

Debtors Eye Refund as They Look to Advance Bankruptcy Fee Feud

By Daniel Gill

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- Appeals courts split on whether fee disparity violates Constitution
- Overturning fees could require emergency funding, launch litigation

A simmering legal dispute over a temporary increase in government fees required in Chapter 11 cases has some bankrupt debtors vying for refunds.

Debtors' fees fund the Justice Department's U.S. Trustee Program, which monitors the bankruptcy proceedings in 48 states and the U.S. territories. Alabama and North Carolina are the exception, and run a different bankruptcy system.

Congress hiked U.S. Trustee Program quarterly fees starting in 2018 for debtors that filed for bankruptcy in the districts that participate in the program. With no corresponding fee hike in Alabama and North Carolina, there was a disparity in the first nine months of 2018, before the districts in the two states matched the fees. Debtors challenged that fee disparity as unconstitutional.

The federal appeals courts are split on the issue, and a case is awaiting a U.S. Supreme Court decision over whether to weigh in. The circuit split has ignited fee disparity critics' hopes that the justices will want to settle the matter.

If the justices strike down the fee increase, the USTP may have to return potentially as much as \$100 million, according to the petition for Supreme Court review filed by the bankruptcy estate of now-defunct Circuit City.

"It seems unfair that if you're a larger operating debtor in 48 states, you're paying much larger fees than those in Alabama or North Carolina," said Robyn Sokol, a partner with Leech Tishman Fuscaldo & Lampl LLC. "It seems to conflict with uniformity among the states in the application of bankruptcy law."

Clawback Fights

During the nine-month period in 2018, debtors with quarterly operating expenses and distributions of at least \$1 million in the jurisdictions under the USTP's system paid more than eight times the amount paid by debtors in Alabama and North Carolina. The quarterly maximum in the USTP states jumped from \$30,000 to \$250,000 during the period.

A high court ruling to force the USTP to return the fees could spur a flurry of litigation.

The U.S. Trustee isn't likely to go through its records and determine who should get a refund if the law is overturned, **Sokol** said. Debtors that believe they're entitled to a refund will have to go to court to recover the higher fees paid during that period, she said.

And other disputes could erupt over whether debtors or their creditors can reopen long-closed bankruptcy cases to get the money back.

"It might be very hard this many years later to take advantage" of a ruling that the fees were wrongly collected, said Robert Fishman, an attorney shareholder with Cozen O'Connor PC. "But you'll see a lot of lawyer creativity if it becomes possible to claw back those fees."

A ruling invalidating the fee hike also would prompt a need for emergency funding from Congress if the program is to stay alive, said Nicholas Koffroth, an attorney with Fox Rothschild LLP.

Such a ruling would threaten a longstanding policy that the U.S. Trustee Program be funded by its users—debtors in bankruptcy—Koffroth said.

If the USTP is forced to return the money and ask Congress to make up the difference, that would shift the cost to taxpayers.

"I think the Supreme Court will tread lightly because of the potential impact and financial implications" of ordering a full refund, Koffroth said.

Different Programs

The USTP oversees bankruptcy cases in 88 of the 94 federal judicial districts. The U.S. attorney general appoints U.S. trustees to monitor bankruptcy proceedings in the USTP districts "to promote the integrity and efficiency of the bankruptcy system," according to the USTP website.

The trustees review most aspects of a bankruptcy case, including the professionals that debtors hire, the creation of creditors committees, and companies' reorganization plans. They also appoint independent professionals as trustees for Chapter 7, 11, 12, and 13 bankruptcies.

By contrast, bankruptcy cases in the six judicial districts in Alabama and North Carolina are overseen by bankruptcy administrators appointed by the U.S. Judicial Conference.

In 2017, Congress passed legislation to address a shortfall in the USTP's coffers, which had shrunk as case filings dropped.

The districts in Alabama and North Carolina didn't enact the same fee increase until October 2018.

The lawsuits that have resulted from the different fee structures have led to a circuit split. The Second and Tenth circuits say the fees during the first three quarters of 2018 were unconstitutional.

The Fourth and Fifth circuits concluded otherwise. The Fourth Circuit case—an appeal out of Circuit City's bankruptcy—is the one now before the Supreme Court.

"I don't see how you can get around the constitutional issue," Fishman said. "There's something wrong if you can get a financial advantage by filing in different districts," he said.

Partial Refund

Even if the justices find the fee increase unconstitutional, there are other ways to remedy the situation, Koffroth said.

Koffroth pointed to an April 2020 decision from the U.S. Bankruptcy Court for the Southern District of Florida, which found only a portion of the fees unconstitutional and thus subject to refund.

Nearly all of the USTP fees, 98%, are directly used to fund the program. But 2% goes directly to the U.S. Treasury, mostly "to offset the cost of extending certain temporary bankruptcy judgeships (including one in North Carolina)," the Florida bankruptcy court found.

Therefore, 2% of the fee increase is unconstitutional and must be paid back, the court concluded.

The case is pending before the Eleventh Circuit, which heard oral arguments but hasn't yet issued a ruling.

The other option is that the Supreme Court doesn't take up the case at all.

That will leave the status quo—that debtors in some parts of the country will get money back from the USTP, while others won't.

With that continued disparity, it may only be a matter of time before the justices are asked again to consider the issue.

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