Ch. 11 Trustee Fee Ruling Leaves Remedy Challenges

By **Sasha Gurvitz** (June 8, 2022)

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In a June 6 unanimous decision authored by Justice Sonia Sotomayor, the U.S. Supreme Court in Siegel v. Fitzgerald addressed the question of "whether Congress' enactment of a significant fee increase that exempted debtors in two states violated the uniformity requirement" of the Constitution.[1]

The case called for the justices to analyze the so-called bankruptcy clause of the Constitution, which grants Congress the right to establish "uniform laws on the subject of bankruptcies throughout the United States,"[2] and the Bankruptcy Judgeship Act of 2017, which increased the quarterly fees payable by certain debtors in bankruptcy cases.[3]

The court concluded that the enactment of the fee increase did violate the uniformity requirement of the bankruptcy clause, reversing the decision of the U.S. Court of Appeals for the Fourth Circuit and remanding for further proceedings.[4] The case appears to have been an easy decision for the unanimous court, but many of the challenging issues are left for remand.

The case concerns quarterly fees payable by Chapter 11 debtors to fund the U.S. Trustee Program, which performs certain administrative functions in bankruptcy cases.[5] In North Carolina and Alabama, the same functions are instead performed by judicially appointed bankruptcy administrators, and parallel fees had been permissibly charged to debtors.[6][7]

Facing a potential budget shortfall, as part of the Bankruptcy Judgeship Act of 2017, Congress significantly increased the quarterly fees payable by Chapter 11 debtors in trustee program states, with the maximum fee increasing from $30,000 per quarter to $250,000 per quarter, effective in newly filed cases and pending cases as of the first quarter of 2018.

These fee increases were not implemented in North Carolina and Alabama, however, until October 2018, and even then, the fee increase in those two states only applied to newly filed cases, and not to pending cases.[8]

In 2021, Congress made the parallel fee provision between the two programs mandatory, rather than permissive.[9] In light of these discrepancies, petitioner Alfred Siegel challenged the fee increase as being nonuniform in violation of the Constitution's bankruptcy clause.[10]

The Supreme Court quickly dispatched with the respondent acting U.S. trustee's first argument in support of the constitutionality of the 2017 act — that the act does not fall within the ambit of the uniformity requirement because the bankruptcy clause only governs substantive, rather than administrative laws.[11]

The court then reviewed its precedent on the uniformity requirement and concluded "that the bankruptcy clause offers Congress flexibility, but does not permit the arbitrary, disparate treatment of similarly situated debtors based on geography."[12]

The court found that the budget shortfall Congress was addressing in enacting the fee increase

> existed only because Congress itself had arbitrarily separated the districts into two different systems with different cost funding mechanisms, requiring trustee program districts to fund the program through user fees while enabling the administrator program districts to draw on taxpayer funds by way of the judiciary's general budget.[13]

Thus, although the "bankruptcy clause affords Congress flexibility to 'fashion legislation to resolve geographically isolated problems,' ... the clause does not permit Congress to treat identical debtors differently based on an artificial funding distinction that Congress itself created."[14]

The court concluded by noting the limits on its decision, namely, that the "court does not today address the constitutionality of the dual scheme of the bankruptcy systems itself," nor should the court's decision "be understood to impair Congress' authority to structure relief differently for different classes of debtors or to respond to geographically isolated problems."[15]

Having found the nongeographically uniform fee increase to violate the uniformity requirement of the bankruptcy clause, the court left the determination of the remedy to the courts below, remanding to the Fourth Circuit to consider the remedial issues in the first instance.[16]

Supreme Court precedent acknowledges that "[w]henever government impermissibly treats like cases differently, it can cure the violation by either 'leveling up' or 'leveling down.'"[17] In this case, the inequity in fees paid in U.S. trustee states versus bankruptcy administrator states could be remedied either by leveling up, meaning requiring retroactive payment of the incremental increased fees in North Carolina and Alabama, or by leveling down, meaning permitting refunds of the incremental increased fees paid in the other states, as the petitioner sought.

Leveling up remedies could involve either requiring North Carolina and Alabama debtors to retroactively pay the increased fees or requiring the states of North Carolina and Alabama to themselves make up the delta in fees paid. Both remedies pose potential challenges.

Requiring North Carolina and Alabama debtors to make up the missed payments retroactively might pose insurmountable cash flow problems for some Chapter 11 debtors, depending on the amount of money at issue. The debtor in Siegel, for example, was required to pay approximately $576,142 in extra fees over the first three quarters of 2018, compared to what the debtor would have paid absent the fee increase in the 2017 act.[18]

Retroactive payment by North Carolina and Alabama debtors also raises potential collectability issues. For cases that have since been closed, should the reorganized debtor be responsible for making the retroactive payment, and what should be the result if the reorganized debtor is no longer in existence?

On the other hand, requiring the states of North Carolina and Alabama to foot the bill for the difference in fees paid by debtors in those states might seem to be a simpler solution at first, and would certainly affect fewer parties, but is there a sound legal basis for foisting these fees onto the states themselves?

The leveling down remedy would be to permit the petitioner to seek a refund of the incremental increased fees paid, effectively undoing the fee increase for the period of time when it was not in effect in North Carolina and Alabama and thereby placing debtors in U.S.

trustee states in the same position as North Carolina and Alabama debtors.

If the Fourth Circuit on remand directs a refund, practitioners across the country in the 48 U.S. trustee states will be seeking to reopen their cases and filing motions on behalf of Chapter 11 debtors requesting similar fee refunds.

Another possible remedy referenced by the court would be to apply the court's ruling prospectively only, meaning parallel fees would be mandated across U.S. trustee and administrator programs going forward, but that the petitioner would get no monetary relief in this case.

Such a prospective solution would seem to leave the constitutional violation wholly unremedied and render the court's decision relatively toothless, particularly because Congress already mandated the payment of parallel fees by statutory amendment in 2021.

The other, more global implication of the court's decision is the viability and/or constitutionality of North Carolina and Alabama's bespoke bankruptcy administrator system.

The U.S. Court of Appeals for the Ninth Circuit previously found in St. Angelo v. Victoria Farms Inc. in 1994 that Congress' decision to permit North Carolina and Alabama to maintain a distinct bankruptcy administrator program while requiring the other states to adopt the more costly U.S. Trustee Program was unconstitutional. However, that issue never reached the Supreme Court and Congress later equalized the fees of the two programs by statutory amendment in 2021.[19]

The court's decision in Siegel expressly leaves that issue open, although the prospects for challenging the dual system in a subsequent case may be hampered by the need to show actual pecuniary harm.

On the other hand, the court's repeated references in Siegel to the arbitrariness of the dual system may leave some practitioners hopeful that the court may be open to such a challenge of the dual system in the future.

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Disclosure: The author's firm advised the trustee in this case but did not appear on behalf of the trustee in this case, and the author was not involved in the case.

[1] Siegel v. Fitzgerald, 596 U.S. ___, 2022 U.S. LEXIS 2681, at *8 (2022).

[2] U.S. Const., Art. I, § 8, cl. 4.

[3] Pub. L. 115-72, Div. B, 131 Stat. 1229.

[4] Siegel, 2022 U.S. LEXIS 2681 at *27.

[5] 28 U.S.C. § 1930(a)(6).

[6] See 28 U.S.C. § 581.

[7] 28 U.S.C. § 1930(a)(7).

[8] Siegel, 2022 U.S. LEXIS 2681 at *12-13.

[9] Id. at *13.

[10] Id. at *14-15.

[11] Id.

[12] Id. at *23.

[13] Id. at *25.

[14] Id. at *26 (quoting Regional Rail Reorganization Act Cases, 419 U.S. 102, 159 (1974).

[15] Id. at *26.

[16] Id. at *27.

[17] Comptroller of the Treasury v. Wynne, 575 U.S. 542, 569 (2015).

[18] Siegel, 2022 U.S. LEXIS 2681 at *3.

[19] St. Angelo v. Victoria Farms, Inc., 38 F.3d 1525, 1533 (9th Cir. 1994), amended 46 F.3d 969 (1995).