing INS v. Jong Ha Wang, 450 U.S. 139, 144 (1981); Train v. Nat. Res. Def. Council, Inc., 421 U.S. 60, 87 (1975)).

41. 11 U.S.C. § 525 (2018).

42. S. REP. 95-989, 81 (1978).

43. Perez v. Campbell, 402 U.S. 637, 656 (1971).

44. *Id.* at 643 (citing U.S. Const. Art. VI, cl. 2). The Arizona Act was "designed to secure compensation for automobile accident victims a section providing that a discharge in bankruptcy of the automobile accident tort judgment shall have no effect on the judgment debtor's obligation to repay the judgment creditor." *Id.*

45. *Id.* at 644 (citing Schecter v. Killingsworth, 93 Ariz. 273, 280 (1963)). The Arizona Act's purpose was "the protection of the public using the highways from financial hardship which may result from the use of automobiles by financially irresponsible persons." *Id.*

46. *Id.* at 648.

47. *Id.* (internal quotations omitted) (citing Loc. Loan Co. v. Hunt, 292 U.S. 234, 244 (1934)). *Accord, e.g.*, Harris v. Zion Sav. Bank & Tr. Co., 317 U.S. 447, 451 (1943); Stellwagen v. Clum, 245 U.S. 605, 617 (1918); Williams v. U.S. Fid. & Guar. Co., 236 U.S. 549, 554–55 (1915).

48. *Id.* (citing Lewis v. Roberts 267 U.S. 467, 470 (1925)).

frustration."[49] Thus, the Supreme Court held Section 28–1163(B) to be invalid under the Supremacy Clause.[50]

As a result, Congress codified the *Perez* decision into 11 U.S.C. § 525 in 1978.[51] The relevant analysis falls under § 525(a). Under § 525(a):

> [A] governmental unit may not deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant to, condition such a grant to, discriminate with respect to such a grant against, deny employment to, terminate the employment of, or discriminate with respect to employment against, a person that is or has been a debtor under this title or a bankrupt or a debtor under the Bankruptcy Act, or another person with whom such bankrupt or debtor has been associated, solely because such bankrupt or debtor is or has been a debtor under this title or a bankrupt or debtor under the Bankruptcy Act, has been insolvent before the commencement of the case under this title, or during the case but before the debtor is granted or denied a discharge, or has not paid a debt that is dischargeable in the case under this title or that was discharged under the Bankruptcy Act.[52]

Thus, to prevail on a bankruptcy discrimination claim, a debtor must show: (1) the discriminator is a "governmental unit"[53]; (2) the denial refers to a "license, permit, charter, franchise, or other

49. *Id.* at 651–52.

50. *Id.* at 652.

51. S. REP. 95-989 (1978) ("This section is additional debtor protection. It codified the result of Perez v. Campbell, 402 U.S. 637 (1971), which held that a State would frustrate the Congressional policy of a fresh start for a debtor if it were permitted to refuse to renew a drivers [sic] license because a tort judgment resulting from an automobile accident has been unpaid as a result of a discharge in bankruptcy.").

52. 11 U.S.C. § 525(a).

53. Of relevance, the Bankruptcy Code defines "governmental unit" as the "United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States." *Id.* § 101(27).

similar grant"; and (3) the discriminator discriminated against the debtor only because they are a bankruptcy debtor.[54]

III. THE CURRENT SPLIT: FRAMING THE ARGUMENTS

As noted in Part I,[55] there is a current split between courts on whether the SBA's IFR is lawful under the APA and 11 U.S.C. § 525(a).[56] The fundamental issues are: (1) whether the IFR exceeds its statutory authority under 5 U.S.C. § 706(2)(C); (2) whether the IFR is arbitrary and capricious under 5 U.S.C. § 706(2)(A); and (3) whether the IFR violates 11 U.S.C. § 525(a)'s prohibition against discrimination of bankruptcy debtors. This Part will outline the arguments advanced by both sides of the split on each issue.

A. Whether the IFR Exceeds Statutory Authority

i. The Debtor's Argument

First, the pro-debtor courts acknowledge that Congress did not explicitly deal with whether bankruptcy debtors are eligible for PPP funds.[57] Even so, Congress' silence or ambiguity infers delegation to the agency to "fill in the statutory gaps,"[58] "[i]n extraordinary cases, however, there may be reason to hesitate before concluding that Congress has intended such an implicit delegation."[59]

These courts determined that the PPP is one of those extraordinary cases.[60] As the starting point of the analysis, courts

54. *Id.* § 525(a); Ayes v. U.S. Dep't. of Veterans Affairs, 473 F.3d 104, 107 (4th Cir. 2006).

55. *See supra* Part I.

56. *Supra* note 12.

57. In re Gateway Radiology Consultants, P.A., 616 B.R. 833, 847 (Bankr. M.D. Fla. 2020) [hereinafter *Gateway I*], *vacated in part, appeal dismissed in part* by *Gateway II,* 983 F.3d 1239 (11th Cir. 2020).

58. *Id.* at 846.

59. King v. Burwell, 576 U.S. 473, 485 (2015) (citing FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 159 (2000)).

60. *Gateway I,* 616 B.R. at 847; In re Roman Catholic Church of Archdiocese of Santa Fe, 615 B.R. 644, 655–56 (Bankr. D.N.M. 2020).

determine whether the "statutory language is plain."[61] Determining whether statutory language is plain and unambiguous requires "read[ing] the words 'in their context and with a view to their place in the overall statutory scheme.'"[62] Here, the *Gateway I* court looked at the PPP in the context of the CARES Act,[63] the PPP's place in the overall statutory scheme,[64] and the words found in the CARES Act.[65] When looking at the context of the CARES Act, the courts noted that the COVID-19 pandemic forced the United States into a state of emergency.[66] As for the PPP's place in the statutory scheme, the *Gateway I* court determined that Congress intended to help keep these distressed workers employed based on Title I of the CARES Act, titled "Keeping Workers Paid and Employed Act."[67] Last, the *Gateway I* court looked at the word "shall"[68] when the CARES Act provided that any small business "that has 500 employees or fewer 'shall be eligible' for a PPP loan."[69]

What's more, these courts noted that when "Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress act[ed] intentionally and purposely in the disparate inclusion or exclusion."[70] The courts also noted that CARES Act § 4003(c)(3)(D), codified under Title 15 of the United States Code, specifies that qualifying businesses that are debtors in bankruptcy are not eligible for the mid-size loan under the CARES Act.[71] The courts reasoned that Congress chose not to disqualify bankruptcy debtors from the PPP by including language disqualifying debtors

61. *Gateway I*, 616 B.R. at 847 (citing *King*, 576 U.S. at 486).
62. *Id.* (citing *King*, 576 U.S. at 486 (quoting *Brown & Williamson*, 529 U.S. at 133)).
63. *Id.*
64. *Id.* at 847–48.
65. *Id.* at 848.
66. *Id.* at 847; *In re Skefos*, 2020 WL 2893413, at *10 (Bankr. W.D. Tenn. June 2, 2020). When Congress enacted the CARES Act, close to one million people had lost their jobs because of COVID-19. *Gateway I*, 616 B.R. at 847. As of the *Gateway I* opinion, over 20 million other Americans had lost their jobs. *Id.*
67. *Gateway I*, 616 B.R. at 847–48 (citing CARES Act, DIVISION A, 134 Stat. at 281).
68. "Shall" is defined as "used in laws, regulations, or directives to express what is mandatory." *Shall*, Merriam-Webster, https://www.merriam-webster.com/dictionary/shall.
69. *Gateway I*, 616 B.R. at 848.
70. *Id.* at 849.
71. 15 U.S.C. § 9042(c)(3)(D)(i)(V) (2020) ("the recipient is not a debtor in a bankruptcy proceeding"); *Gateway I*, 616 B.R. at 848; In re Roman Catholic Church of Archdiocese of Santa Fe, 615 B.R. 644, 656 (Bankr. D.N.M. 2020).

in the mid-size business section of the CARES Act, but not from the PPP.[72] As a result, the pro-debtor courts held the SBA exceeded its statutory authority under 5 U.S.C. § 706(2)(C).[73]

ii. The SBA's Argument

The pro-SBA courts found that Congress has not directly spoken to whether bankruptcy debtors are eligible for PPP loans for three reasons.[74] First, the *Gateway II* court noted that "the PPP was not created as a standalone program but was added into the existing § 7(a) program,[75] which subjects it to existing conditions and regulations, as well as existing SBA authority."[76] Because § 7(a) subjects every loan made under that section to the sound value requirement,[77] the courts reasoned that Congress was aware of the sound value requirement when it passed the CARES Act legislation.[78] Second, the *Gateway II* court considered the CARES Act in context.[79] The *Gateway II* court noted that while Congress relaxed some existing section 7(a) requirements,[80] it did not relax the sound value requirement.[81] Third, the *Gateway II* court also reasoned that, under the CARES Act, the use of the word "may,"[82]

---

72. *Gateway I*, 616 B.R. at 849; *Roman Catholic Church*, 615 B.R. at 656.

73. *Gateway I*, 616 B.R. at 849; *In re Skefos*, 2020 WL 2893413, at *10; *Roman Catholic Church*, 615 B.R. at 657.

74. *Gateway II*, 983 F.3d 1239, 1256 (11th Cir. 2020); Tradeways, Ltd. v. U.S. Dep't. of the Treas., CV ELH-20-1324, 2020 WL 3447767, at *14 (D. Md. June 24, 2020).

75. For the purpose of this Article, § 7(a) refers to 15 U.S.C. 636(a) (2018).

76. *Gateway II*, 983 F.3d at 1256 (citing CARES Act, § 1102, 134 Stat. at 286).

77. *Id.* (citing 15 U.S.C. § 636(a)(6) ("[a]ll loans made under [§ 7(a)] shall be of such sound value or so secured as to reasonably assure repayment)); *Tradeways, Ltd.*, 2020 WL 3447767, at *13 (same). The SBA codified the sound value requirement under the Code of Federal Regulations. 13 C.F.R. § 120.150 ("[t]he applicant . . . must be creditworthy" and "[l]oans must be so sound as to reasonably assure repayment."). The SBA considers nine factors in determining the soundness of its repayment criteria, such as "[c]haracter, reputation, and credit history" of the business, "[s]trength of the business," "future prospects" of the business, the business' "[a]bility to repay the loan," and the business' "[p]otential for long-term success." *Id.*

78. *Gateway II*, 983 F.3d at 1256–57; *Tradeways Ltd.*, 2020 WL 3447767, at *13.

79. *Gateway II*, 983 F.3d at 1256 (citing Wachovia Bank, N.A. v. United States, 455 F.3d 1261, 1267 (11th Cir. 2006)).

80. The relaxed requirements include allowing applicants to use PPP loans for "interest on any other debt obligations that were incurred before the covered period," 15 U.S.C. § 636(a)(36)(F)(i)(VII) and giving the SVA "no recourse" against the applicant unless the proceeds are used for an unauthorized purpose. *Id.* § 636(a)(36)(F)(v).

81. *Gateway II*, 983 F.3d at 1257.

82. Under the CARES Act, the SBA "may guarantee covered [PPP] loans under the same terms, conditions, and processes" as loans made under § 7(a). 15 U.S.C. § 636(a)(36)(B).

combined with the fact that the CARES Act provided the SBA with "[e]mergency rulemaking authority" to issue regulations on the PPP,[83] vests the SBA with discretionary authority to handle PPP loans under the sound value requirement.[84]

Next, these courts found the SBA's IFR rested on a reasonable construction of the CARES Act and section 7(a) for two reasons.[85] First, the *Tradeways, Ltd.* court looked at the SBA's justification for excluding bankruptcy debtors from the PPP.[86] It noted that the bankruptcy eligibility criteria to exclude bankruptcy debtors "did not arise out of thin air" but has instead been a part of the SBA's preexisting loan process under section 7(a).[87] Second, the courts noted that Congress gave the SBA fifteen days after enacting the CARES Act to issue regulations on the PPP.[88] Provided that fifteen days is "practically warp speed for regulatory action,"[89] these courts reasoned the SBA prioritized efficiency over accessibility.[90] As a result, the pro-SBA courts held that the PPP does not exceed statutory authority under section 706(2)(C).[91]

B. Arbitrary and Capricious

i. The Debtor's Argument

The pro-debtor courts argued that the IFR is arbitrary and capricious for three reasons. The courts' first reason was that the SBA's justification[92] is arbitrary and capricious because Congress

83. *Id.* § 9012.

84. *Gateway II*, 983 F.3d at 1257 (citing Kingdomware Techs., Inc. v. United States, 136 S. Ct. 1969, 1977 (2016)).

85. *Id.* at 1262; Tradeways, Ltd. v. U.S. Dep't. of the Treas., CV ELH-20-1324, 2020 WL 3447767, at *14 (D. Md. June 24, 2020).

86. *Tradeways, Ltd.*, 2020 WL 3447767, at *14 (citing 85 Fed. Reg. at 2,3451).

87. *Id.* (citing 13 C.F.R. § 120.10).

88. CARES Act, § 1114, 134 Stat. at 312; *Gateway II*, 983 F.3d at 1262; *Tradeways, Ltd.*, 2020 WL 3447767, at *14.

89. *Gateway II*, 983 F.3d at 1262.

90. *Id.*

91. *Id.*; *Tradeways, Ltd.*, 2020 WL 3447767, at *15 (citing Diocese of Rochester v. U.S. Small Bus. Admin., 466 F. Supp. 3d 363, 378 (W.D.N.Y. 2020); *In re Penobscot Valley Hosp.*, 19-10034, 2020 WL 3032939, at *9 (Bankr. D. Me. June 3, 2020) [hereinafter *Penobscot II*]).

92. As noted above, the SBA justified its decision to exclude bankruptcy debtors due to an "unacceptably high risk of an unauthorized use of funds or nonrepayment of unforgiven loans." Business Loan Program Temporary Changes, 85 Fed. Reg. at 23,451.

was not concerned with collectability.[93] The courts evidenced such a lack of concern in two ways.[94] The first way focused on the fact that "Congress requires no collateral or personal guarantee to obtain a PPP loan."[95] The second way relied on the fact that the SBA forgives PPP loans in full, so long as the applicant uses the proceeds for the PPP's specified purposes.[96] As a result, these courts determined that because "PPP loans are designed to be forgiven," the IFR ignored that Congress did not want the SBA to "focus on collectability."[97]

Second, these courts reasoned the IFR is arbitrary and capricious because it ignores protections afforded to debtors under Chapter 11.[98] The *Alaska Urological Inst.* court first looked at the policy behind Chapter 11[99] and the restrictions on what a debtor can and cannot do in a Chapter 11 bankruptcy.[100] As a result, the courts figured that the SBA ignored the purpose of Chapter 11 and the bankruptcy because there was no indication the SBA considered either in coming to its decision to exclude bankruptcy debtors from the PPP.[101]

---

93. Alaska Urological Inst., P.C. v. U.S. Small Bus. Admin., 619 B.R. 689, 709 (D. Alaska 2020); 616 B.R. 833, 850 (Bankr. M.D. Fla. 2020).

94. *Alaska Urological Inst.*, 619 B.R. at 709 (citing *In re Vestavia Hills, Ltd.*, 618 B.R. 294, 304–05 (Bankr. S.D. Cal. 2020)).

95. *Id.*

96. *Id.* ("Congress structured the PPP loans to be completely forgivable so long as the borrower uses the loan proceeds for covered expenses and provides documentation of such to its lender.").

97. *Id.*; *Gateway I*, 616 B.R. at 850.

98. *Alaska Urological Inst.*, 619 B.R. at 708; *Gateway I*, 616 B.R. at 851.

99. *Gateway I*, 616 B.R. at 851. As the court noted,

> The policy of chapter 11 is to provide a forum where troubled businesses can rehabilitate. . . . Chapter 11 embodies a policy that it is generally preferable to enable a debtor to continue to operate and to reorganize or sell its business as a going concern rather than simply to liquidate a troubled business." Continued operation of a business is preferable to liquidation not only because it preserves going-concern value, but because it can save the jobs of employees and the tax base of communities, and generally reduce the upheaval that can result from termination of a business.

Id. (citing *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 527 (1984); *In re Paris Indus. Corp.*, 106 B.R. 339, 341 (Bankr. D. Me. 1989); 7 Collier on Bankruptcy ¶ 1100.01 (Matthew Bender & Co. 16th ed.)).

100. *Alaska Urological Inst.*, 619 B.R. at 708. As the court noted,

> A debtor in chapter 11 bankruptcy must give notice to interested parties where it intends to borrow money outside the ordinary course of business. If the bankruptcy court permits the debtor to borrow money, the court can impose conditions on the debtor's doing so such as restricting [the] use of the loan proceeds. Moreover, debtors are required to file monthly operating reports detailing the debtor's receipts and disbursements.

Id. (citing *In re Vestavia Hills*, 618 B.R. at 305–06).

101. *Alaska Urological Inst.*, 619 B.R. at 709; *Gateway I*, 616 B.R. at 852.

Third, these courts reasoned the IFR is arbitrary and capricious because it fails to counter the evidence.[102] The *Alaska Urological Inst.* court noted that the record is "devoid of evidence that debtors are likely to misuse funds or that they pose a heightened risk of non-repayment of those misused funds."[103] Instead, the court determined it is even less likely that a debtor would misuse those funds based on the bankruptcy process.[104] As a result, the courts reasoned the SBA made no effort to support the IFR with any facts, citations, or evidence, as presented in the administrative record.[105]

ii. The SBA's Argument

These pro-SBA courts originally noted that an agency's explanation is usually "connected to the 'relevant matter presented' during the notice and comment period."[106] Yet these courts determined that this case is rather unusual because Congress ordered the SBA to issue its regulations on the PPP "without regard to the notice requirements [of] 5 U.S.C. § 553(b)."[107] As a result, the administrative record before the PPP's enactment is somewhat limited.[108]

To begin, these courts looked to the SBA's justification in the IFR.[109] The *Gateway II* court noted that none of the four situations in which courts have found an agency's decision to be arbitrary and

102. *Alaska Urological Inst.*, 619 B.R. at 709; *Gateway I*, 616 B.R. at 852.

103. *Alaska Urological Inst.*, 619 B.R. at 709.

104. *Id.* As the court in *Gateway I* noted, the bankruptcy court can order the debtor to only use the proceeds for the specified purposes of a PPP loan and even subject the debtor to file reports with supporting documentation so any interested party can confirm the debtor is using the funds for an authorized purpose. *Gateway I*, 616 B.R. at 854.

105. *Alaska Urological Inst.*, 619 B.R. at 709; *Gateway I*, 616 B.R. at 854.

106. 983 F.3d 1239, 1263 (11th Cir. 2020) (citing 5 U.S.C. § 553(c)).

107. *Id.* (internal quotations omitted) (citing 15 U.S.C. § 9012). This is because, as noted above, Congress required that the SBA issue regulations on the PPP within fifteen days of the "enactment of the [CARES Act]." *Supra* n. 88.

108. *Gateway II*, 983 F.3d 1239, 1263 (11th Cir. 2020).

109. Matter of Henry Anesthesia Assoc. LLC, AP 20-06084-LRC, 2020 WL 3002124, at *9 (Bankr. N.D. Ga. June 4, 2020). The SBA, after consulting the Secretary of the Treasury, justified its decision in the IFR by stating that "providing PPP loans to debtors in bankruptcy would present an unacceptably high risk of an unauthorized use of funds or non-repayment of unforgiven loans." Business Loan Program Temporary Changes, 85 Fed. Reg. 23,451 (Apr. 28, 2020). The SBA reached this conclusion with the expertise of not one, but two agencies: The SBA and the Secretary of the Treasury. *Gateway II*, 983 F.3d at 1263.

capricious are present in this case.[110] As for whether the SBA relied "on factors which Congress has not intended it to consider,"[111] the *Gateway II* court found that the SBA relied on two factors: the unauthorized use of funds and the risk of non-repayment,[112] finding both factors to be relevant.[113] Additionally, the *Gateway II* court noted that no court can say the SBA "failed to consider any important aspect of the problem, or offered an explanation contradicted by evidence that was put before it" because "there was no evidence put before it" to show otherwise.[114] Finally, the *Gateway II* court reasoned that no court can say that the SBA's explanation was implausible, considering the status of bankruptcy debtors[115] and the SBA's decision to consider the bankruptcy status of an applicant "did not arise out of thin [air]."[116]

While several courts disagreed with the SBA's decision to exclude bankruptcy debtors from the PPP,[117] the pro-SBA courts recognized that courts cannot "substitute . . . judgment for that of the [SBA]."[118] As a result, because the SBA's justification aligned with the CARES Act and § 7(a),[119]a bright-line rule to simply speed up decisions on an applicant's PPP-loan eligibility does not make such a rule arbitrary and capricious.[120]

---

110. *Gateway II*, 983 F.3d at 1263–64.

111. Motor Vehicle. Mfrs. Ass'n of U.S., Inc., 463 U.S. 29, 43 (1983).

112. *Gateway II*, 983 F.3d at 1264.

113. *Id.* As for the unauthorized use of funds, Congress created a list of "[a]llowable uses" for PPP loans. *Id.* (citing 15 U.S.C. § 636(a)(36)(F)). As for the risk of non-repayment, Congress additionally created "a specific list of costs for which loan forgiveness would be available." *Id.* (citing 15 U.S.C. § 9005(b)). As a result, it cannot be said that the SBA relied on factors that Congress did not intend for it to rely on. Schuessler v. U.S. Small Bus. Admin., AP 20-02065-BHL, 2020 WL 2621186, at *12 (Bankr. E.D. Wis. May 22, 2020) ("The record shows that the SBA has considered the relevant factors, including the goals of the CARES Act and those statutory provisions that the CARES Act left intact.").

114. *Gateway II*, 983 F.3d at 1263.

115. *Id.* This side noted that because bankruptcy debtors are normally financially distressed and have several competing creditors, "it is not implausible to believe" that giving PPP funds to a bankruptcy debtor "will increase the risk of unauthorized use of funds and non-repayment." *Id.*

116. *Tradeways, Ltd.*, 2020 WL 3447767, at *14 ("Rather, the SBA's preexisting § 7(a) loan application asks a prospective borrower to disclose whether it or an affiliate has filed for bankruptcy." (citing SBA Form 1919: SBA 7(a) Borrower Information Form at 2, *Tradeways, Ltd.*, 2020 WL 3447767, ECF No. 12-1.)).

117. *Id.* at *15; Matter of Henry Anesthesia Assoc. LLC, AP 20-06084-LRC, 2020 WL 3002124, at *10 (Bankr. N.D. Ga. June 4, 2020); *Schuessler*, 2020 WL 2621186, at *12.

118. *E.g.*, Motor Vehicle. Mfrs. Ass'n of U.S., Inc., 463 U.S. 29, 43 (1983); *Schuessler*, 2020 WL 2621186, at *12.

119. *Schuessler*, 2020 WL 2621186, at *12.

120. *Gateway II*, 983 F.3d at 1263.

C. 11 U.S.C. § 525

The SBA conceded that it falls within the definition of "governmental unit" in the Bankruptcy Code and that it denies debtors the opportunity to take part in the PPP because they filed for bankruptcy.[121] Thus, the only element at issue is whether the PPP is a "license, permit, charter, franchise, or other similar grant," as defined in § 525(a).

IV. THE DEBTOR'S ARGUMENT

The pro-debtor courts held that the PPP is not a loan but "a grant or support program."[122] The courts reasoned that the PPP program falls under § 525(a)'s requirements under the "other similar grant" category.[123] While the Bankruptcy Code does not define "other similar grant," these courts rely on the Second Circuit's interpretation of "other similar grant."[124] The Second Circuit characterizes the property interests protected under § 525(a) as having two essential qualities: (1) being "unobtainable from the private sector" and (2) "essential to a debtor's fresh

121. In re Calais Regl. Hosp., 615 B.R. 354, 358 (Bankr. D. Me. 2020); In re Penobscot Valley Hosp., 19-10034, 2020 WL 2201943, at *3 (Bankr. D. Me. May 1, 2020) [hereinafter Penobscot I].

122. In re Roman Catholic Church of Archdiocese of Santa Fe, 615 B.R. 644, 654 (Bankr. D.N.M. 2020); *Calais Regl. Hosp.*, 615 B.R. at 359; *Penobscot I*, 19-10034, 2020 WL 2201943, at *3 (Bankr. D. Me. May 1, 2020).

123. *Roman Catholic Church*, 615 B.R. at 656; *Calais Regl. Hosp.*, 615 B.R. at 358; *Penobscot I*, 2020 WL 2201943, at *4. Of note here, the *Calais Regl. Hosp.* and *Penobscot I* case involved the granting of a temporary restraining order (collectively, "TRO Opinions"). *Calais Regl. Hosp.*, 615 B.R. at 355; *Penobscot I*, 2020 WL 2201943, at *1. The presiding judge in both cases, Judge Michael A. Fagone, is also the author of *Penobscot II*, in which Judge Fagone finds the PPP does not fall under the "other similar grant" language and ruled for the SBA on the § 525(a) issue. *Penobscot II*, No. 19-10034, 2020 WL 3032939, at *14–16 (Bankr. D. Me. Jan. 12, 2021).

124. *Roman Catholic Church*, 615 B.R. at 656 (citing Stoltz v. Brattleboro Hous. Auth. (In re Stoltz), 315 F.3d 80, 88–90 (2d Cir. 2002) (holding that eviction of a debtor from a public unit house solely based on failure to pay a discharged, pre-petition rent violated § 525(a)); *Calais Regl. Hosp.*, 615 B.R. at 358 (citing *Stoltz*, 315 F.3d at 88–90. *See also* In re The Bible Speaks, 69 B.R. 368, 374 (Bankr. D. Mass. 1987) ("Congress intended § 525(a) . . . to expand on and develop *Perez* so that the doctrine would extend to many forms of discrimination."); Rose v. Conn. Hous. Fin. Auth. (In re Rose), 23 B.R. 662, 666–67 (Bankr. D. Conn 1982) (construing § 525(a) given the fresh start policy and concluding that a state may not exempt debtors from a state-sponsored home financing program just because of bankruptcy); 4 Collier on Bankruptcy ¶ 525.02 (16th ed.)); *Penobscot I*, 2020 WL 2201943, at *3 (citing same).

start."[125] According to the pro-debtor courts, the PPP satisfies both conditions.[126] As for the first prong, they reasoned the PPP can "only be offered by the government" because "private lenders do not give away money."[127] As for the second prong, they reasoned the PPP loans are essential to a debtor's fresh start because the PPP is "free money."[128]

What's more, while these courts acknowledge that the PPP characterizes the program as "covered loans" and specifies features specific only to loans,[129] they reasoned that fixating on details takes away from the purpose of the PPP.[130] Lastly, the courts find the argument that § 525(c)[131] proves Congress did not intend for § 525(a) to extend to loans[132] rather unpersuasive.[133]As a result, the pro-debtor courts held that the PPP violates 11 U.S.C. § 525(a).[134]

125. *Stoltz*, 315 F.3d at 88–90.

126. *Roman Catholic Church*, 615 B.R. at 656; *Calais Regl. Hosp.*, 615 B.R. at 358; *Penobscot I*, 2020 WL 2201943, at *3.

127. *Roman Catholic Church*, 615 B.R. at 657. As a result, this side reasoned that PPP funds are unobtainable from the private sector. *Id.* (quotations omitted) (citing *Stoltz*, 315 F.3d at 90).

128. *Id.* ("[o]f all the benefits a government can grant, free money might be the best of all").

129. *See, e.g.*, 15 U.S.C. § 636(a)(36)(A)(ii).

130. *Calais Regl. Hosp.*, 615 B.R. at 359 ("fixation on the details loses the forest in the trees during a conflagration."); *Penobscot I*, 2020 WL 2201943, at *4. As noted in TRO Opinions, the CARES Act "is a grant of aid necessitated by a public health crisis." *Calais Regl. Hosp.*, 615 B.R. at 359; *Penobscot I*, 2020 WL 2201943, at *4. To liken the PPP to a normal loan "may miss the point" of establishing the PPP in the first place. *Calais Regl. Hosp.*, 615 B.R. at 359; *Penobscot I*, 2020 WL 2201943, at *4.

131. Section 525(c) states that "[a] governmental unit . . . may not deny a student grant, loan, loan guarantee, or loan insurance to a person that is or has been a debtor."

132. *See Infra* note 139.

133. *Calais Reg'l. Hosp.*, 615 B.R. at 359. This side finds this argument unpersuasive for two reasons. First, it states that the Supreme Court has "been skeptical of this type of inferential reasoning." *Id.* (citing Mission Prod. Holdings, Inc. v. Tempnology, LLC, 139 S. Ct. 1652, 1664–65 (2019)). Second, it finds that the canon of *expressio unius est exclusio alterius* (the inclusion of one is the exclusion of another) is not an inflexible rule. *Id.* (citing Hewlett-Packard Co., Inc. v. Berg, 61 F.3d 101, 106 (1st Cir. 1995)).

134. In re Roman Catholic Church of the Archdiocese of Santa Fe, 615 B.R.644, 657 (Bankr. D.N.M. 2020); *Calais Reg'l. Hosp.*, 615 B.R. at 359; *Penobscot I*, 2020 WL 2201943, at *4.

V. THE SBA'S ARGUMENT

The pro-SBA courts held that the PPP is a loan, not a grant, for four reasons.[135] The first reason focuses on the text of the CARES Act itself, which categorizes the PPP as a loan.[136] The second reason relies on the statutory context and placement of the PPP.[137] The third reason hinges on the possibility of PPP forgiveness, but still does not make the PPP a grant.[138] The fourth reason focuses on the argument that the inclusion of the word "loan" under § 525(c), but not § 525(a), proves that Congress did not intend for § 525(a) to apply to PPP loans.[139]

What's more, these courts reasoned that even if the PPP is a grant, it does not fall within the scope of § 525(a) because it is not similar to a "license, permit, charter, [or] franchise" to fall under the "other similar grant" requirement of § 525(a).[140] These courts rely heavily on the *Ayes* case, in which the Fourth Circuit reasoned the word "similar" limits the universe of the word "grant" to "license[s], permit[s], charter[s], [and] franchise[s]."[141] The courts

135. *Tradeways, Ltd.*, 2020 WL 3447767, at *17 (D. Md. June 24, 2020); *Penobscot II*, No. 19-10034, 2020 WL 3032939, at *11 (Bankr. D. Me. Jan. 12, 2021).

136. *Tradeways, Ltd., 2020 WL 3447767, at *17* (citing 15 U.S.C. § 636(a)(36)(A)–(F)). The word "loan" appears 75 times in the CARES Act provisions for the PPP. *Id.* As a result, this side reasoned the PPP is a loan, not a grant. *Id.*

137. *Tradeways, Ltd.*, 2020 WL 3447767, at *17 (citing Gundy v. United States, 139 S. Ct. 2116, 2126 (2019)). As is relevant here, Congress did not create a new subchapter under Title 15 for the PPP, as it did for mid-size businesses. *Id.* (citing 15 U.S.C. § 9042). Rather, the CARES Act added the PPP to § 636(a) and subjected it to the requirements of § 7(a). *Id.* As a result, this side reasoned the PPP is a loan, not a grant. *Id.*

138. *Tradeways, Ltd.*, 2020 WL 3447767, at *17. Most notably, the SBA requires PPP borrowers to sign a promissory note when they receive PPP funds. *Id.* (citing 85 Fed. Reg. at 23,450–51 (Apr. 28, 2020); SBA Form 147). What's more, this side reasoned that many federal programs forgive "some or all of the amount borrowed . . . depending on the circumstances." *Id.* (citing 20 U.S.C. § 1087e(m)(1) (Public Service Loan Forgiveness Program); 20 U.S.C. § 1087j(b) (Teacher Loan Forgiveness Program)). As a result, "[t]he existence of favorable terms and a unique feature (namely, forgiveness under specified circumstances) does not change the character of what the [d]ebtor wants to obtain: a loan that might be forgiven by the lender." *Penobscot II*, 2020 WL 3032939, at *11.

139. *Tradeways, Ltd.*, 2020 WL 3447767, at *18 (citing Maine Cmty. Health Options v. United States, 140 S. Ct. 1308, 1323 (2020); Loughrin v. United States, 573 U.S. 351, 358 (2014)).

140. *Tradeways, Ltd.*, 2020 WL 3447767, at *19; *Penobscot II*, 2020 WL 3032939, at *14.

141. *Tradeways, Ltd.*, 2020 WL 3447767, at *16 (citing Ayes v. U.S. Dep't. of Veterans Affairs, 473 F.3d 104, 108 (4th Cir. 2006)); *Penobscot II*, 2020 WL 3032939, at *14 (citing *Ayes*, 473 F.3d at 108). Like the Second Circuit, the Fourth Circuit reasoned that "[l]icenses, permits, charters, and franchises" under § 525(a) are all meant (1) to "permit an individual to pursue some occupation or endeavor aimed at economic betterment" and, (2) implicate the "government's role as a gatekeeper in determining who may pursue certain livelihoods."

reasoned the PPP fits neither characteristic required of a "license, permit, charter, [or] franchise" under § 525(a).[142] Thus, the pro-SBA courts held the PPP is not a grant similar to a "license, permit, charter, [or] franchise" under § 525(a).[143]

VI. ANALYSIS

While both sides made compelling arguments,[144] only one view can be correct. This Part will first address why the IFR does not exceed statutory authority under 5 U.S.C. § 706(c). Second, it will address why the IFR is not arbitrary and capricious under 5 U.S.C. § 706(a). Third, it will explain why the IFR does not violate 11 U.S.C. § 525(a).

A. THE IFR DOES NOT EXCEED STATUTORY AUTHORITY

i. Congress Has Not Directly Spoken On The Issue

As noted above, the *Chevron* two-step test requires a reviewing court first to determine whether Congress has directly spoken on the issue at hand: Whether bankruptcy debtors are eligible for the PPP.[145] While Congress has not directly spoken on the issue, this is not one of the extreme situations in which Congress's silence provides finality on the matter.[146] Instead, the PPP's placement under § 7(a), a reading of the CARES Act in context, and the SBA's longstanding discretionary authority to implement §7(a) and the sound value requirement make it clear that Congress intended to delegate who is eligible for the PPP to the SBA.

First, while the CARES Act did provide that a small business "that has 500 employees or fewer 'shall be eligible' for a PPP

Tradeways, Ltd., 2020 WL 3447767, at *16 (citing *Ayes*, 473 F.3d at 108–09); *Penobscot II*, 2020 WL 3032939, at *14 (citing *Ayes*, 473 F.3d at 108–09).

142. *Tradeways, Ltd.*, 2020 WL 3447767, at *16; *See Infra* note 226–31.

143. *Tradeways, Ltd.*, 2020 WL 3447767, at *16 (citing *Ayes*, 473 F.3d at 108–09); *Penobscot II*, 2020 WL 3032939, at *15 (citing *Ayes*, 473 F.3d at 108–09).

144. *See supra* Part III.

145. Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837, 842 (1984).

146. King v. Burwell, 576 U.S. 473, 485 (2015) (citing FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 159 (2000)).

loan,"[147] the PPP's placement under § 7(a) makes it clear that Congress intended to delegate regulations on PPP eligibility to the SBA.[148] Any loan made under § 7(a) subjects the SBA to the sound value requirement to "assure repayment" of such loan.[149] The SBA, facing the sound value requirement, generally considers nine factors in determining the soundness of its repayment.[150] These factors include "[c]haracter, reputation, and credit history" of the business, "[s]trength of the business," "future prospects" of the business, the business' "[a]bility to repay the loan," and the business' "[p]otential for long-term success."[151] While it is true that the CARES Act did render mid-size businesses ineligible for loans under the Act,[152] it needed to do so because Congress created a new subchapter under Title 15 for mid-size businesses.[153] The same is not true for the PPP. The PPP "was not created as a standalone program[,] but was added into the existing § 7(a) program," subjecting the PPP to the existing § 7(a)'s conditions, rules, and regulations.[154] As a result, because courts presume that "Congress is aware of existing law when it passes legislation,"[155] one can assume Congress knew that placing the PPP under § 7(a) subjected it to the sound value requirement and the SBA's discretion.

Second, another indicator that Congress intended to delegate the authority to the SBA derives from reading the text of the CARES Act. In the context of the PPP, the CARES act relaxed specific requirements under § 7(a).[156] Yet Congress did not render

---

147. *Gateway I*, 616 B.R. 833, 848 (Bankr. M.D. Fla. 2020), *vacated in part*, *appeal dismissed in part*, *Gateway II*, 983 F.3d 1239 (11th Cir. 2020).

148. Mississippi ex rel. Hood v. AU Optronics Corp., 571 U.S. 161, 169 (2014) (citing Hall v. United States, 566 U.S. 506, 516 (2012)).

149. 15 U.S.C. § 636(a)(6).

150. 13 C.F.R. 120.150.

151. *Id.*

152. 15 U.S.C. § 9042(c)(3)(D)(i)(V) ("the recipient is not a debtor in a bankruptcy proceeding"); *Gateway I*, 616 B.R. at 848; In re Roman Catholic Church of the Archdiocese of Santa Fe, 615 B.R. 644, 655–56 (Bankr. D.N.M. 2020).

153. 15 U.S.C. § 9042.

154. *Gateway II*, 983 F.3d 1239, 1256 (11th Cir. 2020) (citing CARES Act, § 1102, 134 Stat. at 286 (noting that Congress "amended" § 7(a) of the Small Business Act to include the PPP)). As a result, Congress subjected the PPP to "existing conditions and regulations, as well as existing SBA authority." *Id.*

155. Mississippi ex rel. Hood v. AU Optronics Corp., 571 U.S. 161, 169 (2014).

156. *See, e.g.*, 15 U.S.C. § 636(a)(36)(D) (increasing "eligibility for certain small businesses and organizations" under the PPP); 15 U.S.C. § 636(a)(36)(I) ("[d]uring the

PPP loans inapplicable to the sound value requirement. Because Congress "does not alter . . . fundamental details of a regulatory scheme in vague terms or ancillary provisions,"[157] one cannot infer that Congress intended to render PPP loans inapplicable to § 7(a) based on its silence.[158] As a result, "[a]ny tension between the more lenient aspects of the CARES Act and the existing § 7(a) sound value requirement" is more evidence that Congress identified several interests it wanted accommodated but delegated the task to the SBA.[159]

Last, the final indicator that Congress intended to delegate the matter to the SBA stems from the SBA's longstanding discretionary authority to implement the sound value requirement.[160] As usual, Congress gave the SBA its ordinary discretionary authority to enforce the PPP under the normal § 7(a) provisions.[161] Yet the CARES Act also gave the SBA "[e]mergency rulemaking authority" to "issue regulations to carry out" the PPP without regard to the general notice requirements of 5 U.S.C. § 553(b).[162] That the SBA can bypass standard rulemaking requirements for the PPP makes it clear Congress intended for the SBA to have discretion on who can be a debtor under the CARES Act.

---

covered period, the requirement that a small business concern is unable to obtain credit elsewhere, as defined in section 632(h) of this title, shall not apply to a covered loan.").

157. Whitman v. Am. Trucking Ass'ns , 531 U.S. 457, 468 (2001) (congress does not "hide elephants in mouseholes.").

158. *Id.*

159. *Gateway II*, 983 F.3d at 1257 (citing Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837, 865 (1984)).

160. When Congress created the Small Business Act of 1953, it declared "the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small-business concerns in order to preserve free competitive enterprise . . . and to maintain and strengthen the overall economy of the Nation." 15 U.S.C. § 631(a). The SBA, created to carry out these policies, "was given extraordinarily broad powers to accomplish [its] important objectives, including that of lending money to small businesses whenever they could not get necessary loans on reasonable terms from private lenders." Small Bus. Administration v. McLellan, 364 U.S. 446, 447 (1960).

161. Under the CARES Act, Congress noted that the SBA "may guarantee covered [PPP] loans under the same terms, conditions, and processes" as loans made under § 7(a). 15 U.S.C. 636(a)(36)(B). The use of the word "may" vests the SBA with discretionary authority to manage the PPP loan process under the sound value requirement. Kingdomware Techs., Inc. v. U.S., 136 S. Ct. 1969, 1977 (2016) (citing United States v. Rodgers, 461 U.S. 677, 706 (1983)).

162. 5 U.S.C. § 9012.

B. THE SBA BASED THE IFR ON A PERMISSIBLE CONSTRUCTION OF THE STATUTE

Because Congress has not spoken on the issue at hand, this Article must turn to the second step in *Chevron*: whether the SBA based the IFR on a "permissible construction of the statute."[163] Because Congress's delegation was implicit rather than explicit, the IFR's validity hinges on whether it was reasonable.[164] As explained below, the IFR is reasonable based on the circumstances leading up to the IFR's enactment.

To begin, the IFR is reasonable based on the SBA's justification. The SBA justified the IFR by stating that "providing PPP loans to debtors in bankruptcy would present an unacceptably high risk of an unauthorized use of funds or nonrepayment of unforgiven loans."[165] What's more, Congress only gave the SBA fifteen days to issue regulations on the PPP.[166] Fifteen days "is practically warp speed for regulatory action, a command that undoubtedly sprang from the felt need for quick action in light of the burgeoning economic crisis stemming from the pandemic."[167]

While it is true that financial distress is a baseline for PPP funding approval, "the SBA perceived an additional risk that PPP loan funds might not be used for their intended purposes" by bankruptcy debtors, such as paying administrative creditors.[168] Furthermore, while it is true that many Chapter 11 debtors are trying to reorganize, "the SBA simply did not have the luxury of considering" each individualized bankruptcy case given the ongoing pandemic.[169] As the *Penobscot III* court reasoned, "many reorganizations do fail despite" the best efforts of the debtors.[170] When reorganization fails, one of the options is that the Chapter 11 reorganization converts to a Chapter 7 liquidation.[171]

163. *Chevron*, 467 U.S. at 843.
164. *Gateway II*, 983 F.3d at 1261.
165. Business Loan Program Temporary Changes, 85 Fed. Reg. 23,450, 23,451 (Apr. 28, 2020).
166. *Gateway II*, 983 F.3d at 1262.
167. *Id.*; CARES Act, § 1114, 134 Stat. at 312.
168. In re Penobscot Valley Hosp., No. 19-10034, 2021 WL 150412, at *13 (Bankr. D. Me. Jan. 12, 2021) [hereinafter *Penobscot III*].
169. *Id.*
170. *Id.*
171. *Id.* (citing 11 U.S.C. 1112) (under chapter 7, any unencumbered assets "would be distributed in accordance with the waterfall contained in 11 U.S.C. § 726.").

The possibility of a PPP borrower converting their Chapter 11 bankruptcy to a Chapter 7 bankruptcy is problematic. Liquidation does not further the purpose of the PPP because of the possibility of using funds for unauthorized purposes.[172] What's more, liquidation also accentuates the risk of non-repayment.[173] As explained below, these are two factors Congress intended for the SBA to rely on in regulating the PPP.[174] To bypass such concerns and implement Congress's wishes, "[t]he SBA . . . simplified the process by adopting a bright-line rule rendering debtors in bankruptcy ineligible."[175] The SBA's decision "obviat[ed] the need for a lender or the SBA to review the circumstances of individual debtors and to monitor ongoing bankruptcy cases."[176]

While the SBA's interpretation is likely not "the reading [one] would . . . reach[] if the question initially had arisen in a judicial proceeding," a reviewing court cannot substitute their judgment for that of the SBA.[177] Still, given the SBA's reasoning and the circumstances surrounding the enactment of the IFR, the SBA based the IFR on a permissible construction of the CARES Act and § 7(a).[178] As a result, the SBA did not exceed its statutory authority under 5 U.S.C. § 706(2)(C).

172. *Id.* at 368–69.
173. *Id.*
174. *See infra* notes 181–85.
175. *Penobscot III*, 2021 WL 150412, at *12. As noted above, the decision to consider the bankruptcy status of an applicant "did not arise out of thin [air]." Tradeways, Ltd. v. U.S. Dep't. of the Treas., CV ELH-20-1324, 2020 WL 3447767, at *14 (D. Md. June 24, 2020). As explained above, "the SBA is constrained and guided by the terms" of § 7(a) and the sound value requirement. *Penobscot III*, 2021 WL 150412, at *3. Given the constraints of the sound value requirement, the SBA considers an applicant's bankruptcy history, as "applicants are asked to disclose prior bankruptcy filings." *Id.*
176. *Id.*
177. *Gateway II*, 983 F.3d 1239, 1261–62 (11th Cir. 2020).
178. *Id.*

C. THE IFR IS NOT ARBITRARY AND CAPRICIOUS

While multiple courts agree that the arbitrary and capricious test overlaps with the second step of *Chevron*,[179] this Article will address each test separately. When applying the four elements mentioned in *Motor Vehicle. Mfrs. Ass'n of U.S., Inc.*, the only conclusion a reviewing court can reach is that none of them apply here.[180]

First, the SBA focused on factors Congress intended for it to rely on. In the IFR, the SBA focused on the "unacceptably high risk of an unauthorized use of funds or non-repayment of unforgiven loans" when justifying its decision to exclude bankruptcy debtors from the PPP.[181] While the court's ruling for the debtor has held the IFR to be arbitrary and capricious because Congress was not concerned with collectability,[182] such reasoning disregards provisions in the CARES Act that say otherwise. Regarding the unauthorized use of funds, Congress defined a specific list of "[a]llowable uses" for PPP loans.[183] On the non-repayment of unforgiven loans, this argument fails because Congress enacted a list of specific costs for which loan forgiveness would be available for the PPP.[184] What's more, Congress also factored the risk of non-repayment into the PPP "by adding [the] PPP into § 7(a) and maintaining the sound value requirement, which is implemented by creditworthiness regulations."[185]

Additionally, no court can say the SBA "failed to consider any important aspect of the problem, or offered an explanation contradicted by evidence that was put before it" because "there was no evidence put before it" to show otherwise.[186] Typically, an

---

179. *See, e.g.*, River St. Donuts, LLC v. Napolitano, 558 F.3d 111, 117 (1st Cir. 2009).

180. 463 U.S. 29, 43 (1983).

181. Business Loan Program Temporary Changes, 85 Fed. Reg. 23,451 (Apr. 28, 2020).

182. Alaska Urological Inst., P.C. v. U.S. Small Bus. Admin., 619 B.R. 689, 710 (D. Alaska 2020); *Gateway I*, 616 B.R. 833, 850 (Bankr. M.D. Fla. 2020).

183. 15 U.S.C. § 636(a)(36)(F)(i).

184. 15 U.S.C. § 9005(b) (current version at 15 U.S.C. § 636(m)).

185. *Gateway II*, 983 F.3d 1239,1264 (11th Cir. 2020); Matter of Henry Anesthesia Associates LLC, AP 20-06084-LRC, 2020 WL 3002124, at *9 (Bankr. N.D. Ga. June 4, 2020). What's more, if the SBA does not forgive the PPP amount, the PPP turns into a full-fledged loan, with a ten-year maturation period and an interest rate of up to four percent. CARES Act § 1102, 134 Stat. at 291. Thus, while Congress was not concerned with the collectability of forgiven loans, the same is not true for unforgiven PPP loans.

186. *Gateway II*, 983 F.3d at 1263.

agency's explanation "is connected to the 'relevant matter presented' during the notice and comment period."[187] A formal notice and comment period was impossible because Congress gave the SBA such short notice to create these regulations.[188] Provided that fifteen days is "practically warp speed for regulatory action,"[189] to hold the SBA liable for a devoid record would be to punish the SBA for doing what Congress intended for it to do.

Finally, while it is true that Chapter 11 affords debtors more protections than it would under Chapter 7, "the SBA simply did not have the luxury of considering" each individualized bankruptcy case given the ongoing pandemic.[190] Instead, the SBA looked at bankruptcy debtors generally[191] and "decided to streamline processing by imposing a bright line exclusion of debtors in bankruptcy,"[192] a consideration that "did not arise out of thin [air]."[193] As a result, the SBA's decision to create a bright-line exclusion for bankruptcy to speed up PPP eligibility is not implausible, irrational, nor is it the product of arbitrary and capricious decision making.[194]

None of the four situations from *Motor Vehicle Mfrs. Ass'n*, in which courts have found an agency's decision to be arbitrary and capricious, are present here.[195] As a result, a reviewing court must defer to the SBA's reasoning[196] and cannot "substitute its judgment

187. *Id.* (citing 5 U.S.C. § 553(c)).

188. *Id.* at 1262; CARES Act § 1114, 134 Stat. at 312; Tradeways, Ltd. v. U.S. Dep't. of the Treas., CV ELH-20-1324, 2020 WL 3447767, at *14 (D. Md. June 24, 2020).

189. *Gateway II*, 983 F.3d at 1262.

190. *Penobscot III*, 626 B.R. at 368.

191. Bankruptcy debtors are normally financially distressed and have several competing creditors. *Gateway II*, 983 F.3d at 1263.

192. Diocese of Rochester v. U.S. Small Bus. Admin., 466 F. Supp. 3d 363, 378 (W.D.N.Y. 2020).

193. *Tradeways, Ltd.*, 2020 WL 3447767, at *14. "Rather, the SBA's preexisting § 7(a) loan application asks a prospective borrower to disclose whether it or an affiliate has filed for bankruptcy." *Id.* (citing ECF 12-1).

194. *Id.*; Schuessler v. U.S. Small Bus. Admin., AP 20-02065-BHL, 2020 WL 2621186, at *12 (Bankr. E.D. Wis. May 22, 2020) ("[t]he SBA's explanation is consistent with the record and the court cannot conclude that it is 'implausible.'").

195. 463 U.S. at 43–44.

196. *Penobscot II*, No. 19-10034, 2020 WL 3032939, at *9 (Bankr. D. Me. Jan. 12, 2021) ("[t]he SBA's bankruptcy exclusion was a reasonable effort to accommodate the conflicting policies committed to the SBA's care, and one that Congress might reasonably have sanctioned."); *Schuessler*, 2020 WL 2621186, at *12 ("[t]he record shows that the SBA has considered the relevant factors, including the goals of the CARES Act and those statutory provisions that the CARES Act left intact. The denial of PPP participation to entities that have already resorted to bankruptcy, while reserving PPP loans to those whose financial

for that of the [SBA]."[197] Thus, the IFR is not arbitrary and capricious under 5 U.S.C. § 706(2)(A).

D. THE IFR DOES NOT VIOLATE 11 U.S.C. § 525(a)

The SBA concedes that it falls within the definition of "governmental unit" in the Bankruptcy Code and that it denies debtors the opportunity to take part in the PPP because they filed for bankruptcy.[198] Thus, the only remaining element at issue is whether the PPP is a "license, permit, charter, franchise, or other similar grant," as defined in § 525(a). As explained below, the PPP does not fall into such a categorization. Even if the PPP were a grant, though, it still does not violate § 525(a) because it is not similar to a "license, permit, charter, franchise, or other similar grant."

i. The PPP is a loan, not a grant

While some courts, when ruling in favor of debtors, characterize the PPP as a grant,[199] this goes against the plain meaning of the words in the CARES Act.[200] First, the CARES Act characterizes the PPP as a "covered loan" and defines an eligible recipient as "an individual or entity that is eligible to receive a covered loan."[201] Further, Congress authorized the SBA to guarantee these "covered loan[s]" issued under the PPP and directed the SBA to "register the [PPP] loan]" within fifteen days of disbursement of the PPP proceeds.[202] Congress also titled the section that determines how much PPP funds a recipient receives the "[m]aximum loan amount."[203] Finally, the CARES Act specifies

---

troubles have not yet gotten to the point (and perhaps never will) is a rational policy choice. The agency's policy choice is consistent with the CARES Act and the SBA's preexisting statutory mandate.").

197. *E.g.*, Motor Vehicle. Mfrs. Ass'n of U.S., Inc., 463 U.S. 29, 43 (1983); *Schuessler*, 2020 WL 2621186, at *12.

198. *E.g.*, In re Calais Regl. Hosp., 615 B.R. 354, 358 (Bankr. D. Me. 2020); *Penobscot I*, 19-10034, 2020 WL 2201943, at *3 (Bankr. D. Me. May 1, 2020).

199. *E.g.*, *Calais Reg'l Hosp.*, 615 B.R. at 359; *Roman Cath. Church*, 615 B.R. at 656; *Penobscot I*, 2020 WL 2201943, at *3.

200. Conn. Nat'l Bank v. Germain, 503 U.S. 249, 253–54 (1992).

201. 15 U.S.C. §§ 636(a)(36)(A)(ii), (iv).

202. *Id.* §§ 636(a)(36)(B), (C).

203. *Id.* § 636(a)(36)(E).

that financial lenders exercise the SBA's authority to make and approve these "covered loans."[204] Overall, the word "loan" appears seventy five times within the CARES Act when describing the PPP.[205] Because the words "loan" and "grant" have different meanings[206] and are unambiguous in the context of the CARES Act,[207] that Congress categorized the PPP as a loan rather than a grant makes it not subject to § 525(a).

Additionally, the statutory context of the CARES Act reinforces the idea that the PPP is a loan, not a grant. As mentioned above, Congress decided to add the PPP as a subsection to § 7(a). Congress did not do the same thing for loans for mid-size businesses.[208] Instead, Congress enacted a new subchapter under Title 15 for mid-size business loans.[209] Because "Congress is aware of existing law when it passes legislation,"[210] Congress knew that, by adding the PPP as a subsection to § 636(a) rather than creating a new subchapter for it under Title 15, it characterized the PPP as a loan and subjected the PPP to the "sound value" requirement. Thus, the location of the PPP's placement under section 636(a) makes it clear that the PPP is a loan program, not a grant program.

Further, the statutory canon that "the expression of one thing is the exclusion of another" counsels a reviewing court from reading § 525(a) to encompass loans.[211] While it is true that § 525(a) does mention a "similar grant" applying under § 525(a), 11 U.S.C. § 525(c) states that "[a] governmental unit . . . may not deny a student grant, loan, loan guarantee, or loan insurance to a person that is or has been a debtor under this title. . . ." That

---

204. *Id.* § 636(a)(36)(F)(ii)(I).

205. Tradeways, Ltd. v. U.S. Dep't. of the Treas., CV ELH-20-1324, 2020 WL 3447767, at *17 (D. Md. June 24, 2020).

206. A loan is "money lent at interest." *Loan*, Merriam-Webster, https://www.merriam-webster.com/dictionary/loan (last visited Mar. 21, 2022). On the other hand, a grant is "a gift (as of land or money) for a particular purpose." *Grant*, Merriam-Webster, https://www.merriam-webster.com/dictionary/grant (last visited Mar. 21, 2022).

207. *Tradeways, Ltd.*, 2020 WL 3447767, at *17.

208. 15 U.S.C. § 9042.

209. *Id.* § 9042.

210. Mississippi ex rel. Hood v. AU Optronics Corp., 571 U.S. 161, 169 (2014) (citing Hall v. United States, 566 U.S. 506, 516 (2012)).

211. *Tradeways, Ltd.*, 2020 WL 3447767, at *18 (citing Maine Cmty. Health Options v. United States, 140 S. Ct. 1308, 1323 (2020); Loughrin v. United States, 573 U.S. 351, 358 (2014)).

Congress included loans under § 525(c), but not § 525(a), makes it clear that Congress did not intend for § 525(a) to cover loans.[212]

Lastly, any argument that the PPP is a grant rather than a loan because of its "generous forgiveness terms" is troublesome.[213] First, in some cases, the SBA does not forgive a PPP loan.[214] When the SBA does not forgive a PPP loan, the PPP turns into a full-fledged loan, with a ten-year maturation period and an interest rate of up to four percent.[215] What's more, many federal programs forgive "some or all of the amount borrowed . . . depending on the circumstances."[216] That the SBA forgives some or even all of the PPP funds does not change that the PPP is, in essence, a loan. As a result, "the mere existence of favorable forgiveness terms in the CARES Act does not transform a PPP loan into a grant."[217] Thus, because the PPP is by nature a loan, although a forgivable one,[218] it cannot be subject to § 525(a).[219]

E. THE PPP IS NOT SIMILAR TO A "[L]ICENSE, [P]ERMIT, [C]HARTER, [OR] [F]RANCHISE" UNDER § 525(a)

Even if a reviewing court did characterize the PPP as a grant, it still would not fall within the scope of § 525(a). In *Ayes*, the Fourth Circuit focused on whether a guaranty entitlement, "undoubtedly a 'grant' as that term is used in the statute," falls under § 525(a)'s "other similar grant" requirement.[220] The court reasoned that the word "similar," based on its plain meaning,[221]

212. *Id.* at *16.

213. *Id.* at *17.

214. 15 U.S.C. § 636m.

215. CARES Act, § 1102, 134 Stat. at 291.

216. *Tradeways, Ltd.*, 2020 WL 3447767, at *17 (citing 20 U.S.C. § 1087e(m)(1) (Public Service Loan Forgiveness Program); 20 U.S.C. § 2087j(b) (Teacher Loan Forgiveness Program)).

217. *Id.* (citing Diocese of Rochester v. U.S. Small Bus. Admin., 466 F. Supp. 3d 363, 379 (W.D.N.Y. 2020); No. 19-10034, 2020 WL 3032939, at *15 (Bankr. D. Me. Jan. 12, 2021); Schuessler v. U.S. Small Bus. Admin., AP 20-02065-BHL, 2020 WL 2621186, at *2 (Bankr. E.D. Wis. May 22, 2020)).

218. *See supra* notes 213–17.

219. *Tradeways, Ltd.*, 2020 WL 3447767, at *18 (citing Maine Cmty. Health Options v. United States, 140 S. Ct. 1308, 1323 (2020); Loughrin v. United States, 573 U.S. 351, 358 (2014)).

220. Ayes v. U.S. Dep't. of Veterans Affairs, 473 F.3d 104, 108 (4th Cir. 2006).

221. Merriam-Webster defines the word "similar" as "having characteristics in common" and "alike in substance or essentials." *Similar*, Merriam-Webster, https://www.merriam-webster.com/dictionary/similar (last visited Mar. 21, 2022).

limits any grants to those resembling "license[s], permit[s], charter[s], [and] franchise[s]."[222] This is because, as noted above, "[l]icenses, permits, charters, and franchises are all governmental authorizations that typically permit an individual to pursue some occupation or endeavor aimed at economic betterment,"[223] and that those interests "implicate 'government's role as a gatekeeper in determining who may pursue certain livelihoods.'"[224] Thus, the court held § 525(a) did not cover the economic guaranty entitlement.[225]

The same reasoning applies here. While the PPP helps businesses struggling from the Coronavirus pandemic by providing emergency funding, it is not a government authorization to help individuals pursue an occupation or economic betterment.[226] For example, unlike those who do not receive a "license, permit, charter, [or] franchise" from the government, who cannot operate otherwise, businesses excluded from the PPP are not prohibited from operating.[227] Rather, to be eligible for a PPP loan, the business must have been operating before February 15, 2020.[228] What's more, should the entity not receive a PPP loan, it may still be eligible for other relief under the CARES Act, such as the Emergency Economic Injury Disaster Loan or even a loan from a private lender.[229] In administering PPP loans, the SBA cannot be a "gatekeeper in determining who may pursue certain livelihoods," as one providing "[l]icense[s], permit[s], charter[s], [and] franchise[s]" would be under § 525(a).[230] As a result, one cannot conclude the PPP is like the "license[s], permit[s], charter[s], [and] franchise[s]" described in § 525(a).[231] Thus, the SBA's IFR cannot violate 11 U.S.C. § 525(a).

---

222. *Ayes*, 473 F.3d at 108.

223. *Id.* (citing Watts v. Pennsylvania Hous. Fin. Co., 876 F.2d 1090, 1093 (3d Cir. 1989)); *Supra* n. 141.

224. *Id.* at 109 (citing Toth v. Michigan State Hous. Dev. Auth., 136 F.3d 477, 480 (6th Cir. 1998)).

225. *Id.* at 111. Several courts have reached the same ruling as *Ayes*. *E.g.*, *Watts*, 876 F.2d at 1093–94; *Toth*, 136 F.3d at 479–80; In re Goldrich, 771 F.2d 28, 30 (2d Cir. 1985).

226. *Ayes*, 473 F.3d at 108.

227. Tradeways, Ltd. v. U.S. Dep't. of the Treas., CV ELH-20-1324, 2020 WL 3447767, at *19 (D. Md. June 24, 2020).

228. CARES Act, § 1102, 134 Stat. at 290; *Tradeways, Ltd.*, 2020 WL 3447767, at *4.

229. CARES Act, § 1110, 134 Stat. at 306; *Tradeways, Ltd.*, 2020 WL 3447767, at *19.

230. *Tradeways, Ltd.*, 2020 WL 3447767, at *19.

231. *Id.* (citing Diocese of Rochester v. U.S. Small Bus. Admin., 466 F. Supp. 3d 363, 379–80 (W.D.N.Y. 2020); *Schuessler*, 2020 WL 2621186, at *9).

VI. CONCLUSION

As explained above, the SBA did not violate 5 U.S.C. § 706(2)(A), 5 U.S.C. § 706(2)(A), or 11 U.S.C. § 525(a) when it rendered bankruptcy debtors ineligible for the PPP. One potential option to bypass this issue would be for a debtor to dismiss their bankruptcy case, obtain the CARES Act funding, and reinstate the bankruptcy.[232] Yet, should the debtor not dismiss their bankruptcy case to get the funds, unless Congress clarifies the situation, the chances of obtaining PPP funds are limited.

232. This precise outcome happened in Ryan Turner Investments, LLC v. Jackson Durham Floral-Event Design, LLC. 3:20-CV-00400, 2021 WL 602908 (M.D. Tenn. Feb. 16, 2021). In *Ryan Turner Investments, LLC*, the bankruptcy court reasoned that dismissing the bankruptcy case "is the most viable option and it keeps all the parties in an equal setting in which they could avail themselves of the CARES Act (indiscernible) and the debtor has a shot, at least, of obtaining funds to continue operations." *Id.* at *3. The bankruptcy court thereby granted the debtor's motion to dismiss, and the debtor managed to receive PPP funding. *Id.* The district court, in reviewing the motion to dismiss, reasoned the bankruptcy judge "considered the interest of both the debtor and the creditors" in reaching its conclusion. *Id.* at *9. As a result, the district court held the bankruptcy court did not abuse its discretion by dismissing the case. *Id.* Two other courts have followed the same reasoning by granting the debtor's motion to dismiss, allowing the debtor to receive PPP funding, granting the debtor's motion to reconsider dismissal, and reinstating the bankruptcy case. Advanced Power Technologies LLC, Case No. 20-13304 (Bankr. S.D. Fla. Apr. 24, 2020); In re Blue Ice Inv., LLC v. U.S. Small Bus. Admin., Adv. No. 2:20-AP-00095 (Bankr. Ariz. 2020).

NARROWING THE ROAD TO RECOVERY: A PROPOSAL TO TIGHTEN THE REINS ON THE DOCTRINE OF PIERCING THE CORPORATE VEIL

BY: LAUREN E. DOUGLAS*

I. INTRODUCTION

Limited liability is the pride and joy of the corporate form.[1] Most often, limited liability holds an investor's personal assets out of reach of an incorporated entity's creditors, thereby reducing the investor's personal exposure to corporate liability.[2] When applied to corporate groups (that is, a parent company and its subsidiaries "collectively conducting a business enterprise"), limited liability protects not only the investors from the debts of the enterprise, but also each of the subsidiaries within that enterprise.[3]

Situations may arise, however, where the limited liability enjoyed by corporate actors and subsidiaries is exploited for unfair or fraudulent business practices, thereby creating a judicial tension between recognizing a corporation's limited liability status and upholding fundamental notions of fairness. To resolve such tension, American courts developed the doctrine of piercing the corporate veil.[4] In essence, the piercing doctrine allows the court system to disregard a corporation's separate-entity status and hold equity investors and other related parties financially responsible for corporate debts in instances of fraud or misrepresentation by corporate actors.[5]

---

* Wake Forest University School of Law, J.D. 2022; Finance, B.S. 2019, Endicott College. Managing Editor of the *Wake Forest Law Review*, Volume 56.3–57.2. Special thanks to Abigail Castaldi for her insightful suggestions on the initial draft, for Professor Alan Palmiter for introducing me to the world of corporate veil-piercing, and for the editors of the *Stetson Business Law Review*.

1. Christopher W. Peterson, *Piercing the Corporate Veil by Tort Creditors*, 13 J. BUS. & TECH. L. 63, 63 (2017).
2. *Id.* at 63-64.
3. Philip I. Blumberg, *Limited Liability and Corporate Groups*, 11 J. CORP. L. 573, 575 (1986).
4. Jonathan A. Marcantel, *Because Judges are Not Angels Either: Limiting Judicial Discretion by Introducing Objectivity into Piercing Doctrine*, 59 KAN. L. REV. 191, 195 (2010).
5. *Id.*

While piercing the corporate veil is among the most litigated issues in corporate law, it also remains one of the least understood.[6] The doctrine itself is cloaked in "misperception and confusion," and is a concept that American courts have grappled with for decades.[7] Despite this, the piercing doctrine remains the primary exception to limited liability and is a staple of corporate law that impacts virtually all aspects of business planning.[8]

State courts currently employ a wide range of murky tests to determine whether a case warrants piercing of the corporate veil.[9] Unfortunately, these tests, and their troubling lack of explanation, lead to confusion among legal scholars and inconsistency among state courts.[10] Even more troubling is the fact that courts consistently fail to distinguish between types of plaintiffs–specifically, between a plaintiff who is a voluntary contract creditor as opposed to an involuntary tort creditor (that is, a plaintiff that intentionally forms a relationship with the business versus a plaintiff who engages with the business purely by accident or happenstance, respectively).[11] Drawing a clear distinction between categories of victims is an important and often undervalued element of the analysis that, if considered, could provide an ounce of clarity to the piercing doctrine.[12] This Article aims to offer such clarity.

Part II provides an overview of the theory of limited liability, along with its benefits and drawbacks. Part III discusses the history and development of the piercing doctrine and offers insight into Delaware's view on the subject. Part IV analyzes the distinction between involuntary tort creditors and voluntary

6. Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1058 (1990-1991).

7. Jonathan Macey & Joshua Mitts, *Finding Order in the Morass: The Three Real Justifications for Piercing the Corporate Veil*, 100 CORNELL L. REV. 99, 100 (2014).

8. Peter B. Oh, *Veil-Piercing*, 89 TEX. L. REV. 81, 90–91 (2010).

9. Speer, Denise L., Comment, *"Piercing the Corporate Veil" in Maryland: An Analysis and Suggested Approach*, 14 U. BALT. L. REV. 311, 311 (1985).

10. *Id*. Scholarly discussion also exists regarding the doctrine of piercing the corporate veil with regard to federal question litigation. However, this Comment focuses solely on piercing the corporate veil as it relates to state courts, and the term "courts" refers solely to state courts from this point forward. Piercing the corporate veil in the federal context is outside the scope of this Comment and will not be discussed further.

11. *See* Peterson, *supra* note 1, at 67 (recognizing that most courts apply the same veil piercing test in both tort and contract cases).

12. *See* David Millon, *Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability*, 56 EMORY L. J. 1305, 1317 (2007) (discussing a distinction between contract creditors and tort creditors). *See generally* Peterson, *supra* note 1 (same).

contract creditors and proposes that forming two groups of voluntary creditors–referred to hereinafter as "ordinary creditors" and "sophisticated creditors"–would pave a way for courts to solidify numerous aspects of the piercing doctrine once and for all. Ultimately, Part IV, and this Article as a whole, argues that sophisticated contract creditors should not be able to reap the benefits of piercing the corporate veil because they nearly always have a sufficient opportunity to protect themselves against risk of loss prior to contracting with the corporate actor. Part V furthers this argument by suggesting that courts should instead utilize the Uniform Fraudulent Transfer Act or equivalent to govern the recovery of sophisticated creditors. Part VI offers a brief conclusion.

II. THE THEORY OF LIMITED LIABILITY: A PRIMER

A fundamental principle of corporate law in the United States is that a business operating as an incorporated entity is legally recognized as being separate and distinct from its "creditors, shareholders, directors, and other constituencies."[13] The general result of such separateness is twofold. First, the corporation enjoys many rights similar to individuals, such as the ability to "enter into contracts; sue and be sued; be responsible for paying taxes[,] and complying with laws and regulations[.]"[14] In essence, the law tends to view the corporation as its own person.[15]

Second, the separateness between a corporation and its constituents exempts corporate shareholders from facing personal liability for debts incurred or torts committed by the corporation–a concept known as "limited liability."[16] Under the doctrine of limited liability, absent a personal breach of duty either in contract or tort, investors in a corporation, LLC, or other separate entity[17] are only liable for the amount of money they invest into the venture and are not liable for any other business obligation taken on by the

13. Macey & Mitts, *supra* note 7, at 104.
14. *Id.*
15. *Id.*
16. Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. L. 479, 480 (2001).
17. *Id.* It should be noted that this Article is limited in scope to limited liability and piercing the corporate veil as it relates to the corporate form. While the general concepts presented ring true for limited liability entities outside of the corporation, non-corporate entities, such as LLCs, LLPs, and LPs are bound by state laws that may have nuanced differences that those discussed here.

entity.[18] In other words, if a corporation fails, limited liability caps a shareholder's loss at the amount of money they invested—the investor does not lose *more* money; rather, he simply does not receive any *return* on his already-invested .funds.[19] This makes sense. If the law recognizes the corporation as its own person, it logically follows that the corporation itself is almost exclusively responsible for its own wrongdoing. Such limited liability is perhaps the most sought-after aspect of the corporate form and has been deemed the "hallmark" of corporate status.[20]

A. The History and Evolution of Limited Liability

Although the global origins of limited liability are not entirely clear, it is certain that limited liability in the United States began as a feature solely for "infrastructural projects" such as railroad development.[21] This narrow use expanded throughout the Industrial Revolution and, by the 1840s, most United States jurisdictions had adopted limited liability in some form.[22] Such adoption occurred enthusiastically, as states embraced the theory that limited liability would encourage investment and increase economic competition.[23]

Today, limited liability is a default rule and applies absent an agreement otherwise.[24] The Model Business Corporation Act ("MBCA")[25] provides that shareholders are not personally liable for corporate debts or actions unless the articles of incorporation expressly provide otherwise or if the shareholder becomes personally liable "by reason of [his] own conduct or acts."[26] This

---

18. Peterson, *supra* note 1, at 66.
19. Bainbridge, *supra* note 16, at 480–81.
20. *See* Peterson, *supra* note 1, at 63.
21. Marcantel, *supra* note 4, at 194.
22. *Id.*
23. *Id.*
24. Bainbridge, *supra* note 16, at 501. *See, e.g.*, MODEL BUS. CORP. ACT § 6.22(b) (2002) (providing for shareholder limited liability unless liability might be warranted by virtue of the shareholder's own conduct).
25. MODEL BUS. CORP. ACT (2002). The MBCA is a body of laws designed to regulate corporate affairs uniformly across different states. The majority of states have adopted the full MBCA as the basis of their own laws, though each state has modified the provisions to some extent. *See A Map of Model Business Corporation Act States*, PROFESSORBAINBRIDGE.COM (Nov. 04, 2013, 1:03 PM), https://www.professorbainbridge.com/professorbainbridgecom/2013/11/a-map-of-model-business-corporation-act-states.html.
26. Thompson, *supra* note 6, at 1042 (citing MODEL BUS. CORP. ACT § 6.22(b) (1985)).

means that "outsiders," such as banks and other lenders, can demand that corporate "insiders," such as shareholders, assume contractual responsibility for corporate obligations.[27] For example, commercial lenders often require that corporate contractors sign a personal guarantee before extending credit to closely held corporations.[28] However, absent such an agreement, the rule is that corporate participants are not personally liable for corporate obligations; in this case, the bank enters into a "nonrecourse relationship" with the insiders, limiting each shareholder's liability to the amount of investment.[29]

An argument can be made, however, that companies regularly stretch limited liability far beyond its original objective. For instance, in modern-day America, it is very common for companies to organize themselves in the form of a parent corporation with dozens of subsidiary corporations. In fact, multinational corporations with this structure conduct most of the world's business.[30] Corporations that employ this tiered structure have essentially manipulated limited liability to shield each tier of the corporate group, thus achieving layers upon layers of insulation for the parent corporation and opening the door for possible abuse of limited liability.[31]

B. The Benefits of Limited Liability

Limited liability has been "compared to that of a steam engine, and likened to the discovery of electricity" due to the laundry list of benefits that it presents to incorporated entities.[32] Limited

---

27. *See* Merle F. Wilberding, *Tax Consequences of Shareholder Guarantees: There's Still Hay in Tulia Feedlot*, 6 WYO. L. REV. 165, 166 (2006) (indicating that personal shareholder guarantees of corporate obligations are "a way of life" for most privately-owned corporations).

28. ALAN R. PALMITER, CORPORATIONS 608 (8th ed. 2015). For readers not well-versed in commercial lending, a "personal guarantee" is "a legal contract requiring an individual – typically an officer or owner of the business borrowing money – to personally repay the loan in the event the business is unable to do so . . . ." Rebecca Lake, *Should You Sign a Personal Guarantee for a Business Loan?*, U.S. NEWS (June 3, 2019), https://loans.usnews.com/articles/should-you-sign-a-personal-guarantee-for-a-business-loan.

29. *Id.*

30. Blumberg, *supra* note 3, at 575.

31. *Id.*

32. Ron Harris, *A New Understanding of the History of Limited Liability: An Invitation for Theoretical Reframing* (March 28, 2020) (manuscript at 2), https://ssrn.com/abstract=3441083.

liability generally shields all investors equally, regardless of the amount of money invested, and regardless of whether the entity consists of one individual or millions of shareholders.[33] Perhaps one of the greatest benefits of limited liability is that it allows entities to aggregate large amounts of capital from numerous investors of all sizes, many of whom would be reluctant to risk their personal wealth if they might be held liable for corporate missteps.[34] As such, investors of all statures are enticed to invest in desirable yet risky businesses because their other assets remain protected.[35] Limited liability also allows recreational and sophisticated investors alike to build diversified wealth portfolios in a vast array of companies, thereby reducing their exposure to potential financial ruin.[36] Such protection therefore facilitates and encourages investments that would otherwise not occur, and acts as an extremely important driver of economic growth.[37]

Limited liability, specifically with regard to a shareholder's ability to diversify her portfolio, also facilitates management risk-taking.[38] Without limited liability, risk-averse or risk-neutral shareholders who throw all of their financial eggs into one corporate basket might discourage managers from undertaking projects that carry higher-than-average risk, even if the project ensures net positive returns.[39] As such, limited liability gives managers the green light to make risky business decisions in an effort to yield higher returns–a benefit to both the investor and the company itself.

---

33. *See* Nellie Akalp, *Party of One: Setting Up Your Single-Person Corporation*, ENTREPRENEUR (Dec. 14, 2016), https://www.entrepreneur.com/article/283918 (discussing how a corporation can consist of a "board of directors [that] hold shareholder meetings" or "just one owner").

34. Peterson, *supra* note 1, at 63–64. *See also* Dane Shikman, Note, *A Risk-Based Approach to Limited Liability for Individuals and Corporate Parents*, 84 GEO. WASH. L. REV. 1104, 1105 (2016) ("[A corporation's] willingness to take investment risks often exceeds that of an individual, who might be loath to gamble his personal retirement account on a new business venture.").

35. PALMITER, *supra* note 28, at 608.

36. Peterson, *supra* note 1, at 64.

37. *Id.*

38. *See generally* Marcantel, *supra* note 4.

39. PALMITER, *supra* note 28, at 608.

C. The Drawbacks of Limited Liability

As no rose comes without its thorns, there are inevitable downsides to limited liability hidden beneath the attractive benefits discussed above. One substantial risk of limited liability is that creditors are often discouraged from extending credit to seemingly-unstable corporations.[40] A well-established principle of debt-versus-equity financing is that, in the event of corporate insolvency, debt creditors (i.e., banks and other financial institutions) receive repayment of their outstanding loans before equity investors can recover anything.[41] However, if a company has insufficient assets to repay a creditor in full, limited liability bars that creditor from recovering more than the corporation has to offer.[42] Since creditors must bear the loss if a corporation cannot fulfill its obligations, they might not feel comfortable investing in the corporation at all.[43]

Another significant, albeit intangible, drawback of limited liability is the risk of creating a "moral hazard";[44] that is, since management does not face the same scrutiny by shareholders as do managers in unincorporated entities, and since such shareholders themselves do not bear losses beyond initial investment, corporate individuals might comfortably pursue overly-risky business ventures or become disconnected with their moral compass in an effort to line their own pockets with gold.[45] For example, an investor in a cigarette corporation that does not bear the loss of individuals who die as a result of smoking might not care that he supports a company that sells deadly and addictive products so long as he receives a positive return on his investment.[46] In this sense, limited liability arguably allocates part

40. ALAN PALMITER ET AL., BUSINESS ORGANIZATIONS: A CONTEMPORARY APPROACH 337 (3d ed. 2019).

41. *See* Andrew Gellert, *Who Has Priority: a Shareholder or a Creditor?*, CHRON., https://smallbusiness.chron.com/priority-shareholder-creditor-75052.html (last updated Oct. 19, 2018) (explaining that "[t]he pecking order dictates that the debt owners, or creditors, will be paid back before the equity holders, or shareholders").

42. PALMITER ET AL., *supra* note 40, at 337.

43. *Id*. This result of limited liability seems to run counter to the states' goal of economic growth, but I digress.

44. Peterson, *supra* note 1, at 65.

45. *See* David L. Cohen, *Theories of the Corporation and the Limited Liability Company: How Should Courts and Legislatures Articulate Rules for Piercing the Veil, Fiduciary Responsibility and Securities Regulation for the Limited Liability Company?*, 51 OKLA. L. REV. 427, 439–40 (1998); Thompson, *supra* note 6, at 1040.

46. *See* Cohen, *supra* note 45, at 439–40.

of its risk to those outside the corporation, such as tort victims, small uninformed creditors, or innocent consumers, thus shifting the cost of doing business "away from the corporation and to other parts of society."[47]

The practice of reallocating risk can severely impact a number of outsiders. When a company invokes the principle of limited liability and engages in what is called "risk externalization," some other entity typically bears the costs on the other side.[48] Such costs impact parties that voluntarily contract with the business (such as suppliers, employees, and customers) as well as individuals who involuntarily become creditors of the entity (such as tort victims and uninformed consumers). Because risk externalization occurs in the case of "every transaction where parties are not in a practical position to negotiate credit terms,"[49] the term *involuntary creditors* often encompass many small trade creditors, consumers, and workers as well as tort creditors.[50] As such, corporations who unnecessarily externalize risks onto involuntary creditors (especially tort creditors) are acting outside the scope of behavior that limited liability exists to protect. Perhaps the biggest risk that stems from this is that corporate actors might use their limited liability shield to conduct shady or illegal behavior, and as a result, injure innocent outsiders along the way.[51]

In sum, limited liability aims to shield individual actors or investors from liability for the corporation's losses and to achieve certain social and public policy goals. However, when the costs of limited liability heavily outweigh its benefits–such as when it is used as a device to extract value deliberately or recklessly from or escape liability from third parties without consent or compensation[52]–the U.S. legal system owes it to creditors of all types to analyze whether to set aside the benefits of limited liability to allow for recovery beyond the corporate borders. Enter the doctrine of piercing the corporate veil.

---

47. Thompson, *supra* note 6, 1040.
48. Peterson, *supra* note 1, at 64. *See also* Blumberg, *supra* note 3, at 576 (recognizing that limited liability "raises serious problems" by allowing corporations to "externalize [their] costs").
49. Blumberg, supra note 3, at 576.
50. Thompson, *supra* note 6, 1040.
51. Millon, *supra* note 12, at 1307.
52. Millon, *supra* note 12, at 1307–08.

III. AN OVERVIEW OF CORPORATE VEIL PIERCING

While most often accepted as being separate and distinct from its shareholders, the corporation does not always shield shareholders from personal liability.[53] Though often not discussed in detail during the incorporation process, the risk of personal liability still looms in the shadows via the doctrine of piercing the corporate veil.[54] The piercing doctrine is thus a fundamental concept for any businessperson to understand.

Piercing the corporate veil is a judicially-created equitable doctrine that allows a creditor to disregard the separate corporate identity and forces shareholders to satisfy the entity's debts if the entity is unable to do so independently.[55] Notably, the doctrine itself is not a separate cause of action; a plaintiff generally cannot seek to pierce the corporate veil until the court finds the corporation liable for wrongdoing and cannot satisfy the judgment against it while maintaining its limited liability status.[56] The piercing doctrine aims to prevent corporate fraud and achieve justice in situations where allowing corporate actors to hide behind a shield of limited liability would be immoral.[57] As an equitable remedy, the doctrine has the power to do justice "by exercising discretion to mitigate the rigidity of strict legal rules" vis-à-vis the exclusion of limited liability protection when it would be grossly unfair not to.[58]

The judicial system's desire to ensure an equitable remedy in suspicious cases is in inevitable tension with the fundamental understanding that the corporation is an entity legally recognized as its own person.[59] As such, courts in all jurisdictions acknowledge that, in order for investors to feel comfortable relying on limited

---

53. Speer, *supra* note 9, at 312.

54. *See* Douglas C. Michael, *To Know a Veil*, 26 J. CORP. L. 41, 42 (2001) ("What counsel does not wince when telling her client that liability is limited except in certain unspecified and unpredictable situations?").

55. Marcantel, *supra* note 4, at 195.

56. T. Richmond McPherson & Nader Raja, *Corporate Justice: An Empirical Study of Piercing Rates and Factors Courts Consider When Piercing the Corporate Veil*, 934 WAKE FOREST L. REV. 931, 934 (2013).

57. Peterson, *supra* note 1, at 68.

58. *Id.*

59. Thompson, *supra* note 6, at 1036.

liability when choosing how to allocate their money, piercing the corporate veil must be conducted reluctantly and cautiously.[60]

A. Development of the Equitable Doctrine of Piercing the Corporate Veil

As mentioned in Part II(A), jurisdictions across the nation enthusiastically adopted the concept of limited liability during the Industrial Revolution.[61] Over time, however, courts began facing situations where limited liability yielded inequitable results in cases where, morally, the corporation's liability shield should have been disregarded.[62] To combat inequities in judicial results, courts developed (or attempted to develop) the doctrine of piercing the corporate veil.[63] Veil-piercing law began as an application of equitable maxims but has subsequently diverged into messy state-specific tests.[64] Unfortunately, no reliable concrete analysis or general consensus has emerged over time; rather, veil-piercing law remains a murky free-for-all across jurisdictions. While courts uniformly agree on the doctrine's intended effect, a concrete pathway to victory has yet to be articulated.

In 1926, Justice Cardozo described the piercing doctrine as being "enveloped in the mists of metaphor."[65] Courts have enjoyed little progress since then, and commentators continue to criticize the doctrine's unruly process, describing judicial decisions calling for corporate veil piercing as "irreconcilable," "not entirely comprehensible," and "defy[ing] any attempt at rational explanation."[66] It is no surprise, then, that judges, lawyers, law students, and law professors have a complicated love-hate relationship with this doctrine.[67]

60. *See* Maurice Wormser, *Piercing the Veil of the Corporate Entity*, 12 COLUM. L. REV. 496, 496 (1912) (emphasizing that piercing the corporate veil is not an "open sesame" concept that will always warrant disregarding the corporate form).
61. *See supra* Part II(A).
62. Marcantel, *supra* note 4, at 194–95.
63. *Id.* at 195.
64. *See generally* Sam F. Halbi, *Veil-Piercing's Procedure*, 67 RUTGERS U. L. REV. 1001 (2015) (discussing the various veil piercing procedures used by courts across the United States).
65. Thompson, *supra* note 6, at 1036.
66. *Id.* at 1037.
67. *See* Michael, *supra* note 54, at 41 (describing the complex relationship between the piercing doctrine and the legal profession).

B. Judicial Morals of the Piercing Process

While courts never disregard the corporate form lightly, cases do arise where the only equitable solution is to pierce the veil and impose individual shareholder liability. Since courts readily recognize that "the corporate veil exists for a reason,"[68] conflicting policy considerations exist that make judges hesitant to pierce.[69] In this sense, the angel and the devil are hard at work on the courts' shoulders, narrating a serious judicial struggle between making a harmed plaintiff whole and upholding the hallmark of the corporate form.[70] On one hand, there is a strong policy argument for maintaining shareholder limited liability in order to promote capital growth and investment.[71] On the other hand, there is a competing judicial interest in serving justice in a situation where upholding the theory of limited liability would be inequitable.[72] Because of this tension, courts have yet to announce a black-and-white piercing test and instead rely heavily on the specific facts of each case.[73] In essence, the courts have merely outlined a gray, or even invisible, test left up to scholars to decode.[74]

C. The Muddle of Modern Veil-Piercing Analyses

While piercing the corporate veil is perhaps the most litigated issue in corporate law, it remains one of the least understood and often results in court decisions that appear confusing and incoherent.[75] In piercing cases, courts typically base their decisions on nothing more than "conclusory references to criteria of doubtful relevance."[76] Rather than concrete legal principles, judges hang

68. Cascade Energy and Metals Corp. v. Banks, 896 F.2d 1557, 1576 (10th Cir.1990).

69. Speer, *supra* note 9, at 313.

70. Ryan Bottegal, Comment, *Liberalizing Maryland's Approach to Piercing the Corporate Veil*, 42 U. BALT. L. REV. 821, 824–25 (2013) ("Since piercing the corporate veil is an exception to a primary reason for incorporating a business, 'courts addressing the issue are often caught between the conflicting goals of preserving the corporate entity and affording relief to the victim.'").

71. Speer, *supra* note 9, at 313.

72. *Id.*

73. Millon, *supra* note 12, at 1327.

74. *See* Speer, *supra* note 9, at 313 ("[C]ourts are often inconsistent in which factors are dispositive when confronted with a veil piercing case.")

75. *See* ROBERT C. CLARK, CORPORATE LAW 38 (1986) (describing veil piercing as "intellectually disturbing").

76. Millon, *supra* note 12, at 1307.

their hats on the uber-specific fact patterns of each case and on their own feelings of right and wrong.[77] Such practices result in caselaw that is largely reflective of the judges' personal opinions as opposed to their interpretation of the law.[78] Results are thus unpredictable, so much so that critics have emphasized unpredictability as a reason to abolish the doctrine altogether.[79] However, despite the fact that many critics turn up their noses at the courts' decision-making processes, there is a general consensus that judges deciding piercing cases nearly always reach the "correct" conclusion.[80]

Part of the headache surrounding the piercing doctrine is that each jurisdiction employs its own convoluted analysis of each case.[81] Courts take several approaches when describing a respective state's approach to piercing the corporate veil.[82] Some jurisdictions, including but not limited to, Illinois, Kansas, Maine, Massachusetts, and New York, have attempted to articulate the relevant factors that may be considered in piercing cases.[83] For example, Massachusetts courts have expressly articulated the laundry list of relevant factors that must be considered before applying the piercing doctrine.[84] In contrast, courts in other jurisdictions, such as Delaware, have merely recognized that piercing the corporate veil is "appropriate under some circumstances" but have not expressly defined what those circumstances are.[85] Nonetheless, cases in most instances seem to

---

77. *See* Marcantel, *supra* note 4, at 198 (noting that most states permit trial courts to "consider, ignore, and weigh" different piercing factors as necessitated by case facts).

78. *Id.*

79. Oh, *supra* note 8, at 85 (citing, generally, Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. L. 479 (2001)). *See also* Douglas C. Michael, *To Know a Veil*, 26 J. CORP. L. 41 (2000).

80. *See, e.g.*, Macey & Mitts, *supra* note 7, at 103 ("[I]n our view, judges generally reach the correct results in the cases they decide.").

81. Marcantel, *supra* note 4, at 195.

82. Fredric J. Bendremer, *Delaware LLCs and Veil Piercing: Limited Liability Has its Limitations*, 10 FORDHAM J. CORP. & FIN. L. 385, 390–91 (2005).

83. *Id.* at 390–91.

84. *Id.* at 390. As interpreted by the First Circuit, under Massachusetts law, courts may consider many specific factors in a veil piercing analysis, including, among other things:

(i) common ownership; (ii) pervasive control; (iii) confused intermingling of business activity; (iv) insufficient capitalization; (v) nonobservance of corporate formalities; (vi) nonpayment of dividends; (vii) insolvency of the corporation at the time of transaction; (viii) siphoning of corporate funds by the dominant shareholders; (ix) nonfunctioning of officers and directors other than the shareholders; (x) absence of corporate records; (xi) use of the corporation for transactions of the dominant shareholders; and (xii) use of the corporation in promoting fraud. *Id.*

85. *Id.* at 391.

turn on whether the court sees the corporate defendants as "good" or "bad," and the fact-dependent question often appears to be whether the defendants abused the "privilege" of limited liability.[86] For a coherent analysis, it is helpful to break the unruly, tangled mess into more bite-sized pieces.

i. The First Prong: "Formalities"

To begin the veil-piercing analysis, courts typically look first at factors involving the defendant's compliance with corporate formalities–known by some as the "formalities prong" of the judicial analysis.[87] The formalities prong, which is also referred to as the control[88] or alter ego[89] prong, essentially requires the plaintiff to prove that a parent corporation and its subsidiary or shareholders have such a strong unity of interest and ownership that their "separate personalities" no longer exist.[90] The formalities prong is often analyzed using a number of factors that aim to determine whether a sufficient "unity of interest" exists between the actors, such that the business or shareholder has *no separate mind or will of its own* and is merely the *alter ego* of its parent.[91] Regardless of the language chosen by the court, a bright-line standard does not lie below.[92] A judge may consider as many as twenty factors, but is not limited to an exclusive or definitive list.[93]

Although the outcome from a piercing the corporate veil inquiry depend on the facts of each case, courts are more likely to pierce in cases that involve the following six situations: (1) closely-held corporations; (2) defendants that actively participated in the

86. PALMITER ET AL., *supra* note 40, at 334.
87. Peterson, *supra* note 1, at 71.
88. *See, e.g.*, Dombroski v. WellPoint, Inc., 895 N.E. 2d 538, 543 (Ohio 2008) (referencing Ohio's test as the "control" test).
89. *See, e.g.*, Perpetual Real Estate Servs., Inc. v. Michaelson Props., Inc., 974 F.2d 545, 548 (4th Cir. 1992) (applying a test referred to by the court as an "alter ego" analysis).
90. Peterson, *supra* note 1, at 71.
91. *See* United States *ex rel.* Landis v. Tailwind Sports Corp., 51 F. Supp. 3d 9, 62 (D.D.C. 2014).
92. *See* Bainbridge, *supra* note 16, at 506–07 (recognizing that language such as "alter ego" and "corporate dummy" yield no clarity in the analysis used by the court).
93. *See, e.g.* Assoc. Vendors, Inc. v. Oakland Meat Co., 26 Cal. Rptr. 828, 838–39 (Cal. Ct. App. 1962) (noting twenty potential factors); Laya v. Erin Homes, Inc., 352 S.E.2d 93, 98–99 (W.Va. 1986) (noting nineteen factors considered amid the totality of the circumstances).

business; (3) insiders that disregarded corporate formalities; (4) insiders that commingled business and personal assets for noncorporate use; (5) insiders that did not adequately capitalize the business; and (6) a company that deceived or misrepresented information to its creditors.[94] Unfortunately, little, if anything, is said about the weight given to each factor or about which ones are "necessary or sufficient" on their own to support a piercing result.[95]

Notably, courts *do not* pierce the corporate veil solely because a corporation is undercapitalized.[96] This finding is consistent with the fact that legislatures permit thinly capitalized firms to engage in business and generally do not hold adequate capitalization as a requisite to formation.[97] It is also significant to clarify that, even though closely held corporations have their veils pierced significantly more often than public corporations, being a closely held corporation, without more, is *not* sufficient for courts to disregard the corporate form.[98] This is because a public corporation typically has a high number of shareholders, which prevents the level of individual control required to justify a court's piercing of the corporate veil. In contrast, a shareholder in a closely held corporation is more likely to be actively involved with management and decision-making, thus giving them a greater opportunity at "pierceable" corporate control.[99]

ii. The Second Prong: "Fairness"

In the event a plaintiff is able to establish under the formalities prong that the defendant-shareholder had complete control over the corporation and that the entity was the mere "alter

94. PALMITER ET AL., *supra* note 40, at 354–55.

95. Millon, *supra* note 12, at 1327.

96. Macey & Mitts, *supra* note 7, at 103.

97. *Id.* Similarly, particularly in the LLC context, courts may be reluctant to use the failure to follow corporate formalities as a piercing factor for small corporations or LLCs because they typically do not have the organizational structure of an established corporation with meetings of directors and shareholders. *See, e.g.*, REVISED UNIF. LTD. LIAB. CO. ACT § 304(b) (2006) ("[T]he failure of a limited liability company to observe formalities relating to the exercise of its powers or management of its activities and affairs is not a ground for imposing liability on the member or manager for a debt, obligation, or other liability of the company.").

98. *See* Bottegal, *supra* note 70, at 825–26 (noting that, in theory, the limited liability doctrine "extends with equal force to all variations on the corporate form," but in practice, closely held corporations are exponentially more likely than publicly held corporations to have their veils pierced).

99. Millon, *supra* note 12, at 1315.

ego" of the shareholder, the court will then try to determine what is blameworthy about the defendant's use of that control–this is the "fairness" prong of the piercing analysis.[100] To do so, the judge combs through the particular facts of the case with an overarching theme of fairness in mind and asks whether it would be inequitable to the plaintiff to keep corporate limited liability intact.[101] In essence, the fairness prong reflects the idea that investors should not be allowed to "hide from the normal consequences of *carefree* entrepreneuring by doing so through a corporate shell."[102] As such, this prong most often requires a general determination of fraud, illegality, inequity, injustice, or some other wrongdoing by the corporate entity.[103] "Fraud," in the context of piercing the corporate veil, is used generally to mean bad faith or unfairness rather than strictly "deliberate dishonesty" intended to induce reliance.[104]

Despite a thorough analysis of both the formalities and the fairness prongs, it is still possible for a court to reach an unanticipated, seemingly convoluted result. This is because courts look heavily to the totality of the circumstances rather than to whether a certain number of boxes are checked on the veil-piercing scorecard.[105] Totality of the circumstances tests, unlike strict factor tests, allow judges to weigh all "known and relevant" information in light of all "known and conceivable circumstances."[106] Part of the murkiness surrounding the piercing doctrine is that the weight given to each factor remains a mystery.[107] Thus, while courts must at least review the various factors set forth in prior caselaw, judges are awarded significant discretion to consider any other "known and conceivable circumstances" relevant to the case at bar.[108] It follows that such significant discretion often results in caselaw rooted in personal opinion than in legal principle.

---

100. *See id.* at 1332–34; Peterson, *supra* note 1, at 71–72.

101. Peterson, *supra* note 1, at 72.

102. Labadie Coal Co. v. Black, 672 F.2d 92, 100 (D.C. Cir. 1982).

103. *See* Dombroski v. WellPoint, Inc., 895 N.E.2d 538, 543-44 (Ohio 2008) (discussing fraud, illegality, and injustice requirements); Nat'l Labor Relations Bd. v. Greater Kan. City Roofing, 2 F.3d 1047, 1052 (10th Cir. 1993).

104. Peterson, *supra* note 1, at 72–73.

105. Bottegal, *supra* note 70, at 825.

106. Peterson, *supra* note 1, at 74. A factor-based test, on the other hand, restricts the judge's discretion to only "consideration and balancing of a certain closed set of factors." *Id.* at 73.

107. Millon, *supra* note 12, at 1327; *see supra* Part III(C)(1).

108. Peterson, *supra* note 1, at 73-74.

D. Delaware's Take on the Piercing Doctrine

Because the state of Delaware is a powerhouse for corporate formation, this Article would be incomplete without analyzing how its courts apply the equitable doctrine of piercing the corporate veil. As a whole, Delaware is the state with the most robust collection of general corporate caselaw, which can be largely credited to the state legislature's efforts to create a flexible system that favors both managers and shareholders alike.[109] However, to the surprise of many, Delaware's caselaw surrounding piercing the corporate veil remains largely underdeveloped compared to that of other states.[110] In fact, Delaware's caselaw is so scant that some sources actually suggest looking outside of Delaware to best understand the piercing doctrine.[111]

To give credit where credit is due, Delaware has clearly recognized piercing the corporate veil as an appropriate equitable remedy.[112] Further, presumably because of the inherent complexity that accompanies piercing cases, Delaware requires all piercing suits to be brought "only in a court of chancery."[113] It has not, however, been transparent in defining the circumstances in which it will invoke the doctrine, though it is understood that piercing "may be effected only in the interest of justice."[114]

While robust caselaw touching all corners of corporate law is empowering, the reasoning behind Delaware's choice to hide its cards about the piercing doctrine might be simple. As mentioned, Delaware is a powerhouse for corporate formation. "More than 65 percent of all Fortune 500 companies and more than half of U.S. publicly-traded companies are incorporated in Delaware."[115] Delaware's laws are optimal for corporations in large part because of their "predictability and dependability" in both the judicial and

---

109. STEPHEN B. PRESSER, PIERCING THE CORPORATE VEIL § 2.8 (2020–2021 ed. 2020).

110. *See* Bendremer, *supra* note 82, at 389.

111. *Id.* at 390-91

112. *Id.* at 391.

113. *See, e.g.*, Sonne v. Sacks, 314 A.2d 194, 197 (Del. 1973) (ordering the case to be transferred from Delaware's supreme court to its Court of Chancery); Hanna v. Baier, No. CV S12J-03-058 RFS, 2020 WL 391924, at *3 (Del. Super. Ct. Jan. 22, 2020) (same).

114. Bendremer, *supra* note 82, at 391.

115. Harvard Business Services, Inc., *Why Incorporate in Delaware?*, DELAWARE INC.COM, https://www.delawareinc.com/before-forming-your-company/benefits-of-incorporating-in-delaware/ (last visited Feb. 21, 2022).

legislative context.[116] In significant contrast, the piercing doctrine is the *furthest* thing in corporate law from predictable and dependable.[117] Delaware thus has an interest in leaving the waters of the piercing doctrine as uncharted as possible to maintain its seemingly pristine oasis of corporate paradise and to uphold the promise of limited liability as best it can.

I. TORT CREDITORS, CONTRACT CREDITORS, AND THE NEED FOR JUDICIAL REFORM

A muddled legal doctrine filled with ill-defined and boundless tests might be part of why so many plaintiffs try to pierce the corporate veil. The first step courts can take to uncoil the knots of the piercing doctrine is to uncross the paths of involuntary tort victims and voluntary contract creditors and provide each group with its own unique path to recovery. For clarity's sake, the most important distinction between these two groups is that contract creditors have an opportunity to evaluate the risks of interacting with the corporation and can subsequently protect themselves from potential harm before engaging with the corporation, while tort creditors do not.[118] Such differently situated plaintiffs require legal doctrines tailored to their specific condition, not a blanket approach resulting in a haphazard, often inappropriate application.

A. The Empirical Landscape of Piercing the Corporate Veil

In the early 1990s, Professor Robert Thompson analyzed roughly 1,600 Westlaw cases through the year 1985 involving the veil piercing issue in an attempt to give the piercing doctrine some shape.[119] Despite Thompson's reservations on judicial use of the information, courts and scholars regularly cite his findings, and attorneys use them to advise corporate clients.[120] Among Thompson's most important conclusion was that

116. *Id.*
117. *See* Michael, *supra* note 54, at 41 (describing the complex relationship between the piercing doctrine and the legal profession).
118. Oh, *supra* note 8, at 87.
119. Thompson, *supra* note 6, at 1044.
120. Oh, *supra* note 8, at 88.

misrepresentation, illegality, and fraud are the most predictive factors of when courts will allow parties to pierce the corporate veil.[121] Specifically, the corporate veil was pierced in 91.6 percent of cases where corporate misrepresentation was found, and in 85.3 percent of instances where parties comingled personal and corporate assets.[122]

Another one of Thompson's most valuable findings was that piercing occurred more often in contract cases (roughly 42.0 percent of the time) than in tort cases (roughly 31.0 percent of the time).[123] These results indicated that, contrary to the assumption that courts in piercing cases are more sympathetic to tort victims who cannot contract around their potential injury, courts actually decide to award tort creditors less often than contract creditors.[124]

Nearly two decades after Thompson published his study, no explanation for the "dominance" of veil-piercing for contract creditors versus tort creditors had emerged.[125] Some commentators opined that contract claims may simply be a stronger channel for getting piercing cases in front of a judge, while others viewed the findings as evidence of how poorly courts were handling the piercing doctrine.[126] In a search for clarity, Professor Peter Oh conducted a follow-up study in the late 2000s to determine exactly what the relationship is between voluntary creditors, involuntary tort victims, and the piercing doctrine. Professor Oh's study involved a wider timeframe than Thompson's and analyzed a total of 2,908 piercing cases.[127] His results confirmed many of Thompson's findings, including that the most successful veil piercing claims are rooted in fraud or misrepresentation and are supported by specific evidence of such conduct.[128] This helps solidify the argument that limited liability should not (and apparently does not) allow shareholders to behave opportunistically toward third parties, whether they be contract creditors or tort creditors.[129]

---

121. PALMITER ET AL., *supra* note 40, at 335. This source articulates Thompson's results much more succinctly than his original study does and will thus be referenced for Thompson's additional findings.
122. *Id.*
123. *Id.*
124. Thompson, *supra* note 6, at 1059.
125. Oh, *supra* note 8, at 88.
126. *Id.*
127. *Id.* at 89.
128. *Id.* at 90.
129. Millon, *supra* note 12, at 1307.

However, in stark contrast to Thompson's findings, Oh's results indicated that tort creditors prevail more often than contract creditors–47.8 percent and 46.2 percent of all piercing cases, respectively–thus placing results back in line with intuitive thinking.[130] These figures raise the question of why piercing happens as often in contract law as in tort law. Some commentators suggest that commercial litigators realize that businesses often fail for reasons other than those that warrant piercing and are thus more selective of when to bring piercing cases, whereas a personal injury lawyer may bring a piercing claim as often as possible to satisfy his search for a deep pocket.[131]

B. A Closer Look at Tort Creditors (aka Involuntary Creditors)

Oh's findings indicate that involuntary tort creditors have an easier path to recovery under the piercing doctrine because of their inability to protect themselves from potential injury ahead of time.[132] While courts weigh equities in favor of piercing the veil for injured tort victims more often than ever before, courts have been slow to recognize the distinction between creditor types; most courts have only done so within the last thirty years.[133] Of course, the ability for involuntary tort creditors to recover under the veil piercing doctrine embodies the equitable principles of American law. Like tort claims against any type of defendant, judgments against corporations for tortious conduct can be very large and can very easily exceed the amount of assets a corporation can offer for recovery. Because of this, justifications for allowing tort plaintiffs to pierce the corporate veil are "found in the desire" to incentivize corporations to avoid injury-causing behavior or to allocate risks to those more able to bear them.[134] Moreover, since there is no element of consensual dealing between the plaintiff and the corporation, investors should not "be able to transfer a risk of loss or injury to members of the general public."[135]

---

130. Oh, *supra* note 8, at 90; PALMITER ET AL., *supra* note 40, at 358.
131. *See* PALMITER ET AL., *supra* note 40, at 358.
132. *See* Oh, *supra* note 8, at 90 (concluding that tort creditors recover via the piercing doctrine more often than contract creditors).
133. Peterson, *supra* note 1, at 66.
134. Michael, *supra* note 54, at 49.
135. Peterson, *supra* note 1, at 80.

Perhaps the biggest factor behind the courts' new treatment of tort piercing cases is the severe disconnect between the piercing doctrine and the definition of tort. As discussed throughout, and as proven by Oh, the most significant factor driving a decision to pierce the corporate veil is a showing of fraud, misrepresentation, or illegality.[136] However, "by definition, there can be no misrepresentation to, or reliance by, involuntary [tort] plaintiffs" in any setting.[137] As such, discussions of fraud, misrepresentation, and (arguably) undercapitalization should have no bearing on the analysis of recovery in piercing cases with tort victims because tort victims are completely disconnected from the corporation until an accident occurs.[138] Thus, inclusion of such factors in the analysis demonstrates just how dissociated the doctrine is from the circumstances surrounding its use and emphasizes its need for a judicial face lift.[139]

C. A Closer Look at Contract Creditors (aka Voluntary Creditors)

In contrast to tort creditors, contract creditors are parties who voluntarily contract for a relationship with the corporation.[140] The biggest distinction between a contract creditor and a tort creditor is that, unlike a tort creditor, many contract creditors often have ample opportunity to evaluate the credit risks and contract around potential injury with the corporation before forming a relationship with the enterprise.[141] This opportunity is arguably the single-most important advantage that voluntary creditors have over involuntary creditors. The overwhelming motivator behind the piercing doctrine was to protect contract creditors.[142] When a corporation engaged in fraud or misrepresentation, voluntary creditors were subsequently misled into believing a risk of default was lower than it truly was and thus unwillingly and unknowingly

136. *See supra* Part III(C)(1) and accompanying text.
137. Michael, *supra* note 54, at 49.
138. *See* W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 105 (5th ed. 1984) (noting that reliance is a quintessential element of an actionable misrepresentation).
139. As mentioned, as much as a lengthy argument about how a new piercing analysis is necessary for tort creditors, the scope of this Article is limited to why the argument for piercing in favor of sophisticated contract creditors is weak.
140. Marcantel, *supra* note 4, at 199.
141. Millon, *supra* note 12, at 1316.
142. Peterson, *supra* note 1, at 78.

carried such risk.[143] Piercing the corporate veil became an equitable way to reallocate the risk back to the corporation's shareholders in events of fraud or misrepresentation.[144] However, not all contract creditors are created equal, and the judicial system has reached a point where the piercing doctrine would benefit from recognizing some distinctions.

i. The Distinction Between "Ordinary Creditors" and "Sophisticated Creditors"

Because limited liability is designed to externalize the risk of corporate insolvency that shareholders would otherwise bear themselves,[145] the piercing doctrine exists to reimburse creditors (tort and contract alike) for the costs incurred from the unjust allocation of risk.[146] One category of such costs stems from the often imperfect information available to parties like banks and suppliers when deciding whether to pursue a contractual relationship with a corporate entity.[147] Contract creditors might inaccurately gauge the risks of transacting business with a corporation, either due to misrepresentations made by the company or because the creditor lacks access to information found in credit reports or other documents.[148] Additionally, a significant imbalance in bargaining power might preclude the contracting party from obtaining valuable information and from negotiating things like shareholder guarantees or security interests before signing on the dotted line.[149] For these reasons, it is equitable to allow such creditors to recover under the piercing doctrine if things go awry.

Some commentators argue that contract creditors should not be able to pierce the corporate veil at all, based on the theory that

143. Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 112 (1985).

144. Peterson, *supra* note 1, at 78.

145. Millon, *supra* note 12, at 1316.

146. Easterbrook & Fischel, *supra* note 144, at 112.

147. *See* Alan Schwartz & Louis L. Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630, 632–33 (1979) (explaining that one justification for legal intervention is that consumers cannot contract in their own interest without the necessary information to make the best decisions).

148. Elizabeth S. Fenton, *Trends in Piercing the Corporate Veil*, 20 BUS. TORTS LITIG. 10, 10 (2013).

149. Robert B. Thompson, *Piercing the Veil: Is the Common Law the Problem?*, 37 CONN. L. REV. 619, 631 (2005).

they can always obtain a personal guarantee ahead of time.[150] While logical at its roots, this statement is overbroad because not all contract creditors are created equal.[151] Voluntary creditors can range in size and sophistication from an individual citizen who buys concert tickets at a corporation's venue to an enormous international banking firm. Of course, larger, more sophisticated contract creditors have greater resources available than individual contractors do for a pre-signing risk analysis.[152] Because of this, it is illogical to make an all-or-nothing determination about whether *all* contract creditors *as a group* should be able to pierce the corporate veil. Rather, it is appropriate to make an initial distinction between what this Article refers to as "ordinary creditors" and "sophisticated contract creditors."

For purposes of this Article, an "ordinary creditor" is a contract creditor that lacks adequate resources to limit its contractual risk and is thus vulnerable to being victimized by corporate fraud or misrepresentation (like the consumer who buys concert tickets from a corporation's venue). Because of this, ordinary creditors deserve the power to pierce the corporate veil if necessary. In contrast, a "sophisticated creditor" is a contract creditor that has ample opportunity and resources to protect itself from risk ahead of time via steps like a credit check or personal guarantee. Examples of sophisticated creditors include banks, commercial real estate companies, and large suppliers. In essence, for purposes of this Article, sophisticated creditors are ones who, frankly, should have known better than to contract with a corporation absent sufficient protection and thus do not deserve the ability to recover under the piercing doctrine.

It is important to address a potential counterargument to the distinction between ordinary creditors and sophisticated creditors. While it is technically possible for an ordinary creditor to require a personal guarantee or adequately research the company to avoid potential losses, it is simply not a viable requirement to impose on ordinary creditors. The biggest reason for this is the incredibly

150. PALMITER ET AL., *supra* note 40, at 358.

151. *See* Michael, *supra* note 54, at 47. (referencing a commentator's view that "[t]he sheer breadth of this [veil-piercing doctrine] renders it almost totally useless").

152. *See generally, e.g.*, WILLIAM A. KLEIN & JOHN C. COFFEE, JR., BUSINESS ORGANIZATION AND FINANCE 142 (8th ed. 2002) (describing large entities such as banks, lenders, and large suppliers as capable of analyzing corporate risk and obtaining personal guarantees but making no mention of this ability with regard to smaller creditors).

unequal bargaining power between the corporation and the ordinary creditor,[153] such as someone who buys a concert ticket at a venue that subsequently shutters its doors. While the individual is technically a voluntary creditor, her ability to obtain a personal guarantee on her concert ticket is an infeasible expectation that would just result in the corporation making an "if you don't like the contract, don't sign it" ultimatum—and the corporation would win every time.[154]

Additionally, the fact that piercing occurs exclusively against closely held corporations makes it completely impracticable to require ordinary creditors to obtain credit reports and other corporate documents.[155] Unlike public companies, private companies are not required to file financial statements or other formal documents with the Securities and Exchange Commission ("SEC"), so the type of information accessible on public companies is not necessarily available for private companies absent some serious, potentially expensive digging.[156] As such, it is impracticable to expect an ordinary creditor to conduct such extensive, lengthy, and tedious research every single time she buys concert tickets or orders an item from Amazon.[157]

It is largely for the foregoing reasons that recognizing a distinction between ordinary creditors and sophisticated creditors makes great sense when navigating the choppy waters of the piercing doctrine. While the storm still roars regarding how to clarify the doctrine for involuntary tort victims, adopting separate standards for ordinary and sophisticated creditors would part the clouds in the voluntary creditor context. Therefore, the nuanced

---

153. *See* Thompson, *supra* note 152, at 628 (discussing how unequal bargaining power can significantly disadvantage a weaker party from obtaining information necessary to fully eliminate contractual risk).

154. In contrast, instead of a "take it or leave it" ultimatum, a sophisticated creditor, such as a large supplier of goods, could simply raise its prices to reflect the increased risk of contracting with the company or demand a security interest on the contract. *See* Roger E. Meiners et al., *Piercing the Veil of Limited Liability*, 4 DEL. J. CORP. L. 351, 361 (1979) (recognizing that "market conditions force [an individual or other type of contract creditor] to pay a price for limited liability").

155. *See* Oh, *supra* note 8, at 86 ("[Robert] Thompson found that veil-piercing claims succeed[] 40.18 percent of the time, and exclusively against close corporations.").

156. *Doing Company Research: U.S. Private Companies*, LIBRARY OF CONGRESS, https://guides.loc.gov/company-research/private (last visited Dec. 14, 2020).

157. In addition, separating creditors into groups based on incorporation status is equally as impracticable because, as noted, corporations can be thousands of people large or one person small. *See* Akalp, *supra* note 33 (discussing how a corporation can consist of "a board of directors [that] hold shareholder meetings" or "just one owner").

argument asserted herein is that *sophisticated* contract creditors, such as commercial lenders, real estate companies, and large suppliers, should be barred from recovery under the doctrine of piercing the corporate veil absent incredibly rare circumstances.

ii. The Argument Against Piercing the Corporate Veil through Sophisticated Creditors

After distinguishing ordinary creditors from sophisticated creditors, the argument that sophisticated creditors should be barred from recovery via the piercing doctrine emerges clearly from the shadows. The argument itself is quite simple: sophisticated creditors have the ability, "through [requiring] personal guarantees, security agreements, diversification, or similar mechanisms," to protect themselves from potential losses or misrepresentation when contracting with a limited liability entity.[158] More specifically, sophisticated creditors who knowingly contract with limited liability entities can factor the limited liability status into their analysis of things like appropriate interest rates, personal guarantees, security interests in assets or company stock, or contractual provisions that limit the corporations' freedom to "engage in conduct that would increase the risk of default" on their contracts.[159] Because of this ability, sophisticated contract creditors can better gauge the risk of loss than ordinary creditors and tort creditors can.[160]

Since the sophisticated creditor is almost always able to adequately protect itself, it follows that it should not be entitled to recover under the doctrine of piercing the corporate veil. Allowing such recovery provides the sophisticated creditors with a do-over at their botched transactional effort—a concept that goes entirely against the fundamental purpose of a contract.[161] In essence, this is a type of "you made your bed, now lie in it" approach: to the extent a sophisticated creditor passes up its chance to protect its

158. Cascade Energy & Metals Corp. v. Banks, 896 F.2d 1557, 1557 (10th Cir. 1990).
159. Millon, *supra* note 12, at 1316.
160. *See* Easterbrook & Fischel, *supra* note 146, at 112.
161. *See* Stephanie Faris, *What is the Importance of Contract to a Business?*, CHRON (March 25, 2019), https://smallbusiness.chron.com/importance-contracts-business-906.html (stating that a contract is intended to be a binding recording of party expectations and consists of various protections put in place by each party to mitigate risk).

own interests before executing a contract, it assumes the risks of dealing with a limited liability entity.[162]

A case demonstrating such treatment of sophisticated creditors is *Theberge v. Darbro, Inc*.[163] This case was decided in 1996 by the Maine Supreme Judicial Court and still reflects the state's approach to piercing cases with regard to well-situated contract creditors. In relevant part, Plaintiff-creditors alleged that defendant-businessmen were guarantors of notes payable on a sale of real property, and sought to pierce the corporate veil to collect the debt from the corporate officers.[164] Plaintiffs contended, and the trial court determined, that the corporate veil should be pierced because one of the defendants falsely represented that he was "a person of financial substance" who would stand behind the obligations of the contract.[165] However, the Supreme Judicial Court ultimately reversed, finding that defendants did not act "illegally or fraudulently," but rather conducted themselves "shrewdly" and "employed sharp business practices."[166] Importantly, the Court dubbed the plaintiffs as "sophisticated real estate professionals who understood the significance of a personal guarantee" and determined that, since plaintiffs were fully aware that the documents neither released them from liability for, nor personally obligated the defendants on, the payment of the mortgage, there was no basis for piercing.[167] In other words, the plaintiff-creditor should have been more careful and taken adequate steps to protect its financial interests.

Despite the logical approach outlined above, a predictable counterargument against barring sophisticated creditors from invoking the piercing doctrine is that they should still be able to pierce the veil in instances of fraud, illegality, or misrepresentation. However, this argument holds little water. As discussed in Part V below, even without piercing the corporate veil, sophisticated creditors have numerous other doctrines and statutes to utilize if they wish to bring a claim for fraud or misrepresentation and thus are not harmed if the confusing,

162. *See* Bainbridge, *supra* note 16, at 501 ("[T]he creditor ought to lose because it assumed the risk of doing business with an individual who chose incorporation [and decided not to protect itself beforehand].").

163. Theberge v. Darbro, Inc., 684 A.2d 1298 (Me. 1996).

164. *Id.* at 1299–300.

165. *Id.* at 1301.

166. *Id.*

167. *Id.*

abstract piercing doctrine is removed from their arsenal of recovery.

II. THE UNIFORM FRAUDULENT TRANSFER ACT: AN ALTERNATIVE STATUTORY ROAD TO RECOVERY FOR SOPHISTICATED CONTRACT CREDITORS

The prohibition of creditors from using "sham transactions" to hide their assets from creditors is a concept "as old as Roman law" and was codified in England's Statute of Elizabeth in 1571.[168] Today, it is codified in America's Uniform Fraudulent Transfer Act ("UFTA").[169] Originally completed in 1918 and revised in 1984, the UFTA is a model code that provides a creditor "with the means to reach assets that a debtor has transferred to another person to keep them from being used to satisfy a debt."[170] In other words, it is a remedy by which voluntary contract creditors can recover against corporate debtors that participate in fraudulent business practices without invoking the common law piercing doctrine. All but seven states have adopted the UFTA in some form.[171]

While completely disconnected from the piercing doctrine, the UFTA helps explain many of the piercing factors, as well as whether they are (or are not) relevant to a particular case.[172] The UFTA defines certain debtor transactions as "fraudulent" and

168. PALMITER, *supra* note 28, at 684.

169. UNIF. FRAUDULENT TRANSFER ACT (UNIF. L. COMM'N 1984). While other doctrines, such as the doctrine of fraudulent conveyance and the doctrine of equitable subordination, also exist to protect the interests of creditors, they are more applicable to the bankruptcy context and are therefore outside the scope of discussion for this Article.

170. *Fraudulent Transfer Act*, UNIFORM LAW COMM'N, https://www.uniformlaws.org/committees/community-home?CommunityKey=4226ae7c-91c0-4ce9-b488-8520dbc39ea3#:~:text=The%20Uniform%20Fraudulent%20Transfer%20Act,the%20Uniform%20Voidable%20Transaction%20Act (last visited Dec. 15, 2020). In 2014, the UFTA was revised to include a few "narrowly-defined issues" and was renamed the Uniform Voidable Transfer Act. *Voidable Transactions Act Amendments – Formerly Fraudulent Transfer Act*, UNIFORM LAW COMM'N, https://www.uniformlaws.org/committees/community-home?CommunityKey=64ee1ccc-a3ae-4a5e-a18f-a5ba8206bf49 (last visited Dec. 15, 2020). Because these changes have only been adopted by a handful of states, this Article will base its analysis on the 1984 version of the UFTA. *See id*.

171. UNIFORM LAW COMM'N, *supra* note 173. The seven states who have not yet adopted the UFTA are Alaska, Louisiana, Maryland, New York, South Carolina, Vermont, and Virginia. *Id*.

172. *See* PALMITER, *supra* note 28, at 686 ("In [light of the UFTA] it is easier to see the relevance of corporate formalities and the intermingling of corporate and personal assets or affairs in deciding piercing cases. Disregarded formalities provide indirect evidence of fraudulent transfers and intermingling may provide direct evidence.").

allows creditors with viable claims to void such transactions or seize the property fraudulently conveyed by the debtor.[173] The UFTA and the piercing doctrine both consider some of the same factors to find fraud.[174] Notably, when it cannot be shown that the debtor is purposefully avoiding its creditors, the UFTA deems transfers by the creditor as "constructively" fraudulent if they are for amounts of questionable value or threaten the debtor's ability to pay its other debts as they become due.[175] Both doctrines also create implicit duties for corporate participants (similar to fiduciary duties[176]) that require them to place a creditor's expectations ahead of their own interests.[177]

Due to the stark similarities between the UFTA and the piercing doctrine, a reasonable question lingers: why have courts not replaced the incoherent, ambiguous piercing doctrine with the UFTA or state equivalent?[178] The answer, while acceptable to some, leaves something to be desired. Supposedly, there are many difficulties involved in invoking the UFTA, such as the fact that fraudulent transfer law relies on a creditor's ability to identify specific transactions conducted by the debtor that give rise to fraudulent activity, rather than just arguing fraud as the outcome.[179] Specifically, under the UFTA, a creditor must demonstrate that a particular transaction falls into at least one of three categories of fraudulent transfers: (1) any transfer the debtor made with the "actual intent to hinder, delay, or defraud" present or future creditors; (2) any transfer for which the debtor does not receive "reasonably equivalent value" in return; and (3) any transfer that leaves the debtor with "unreasonably small" assets in relation to its actual or expected business needs, or that the debtor knew or should have known would result in insolvency.[180]

173. UNIF. FRAUDULENT TRANSFER ACT §§ 4, 7 (UNIF. L. COMM'N 1984).

174. *Id.* § 4. *See also* Bendremer *supra* note 82, at 390.

175. PALMITER, *supra* note 28, at 685.

176. *See* Kat Tretina & Benjamin Curry, *How Fiduciary Duty Impacts Financial Advisors*, FORBES ADVISOR, https://www.forbes.com/advisor/investing/what-is-fiduciary-duty/ (last updated May 14, 2021, 11:37 AM) (describing a fiduciary duty as the requirement of certain professionals to act solely in the beneficiary's best interest, mainly through the duties of care and loyalty).

177. PALMITER, *supra* note 28, at 686.

178. Since there are seven states that have not adopted the UFTA, the state equivalent takes the place of the UFTA in this analysis. UNIFORM LAW COMM'N, *supra* note 173.

179. *See* UNIF. FRAUDULENT TRANSFER ACT § 4(a) (UNIF. L. COMM'N 1984) (requiring a creditor indicate where a transaction leaves a corporation with "unreasonably small" capital or that lack "reasonably equivalent value.").

180. *Id.*

Concededly, it could be difficult for a creditor to pinpoint all transactions that defrauded her or left the debtor's business with unreasonably small capital if, for example, corporate records are sketchy, sloppy, or not kept at all. The broader piercing doctrine avoids such problems of proof and has greater "deterrent and compensatory force."[181] However, limited liability is such a cornerstone of the corporate form that a creditor–a sophisticated creditor, at least–seeking to hold shareholders personally liable should be required to prove its case in some particular form rather than allowing judges to rule based on emotion and opinion. Thus, prohibiting sophisticated creditors from recovering under the fluid piercing doctrine and instead requiring them to jump over the UFTA's hurdles is a fair solution that welcomes a structured and transparent court analysis. The solution also provides a balance between the prestige of limited liability, a sophisticated creditor's ability to protect itself *ex ante* (or failure to do so), and the court's ability to set limited liability aside in a constricted set of tangible circumstances.

Another purported shortfall of applying the UFTA in piercing cases is that fraudulent transfer law focuses on the "shady" actions of corporate participants rather than on the creditor's understanding of the transaction.[182] In particular, the UFTA focuses on the actions of business insiders rather than on the issues of "confusion" and "deception" as perceived by creditors, and thus might not detect some cases where the debtor's deception led the creditor to contract with the debtor with limited or faulty information.[183] However, this argument is nullified by implementing the proposed distinction between ordinary creditors and sophisticated creditors.[184] Per the distinction, sophisticated contract creditors all have an ample opportunity to conduct pre-relationship research, require personal guarantees or security interests, and add contractual provisions to best protect themselves from the risk of loss. Thus, the argument that the UFTA is inadequate because it focuses less on less-powerful creditors is irrelevant and moot.

In short, adopting the distinction between ordinary and sophisticated creditors invalidates the arguments against limiting

181. PALMITER, *supra* note 28, at 686.
182. *Id.*
183. *Id.*
184. *See supra* Part IV(C)(1).

sophisticated creditors to recovery under the UFTA. While there are a number of supposed difficulties intertwined with the UFTA—many of which are applicable with regard to ordinary creditors—the UFTA nonetheless provides sophisticated creditors with a fair and concrete road to recovery as opposed to the abstract, insubstantial doctrine of piercing the corporate veil.

III. CONCLUSION

Since its inception, the American judicial system prides itself on the ability to ensure the predictable and consistent administration of justice.[185] The doctrine of piercing the corporate veil embodies the exact opposite characteristics, resulting in a completely unpredictable analysis that is often not rooted in law regardless of the test or language used by the courts. While a general distinction exists between involuntary tort victims and voluntary contract creditors, courts almost always implement the same so-called "analysis," regardless of who the plaintiff is. Not only is this approach outdated, but it just adds fuel to the unruly fire that is the piercing doctrine.

Ultimately, the doctrine of piercing the corporate veil needs some serious modernization and stabilization. To provide clarity to the murky doctrine, courts must recognize two different subsections of contract creditors: ordinary and sophisticated. Because ordinary creditors lack the ability to adequately gather information and add contractual provisions protecting themselves from potential losses, this group should retain the legal ability to invoke the piercing doctrine if necessary. In contrast, sophisticated contractors have sufficient resources to contract around risk, require a personal guarantee, and obtain information about the corporation, so they should be barred from recovery under the piercing doctrine and should instead be limited to the more concrete system of the UFTA—a clear, unbiased, emotionless route of recovery. While not explicitly stated, this distinction appears to already be recognized in Maine via its decision in *Theberge v. Darbro, Inc.* in 1996.[186] More states should follow this lead to provide some stability in the doctrine and provide another layer of

---

185. *See The Judicial Branch*, THE WHITE HOUSE, https://www.whitehouse.gov/about-the-white-house/the-judicial-branch/ (last visited Dec. 10, 2020).

186. *See* Theberge v. Darbro, Inc., 684 A.2d 1298 (Me. 1996).

safety to the corporate construct that is limited liability. Only then can we untangle the unruly web of judicial veil-piercing.

CITY OF CHICAGO, ILLINOIS v. FULTON: MAINTAINING THE STATUS QUO AFTER THE TOW

By: Robert T. Reeder*

I. INTRODUCTION

Tow trucks are a common sight to see driving on city streets, perhaps on their way to assist a motorist in need or help to clear a wreck. However, some communities are less welcoming to tow trucks due to the inconveniences they are capable of causing. When a person's vehicle is towed and impounded, accrued fees and the threat of sale amplify the inconvenience of not having access to the vehicle. Unfortunately, many people are the target of towing operations, yet are unable to afford the fees to have their vehicle returned. For them, filing a petition for bankruptcy may be a viable option. The case under analysis addressed a dispute regarding the function of a fundamental protection afforded by filing a bankruptcy petition – the automatic stay of 11 U.S.C. section 362(a)(3).

City of Chicago, Illinois v. Fulton, 141 S. Ct. 585 (2021) was decided by the United States Supreme Court on January 14, 2021.[1] The issue ultimately presented to the Supreme Court in *Fulton* developed from the consolidated appeal of four Chapter 13 cases wherein "each respondent filed a bankruptcy petition and requested that the City of Chicago ("the City") return his or her vehicle, which was impounded for failure to pay fines for motor vehicle infractions."[2] The City acquired possessory liens through

* J.D. Stetson University College of Law (2022); B.S. Florida State University (2019). I thank Professor Charles J. Tabb for his guidance and feedback throughout the drafting process, Professor Andrew Appleby for his support as my faculty advisor, and Professor Theresa Pulley Radwan for sparking my interest in Bankruptcy. I also wish to express my gratitude to Editor-in-Chief Omar M. Hussein and Articles & Symposia Editor Kyle N. Mosey, along with all members of *Stetson Business Law Review*, for their hard work and dedication. I am deeply grateful for the constant support and encouragement received from my fiancé, parents, family, and friends.

1. *City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585 (2021).
2. *Id.* at 587.

its municipal code.[3] "In each case, the [City refused to return the debtor's vehicle, and] was held by a bankruptcy court to violate the automatic stay."[4] The City then appealed each of the four bankruptcy cases[5] which were consolidated into one case[6] heard by the Seventh Circuit Court of Appeals. "The Seventh Circuit affirmed, concluding that by retaining possession of the vehicles the City had acted 'to exercise control over respondents' property in violation of [section] 362(a)(3)."[7] The City petitioned for a Writ of Certiorari[8] which was granted on December 18, 2019.[9]

The Supreme Court resolved the controversy by ruling that "mere retention of estate property after the filing of a [Chapter 13] bankruptcy petition did not violate [section] 362(a)(3) of the Bankruptcy Code ("Code")."[10] The Court stated that the "most natural reading of [the phrase, 'stay of any act to exercise control over the property of the estate,'] prohibits *affirmative* acts that would disturb the status quo of estate property as of the time when the bankruptcy petition was filed."[11] Prior to the Supreme Court's opinion in *Fulton*, there was disagreement among circuits regarding their respective interpretations of how the automatic stay operated in practice and what conduct by a party in possession of estate property at the time a petition is filed is deemed

3. Municipal Code of Chicago § 9-92-080(f) (2020) ("Any vehicle impounded by the City or its designee shall be subject to a possessory lien in favor of the City in the amount required to obtain release of the vehicle.").

4. *Fulton*, 141 S. Ct. at 587.

5. *In re Shannon*, 590 B.R. 467 (Bankr. N.D. Ill. 2018), *aff'd sub nom. In re Fulton*, 926 F.3d 916 (7th Cir. 2019), *vacated and remanded sub nom. City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585 (2021); *In re Peake*, 588 B.R. 811 (Bankr. N.D. Ill. 2018), *aff'd sub nom. In re Fulton*, 926 F.3d 916 (7th Cir. 2019), *vacated and remanded sub nom. City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585 (2021); *In re Howard*, 584 B.R. 252 (Bankr. N.D. Ill. 2018), *aff'd sub nom. In re Fulton*, 926 F.3d 916 (7th Cir. 2019), *vacated and remanded sub nom. City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585 (2021); *In re Fulton*, No. 18 BK 02860 (Bankr. N.D. Ill. May 31, 2018), *aff'd,* 926 F.3d 916 (7th Cir. 2019), *vacated and remanded sub nom. City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585, 208 L. Ed. 2d 384 (2021).

6. *In re Fulton*, 926 F.3d 916, 920 (7th Cir. 2019), *cert. granted sub nom. City of Chicago, Illinois v. Fulton*, 140 S. Ct. 680 (2019), and *vacated and remanded sub nom. City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585 (2021).

7. *Fulton*, 141 S. Ct. at 587. (internal quotation marks omitted).

8. *See Pet'r's Pet. for a Writ of Cert.* at i, September 17, 2019 (presenting the question of "[w]hether an entity that is passively retaining possession of property in which a bankruptcy estate has an interest has an affirmative obligation under the Bankruptcy Code's automatic stay, 11 U.S.C[.] § 362, to return that property to the debtor or trustee immediately upon filing of the bankruptcy petition.").

9. *See generally City of Chicago v. Fulton*, No. 19-357, Press Rel. (U.S. April 13, 2020), available at https://www.supremecourt.gov/qp/19-00357qp.pdf.

10. *Fulton*, 141 S. Ct. at 587.

11. *Id.* (internal quotations omitted) (emphasis added).

permissible pursuant to that function. Notable topics of controversy included the purpose and development of the bankruptcy system as a whole and the concept of a status quo that the automatic stay seeks to protect. The *Fulton* Court distinguished the separate functions and purposes of sections 362(a)(3) and 542 of the Bankruptcy Code while simultaneously creating a universal 'safe-harbor' for mere possession of lawfully repossessed property seized pre-petition.

In Section II, the history and development of this issue will be addressed to provide a background to *Fulton*, as well as to explore the development of the law leading to this case. Section III will provide a summary of the Court's reasoning, along with the valid concerns and conclusions related to the ruling in Justice Sotomayor's concurrence. Section IV contains the writer's analysis of the Court's reasoning and decision with respect to the historical development, facts, and precedent leading up to this case. Section V concludes the analysis with a brief summary of the main points addressed in this case note.

I. HISTORY AND DEVELOPMENT

A. Bankruptcy Amendments and the Federal Judgeship Act of 1984

In 1984, Congress amended the Bankruptcy Code ("1984 Amendments"). Among the changes Congress implemented, as relevant to this case, was the addition of specific language to 11 U.S.C. section 362(a)(3). The section was amended " . . . in paragraph (3), by inserting 'or to exercise control over property of the estate' after 'estate' the second place it appears."[12] No notes accompanied the change, leaving the official explanation of the change unclear. Courts and scholars alike were relegated to opine on why Congress made these changes, leading to disputes regarding the interpretation of the added language. The following case reflects the Seventh Circuit's interpretation, which was relied upon by courts involved in the development of *Fulton*.

12. *Bankruptcy Amendments and Federal Judgeship Act of 1984*, Pub. L. No. 98–353, § 441(a)(2), 98 Stat. 333, 371 (July 10, 1984).

B. Thompson v. Gen. Motors Acceptance Corp., LLC, 566 F.3d 699, 701 (7th Cir. 2009)

Thompson (2009) was heavily relied upon by the Seventh Circuit when it decided *In re Fulton* in 2019. In *Thompson*, the debtor contracted with the General Motors Acceptance Corporation (GMAC) to purchase a vehicle, but later defaulted on payments.[13] Shortly after GMAC repossessed the vehicle, the debtor filed a petition for Chapter 13 bankruptcy in the U.S. Bankruptcy Court for the Northern District of Illinois.[14] The debtor asked GMAC to return the vehicle,[15] but "GMAC refused to return the vehicle to the estate absent . . . 'adequate protection' of its interests."[16] "Thompson moved for sanctions pursuant to 11 U.S.C. [section] 362(k), claiming that GMAC willfully violated the automatic stay provision in 11 U.S.C. [section] 362(a)(3)."[17] The bankruptcy court, relying on precedent, denied the motion.[18]

The *Thompson* court concerned itself with two issues: (1) "whether GMAC 'exercised control' over property belonging to Thompson's bankruptcy estate simply because it refused to return it to the estate after Thompson filed for bankruptcy;"[19] and (2) "whether GMAC, or a like-situated creditor, is required to return the asset prior to the bankruptcy court establishing that the debtor can provide 'adequate protection' of the creditor's interest in the asset."[20]

The court attempted to define the phrase 'exercise control' by looking to its plain meaning.[21] Using an ordinary dictionary, the court understood it to mean "[h]olding onto an asset, refusing to return it, and otherwise prohibiting a debtor's beneficial use of an asset[.]"[22] It supported this interpretation by comparing it to the

13. *Thompson v. Gen. Motors Acceptance Corp., LLC*, 566 F.3d 700, 701 (7th Cir. 2009).
14. *Id.*
15. *Id.*
16. *Id.*
17. *Id.*
18. *Id. See In re Nash*, 228 B.R. 669 (Bankr. N.D. Ill. 1999), *abrogated by Thompson v. Gen. Motors Acceptance Corp., LLC*, 566 F.3d 699 (7th Cir. 2009); *In re Spears*, 223 B.R. 159 (Bankr. N.D. Ill. 1998), *abrogated by Thompson v. Gen. Motors Acceptance Corp., LLC*, 566 F.3d 699 (7th Cir. 2009) ("a creditor need not return seized property to a debtor's estate absent adequate protection of its interests").
19. *Thompson*, 566 F.3d at 701.
20. *Id.*
21. *Id.* at 702.
22. *Id.* (citing Merriam–Webster's Collegiate Dictionary (11th Ed.2003)).

primary goal of reorganization bankruptcy, which it defined as "group[ing] all of the debtor's property together in his estate such that he may rehabilitate his credit and pay off his debts; this necessarily extends to all property, even property lawfully seized pre-petition."[23] Critically, the court states, "[a]n asset actively used by a debtor serves a greater purpose to both the debtor and his creditors than an asset sitting idle on a creditor's lot."[24]

Beyond policy concerns, the court assumed that it was the intent of Congress to include the prohibition of mere possession. It reasoned that Congress understood that the provision prohibited conduct related to obtaining possession, but by amending it "to prohibit conduct above and beyond obtaining possession of an asset suggests that it intended to include conduct by creditors who seized an asset pre-petition."[25] The court referenced Sixth[26] and Ninth[27] Circuit decisions as support for this position, stating "withholding possession of property from a bankruptcy estate is the essence of exercising control over possession because it prevents the debtor from achieving beneficial use of the estate's property."[28]

GMAC argued that its possession was passive and "that further action, such as selling the car, is required to satisfy the Code's definition of 'exercising control' over the asset."[29] "In support of [its] proposition, GMAC relie[d] solely on *In re Spears*, 223 B.R. 159, 165 (Bankr. N.D. Ill. 1998), which simply reiterates the rationale expressed in *In re Young*, 193 B.R. 620, 624 (Bankr. D.D.C. 1996)."[30] Together:

> These courts find that a creditor that retains possession of a lawfully seized vehicle does not take any action; instead, these courts reason that the

---

23. *Thompson*, 566 F.3d at 702. *See United States* v. *Whiting Pools, Inc.,* 462 U.S. 198, 203-204 (1983); *In re Yates*, 332 B.R. 1, 5 (10th Cir. BAP 2005) ("As a practical matter, there is little difference between a creditor who obtains property of the estate before bankruptcy is filed, or after bankruptcy is filed. The ultimate result is the same—the estate will be deprived of possession of that property. This is precisely the result § 362 seeks to avoid.").

24. *Thompson*, 566 F.3d at 702.

25. *Id.*

26. *See In re Javens*, 107 F.3d 359 (6th Cir. 1997).

27. *See In re Del Mission Ltd.*, 98 F.3d 1147 (9th Cir. 1996), *abrogated by City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585 (2021).

28. *Thompson*, 566 F.3d at 703 (*quoting In re Sharon*, 234 B.R. 676, 682 (6th Cir. BAP 1999)) (internal quotation marks omitted).

29. *Id.* at 702.

30. *Id.*

> creditor simply maintains the pre-bankruptcy status quo (creditor in possession of the asset), which is the purpose of the Code's automatic stay provision. They hold that the 'Code restricts only obtaining possession of the property, rather than the passive act of simply continuing to possess it.'[31]

Rejecting GMAC's arguments, the court found "the act of passively holding onto an asset constitutes 'exercising control' over it, and such action violates section 362(a)(3) of the Bankruptcy Code . . . Here, GMAC exercised control over Thompson's vehicle when it refused to return it to the bankruptcy estate upon request."[32]

Nearly ten years after *Thompson* was decided, four debtors would have their bankruptcy cases consolidated into an appeal that would ultimately present a similar issue to be addressed and decided by the United States Supreme Court.

C. In re Fulton, 926 F.3d 916, 920 (7th Cir. 2019)

Fulton (2021) stemmed from the "consolidated appeal of four Chapter 13 bankruptcies in the United States Bankruptcy Court for the Northern District of Illinois, Eastern Division.[33] The United States Court of Appeals for the Seventh Circuit considered "whether the City of Chicago may ignore the Bankruptcy Code's automatic stay[34] and continue to hold a debtor's vehicle until the debtor pays her outstanding parking tickets."[35] In each of the individual bankruptcy cases, "the City impounded each of their vehicles for failure to pay multiple traffic fines,"[36] obtaining a possessory lien in the amount of fees owed to it under the 2016 amendments to the Chicago Municipal Code.[37] The debtors were unable to pay, instead choosing to file petitions for Chapter 13

31. *Thompson*, 566 F.3d at 702. (quoting *In re Young*, 193 B.R. at 624).
32. *Id.* at 703.
33. *Id.*
34. 11 U.S.C. § 362(a)(3) (2020). The filing of a bankruptcy petition "operates as a stay, applicable to all entities, of . . . any act to obtain possession of property of the estate or of property from the estate to exercise control over property of the estate."
35. *In re Fulton*, 926 F.3d at 920.
36. *Id.*
37. *Id. See* CHI., ILL., MUN. CODE § 9-92-080(f) (2016). *See also supra* text accompanying note 3.

Bankruptcy; however, the City did not return the debtor's vehicles, and justified its actions by "claiming it needed to maintain possession to continue perfection of its possessory liens on the vehicles and that it would only return the vehicles when the debtors paid in full their outstanding fines."[38]

The named debtor-appellee under whom the cases were consolidated was Robbin Fulton,[39] who used her "vehicle to commute to work, transport her young daughter to day care, and care for her elderly parents on weekends."[40] Fulton purchased a 2015 Kia Soul in December of 2017;[41] three weeks later, "the City towed and impounded the vehicle for a prior citation of driving on a suspended license."[42] "On May 2, Fulton filed a motion for sanctions arguing the City was required to turn over her vehicle pursuant to *Thompson*[43] and that failure to do so was sanctionable conduct."[44] The City refused, arguing that Fulton needed to initiate an adversary proceeding under section 542.[45] "On May 25, the bankruptcy court held that the City was required to return Fulton's vehicle under *Thompson* and that the city was not excepted from the stay under [section] 362(b)(3)."[46] The court ordered the vehicle to be returned and imposed sanctions for each day it failed to do so.[47] "The City moved to stay the order in the district court pending appeal; the district court denied the stay request on September 10."[48]

The additional cases consolidated into the appeal contained similar fact patterns.[49] The Seventh Circuit addressed the appeal, distinguishing its decision in *Thompson v. General Motors Acceptance Corp*.[50] The court explains that in *Thompson*:

38. *In re Fulton*, 926 F.3d at 920.
39. *Id.*
40. *Id.* at 920-21.
41. *Id.* at 921.
42. *Id.*
43. *Thompson*, 566 F.3d at 703-04 (A creditor must comply with the automatic stay and return a debtor's vehicle upon filing of a bankruptcy petition).
44. *In re Fulton*, 926 F.3d at 921.
45. *Id.*
46. *Id.*
47. *Id.* at 920.
48. *Id.* at 921.
49. *In re Fulton*, 926 F.3d at 923.
50. *Id.* (citing *Thompson*, 566 F.3d at 701).

> [A] creditor seized a debtor's car after he defaulted on payments. The debtor filed a Chapter 13 petition and attempted to retrieve his car, but the creditor refused. We considered two issues relating to [section] 362(a)(3): whether the debtor "exercised control" of property of the bankruptcy estate by failing to return the vehicle after the debtor filed for bankruptcy, and whether the creditor was required to return the vehicle prior to a court determination establishing the debtor could provide adequate protection for the creditor's interest in the vehicle.[51]

The court next addressed the issues of exercising control and compulsory turnover.[52] It relied on *Thompson* and *Whiting Pools* to establish that "the debtor has an equitable interest in his vehicle, and as such, it is property of his bankruptcy estate."[53] The court rejected the City's argument regarding the exercise of control, finding "passively holding the asset did not satisfy the Code's definition of exercising control."[54] It also rejected the City's interpretation of the phrase 'exercising control,' stating that such an interpretation:

> did not fit with bankruptcy's purpose: . . . to group *all* of the debtor's property together in his estate such that he may rehabilitate his credit and pay off his debts; this necessarily extends to all property, even property lawfully seized pre-petition.[55]

The court also looked to how section 362(a)(3) was amended in 1984 by Congress to "prohibit conduct that 'exercise[d] control' over

51. *In re Fulton*, 926 F.3d at 923 (citing *Thompson*, 566 F.3d at 700).
52. *In re Fulton*, 926 F.3d at 924.
53. *Id.* at 923 (citing *Thompson*, 566 F.3d at 701 (quoting *Whiting Pools, Inc.*, 462 U.S. at 203)) (internal quotation marks omitted).
54. *In re Fulton*, 926 F.3d at 923. The court utilizes a definition from *Thompson* here: "Holding onto an asset, refusing to return it, and otherwise prohibiting a debtor's beneficial use of an asset all fit within [the] definition, as well as within the commonsense meaning of the word." *Thompson*, 566 F.3d at 702. The *Fulton* court also explained that "limiting the reach of 'exercising control' to 'selling or otherwise destroying the asset,' as the creditor proposed, did not fit with bankruptcy's purpose."
55. *In re Fulton*, 926 F.3d at 923 (citing *Thompson*, 566 F.3d at 702 (quoting *Whiting Pools*, 462 U.S. at 203-04)) (internal quotation marks omitted).

estate assets."[56] The court understood the changes to suggest "congressional intent to make the stay more inclusive by including conduct of creditors who seized an asset pre-petition."[57] The City unsuccessfully petitioned the court to overrule *Thompson* for three reasons:

> (1) property impounded prior to bankruptcy is not property of the bankruptcy estate because the debtors did not have a possessory interest in their vehicles at the time of filing; (2) the stay requires creditors to maintain the status quo and not take any action, such as returning property to the debtor, so the onus is on the debtor to move for a turnover action to retrieve her vehicle; and (3) the plain language of [section] 362(a)(3) requires an act to exercise control, and passive retention of the vehicle is not an act.[58]

The court alluded to the fundamental principle of bankruptcy in its decision to reject these arguments, "to allow the debtor to regain his financial foothold and repay his creditors."[59] The court further cited to *Thompson* in support of the notion that "a debtor must be able to use his assets 'while the court works with both debtor and creditor to establish a rehabilitation and repayment plan.'"[60] The court considered this principle the basis for compelling turnover under section 542[61] to maintain the status quo of bankruptcy, which it defined as "the return of the debtor's

---

56. *In re Fulton*, 926 F.3d at 923.

57. *In re Fulton*, 926 F.3d at 923 (citing *Thompson*, 566 F.3d at 702 (quoting *Whiting Pools*, 462 U.S. at 203-04)) (internal quotation marks omitted). *See In re Javens*, 107 F.3d at 368 ("The fact that 'to obtain possession' was amended to 'to obtain possession . . . or to exercise control' hints that this kind of 'control' might be a broadening of the concept of possession . . . It could also have been intended to make clear that [§ 362](a)(3) applied to the property of the estate that was not in possession of the debtor.") (first alteration in original). *See also In re Del Mission Ltd.*, 98 F.3d at 115 ([The 1984] amendment 'broaden[ed] the scope of § 362(a)(3) to proscribe the mere knowing retention of estate property').

58. *In re Fulton*, 926 F.3d at 925 (internal quotation marks omitted).

59. *Id.* citing *Thompson*, 566 F.3d at 706.

60. *Id.* citing *Thompson*, 566 F.3d at 707.

61. *Id. See Whiting Pools*, 462 U.S. at 205; *In re Weber*, 719 F.3d 72, 79 (2d Cir. 2013) *abrogated by City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585 (2021) ("*Whiting Pools* teaches that the filing of a petition will generally transform a debtor's equitable interest into a bankruptcy estate's possessory right in the vehicle.").

property to the estate."[62] By defining the status quo of bankruptcy this way, the court found that "the City was not passively abiding by the bankruptcy rules but actively resisting [section] 542(a) to exercise control over the debtor's vehicles."[63]

The court noted that "the Tenth Circuit recently adopted[64] the City's view,"[65] but it felt that decision reflected the minority view, with "*Thompson* [bringing] our Circuit in line with the majority rule, held by the Second, Eighth, and Ninth Circuits."[66] The Seventh Circuit court believed the "City want[ed] to maintain possession of the vehicles not because it want[ed] the vehicles but to put pressure on the debtors to pay their tickets[,] . . . [which] is precisely what the stay is intended to prevent."[67]

II. COURT'S ANALYSIS

In *City of Chicago, Illinois v. Fulton*, Justice Alito delivered the opinion of the Supreme Court of the United States on January 14, 2021.[68] The question presented was "whether an entity violates [section 362(a)(3)] by retaining possession of a debtor's property after a bankruptcy petition is filed."[69] The Court concluded "that mere retention of property does not violate [section] 362(a)(3)."[70]

In reaching this conclusion, the Court relied on section 541(a)(1), which creates an estate that "comprises 'all legal or equitable interests of the debtor in property as of commencement of the case.'"[71] It then looked to section 542, which requires "that an entity (other than a custodian) in possession of property of the bankruptcy estate 'shall deliver to the trustee, and account for'

62. *In re Fulton*, 926 F.3d at 925.
63. *In re Fulton*, 926 F.3d at 925.
64. *In re Cowen*, 849 F.3d 943 (10th Cir. 2017).
65. *In re Fulton*, 926 F.3d at 925.
66. *Id.* The court provides references to the following cases in support of its position that its ruling is in line with the 'majority' view. *In re Weber*, 719 F.3d 72 (2013); *In re Del Mission Ltd.*, 98 F.3d 1147 (1996); *In re Knaus*, 889 F.2d 773 (8th Cir. 1989), *abrogated by City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585 (2021).
67. *In re Fulton*, 926 F.3d at 925-926. *See also In re Fulton*, 926 F.3d at n. 1. (citing *In re Shannon*, 590 B.R. 467 (2018) ("[Sections] 362(a)(4) and (a)(6) also prohibit the City's continued retention of debtors' vehicles. Because the City is bound by the stay under [section] 362(a)(3), we do not reach the applicability of additional stay provisions.").
68. *City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585 (2021).
69. *Id.* at 589.
70. *Id.*
71. *Id.*

that property."[72] The section in question, 362(a), functions as a stay "of efforts to collect from the debtor outside of the bankruptcy forum."[73] Additionally, the function "serves the debtor's interests by protecting the estate from dismemberment, and it also benefits creditors as a group by preventing individual creditors from pursuing their own interests to the detriment of others."[74] Important to the controversy in this case, section 362(a)(3) 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 estate*."[75]

The Court found that "the most natural reading of [the] terms—'stay,' 'act,' and 'exercise control'—is that section 362(a)(3) prohibits affirmative acts that would disturb the status quo of estate property at the time when the bankruptcy petition was filed."[76] After discussing the meaning of these terms in context, the Court stated "we do not maintain that these terms definitively rule out the alternative interpretation adopted by the court below and advocated by respondents[,]"[77] because "omissions can qualify as 'acts' in certain contexts, and the term 'control' can mean 'to have power over.'"[78] However, the Court found that "[a]ny ambiguity in the text of [section] 362(a)(3) is resolved decidedly in the City's favor by the existence of a separate provision, [section] 542, that expressly governs the turnover of estate property."[79]

The Court turned to the problems that the Respondents' interpretation would cause: (1) "it would render the central command of [section] 542 largely superfluous[;]"[80] and (2) it "would render the commands of [section] 362(a)(3) and [section] 542 contradictory."[81] The Court noted that "[r]eading 'any act . . . to exercise control' in [section] 362(a)(3) to include merely retaining possession of a debtor's property would make that section a blanket turnover provision[,]"[82] making the mandate of section 542 "surplusage if [section] 362(a)(3) already required an entity

72. *Fulton*, 141 S. Ct. at 589.
73. *Id.*
74. *Id.*
75. *Id.*
76. *Fulton*, 141 S. Ct at 590.
77. *Id.*
78. *Id.* (citing *Thompson*, 566 F.3d at 702).
79. *Id*
80. *Id.* at 591.
81. *Fulton*, 141 S. Ct. at 591.
82. *Id.*

affirmatively to relinquish control of the debtor's property at the moment a bankruptcy petition is filed."[83] The Court found no textual basis to justify the inconsistency of Respondents' interpretation of the stay where exceptions to turnover apply, yet "[section] 362(a)(3) would command turnover all the same."[84] "[I]t would be 'an odd construction' of [section] 362(a)(3) to require a creditor to do immediately what [section] 542 specifically excuses."[85]

The Court also found a distinct lack of evidence showing Congressional intent that would support the Respondents' view, noting that "it would have been odd for Congress to [transform the stay in section 362 into an affirmative turnover obligation] by simply adding the phrase 'exercise control.'"[86] The Court posited that "the 1984 amendment . . . simply extended the stay to acts that would change the status quo with respect to intangible property and acts that would change the status quo with respect to tangible property without 'obtain[ing]' such property."[87] It concluded, "[w]e only hold that mere retention of estate property after the filing of a bankruptcy petition does not violate [section] 362(a)(3) of the Bankruptcy Code."[88]

Justice Sotomayor, in a concurring opinion, addressed the concerns of parties arguing the Respondents' view in favor of the debtors.[89] The concurrence discussed the underlying feelings of unfairness related to the debtors' situation, but laid out the alternative:

> Although the Court today holds that [section] 362(a)(3) does not require creditors to turn over impounded vehicles, bankruptcy courts are not powerless to facilitate the return of debtors' vehicles to their owners . . . [leaving] open the possibility of relief under [section] 542(a).[90]

---

83. *Id.*
84. *Id.*
85. *Fulton*, 141 S. Ct. at 591 (citing *Citizens Bank of Md. v. Strumpf*, 516 U.S. 16, 20 (1995)).
86. *Id.* at 591-92.
87. *Id.* at 592.
88. *Id.*
89. *Fulton*, 141 S. Ct. at 592–95 (J. Sotomayor, concurring).
90. *Id.* at 594 (J. Sotomayor, concurring).

The Concurrence addressed inconveniences related to section 542 turnover proceedings, noting that "turnover proceedings can be quite slow."[91] "Of the turnover proceedings filed after July 2019 and concluding before June 2020, the average case was pending for over 100 days."[92] Understanding how this may affect the individual debtor unable to use their vehicle, Justice Sotomayor stated "[o]ne hundred days is a long time to wait for a creditor to return your car, especially when you need that car to get to work so you can earn an income and make your bankruptcy-plan payments."[93]

The Concurrence then addressed judicially devised remedies created in an attempt to "hurry things along."[94] It goes on to state, "any gap left by the Court's ruling today is best addressed by rule drafters and policymakers, not bankruptcy judges."[95] Justice Sotomayor stated:

> It is up to the Advisory Committee on Rules of Bankruptcy Procedure to consider amendments to the Rules that ensure prompt resolution of debtors' requests for turnover under [section] 542(a), especially where debtors' vehicles are concerned. Congress, too, could offer a statutory fix, either by ensuring that expedited review is available for [section] 542(a) proceedings seeking turnover of a vehicle or by enacting entirely new statutory mechanisms that require creditors to return cars to debtors in a timely manner. Nothing in today's opinion forecloses these alternative solutions. With that understanding, I concur.[96]

Thus, Justice Sotomayor's concerns related to delays in the return of debtors' vehicles via section 542(a) turnover proceedings are addressed by calling upon the Advisory Committee on Rules of

91. *Fulton*, 141 S. Ct. at 593–-594 (J. Sotomayor, concurring).

92. *Id.* at 594. (J. Sotomayor, concurring); *see* Administrative Office of the United States Courts, *Time Intervals in Months From Filing to Closing of Adversary Proceedings Filed Under 11 U.S.C. § 542 for the 12-Month Period Ending June 30, 2020*, Washington, DC: Sept. 25, 2020.

93. *Id.* (J. Sotomayor, concurring).

94. *Id.* (J. Sotomayor, concurring).

95. *Id.* at 595 (J. Sotomayor, concurring).

96. *Fulton*, 141 S. Ct. at 595 (J. Sotomayor, concurring).

Bankruptcy Procedure as well as Congress to provide an adequate legislative solution.

I. ANALYSIS

Fulton[97] solidified the purpose of the automatic stay, defined the status quo it protects, and set it apart from the function and purpose of an adversary proceeding under section 542. The Supreme Court limited the scope of its opinion, found that mere retention of property of the bankruptcy estate is not violative of the automatic stay,[98] vacated the lower court's ruling, and remanded for further proceedings.[99] The Supreme Court arrived at the proper conclusion, resolving a circuit split that had been troubling the bankruptcy system following the implementation of additional language in section 362(a)(3) when the 1984 amendments[100] were enacted.[101] Although the Fulton court established a helpful uniform interpretation, some points addressed could have been expanded upon to prevent future controversy in practice. Justice Sotomayor's concurrence,[102] in consideration of the seeming unfortunate effects this precedent will have on debtors, is nothing short of a call for help to Congress.[103] Due to these noted effects, Congress must amend the Code to make it easier for debtors to recover their vehicles in similar situations without impairing the rights of creditors.

Each of the following issues will be addressed in this analysis: (1) the function and purpose of the automatic stay and term status quo, as relevant; (2) the differing interpretations that caused the underlying controversy; (3) the prohibitive function of the automatic stay; (4) the proper avenue for turnover of estate property; and (5) whether the City may still be found to have engaged in prohibited conduct under the automatic stay of section 362(a)(3).

---

97. *City of Chicago, Illinois, v. Fulton*, 141 S. Ct. 585 (2021).
98. *Id.* at 589, 592.
99. *Id.* at 592.
100. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98–353, § 441(a)(2), 98 Stat. 333, 371 (July 10, 1984).
101. *Fulton*, 141 S. Ct. at 589–590.
102. *Id.* at 592-595 (J. Sotomayor, concurring).
103. *Id.* at 595 (J. Sotomayor, concurring).

A. Defining The Stay And Status Quo

The *Fulton* opinion decisively instructs courts that the automatic stay operates as a prohibition on conduct that would disrupt the status quo of assets at the time the petition is filed.[104] Therefore, the automatic stay does not mandate the return of lawfully repossessed assets seized prepetition to the trustee or debtor-in-possession.[105] This is the correct interpretation of the function of the stay. The automatic stay exists to protect debtors from further affirmative acts that would dismember, dispose, or otherwise transfer property of the estate.[106] It also prohibits further acts to collect on pre-petition debts.[107] Because the automatic stay is similar in function to a prohibitory injunction[108] rather than one mandating turnover, in practice, section 362(a)(3) should operate to prohibit certain impermissible conduct by parties to the bankruptcy filing, carrying the threat of sanctions for that which is deemed violative.[109] The *Fulton* Court is clear on this point: sections 362(a)(3) and 542 are separate provisions accomplishing separate functions,[110] and Congress would not have failed to include cross-references or gone to greater lengths to delineate an enforcement function of section 362(a)(3) had it intended to do so.[111] The Court reasoned there is no textual basis

104. *Fulton*, 141 S. Ct. at 590 ("[Section] 362(a)(3) halts any affirmative act that would alter the status quo as of the time of the filing of a bankruptcy petition.").

105. *Id.* at 591 ("Section 362(a)(3) prohibits collection efforts outside the bankruptcy proceeding that would change the status quo, while § 542(a) works within the bankruptcy process to draw far-flung estate property back into the hands of the debtor or trustee.").

106. *Id.* at 589 ("The automatic stay serves the debtor's interests by protecting the estate from dismemberment, and it also benefits creditors as a group by preventing individual creditors from pursuing their own interests to the detriment of the others.").

107. *Id.* at 589 ("When a debtor files a petition for bankruptcy, the Bankruptcy Code protects the debtor's interests by imposing an automatic stay on efforts to collect prepetition debts outside the bankruptcy forum.").

108. *Prohibitory Injunction*, THE LAW DICTIONARY, https://thelawdictionary.org/prohibitory-injunction/ (last visited July 14, 2021) ("Prohibition of execution of certain actions by a certain party by a legal authority, normally a court.").

109. *See* 11 U.S.C. § 363(k)(1) ("Except as provided in paragraph (2), an individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages.").

110. *Fulton*, 141 S. Ct. at 591–92.

111. *Fulton*, 141 S. Ct. at 591–92 ("Had Congress wanted to make § 362(a)(3) an enforcement arm of sorts for § 542(a), the least one would expect would be a cross-reference to the latter provision, but Congress did not include such a cross[-]reference or provide any other indication that it was transforming § 362(a)(3).").

to identify an enforcement function that requires turnover in section 362(a)(3).[112] In addition to the lack of evidence suggesting Congressional intent to that end, the Court is not free to write its own law or amend existing law.[113] However, this does not mean the Court is devoid of power to identify a need for Congress to address the issue and call upon it for a legislative solution.[114] This is seen in Justice Sotomayor's Concurrence, which will be more thoroughly addressed in subsection *D* of this analysis.[115]

The Supreme Court concluded that mere possession did not constitute an affirmative act that disrupts the status quo, much to the dismay of those assuming Respondents' interpretation.[116] Although the Seventh Circuit's interpretation received some support from scholars and practitioners alike,[117] the Supreme Court correctly decided *Fulton*. To properly understand the Court's reasoning and ultimate decision, it is important to identify and define the 'status quo' protected by the automatic stay. The *Fulton* Court defined the status quo as the current state of assets, whether they be possessed by the debtor or otherwise, at the time the petition is filed.[118] Following the Court's interpretation of the automatic stay pursuant to Section 362(a)(3), any affirmative act or omission to exercise control that disrupts the status quo will be deemed violative of the stay.[119] Accordingly, parties, such as creditors who carried out a prepetition repossession or perfected

112. *Id.* at 592 ("[I]t would have been odd for Congress to accomplish that change by simply adding the phrase "exercise control," a phrase that does not naturally comprehend the mere retention of property and that does not admit of the exceptions set out in § 542.").

113. *Id.* at 595 (J. Sotomayor, concurring). *See infra* text accompanying note 127.

114. *Fulton*, 141 S. Ct. at 595 (J. Sotomayor, concurring).

115. *See infra* Part IV (D), discussing Justice Sotomayor's concurrence.

116. *Fulton*, 141 S. Ct. at 589, 592.

117. *See* Brief for the LAF, National Consumer Bankruptcy Rights Center, and National Association of Consumer Bankruptcy Attorneys as Amicus Curiae, *City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585 (2021) (No. 18-2527, 18-2835, 18-3023); Brief for the American Civil Liberties Union, the American Civil Liberties Union of Illinois, the Cato Institute, the Fines and Fees Justice Center, the Institute for Justice, the R Street Institute, and the Rutherford Institute as Amicus Curiae, *City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585 (2021) (No. 19-357); Brief for the National Consumer Bankruptcy Rights Center, National Association of Consumer Bankruptcy Attorneys, and Legal Aid Chicago as Amicus Curiae, *City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585 (2021) (No. 19-357); Brief for the Professors John A. E. Pottow and Jay Lawrence Westbrook as Amicus Curiae, *City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585 (2021) (No. 19-357); Brief for the National Association of Chapter Thirteen Trustees as Amicus Curiae, *City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585 (2021) (No. 19-357); Brief for Geraci Law, L.L.C., as Amicus Curiae, *City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585 (2021) (No. 19-357).

118. *Fulton*, 141 S. Ct. at 590. *See supra* text accompanying note 104.

119. *Fulton*, 141 S. Ct. at 590.

on a lien through control or possession prior to the filing of such a petition, are no longer engaging in sanctionable conduct constituting a violation of section 362 if they merely possess the property because this conduct does not rise to the level of an affirmative act.[120] Essentially, the Supreme Court created a universal safe harbor for mere possession of estate property in similar factual situations.[121]

Some may argue that the City exerted influence over the debtors' vehicles by maintaining them in impound, reasoning that such conduct constitutes an affirmative act or omission violative of the stay because the City made an active decision to exercise control over the vehicles by refusing to release them.[122] To properly understand why impoundment does not constitute a violation, it is important to note that the impoundment occurred lawfully, prior to the filing of the bankruptcy petition.[123] Because this was the state of the asset prior to filing, impoundment is the status quo protected by the automatic stay.[124] Additionally, there is no mandatory turnover function of section 362(a)(3). Debtors wishing to recover their vehicles must initiate an adversary proceeding under section 542, even though it may be inconvenient.[125] Adversary proceedings under section 542 are the proper mechanism by which a debtor may retrieve far-flung property of the estate[126] and as Justice Sotomayor alludes to in the Concurrence, inconveniences of these proceedings should be addressed by Congress rather than by relying on courts to implement judicially devised 'workarounds.' Especially when the function of these courts is merely to interpret and apply the provisions of the Code as written.[127] Accordingly, section 362(a)(3)

120. *Id.* at 589, 592.

121. *Id.* at 594 (J. Sotomayor, concurring) ("[T]he Court today holds that § 362(a)(3) does not require creditors to turn over impounded vehicles.").

122. *See* Brief for the LAF, et al.; Brief for Amici Curiae Nat'l Consumer Bankr. Rts. Ctr. Nat'l Ass'n of Consumer Bankr. Att'ys, and Legal Aid Chi. in Support of Respondents No.19–357 at 4. ("For purposes of section 362, the 'act' of holding onto property is as much an 'act' as taking it-to take and to hold are both 'acts' within the ordinary meaning of the term").

123. *In re Fulton*, 926 F.3d 916, 920 (2019). The City of Chicago obtained a possessory lien in the amount owed on the vehicle under M.C.C. § 9-92-080(f) (2016). In each of the individual bankruptcy cases, the City perfected on its security interest through control or possession via impoundment.

124. *Fulton*, 141 S. Ct. at 590.

125. *Fulton*, 141 S. Ct. at 594–95 (J. Sotomayor, concurring).

126. *Id.* at 591. *See supra* text accompanying note 105.

127. *Id.* at 595 (J. Sotomayor, concurring) ("Ultimately, however, any gap left by the Court's ruling today is best addressed by rule drafters and policymakers, not bankruptcy

prohibits the City from engaging in affirmative acts that would disrupt the status quo upon the filing of the bankruptcy petition.[128] However, *Fulton* does not preclude the possibility that the City engaged in conduct violative of the automatic stay, which will be discussed later in this analysis.[129]

B. Differing Interpretations

Bankruptcy courts are afforded some discretion when they are called upon to interpret and carry out provisions of the Code,[130] but through its ruling to vacate and remand the lower courts' mistaken interpretations, the United States Supreme Court indicated that mere possession is not violative of the automatic stay, solidifying its function. Prior to *Fulton*, several Circuits, including the Seventh Circuit, utilized the automatic stay as a judicially devised 'workaround' to turnover proceedings under section 542, operating as a mandatory injunction[131] requiring the return of estate property to maintain the 'status quo,' which these courts defined as "the return of the debtor's property to the estate."[132] The concept that the automatic stay under section 362(a)(3) could function as a mandatory injunction requiring turnover of estate property upon filing of a bankruptcy petition is relatively new, developed after new language was added to the section when the 1984 Amendments to the Code were enacted.[133] *Fulton* now instructs

judges. It is up to the Advisory Committee on Rules of Bankruptcy Procedure to consider amendments to the Rules that ensure prompt resolution of debtors' requests for turnover under § 542(a), especially where debtors' vehicles are concerned. Congress, too, could offer a statutory fix, either by ensuring that expedited review is available for § 542(a) proceedings seeking turnover of a vehicle or by enacting entirely new statutory mechanisms that require creditors to return cars to debtors in a timely manner.").

128. *Fulton*, 141 S. Ct. at 592.

129. *See infra*, Part IV (E), which discusses the City's possible violative conduct of the automatic stay.

130. *See* 11 U.S.C. § 105(a) ("The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.").

131. *Mandatory Injunction*, THE LAW DICTIONARY, https://thelawdictionary.org/mandatory-injunction/ (last visited July 14, 2021) ("Court order mandating a mandatary entity to perform or cease a specific act.").

132. *In re Fulton*, 926 F.3d 916, 925.

133. Brief for the Professors Ralph Brubaker, Ronald J. Mann, Charles W. Mooney, Jr., Thomas E. Plank, and Charles J. Tabb as Amicus Curiae at 13, *City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585 (2021) (No. 19-357) ("Courts adopting the Seventh Circuit's

courts to uniformly interpret and enforce the automatic stay provision as a prohibitory injunction that forbids creditors lawfully in possession of estate property from engaging in affirmative acts that would change or otherwise alter the status quo of the asset at the time the petition is filed.[134]

The lower courts, as well as the courts that rendered decisions creating the precedent they relied upon, may have been misguided in their interpretation of section 362(a)(3). However, it is unlikely they came to their conclusions in bad faith. There was an underlying premise of unfairness that the Seventh Circuit and bankruptcy courts identified with regard to the City's choice to retain possession and refuse to return vehicles that the debtors had an equitable interest in.[135] The City awarded itself a possessory lien through its own municipal code, and in some cases, the fees were high with respect to the liquidation value of the debtors' vehicles.[136] The debtors took the affirmative step of filing Chapter 13 bankruptcy petitions, hoping to financially rehabilitate

---

interpretation of §362(a)(3) have cited no pre-1984 case holding to the contrary. Those courts have misconstrued §542(a) turnover as somehow being self-executing under the influence of their misinterpretation of the 1984 amendment to §362(a)(3).").

134. *Fulton*, 141 S. Ct. at 590.

135. *In re Fulton*, 926 F.3d at 926 ("The City's argument that it will be overburdened with responding to Chapter 13 petitions is ultimately unavailing; any burden is a consequence of the Bankruptcy Code's focus on protecting debtors and on preserving property of the estate for the benefit of *all* creditors. It perhaps also reflects the importance of vehicles to residents' everyday lives, particularly where residents need their vehicles to commute to work and earn an income in order to eventually pay off their fines and other debts.") (emphasis in original). The Seventh Circuit had a history of similar decisions in very similar factual circumstances. One of the primary concerns of the court, even if not stated by the *In re Fulton* court, was the balance of the creditors' and debtors' rights. The court preferred to preserve the debtor's ability to have beneficial use of their property, in which they maintained an equitable interest. Furthermore, the courts believed that the City's failure to seek adequate protection had waived its argument on that point. *See In re Cross*, 584 B.R. 833, 843–44 (Bankr. N.D. Ill. 2018) ("What the City is attempting to do is use this state statute as a means to circumvent U.S. Bankruptcy law and the rights of debtors therein to drive their cars to work in order to keep their jobs . . . [t]he City is clearly incorrect that Debtor does not have an interest in the vehicle pursuant to 11 U.S.C. § 542. First, Debtor is the owner of the vehicle, as she has stated in her Complaint and that alone establishes an interest in the vehicle. Moreover, the Debtor has an interest the moment she requests turnover of the vehicle from a creditor during the pendency of her bankruptcy. The City undoubtedly has authority to impound and hold a debtor's vehicle when they have committed violations and refused to pay their tickets. But, once that debtor enters bankruptcy, the City is bound by the ruling in *Thompson* to return the vehicle or seek protection by a motion.").

136. *See In re Fulton*, 926 F.3d at 920–22. In the four underlying bankruptcy cases, the vehicles and their respective fees were: (1) *In re Fulton* – 2015 Kia Soul, amended proof of claim totaled $11,831.20; (2) *In re Shannon* – 1997 Buick Park Avenue, amended proof of claim totaled $5,600; (3) *In re Peake* – 2007 Lincoln MKZ, secured proof of claim totaled $5,393.27; (4) *In re Howard* – unlisted vehicle, secured proof of claim totaled $17,110.80.

themselves to offset the fees and costs owed to the City, which ultimately led to their vehicles being impounded and accrual of additional costs related to such impoundment. Historically, the City returned vehicles when a debtor filed a bankruptcy petition but began refusing to do so under the assumption that it could retain possession of the vehicles and that impoundment was the best course of avenue to ensure payment.[137]

The Supreme Court, as well as the lower courts, identified: "under the Bankruptcy Code, the filing of a bankruptcy . . . petition creates an estate that, with some exceptions, comprises all legal or equitable interests of the debtor in property as of the commencement of the case."[138]

The disagreement was in regard to the function of the stay—the Supreme Court and lower courts interpreted the automatic stay as a provision that protects against dismemberment of the estate, but the interpretation differed as to whether it serves as a prohibition or enforcement provision of the Code.[139] The Seventh Circuit, sharing views with the Second, Eighth, and Ninth Circuits, interpreted the automatic stay to be a function of bankruptcy that required the return of property to the estate.[140] It stated "the primary goal of reorganization bankruptcy is to group *all* of the debtor's property together in his estate such that he may rehabilitate his credit and pay off his debts; this necessarily extends to all property, even property lawfully seized pre-petition."[141]

It continued, "the status quo in bankruptcy is the return of the debtor's property to the estate."[142]

This interpretation of the purpose of Chapter 13 bankruptcy may be correct; however, the interpretation of the status quo, as relevant to the function of the automatic stay, was not. As the Supreme Court clarified in *Fulton*, section 362(a)(3) is not the

137. *In re Fulton*, 926 F.3d at 930 ("We are persuaded that, on balance, this is an exercise of revenue collection more so than police power.").

138. *Fulton*, 141 S. Ct. at 589 (internal quotation marks omitted).

139. *Id.* at 591. *See supra* text accompanying note 105. *See also In re Fulton*, 926 F.3d at n. 3 ("[T]here is no question the stay *compels* the City to return the vehicles.") (emphasis in original).

140. *In re Fulton*, 926 F.3d at n. 3 ("[T]here is no question the stay *compels* the City to return the vehicles.") (emphasis in original).

141. *Id.* at 932 (quoting *Thompson*, 566 F.3d at 702 (citing *Whiting Pools*, 462 U.S. at 203-04)).

142. *Id.* at 925.

primary means of consolidating property of the estate.[143] To retrieve property of the estate, a debtor-in-possession or trustee must initiate an adversary proceeding under section 542.[144] In its opinion, the lower court touched on the inconveniences Justice Sotomayor would later recognize related to adversary proceedings. However, these issues do not justify circumventing section 542 turnover proceedings in favor of interpreting section 362(a)(3) as a mandatory injunction that would require the return of property of the bankruptcy estate to debtors.[145] As the Supreme Court notes:

> Had Congress wanted to make [section] 362(a)(3) an enforcement arm of sorts for [section] 542(a), the least one would expect would be a cross-reference to the latter provision, but Congress did not include such a cross-reference [sic] or provide any other indication that it was transforming [section] 362(a)(3).[146]

This is a critically important statement, because it identifies that Congress had the power to merge these sections or omit section 542 from the Code in its entirety, thereby amending section 362 to accomplish the turnover function of section 542; yet, it did neither.[147]

Hindsight now provides adequate opportunity for reflection on the reasoning set forth in these decisions in light of the Supreme Court's interpretation. Specifically, courts may empathize with debtors in factual situations such as the one presented in *Fulton*, but they must uniformly apply provisions of the Code with respect to all parties, who in turn, must utilize the proper provisions to

---

143. *Fulton*, 141 S. Ct. at 591.

144. *Id*. at 592 (Sotomayor, J. concurring).

145. *Id.* at 594 (Sotomayor, J. concurring) ("The trouble with § 542(a), however, is that turnover proceedings can be quite slow . . . [o]ne hundred days is a long time to wait for a creditor to return your car, especially when you need that car to get to work so you can earn an income and make your bankruptcy-plan payments.").

146. *Id.* at 592.

147. Brief for the Professors Ralph Brubaker, Ronald J. Mann, Charles W. Mooney, Jr., Thomas E. Plank, and Charles J. Tabb as Amicus Curiae at 16-17, *City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585 (2021)
("The 1984 amendment to §362(a)(3) did not repeal pre-1984 turnover law. Neither the text of that amendment nor the legislative record of its enactment suggests repeal. To the contrary, the statutory language of that amendment and the legislative explanations thereof demonstrate that Congress simply extended the protections of the §362(a)(3) stay to intangible property rights that are incapable of actual physical possession.").

accomplish their goals in the interest of fairness to all involved in that matter. This is the basis for Justice Sotomayor's Concurrence, wherein it was reasoned, that section 542 is the proper procedural mechanism for securing the return of property of the estate to the debtor.[148] While Justice Sotomayor does point out that the Supreme Court's holding in *Fulton* may delay the recovery of debtors' vehicles by no longer permitting section 362(a)(3) to function as a shortcut to recovery, it doesn't tip the scale in favor of the Respondents' view because such an interpretation would render section 542 superfluous.[149]

C. What Qualifies As Prohibited Conduct

The Supreme Court's guidance and ultimate decision in *Fulton* directly impact the rights of creditors in possession of property of the bankruptcy estate at the outset of such a matter. The Court expressly states that mere possession is not violative of the automatic stay.[150] This statement, on its own, serves as a safe harbor to specific conduct being deemed a violation of the automatic stay. As helpful as it may be to have definitive guidance regarding mere possession in these types of situations, some questions remain unanswered. Practitioners and courts alike may find themselves limited to the Supreme Court's interpretation of the terms "stay," "act," "exercise," and "control."[151] These terms led

---

148. *Fulton*, 141 S. Ct. at 594 (Sotomayor, J. concurring) (citing *Whiting Pools*, 462 U.S. at 207; 11 U.S.C. § 542(a)) ("[T]he Court leaves open the possibility of relief under § 542(a). That section requires any "entity," subject to some exceptions, to turn over "property" belonging to the bankruptcy estate. 11 U.S.C. § 542(a). The debtor, in turn, must be able to provide the creditor with "adequate protection" of its interest in the returned property, § 363(e); for example, the debtor may need to demonstrate that her car is sufficiently insured. In this way, § 542(a) maximizes value for all parties involved in a bankruptcy: The debtor is able to use her asset, which makes it easier to earn an income; the debtor's unsecured creditors, in turn, receive timely payments from the debtor; and the debtor's secured creditor, for its part, receives "adequate protection [to] replace the protection afforded by possession.").

149. *Id.* at 591 ("Reading § 362(a)(3) to cover mere retention of property, as respondents advocate, would create at least two serious problems. First, it would render the central command of § 542 largely superfluous . . . Second, respondents' reading would render the commands of § 362(a)(3) and § 542 contradictory.").

150. *Fulton*, 141 S. Ct. at 589.

151. *Id.* at 590 ("Taking the provision's operative words in turn, the term 'stay' is commonly used to describe an order that 'suspend[s] judicial alteration of the status quo.' *Nken v. Holder*, 556 U.S. 418, 429, 129 S.Ct. 1749, 173 L.Ed.2d 550 (2009) (brackets in original; internal quotation marks omitted). An 'act' is '[s]omething done or performed . . . ; a deed.' Black's Law Dictionary 30 (11th ed. 2019); see also Webster's New International Dictionary 25 (2d ed. 1934) ('that which is done,' 'the exercise of power,' 'a deed'). To 'exercise'

the Court to interpret the function of the automatic stay as one of prohibiting parties from exercising their power to exert control over property of the estate, whether through an affirmative act or omission qualifying as such, that alters the status quo in the period of time following the filing of the petition for bankruptcy.[152]

There is a high likelihood that this interpretation of the stay will also lead to one or both of the following outcomes: (1) any party in possession of property of the estate is now understood to be acting in compliance with the automatic stay so long as they are merely possessing such property and have not engaged in conduct qualifying as an affirmative act that would alter the status quo of the asset at or after the time the petition for bankruptcy is filed;[153] and (2) courts are now provided with discretion to determine whether *any* act or omission beyond mere possession that alters the status quo qualifies as a violation of the automatic stay.[154] This will inevitably lead to disputes and differing interpretations among circuits as to whether certain conduct or acts may be defined as an affirmative act prohibited by the automatic stay of section 362(a)(3). Due to the lack of specificity in the *Fulton* Court's opinion regarding acts that may or may not qualify as violations of the automatic stay, lower courts will have the discretion to make these determinations pursuant to section 105(a).[155] Future cases will provide opportunities for courts to rule on these issues, but without definitive guidance from the Supreme Court or Congress, there will be additional controversy and discord among circuits related to these determinations. Furthermore, controversy is certain to surround any attempt to create a 'bright line' rule to

in the sense relevant here means 'to bring into play' or 'make effective in action.' Webster's Third New International Dictionary 795 (1993). And to 'exercise' something like control is 'to put in practice or carry out in action.' Webster's New International Dictionary, at 892.").

152. *Id. See supra* text accompanying note 104.

153. *Id.* at 590.

154. *Fulton*, 141 S. Ct. at 590 (citing *Thompson*, 566 F.3d at 702; Merriam-Webster's Collegiate Dictionary 272 (11th ed. 2003)) ("We do not maintain that these terms definitively rule out the alternative interpretation adopted by the court below and advocated by respondents. As respondents point out, omissions can qualify as 'acts' in certain contexts, and the term 'control' can mean 'to have power over.' But saying that a person engages in an "act" to "exercise" his or her power over a thing communicates more than merely "having" that power. Thus, the language of § 362(a)(3) implies that something more than merely retaining power is required to violate the disputed provision.") (internal citations omitted) (internal quotation marks omitted).

155. *See* Brubaker, Mann, Mooney, Plank, & Tabb *supra* at 12 ("Section 542(a) provides an express statutory basis for a bankruptcy court to enter a § 105(a) injunction ordering turnover of property properly in the possession of a secured creditor.").

identify a minimum level of conduct required to be deemed violative. Because these issues affect the rights of parties in possession of estate property and entail a variety of concerns such as the separation of powers, the Supreme Court likely refrained from opining on these issues, choosing instead to call upon Congress to provide guidance in future amendments to the Code.[156]

In *Fulton*, the Supreme Court's interpretation of Congress' choice to add "exercise control" was that the stay extended to "acts that would change the status quo with respect to intangible property and acts that would change the status quo with respect to tangible property without obtain[ing] such property."[157] Thus, it would be helpful if Congress were to amend the Code or otherwise define when an act is considered to alter the status quo to create a bright-line rule for all involved parties. Without a defined level of acceptable conduct beyond mere possession, any party in possession of a debtor's property prior to the filing of a bankruptcy petition should tread carefully so as not to disrupt the status quo by engaging in conduct that may be deemed violative of the automatic stay after a petition is filed. Practitioners and courts alike should prepare for arguments related to what conduct may be deemed an affirmative act and whether such conduct is violative of the automatic stay pursuant to *Fulton*. Because the automatic stay is no longer a permissible procedural mechanism to secure the return of a debtor's property at the outset of a bankruptcy filing in any jurisdiction, practitioners must advise current and prospective clients that a section 542 turnover proceeding is required in similar factual situations to that of *Fulton*. Clients should also be made aware of the costs and timeframe implicated by such a proceeding. In the absence of a legislative solution, practitioners should be ready to address these inconveniences as identified by Justice Sotomayor in the Concurrence.

D. Section 542 Is The Proper Method For Turnover

Following *Fulton*, the burden to recover "far-flung" property of the estate and have it turned over to the debtor-in-possession or trustee is now shifted to the debtor through an adversary

156. *Fulton*, 141 S. Ct. at 595 (Sotomayor, J. concurring).
157. *Id.* at 592.

proceeding under section 542.[158] If a debtor wants the property returned post-petition, they must go through the process of filing an adversary proceeding under section 542 as the proper mechanism for the turnover of estate property, which also protects the creditors' rights and provides assurances that the property will be adequately protected.[159] *Fulton* distinguishes the respective functions of section 362, prohibiting any act that would disrupt the status quo at the time the petition is filed, and section 542, for retrieving "far-flung" property of the estate.[160] The inconveniences related to an adversary proceeding under section 542 serve as the foundation for Justice Sotomayor's concerns raised in the Concurrence; specifically, that there should be a better way for debtors to recover their vehicle without a lengthy and costly adversary proceeding under the umbrella of bankruptcy.[161] As Justice Sotomayor stated, "any gap left by the Court's ruling today is best addressed by rule drafters and policymakers, not bankruptcy judges."[162] Alternative interpretations would unfairly impair the rights of creditors in favor of the debtor.

The *Fulton* opinion reflects the best interpretation of the Code's provisions without creating new law or overstepping what Congress initially intended when it drafted the Code and amended section 362(a)(3) further in 1984. Were the automatic stay to function as a turnover provision, bankruptcy courts would be overburdened with tasks related to enforcement and creditors would be heavily disadvantaged because they would be required to enforce the return of all property of the estate upon the filing of a bankruptcy petition without proper opportunity to protect their rights and ensure adequate protection.[163] Assuming the Respondents' view would require turnover immediately upon filing of the petition—this could be any property—tangible or

158. *Fulton*, 141 S. Ct. at 591.
159. *See id.* at 594 (Sotomayor, J. concurring).
160. *Fulton*, 141 S. Ct. at 591.
161. *Id.* at 593-595 (Sotomayor, J. concurring).
162. *Id.* at 595 (Sotomayor, J. concurring).
163. *See* Brubaker, Mann, Mooney, Plank, & Tabb *supra* at 4-5 ("Forcing immediate turnover of repossessed collateral without adequate protection, as the Seventh Circuit requires, can eviscerate a secured creditor's statutory right to adequate protection. Section 542(a) permits a secured creditor to retain possession of repossessed collateral pending the court's entry of a turnover order and the trustee's provision of statutorily-mandated court-ordered adequate protection. The Court should 'not give §362(a)(3) . . . an interpretation that would proscribe what' the Code's express turnover provisions 'were plainly intended to permit.' *Citizens Bank v. Strumpf*, 516 U.S. 16, 21 (1995).").

intangible.[164] It would also render section 542 superfluous, because section 362(a)(3) would accomplish the same function with reduced time and cost.[165]

It is hard to fault the Supreme Court for coming to this conclusion; *Fulton* protects the integrity of the Code while simultaneously defining the function of sections 362(a)(3) and 542 in a way that is fair to both creditors and debtors.[166] It also discourages debtors from engaging in bad-faith filings where a petition for bankruptcy is filed with the expectation that the debtor will immediately recover their assets.[167] The Supreme Court's interpretation of the automatic stay does involve the grouping of the debtor's assets into a bankruptcy estate; however, it provided further guidance in relation to this goal by finding that section 362(a)(3) does not mandate return of a debtor's assets to group them into the bankruptcy estate.[168] Rather, turnover proceedings are the proper procedural method of accomplishing this goal; precisely why Congress included section 542 in the Code.[169]

E. Fulton Does Not Preclude The Possibility That The City Violated The Automatic Stay

Fulton does not preclude a finding that the City's conduct that exceeded mere possession and violated the automatic stay by altering the status quo; rather, it prohibited a finding that the City's retention of vehicles in the impound lot after debtors filed a petition for bankruptcy was conduct violative of the automatic stay because impoundment constituted mere possession and the

---

164. Brubaker, Mann, Mooney, Plank, & Tabb *supra* at 16-17 ("[T]he statutory language of that amendment and the legislative explanations thereof demonstrate that Congress simply extended the protections of the [section] 362(a)(3) stay to intangible property rights that are incapable of actual physical possession."). By combining this understanding of [section] 362(a)(3)'s scope to the Respondent's view, chaos would ensue in the process of determining and enforcing turnover of any property to the debtor.

165. *See Fulton*, 141 S. Ct. at 591.

166. *Id.*

167. *In re Fulton*, 926 F.3d at 926, 927. *See supra* text accompanying note 135. ("Furthermore, if a debtor files a bankruptcy petition in bad faith and immediately dismisses her case, as the City claims many debtors do solely to retrieve their impounded vehicles, the City has recourse: it may file a bad faith motion against the debtor."). The court fails to identify that this interpretation places the burden of preserving a right to seek adequate protection on the creditor, depriving it of rights in favor of convenience to the debtor.

168. *See* Fulton, 141 S. Ct. at 592.

169. *Id.* at 591-92.

vehicles were lawfully obtained pre-petition.[170] The status quo of the vehicles at the moment the bankruptcy petitions were filed was impoundment. Accordingly, the stay prohibits any further affirmative act or omission beyond mere possession that changes the status quo. The Court expressly limited the scope of its holding to provide the lower courts with discretion to determine what further acts may be deemed violative of section 362(a)(3).[171]

Due to the lack of guidance on what conduct is violative beyond mere possession, there is no clear answer or guidance in *Fulton* as to whether the following situations would be deemed violative of the automatic stay: (1) the City's refusal to return to the vehicle *unless* payment is received after the debtor calls or visits the impound lot; (2) maintaining online collection portals; (3) accruing additional fees for impoundment; (4) modifying the vehicle in any way that would inhibit its function, such as installing a 'boot' or an ignition kill switch; or (5) moving the vehicle within the impound lot or to a different facility.[172] Bankruptcy courts have discretion to decide these issues through the exercise of their powers under section 105(a), so long as their actions are consistent with *Fulton*.[173] In the absence of a legislative solution, courts and practitioners should be mindful of the implications of the Supreme Court's decision and reasoning in *Fulton*, understanding that there is no bright-line rule defining what affirmative act or omission is impermissible beyond mere possession. Additionally, debtors seeking the return of estate property must initiate an adversary proceeding under section 542 and assume the inconveniences related to such an action, rather than by relying on a court to mandate its return under section 362(a)(3) by filing a petition for bankruptcy, as this practice is no longer acceptable in any jurisdiction.

II. CONCLUSION

Despite remaining questions left unanswered by the Supreme Court, courts, practitioners, and scholars alike now have

---

170. *Fulton*, 141 S. Ct. at 592. *See supra* text accompanying note 127.

171. *Id.* at 590.

172. *Id. See supra* text accompanying note 154. It will be interesting to see how courts address situations like these; there can be no doubt that a major issue will be determining when 'something,' as the Court used the term, falls outside the bounds of 'retaining power.'

173. 11 U.S.C. section 105(a). *See supra* text accompanying note 131.

fundamental guidance regarding the function and purpose of the automatic stay as well as the necessity of initiating an adversary proceeding under section 542 to secure the return of assets, which is the proper procedural enforcement mechanism of the Code to accomplish that goal. They have also been provided with an operative definition of the status quo as it pertains to the automatic stay. Importantly, *Fulton* specifically instructs courts how to properly interpret and apply provisions of the Code. The Supreme Court correctly concluded that a creditor's mere possession or retention of property lawfully obtained before the filing of a bankruptcy petition is not violative of section 362(a)(3) because, to date, it is the best interpretation of the Bankruptcy Code's provisions in consideration of the function Congress likely intended for it to accomplish.[174] Section 362(a)(3) may no longer be used as a procedural mechanism mandating turnover when a petition is filed; rather, it "halts any affirmative act that would alter the status quo as of the time of the filing of a bankruptcy petition."[175] An adversary proceeding brought under section 542 is now identified as the proper procedural mechanism for turnover because it "works within the bankruptcy process to draw far-flung estate property back into the hands of the debtor or trustee"[176] while also offering adequate protection to a creditor's interest in the property. If turnover proceedings are ineffective with regard to the expeditious return of essential property, that is a matter best left addressed by Congress.[177]

174. *Fulton*, 141 S. Ct. at 592.
175. *Id.* at 590.
176. *Id.* at 591.
177. *Id.* at 595 (Sotomayor, J. concurring).

Stetson Business Law Review
1401 61st Street South | Gulfport, FL, 33707
https://www.stetson.edu/law/business-law-review/
buslawreview@law.stetson.edu