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Supreme Court Finds 2017 Bankruptcy Fee Increases Unconstitutional But Leaves Remedy Unclear

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In June, the U.S. Supreme Court, by unanimous decision, resolved a split amongst five circuits and determined that a 2017 Congressional amendment to the bankruptcy fee provisions was unconstitutional as violating the Bankruptcy Clause of the US. Constitution. *See, Siegel v. Fitzgerald*, 142 S. Ct. 1770 (2022). The Bankruptcy Clause of the U.S. Constitution empowers Congress to establish "uniform laws on the subject of Bankruptcies throughout the United States." U.S. Const. art. I, §8, cl. 4. The meaning of "uniform" became the subject of debate in the *Siegel* case. The Supreme Court concluded that because the 2017 amendments exempted debtors located in two States, it was not "uniform" as it did not apply equally to all debtors regardless of where they were situated and, therefore, the statute was unconstitutional. *Siegel*, 142 S. Ct. 1770 (2022). A discussion of the Supreme Court's decision in *Siegel*, and relevant factual backdrop precipitating such decision, appears below.

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The United States Trustee Program and Administrator Program

In 1986, Congress created the United States Trustee Program (UST Program) to ease what was previously an administrative burden on bankruptcy judges and assigned responsibility to U.S. Trustees, a component of the Department of Justice. At this time, six judicial districts in North Carolina and Alabama were given permission by Congress to opt out of the UST Program. In these six districts, the bankruptcy courts appoint bankruptcy administrators to perform the administrative functions that would otherwise have been performed by the UST Program but for the election to opt-out. For these six districts, the administrative system is referred to as the Administrator Program. The Administrator Program was scheduled to phase out, but in 2000, Congress permanently exempted the six districts from the requirement to transition to the UST Program. While the functions of the UST Program and the Administrator Program are largely identical, their funding sources are not. The UST Program is funded by user fees paid to the United States Trustee System Fund. These user fees are primarily comprised of fees paid by debtors who file cases under Chapter 11 of the Bankruptcy Code. By contrast, the Administrator Program is funded by the Judiciary's general budget. Funding source differences aside, from 2001 to 2017, all districts within the UST Program and Administrator Program paid identical user fees.

The 2017 Amendments to Bankruptcy Fees Provisions

In 2017, to address a funding shortfall in the UST Program, Congress increased the fees applicable to debtors. *See,* 28 U.S.C. §1930 (2017) (the 2017 Amendments). The 2017 Amendments significantly increased the quarterly fees paid and impacted both small and large debtors. Specifically, Congress added the following provision: "During each of fiscal years 2018 through 2022, if the balance in the United States Trustee System Fund as of September 30 of the most recent full fiscal year is less than $200,000,000, the quarterly fee payable for a quarter in which disbursements equal or exceed $1,000,000 *shall* be the lesser of 1 percent of such disbursements or $250,000." 28 U.S.C. §1930(B) (2017) (emphasis added). For larger debtors, this change resulted in an 833% as prior to 2017, that same debtor would only be required to pay a maximum of $30,000. For

small debtors, the impact of the 2017 Amendments was even worse. For example, a small debtor with assets totaling $2 million and secured liens of $1.1 million who sells substantially all of its assets and pays its lien creditors at closing, would expect for $900,000 less $30,000 in UST fees to be the net return to the estate. However, the 2017 Amendments would require this debtor to pay the UST Program $250,000, thereby reducing the return to the estate by 27%. Prior to the 2017 Amendments, the effect on this small debtor's estate would have only reduced the return to the estate by 3%.

Importantly, the 2017 Amendments did not require the Administrative Program to require debtors within those districts to pay the increased fees. With respect to the Administrative Program, the 2017 Amendments provided that:

> In districts that are not a part of a United States trustee region as defined in section 581 of this title, the Judicial Conference of the United States *may* require the debtor in a case under chapter 11 of title 11 to pay fees equal to those imposed by paragraph (6) of this subjection.

28 U.S.C. §1930(a)(7) (emphasis added).

It is this nonuniform treatment between debtors situated within districts covered by the UST Program and debtors situated within districts covered by the Administrator Program that led to challenges as to the constitutionality of the 2017 Amendments.

Circuit City Stores Chapter 11 Case

In 2008, Circuit City Stores, Inc. filed a Chapter 11 petition for relief in the Eastern District of Virginia (which is a district within the UST Program). Circuit City confirmed its chapter 11 liquidating plan in 2010 and a plan trustee, Alfred Siegel (Siegel), was appointed to oversee the administration and liquidation of all of Circuit City's assets. Like most Chapter 11 plans, the confirmed plan in Circuit City required Siegel to pay quarterly fees to the UST Program until the Chapter 11 case either was closed or converted. When the plan was confirmed in 2010, the maximum quarterly fee to be paid to the UST Program was $30,000.

The administration of the Circuit City plan remained pending when Congress amended the fees in 2017. In only the first three quarters following the 2017 amendments, Circuit City was required to pay in excess of 1100% of the fees it would have been required to pay prior to the increase. More specifically, in 2017, Circuit City paid $632,542 in total fees to the UST Program. Under the prior fee structure, Circuit City would have only had to pay $56,400 for the same period.

Siegel objected to the fee increase on the basis that it was not uniform across all districts in the United States inasmuch as the 2017 Amendments only mandated the increased fees be paid by debtors located within the districts covered by the UST Program and because it was nonuniform across the UST Program districts and the Administrator Program districts, it violated the Constitution's Bankruptcy Clause. The Bankruptcy Court for the Eastern District of Virginia agreed with Siegel and determined that the fees petitioner owes "must be determined based on the [pre-2017] version of the statute" but did not make any determinations regarding Siegel's remedy (*e.g.*, refund for overpayments). The Fourth Circuit reversed. While the Fourth Circuit agreed that the Bankruptcy Clause's uniformity requirement applied to the 2017 Amendments, it determined that the requirement only prohibited arbitrary geographic differences that result in nonuniformity.

The Supreme Court granted Siegel's petition for certiorari to resolve a split amongst the circuits over the constitutionality of the 2017 Amendments. *See, In re John Q. Hammons Fall 2006*, LLC, 15 F.4th 1011 (10th Cir. 2021) (holding the 2017 Amendments unconstitutional); *In re Clinton Nurseries, Inc.*, 998 F.3d 56 (2d Cir. 2021) (same); *In re Mosaic Mgmt. Group, Inc.*, 22 F.4th 1291 (11th Cir. 2022) (2017 Amendments held to be constitutional); *In re Circuit City Stores, Inc.*, 996 F.3d 156 (4th Cir. 2021) (same); *In re Buffets, LLC*, 979 F. 3d 366 (5h Cir. 2020) (same).

The 2020 Amendments to Remedy the Nonuniform Treatment of Debtors

In 2020, and in response to the increasing constitutional challenges to the 2017 Amendments, Congress amended, yet again, section 1930 of title 28 to provide prospective nationwide uniformity in fees between the districts within the UST Program and Administrator Program and applies to both pending and newly filed cases. *See,* 28 U.S.C. 1930(a)(6) and (7) (Supp. II 2020) (the 2020 Amendments). Congressional intent behind enactment of the 2020 Amendments was to remedy any constitutional flaw arising from the short lived and more-favorable fee regime in the six districts covered by the Administrator Programs. 2020 Act §2(a)(4)(B), 134 Stat. 5086 (reaffirming what an express congressional finding called "the longstanding intention of Congress that quarterly fee requirements remain consistent across all Federal judicial districts.").

The Supreme Court Decision In *Siegel v. Fitzgerald*

On cert, the Supreme Court determined that Congress' enactment of a significant fee increase that exempted debtors in two States violated

the uniformity requirement of the Bankruptcy Clause. In reaching this conclusion, the Supreme Court was tasked with first deciding whether the 2017 Amendments were even subject to the Bankruptcy Clause's uniformity requirement. The government argued that the 2017 Amendments were administrative laws designed to help administer substantive bankruptcy laws and were not laws "on the subject of Bankruptcies" as to which the uniformity requirement applies. The Supreme Court disagreed, noting that the Court has never distinguished between substantive and administrative bankruptcy laws or suggested that the uniformity requirement would not apply to both. Indeed, the Court remarked that "[t]he only 'subject' of the 2017 [Amendments] is bankruptcy. Moreover, and importantly, the 2017 [Amendments] do[] affect the 'substance of debtor-creditor relations': Increasing mandatory fees paid out of the debtor's estate decreases the funds available for payment to creditors. As a result, the obligations between creditors and debtors are changed." *Siegel*, 142 S.Ct. 1770, 1779.

Next the Supreme Court had to decide whether the 2017 Amendments were a permissible exercise of the Bankruptcy Clause. In so doing, the Court reaffirmed that the Bankruptcy Clause's uniformity requirement does not deny Congress the power to consider "differences that exist between different parties of the country" and to "fashion legislation to resolve geographically isolated problems." *Siegel*, 142 S.Ct. 1780-1789 (internal citations omitted). The Supreme Court further noted that "Congress may enact geographically limited bankruptcy laws consistent with the uniformity requirement if it is responding to a geographically limited problem." *Siegel*, 142 S.Ct. 1780, 1781. In applying these principles to the facts in Siegel, the Court found that the although the 2017 Amendments were not geographically uniform, the rationale for the fee increase was to address a funding deficit limited to only the districts within the UST Program. In *Siegel*, the Court observed that the "problems prompting Congress' disparate treatment in this case, however, stem not from an external and geographically isolated need, but from Congress' own decision to create a dial bankruptcy stem funded through different mechanisms in which only districts in two States could opt into the more favorable fee system or debtors. The Court concluded that while the Bankruptcy Clause offers Congress flexibility, it does "not permit the arbitrary, disparate treatment of similarly situated debtors based on geography." *Siegel*, 142 S.Ct. 1770, 1781.

In the appellate briefing before the Supreme Court, the government argued that a refund would not be the proper remedy. Siegel, on the other hand, argued that a prospective fix would be inadequate to remedy past unequal treatment. The Supreme Court, however, did not decide the appropriate remedy for debtors affected by the unconstitutional statute or issues of potential waivers by non-objecting debtors and, instead, remanded so that lower courts could address those issues.

Conclusion

The *Siegel* decision provides needed clarity on the issue of the constitutionality of the 2017 Amendments; however, in light of the corrective measures taken by Congress in 2020 (through the 2020 Amendments), the more important issue that remains undecided is the remedy. Among the possible remedies are: a) a refund to those debtors who overpaid during period 2017 through 2020; and b) a "cure" of underpayments made by debtors in the Administrator Program districts during this period. The refund remedy likely will cause additional financial stress upon the UST Program and may even result in another increase to the bankruptcy fee provisions — this time, however, with uniform fees between the debtors located in both the UST Program and Administrator Program districts. The cure remedy, assuming it could withstand retroactivity challenges (as parties relied on the existing fees to structure their Chapter 11 plans and payments) would create practical challenges as the government would have to trace the funds to creditors, professionals, and debtors — and initiate actions to claw-back the amounts of the increased fees. Several courts that have decided the issue have determined the correct remedy is a refund in the amount of the overpayments. *See, e.g., Clinton Nurseries*, 998 F.3d 69-70 (2d Cir. 2021); *John Q. Hammons Fall*, 15 F.4th 1011, 1026. The Supreme Court's decision in *Siegel* left these holdings undisturbed and invites debtors impacted by the overpayments to pursue litigation for refunds.

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