Delaware Bankruptcy Judge Holds That Increased Chapter 11 U.S. Trustee Fees Pass Constitutional Muster

BY MATTHEW B. HARVEY, ESQUIRE

It costs a lot of money to go broke. In the case of a chapter 11 bankruptcy, the cost includes quarterly fees payable to the Office of the United States Trustee (the "UST"), a component of the Department of Justice that oversees bankruptcy cases. The UST's oversight program is funded by chapter 11 debtors pursuant to 28 U.S.C. § 1930(a)(6), which requires each debtor to pay quarterly fees until its case is closed or dismissed. The fee is calculated as a percentage of the debtor's "disbursements" in each quarter. The fees collected are placed in a UST fund to pay the costs of the UST's oversight of chapter 11 cases.

For many years, the fee was capped at $30,000 per quarter. However, with the UST fund balance declining, Congress amended the statute to temporarily increase chapter 11 quarterly fees for each year between 2018 through 2022 in which the UST fund is below $200 million. Under the new law, the maximum fee for each quarter in which disbursements exceed $1 million is the lesser of 1 percent of disbursements or $250,000. This means that chapter 11 debtors disbursing $25 million or more in a quarter saw quarterly fees jump from $30,000 to $250,000 — *an 833 percent increase*. The amendment became effective January 1, 2018, and the UST takes the position that the amendment applies to all pending chapter 11 cases — even those commenced before the amendment took effect.

The UST program is not national, however. Alabama and North Carolina do not participate in the UST program. Bankruptcy cases in those states are overseen by a "Bankruptcy Administrator" ("BA") program, which is part of the judiciary. A companion provision — section 1930(a)(7) — states that the BA program "may require" chapter 11 debtors "to pay fees equal to those imposed by" section 1930(a)(6). The BA program adopted the increased fees effective October 1, 2018, but only as to cases filed on or after that date. This created a disparity in fees for pending cases commenced before October 1, 2018. In UST districts, a debtor whose case was commenced before October 1, 2018, may pay $250,000, while a similarly situated debtor in a BA district may pay $30,000 per quarter.

Given the dramatic increase and disparity between UST and BA districts, debtors in UST districts with cases pending at the time of the enactment have raised constitutional and other legal challenges to the amendment. Every challenge has argued that the law is unconstitutionally non-uniform under one or both of the U.S. Constitution's "Uniformity Clause" (art. I, § 8, cl. 1), which requires that all "duties, imposts and excises shall be *uniform* throughout the United States," or its "Bankruptcy Clause" (art. I, § 8, cl. 4), which authorizes Congress to enact "*uniform* laws on the subject of bankruptcies throughout the United States." Many of the challenges have also argued that the law is improperly being applied retroactively to cases pending before its enactment.

A slim majority of courts have found the amendment to be unconstitutional. In an opinion issued on January 9, 2020, Judge Mary F. Walrath of the U.S. Bankruptcy Court for the District of Delaware joined a minority holding that the amendment is constitutional.

The Majority Rulings

In *In re Buffets, LLC*, 597 B.R. 588 (Bankr. W.D. Tex. 2019), the first case to consider a constitutional challenge to the amendment, the court ruled the amendment was unconstitutional as to cases pending at the time of enactment. The court held that the fee was non-uniform between UST districts and BA districts. Because Congress provided no justification for the non-uniform fee, the law was "irrational and arbitrary," and unconstitutional. The court also held that the amendment did not apply retroactively because it imposed new liabilities and nothing in the statute or legislative history signals retroactive application.

The bankruptcy court in *In re Circuit City Stores, Inc.*, 606 B.R. 260 (Bankr. E.D. Va. 2019), similarly found the

amendment to be unconstitutional as to cases pending at the time of enactment. The court held that if the increased fee was considered a "tax," it was unconstitutional under the Uniformity Clause because similarly situated debtors in BA districts were not subject to the same fee, resulting in a constitutionally prohibited non-uniform tax based on geography. Similarly, the court held that if the increased fee was considered a "user fee," it was unconstitutional under the Bankruptcy Clause because it represented a non-uniform law on the subject of bankruptcies based on geography. The court rejected, however, the challenge that the law could not be applied, retroactively, to cases pending on the effective date of the new law.

Finally, in *In re Life Partners Holdings, Inc.*, 606 B.R. 277 (Bankr. N.D. Tex. 2019), the bankruptcy court reached the same result, holding the provisions unconstitutional and adopting the Uniformity Clause and Bankruptcy Clause rulings from *Circuit City*, as well as the retroactive application holding from *Buffets*.

Judge Walrath Joins the Minority

On January 9, 2020, Judge Walrath issued her opinion in *In re Exide Technologies*, 611 B.R. 21 (Bankr. D. Del. 2020), upholding the amendment. Judge Walrath first held that the fee increase was not retroactive because the amendment applies only to disbursements made after the amendment's effective date. It does not reach fees or disbursements made earlier in the case. Therefore, the amendment is more akin to a prospective tax increase.

Second, Judge Walrath found that the fee was not an impermissible user fee. Larger chapter 11 cases with more disbursements are more complex and require more attention from the UST. Thus, the amount of the fee increase reflects the anticipated increased burden on the UST.

Third, and perhaps most significantly, Judge Walrath held that the amendment did not violate the Bankruptcy Clause. Judge Walrath reasoned that the uniformity requirement does not prevent laws from applying only to particular regions to address unique geographic problems. Judge Walrath found that the amendment was enacted to address a problem specific to UST districts — underfunding of the UST fund — and thus was appropriately geographically limited to those districts. Additionally, the statute provides that the BA program may charge fees equal to UST fees, and thus the BA's failure to charge equal fees was not a problem of uniformity but a failure of enforcement.

The only other court to reach the same result as Judge Walrath is the bankruptcy court in *In re Clinton Nurseries, Inc.*, 608 B.R. 96 (Bankr. D. Conn. 2019), where the court applied similar reasoning.

The Last Word Awaits

Although Judge Walrath's opinion is well reasoned, it surely is not the last word on the issue. The debtors in *Exide* are seeking a direct appeal to the U.S. Court of Appeals for the Third Circuit. There also is a pending proposed class action in the Court of Federal Claims challenging the amendment. Moreover, other decisions discussed above are currently before the relevant circuit's Court of Appeals or pending certification to such courts. Accordingly, there may be Court of Appeals rulings on the issue in the coming year. In the meantime, debtors must adjust their finances to account for the fees and seek to close or dismiss their chapter 11 cases as promptly as possible to avoid the increased fees.

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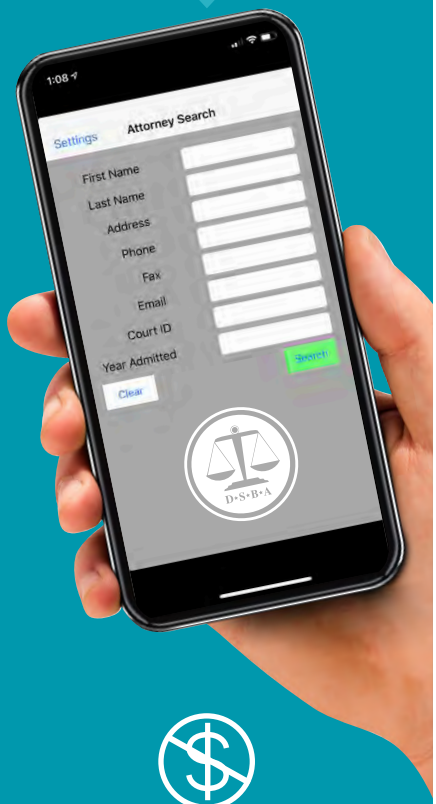

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