New York City
Bankruptcy Conference

Judges' Roundtable: Selected Current Topics

Hon. Michael Wiles, Moderator
U.S. Bankruptcy Court, Southern District of New York

Hon. Martin Glenn
U.S. Bankruptcy Court, Southern District of New York

Hon. Sean Lane
U.S. Bankruptcy Court, Southern District of New York

Hon. Jil Mazer-Marino
U.S. Bankruptcy Court, Eastern District of New York

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Hon. Christopher Sontchi
U.S. Bankruptcy Court, District of Delaware

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U.S. Bankruptcy Court, District of Connecticut

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2018 Increase in U.S. Trustee Fees Held Unconstitutional by the Supreme Court

> The Supreme Court's unanimous opinion avoids saying whether the dual system of U.S. Trustees and Bankruptcy Administrators is itself unconstitutional.

The Supreme Court ruled unanimously today that the increase in fees payable to the U.S. Trustee system in 2018 violated the uniformity aspect of the Bankruptcy Clause of the Constitution because it was not immediately applicable in the two states with Bankruptcy Administrators rather than U.S. Trustees.

The opinion for the Court by Justice Sonia Sotomayor said that the Uniformity Clause "is not a straightjacket: Congress retains flexibility to craft legislation

that responds to different regional circumstances that arise in the bankruptcy system." She remanded for lower courts to determine the proper remedy.

Although Justice Sotomayor pointedly said that her opinion "does not today address the constitutionality of the dual scheme of the bankruptcy system itself," some of her language could be read to imply that the dual system is constitutionally questionable.

The Fee Structure's History

Justice Sotomayor recounted how U.S. Trustees were originally a pilot program after the adoption of the Bankruptcy Code in 1978. In 1986, Congress expanded the program nationwide, but not in North Carolina and Alabama, where she said there was "resistance from stakeholders." Courts in those states retained their Bankruptcy Administrators.

The U.S. Trustee system was designed to be self-funding, with fees paid by chapter 11 debtors in 48 states. Originally, Congress did not require user fees in the two exempted states. After the Ninth Circuit held in 1995 that the dual system was unconstitutional in view of the disparate fees, Congress rewrote the law to say that the Judicial Conference "may" requires fees in Bankruptcy Administrator districts to be equal to those in the other 48 states.

Fees in all states were the same until Congress raised the fees in January 2018 for the U.S. Trustee system. Justice Sotomayor said the increase was "significant."

The Judicial Conference did raise the fees in the two other states effective in October 2018. There were two differences, Justice Sotomayor said.

First, the increase was not effective in the two states until October 2018, while the U.S. Trustee fees had risen everywhere else in January 2018. Second, the increase in the two states only applied to newly filed cases. In U.S. Trustee districts, the increase applied to pending cases, not only new cases.

Procedural History

Circuit City Stores Inc., the debtor that brought the case to the Supreme Court, had confirmed a chapter 11 plan in 2010. Until the increase went into effect, the debtor had been paying $30,000 a quarter, the maximum.

In the period after the increase, the debtor paid $632,500 in fees. Had there been no increase, Justice Sotomayor said the fees during the period would have been only $56,400.

The debtor mounted an objection to the increase on constitutional grounds and won. Bankruptcy Judge Kevin R. Huennekens of Richmond, Va., held that the increased fees violated the Uniformity Clause, if the fee is seen as a tax, and violated the Bankruptcy Clause, if the fee is considered a user fee. *In re Circuit City Stores Inc.*, 606 B.R. 260 (Bankr. E.D. Va. July 15, 2019). To read ABI's report, **click here**.

However, the bankruptcy court did not rule on whether the debtor was entitled to a refund, Justice Sotomayor said.

The Fourth Circuit agreed to hear an interlocutory appeal and reversed in a 2/1 decision. The majority on the Richmond, Va.-based appeals court did not believe that the increase was arbitrary. The dissenter would have held the increase to be unconstitutional. *In re Circuit City Stores, Inc.*, 996 F.3d 156 (4th Cir. April 29, 2021). To read ABI's report, **click here**.

Like the Fourth Circuit, the Fifth Circuit saw no constitutional infirmity. There were dissenters in both opinions. In unanimous opinions, the Second and Tenth Circuits found constitutional transgressions. The Supreme Court granted *certiorari* to resolve the circuit split and heard oral argument on April 18.

Applicability of the Bankruptcy Clause

The Bankruptcy Clause empowers Congress to "establish . . . uniform Laws on the subject of Bankruptcies throughout the United States."

Defending the disparate fee structure, the U.S. Solicitor General argued that the fees were not covered by the Bankruptcy Clause because the fee statutes were not substantive law.

The language of the clause is "broad," Justice Sotomayor said, and "[n]othing in the language of the Bankruptcy Clause itself, however, suggests a distinction between substantive and administrative laws." Furthermore, she said that the Court has never "distinguished between substantive and administrative bankruptcy laws or suggested that the uniformity requirement would not apply to both."

"Not surprisingly," Justice Sotomayor said, all courts to consider the question have concluded that the fees were subject to the Bankruptcy Clause, including those courts that found no constitutional violation.

"Moreover," Justice Sotomayor said, the fees were substantive because they affected the debtor/creditor relationship by making less money available for creditors in 48 states. She said that Congress exempted debtors from the higher fees in two states "without identifying any material difference between debtors across those States."

Precedent Foretells the Outcome

Having decided that the fee structure was subject to the Bankruptcy Clause, Justice Sotomayor addressed the question of whether the disparate fees were "a permissible exercise of that Clause." She discussed the three Supreme Court cases that have confronted the meaning of the clause. "Taken together," she said, "they stand for the proposition that the Bankruptcy Clause offers Congress flexibility, but does not permit arbitrary geographically disparate treatment of debtors."

In 1908 under the former Bankruptcy Act, Justice Sotomayor said that the Supreme Court upheld the constitutionality of state homestead and exemption laws, because the general operation of the law was uniform, although the results might be different in some states. *Hanover Nat. Bank v. Moyses*, 186 U.S. 181, 187 (1902).

In 1974, the Court upheld a railroad reorganization law that only applied to railroads in the Northeast and Midwest. Based on the "flexibility" in the Bankruptcy Clause, the Court upheld the law that addressed "geographically

isolated problems." *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 159 (1974)."

Justice Sotomayor read *Regional Rail Reorganization Act Cases* to mean that "Congress may enact geographically limited bankruptcy laws consistent with the uniformity requirement if it is responding to a geographically limited problem."

In *Railway Labor Executives' Assn. v. Gibbons*, 455 U.S. 457 (1982), the Court struck down a railroad reorganization law than changed the priority scheme, but only for one railroad.

From the three cases, Justice Sotomayor said that the Bankruptcy Clause "does not give Congress free rein to subject similarly situated debtors in different States to different fees because it chooses to pay the costs for some, but not others."

In other words, the clause permits "flexibility, but does not permit arbitrary geographically disparate treatment of debtors," Justice Sotomayor said.

Impermissible Lack of Uniformity

For Justice Sotomayor, the "only remaining question" was "whether Congress permissibly imposed nonuniform fees because it was responding to a funding deficit limited to the Trustee Program districts."

In the case in the Supreme Court, the geographical discrepancy cost Circuit City more than $500,000, Justice Sotomayor said. She said that the budgetary shortfall in the U.S. Trustee districts:

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 Administrator Program districts to draw on taxpayer funds by way of the Judiciary's general budget.

The reasons for the different fees, Justice Sotomayor said, "stem not from an external and geographically isolated need, but from Congress' own decision to

create a dual bankruptcy system funded through different mechanisms in which only districts in two States could opt into the more favorable fee system for debtors."

Consequently, Justice Sotomayor held that "the Clause does not permit Congress to treat identical debtors differently based on an artificial funding distinction that Congress itself created."

Final Comments by Justice Sotomayor

The debtor took the position in the Supreme Court that the dual system itself is unconstitutional. Justice Sotomayor said that the Court was not addressing "the constitutionality of the dual scheme of the bankruptcy system itself."

Indicating that the Court was not overruling the *Regional Rail Reorganization Act Cases*, Justice Sotomayor said the opinion "should not be understood to impair Congress' authority to structure relief differently for different classes of debtors or to respond to geographically isolated problems." Rather, she said that the court was only prohibiting "Congress from arbitrarily burdening only one set of debtors with a more onerous funding mechanism than that which applies to debtors in other States."

Justice Sotomayor ended her opinion by noting how the government and the debtor disagreed about the remedy in the event of reversal. Because the Fourth Circuit had not considered remedy, she reversed and remanded for the Fourth Circuit to consider remedy "in the first instance."

Is the Dual System Constitutionally Sound?

In the context of disparate fees, Justice Sotomayor noted how the Ninth Circuit said that the dual system of U.S. Trustees and Bankruptcy Administrators was unconstitutional. *St. Angelo v. Victoria Farms, Inc.*, 38 F.3d 1525 (1994), *amended*, 46 F.3d 969 (1995). The question never went to the Supreme Court because Congress quickly brought the fees in line.

Litigants may have difficulty attacking the dual system on appeal given the requirement of showing actual pecuniary harm. Furthermore, does the Constitution mandate that all debtors have the same adversary? And if all

debtors must have the same adversary, are court-appointed trustees constitutional in chapters 7 and 13? In other words, overturning the dual system would have wide ramifications.

Several statements by Justice Sotomayor might bear on the constitutionality of the dual system. Early in the opinion, she said that "Congress itself had arbitrarily separated the districts into two different systems." She also said that Congress may "enact geographically limited bankruptcy laws consistent with the uniformity requirement in response to a geographically limited problem."

Is the dual system unconstitutional simply because it is arbitrary? Is the dual system unconstitutional just because there was no geographical mandate? Laws are not unconstitutional just because they are arbitrary.

Although the constitutionality of the dual system is unclear, this writer believes that the system is subject to scrutiny under the Bankruptcy Clause, because Justice Sotomayor several times said the clause must be brought to bear whether the law is substantive or "administrative."

Although the disparate fees are ancient history, the last chapter has not been written. Absent settlement, the lower courts in the *Circuit City* case can decide on remand whether the debtor is entitled to a refund.

The same issue is alive in a now-revived class action that could end up giving refunds to chapter 11 debtors throughout the country that paid higher fees.

The Federal Court of Claims dismissed a class action on ruling that the disparate fees did not violate the Bankruptcy Clause. *See Acadiana Management Group LLC v. U.S.*, 19-496, 151 Fed. Cl. 121 (Ct. Cl. Nov. 30, 2020).

The debtor-plaintiff appealed and is asking the Federal Circuit to reinstate the class action. Oral argument in the Federal Circuit was postponed pending the outcome in *Circuit City*. For ABI's report on *Acadiana*, **click here**.

CASE CITATION: SIEGEL V. FITZGERALD, 21-441 (SUP. CT. JUNE 6, 2022)

CASE NAME: SIEGEL V. FITZGERALD

OPINION LINK: **HTTPS://ABI-OPINIONS.S3.AMAZONAWS.COM/SIEGEL+V.+FITZGERALD+SUP+CT.PDF**

Faculty

Hon. Michael E. Wiles is a U.S. Bankruptcy Judge for the Southern District of New York in New York, sworn in on March 3, 2015. Previously, he was a partner with Debevoise & Plimpton LLP, where he focused on general commercial litigation and bankruptcy. Judge Wiles co-authored the *Collier Business Workout Guide* (Mathew Bender 2007) and has appeared on panels organized by the Association of the Bar of the City of New York, the American College of Investment Council and others to discuss current issues in bankruptcy litigation. He is a former member of the Committee on Bankruptcy and Reorganization of the Association of the Bar of the City of New York. His publications and written CLE materials include "May Parties Consent to Bankruptcy Court Adjudication of '*Stern* Claims'" (September 2014) (presented at a continuing legal education session at the Association of the Bar of the City of New York); "Ponzi Schemes and Avoidance Actions: 3 Issues," *Law360* (March 7, 2011); "The Good Faith Defense to Fraudulent Transfer Claims" (December 2010) (presented at a continuing legal education session at the Association of the Bar of the City of New York); and "At the Crossroads: The Intersection of the Federal Securities Laws and the Bankruptcy Code," *The Business Lawyer* (November 2007). Judge Wiles received his A.B. from Georgetown University in 1975 and his J.D. from Yale Law School in 1978.

Hon. Martin Glenn is Chief U.S. Bankruptcy Judge for the Southern District of New York in New York, sworn in on Nov. 30, 2006, and appointed Chief Judge on March 1, 2022. Previously, he was a law clerk for Hon. Henry J. Friendly, Chief Judge of the U.S. Court of Appeals for the Second Circuit, from 1971-72, and he practiced law with O'Melveny & Myers LLP in Los Angeles from 1972-85 and in New York from 1985-2006, where he focused on complex civil litigation including securities, RICO, financial and accounting fraud, and unfair competition. Judge Glenn is a member of the American Law Institute, International Insolvency Institute, New York Federal-State Judicial Council, New York City Bar, National Conference of Bankruptcy Judges and ABI. He is a past member of the Committee on International Judicial Relations of the U.S. Judicial Conference and the Bankruptcy Judge Advisory Group of the Administrative Office of the U.S. Courts. In addition, he is an adjunct professor at Columbia Law School, a contributing author to *Collier on Bankruptcy* and a frequent lecturer on bankruptcy-related issues. Judge Glenn received his B.S. from Cornell University in 1968 and his J.D. from Rutgers Law School in 1971, where he was an articles editor of the *Rutgers Law Review*.

Hon. Sean H. Lane is a U.S. Bankruptcy Judge for the Southern District of New York in New York, sworn in on Sept. 7, 2010. He previously clerked for Hon. Edmund V. Ludwig, U.S. District Judge for the Eastern District of Pennsylvania, from 1991-92, as well as for Hon. Charles R. Richey, U.S. District Judge for the District of Columbia, from 1992-93. From 1993-97, he practiced with the law firm of BakerHostetler in Washington, D.C., and thereafter served as a trial attorney in the Department of Justice, Civil Division, National Courts Section, until 2000. From 2000 until he was appointed to the bench, Judge Lane served as an assistant U.S. attorney for the Southern District of New York and was also chief of the Tax & Bankruptcy Unit of that office. During his time in the U.S. Attorney's Office, he was awarded the Attorney General's Distinguished Service Award in 2005 and the Henry L. Stimson Medal by the New York City Bar Association in 2008. Judge Lane is a member of the Federal Bar Council and has served as an adjunct professor at both New York University School of Law and

Fordham Law School. He received his B.A. from New York University College of Art & Science in 1987 and his J.D. from New York University School of Law in 1991.

Hon. Jil Mazer-Marino is a U.S. Bankruptcy Judge for the Eastern District of New York in Brooklyn, sworn in on Oct. 23, 2020. She previously was a partner at Cullen and Dykman LLP's Bankruptcy and Creditors' rights department, where her practice was nearly entirely bankruptcy-focused. Judge Mazer-Marino has chapter 11 experience representing debtors, creditors and creditor committees in chapter 11 business reorganizations. She also served as a chapter 7 panel trustee for the Southern District of New York for more than 10 years. Before joining Cullen and Dykman in 2019, Judge Mazer-Marino practiced with Meyer, Suozzi, English & Klein, P.C. from 2008-19, Rosen Slome Marder LLP from 2003-08 and Willkie Farr & Gallagher LLP from 1991-99. She also clerked for former EDNY Chief Bankruptcy Judge Conrad B. Duberstein. Judge Mazer-Marino received her undergraduate degree from the State University of New York at Albany and her J.D. from St. John's University School of Law.

Hon. Cecelia G. Morris is Chief U.S. Bankruptcy Judge for the Southern District of New York in Poughkeepsie, initially appointed on July 1, 2000, and named Chief Judge on March 1, 2012. Prior to her appointment to the bench, she clerked for the U.S. Bankruptcy Court for the Southern District of New York starting in December 1988. Prior to that, she clerked for the U.S. Bankruptcy Court for the Middle District of Georgia from February 1986 until she moved to New York. Before her career with the court, Chief Judge Morris had a private law practice in Macon, Ga., from May 1981 until February 1986. She served as an Assistant District Attorney and as the administrator of the Civil Division Child Support Recovery Unit, Griffin Judicial Circuit in Griffin, Ga., from September 1979 until May 1981. Chief Judge Morris also had a private law practice in Griffin from October 1977 until January 1978 and clerked at Seay Sims & Park (now Bolton & Park) in Griffin in 1976. Chief Judge Morris has participated as a trainer in many mediation/arbitration programs sponsored by the Federal Judicial Center, the Association of the Bar of the City of New York, the National Association of Security Dealer Regulation and Bankruptcy Court, Endispute Inc. and the Center for Public Resources, Inc. She has successfully mediated many disputes in some of the most prominent cases pending before the U.S. Bankruptcy Court for the Southern District of New York. Chief Judge Morris is an active participant in many bar outreach programs and has been honored to be the keynote speaker at several events, including the Federal Judicial Center's Clerk of Court and Chief Deputies Conference and Weil Gotshal and Manges' Women@Weil program. She has served as an editor of a treatise on bankruptcy being developed by Bloomberg Law, and she published an article describing the history and legal basis of the court's loss-mitigation program in the Spring 2011 edition of the *ABI Law Review*. She has also authored several articles on electronic filing, including a chapter on electronic case filing in *Collier on Bankruptcy*, and has published articles on loss-mitigation, mediation, the consumer credit counseling requirement in bankruptcy and cross-border insolvency cases under chapter 15 of the Bankruptcy Code. Chief Judge Morris has testified before Congress and served on the Bankruptcy Judges Advisory Board to the Administrative Office of the U.S. Courts. She also has taught bankruptcy ethics at St. John's University's LL.M. in Bankruptcy program and served as a member of the Barry Zaretsky Roundtable Steering Committee at Brooklyn Law School, on the advisory board of the *ABI Law Review*, and as a member of the International Insolvency Institute, American College of Bankruptcy, National Conference of Bankruptcy Judges and the Global Restructuring Organization's Scientific Committee, headquartered in Modena, Italy. Chief Judge Morris received the Annual Conrad B. Duberstein Memorial Award for Excellence and Compassion in the Bankruptcy Judiciary and the *New York Law Journal* Impact Award

for pioneering the use of e-filing in federal court. She received her B.S. from West Texas State University and her J.D. from the John Marshall Law School.

Hon. John K. Sherwood is a U.S. Bankruptcy Judge for the District of New Jersey in Newark, appointed in June 2015. In private practice, he had more than 25 years of experience in bankruptcy and debtor/creditor matters, including related litigation. Some of his noteworthy engagements were Ocean Place Development Resort (counsel to debtor), MagnaChip Semiconductor Finance Co. (counsel to creditors' committee), Quebecor World (USA) Inc. (litigation counsel), Le Nature's Inc. (counsel to creditors' committee) and the City of Detroit (counsel to union). Judge Sherwood was president of the New Jersey Bankruptcy Lawyers Foundation from 2008-13 and an active member of ABI and the Turnaround Management Association. He was selected by *Chambers USA* from 2013-14 as one of America's Leading Lawyers for Business, and he was recognized in *The Best Lawyers in America* (2012-15) for his work in bankruptcy and in *Super Lawyers* (2006, 2009-14), where he was featured in the bankruptcy section and corporate counsel edition. Judge Sherwood received his undergraduate degree from James Madison University in 1983 and his J.D. in 1986 from Seton Hall University School of Law.

Hon. Christopher S. Sontchi is a U.S. Bankruptcy Judge for the District of Delaware in Wilmington, initially appointed in 2006, and he recently completed a term as the court's Chief Judge. He was recently appointed as an International Judge of the Singapore International Commercial Court, effective upon his upcoming retirement. Judge Sontchi is a frequent speaker in the U.S. and abroad on issues relating to corporate reorganizations, and he is a Lecturer in Law at The University of Chicago Law School. In addition, he has taught corporate bankruptcy to international judges through the auspices of the World Bank and INSOL International. Judge Sontchi is a member of the International Insolvency Institute, Judicial Insolvency Network, National Conference of Bankruptcy Judges, ABI and INSOL International. He was recently appointed to the International Advisory Council of the Singapore Global Restructuring Initiative and the Founders' Committee of The University of Chicago Law School's Center on Law and Finance. Judge Sontchi has testified before Congress on the safe harbors for financial contracts, and has published articles on creditors' committees, valuation, asset sales and safe harbors. Prior to his appointment, he was in private practice, representing a wide variety of nationally based enterprises with diverse interests in most of the larger chapter 11 reorganization proceedings filed in Delaware. Judge Sontchi served on the ABI Commission to Study the Reform of Chapter 11's Financial Contracts, Derivatives and Safe Harbors Committee and testified on safe harbors for financial contracts before the Subcommittee on Regulatory Reform, Commercial and Antitrust Law of the House Committee on the Judiciary. Following law school, Judge Sontchi clerked for Hon. Joseph T. Walsh in the Delaware Supreme Court. He received his B.A. Phi Beta Kappa with distinction in political science from the University of North Carolina at Chapel Hill and his J.D. from the University of Chicago Law School.

Hon. James J. Tancredi is a U.S. Bankruptcy Judge for the District of Connecticut in Hartford, sworn in on Sept. 1, 2016. Prior to his appointment to the bench, he was a commercial litigation and business restructuring partner at Day Pitney, LLP (f/k/a Day Berry & Howard), where, as a business litigator and commercial restructuring lawyer, he co-founded the firm's regional and national bankruptcy practice. He had cultivated a diverse and challenging practice that crossed major industries, moved from regional to national scope and secured material roles in prominent restructuring and bankruptcies. During his 37-year career at Day Pitney, LLP, Judge Tancredi he represented financial institutions

and other major constituents in a broad range of prominent insolvency-related proceedings pending in courts along the Amtrak corridor. He frequently lectured at the University of Connecticut School of Law and at bar association Continuing Legal Education programs on a broad range of commercial, real estate and restructuring issues and strategies. His professional and bar association activities included service as president and director of the Hartford County Bar Association and the Connecticut Turnaround Management Association. Judge Tancredi has been an active member of the Connecticut Bar Association, American Bar Association and American Trial Lawyers Association, and he was a director of the Hartford County Bar Foundation and Connecticut Mental Health Association. He is also a Connecticut Bar Foundation James W. Cooper Fellow. These platforms provided invaluable opportunities for enhanced legal education and service to the bench and bar and served to drive local community *pro bono* initiatives. Judge Tancredi has written widely about business restructuring issues and co-authored the Connecticut chapter in *Strategic Alternatives for and Against Distressed Businesses* (2016 Edition), published by Thomson Reuters. He received his B.A. *magna cum laude* in urban studies and political science from the College of the Holy Cross in Worcester, Mass., and his J.D. *magna cum laude* from the University of Connecticut School of Law.