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Tenth Circuit Deepens Circuit Split over Constitutionality of Fee Increases for United States Trustee Program

On October 5, 2021, the Tenth Circuit joined the Second Circuit in concluding statutory fee increases that applied only to debtors filing for bankruptcy in judicial districts administered by the United States Trustee Program (the "US Trustee" or the "UST Program") violated the U.S. Constitution's requirement for "uniform" bankruptcy laws.[1] This ruling exacerbates a burgeoning circuit split, as both the Fourth and the Fifth Circuits had previously rejected similar constitutional challenges.[2] Although Congress has already addressed the potential constitutional infirmities created by these fee increases, debtors that paid excess fees during the relevant period may nonetheless pursue potentially substantial refunds.[3]

The UST Program Administers Most, But Not All Bankruptcy Cases

In 1978, Congress sought to modernize bankruptcy case administration by establishing the UST Program. In subsequent years, Congress expanded the UST Program to encompass nearly every judicial district across the federal system. Only Alabama and North Carolina have declined to participate. As a result, so-called "Bankruptcy Administrators" still oversee bankruptcy cases in the six judicial districts comprising these two states.

Congress provides funding for Bankruptcy Administrators, on the one hand, and the UST Program, on the other, through distinct sources. Quarterly fees paid by debtors support the UST Program. Bankruptcy Administrators, by contrast, draw funding from the federal judiciary's general budget. As a result, debtors that file for bankruptcy in judicial districts administered by the UST Program sometimes paid higher fees than similarly situated debtors in judicial districts overseen by Bankruptcy Administrators. In the early 1990s, however, the Ninth Circuit sustained a legal challenge to this disparity on the basis of the Constitution's requirement for "uniform" bankruptcy laws.[4]

Congress effectively solved this problem for two decades by permitting the Judicial Conference to require debtors in districts overseen by Bankruptcy Administrators to pay fees in the same amount as similarly situated debtors in districts administered by the UST Program.[5] In 2017, however, Congress addressed the UST Program's budgetary difficulties by sharply increasing the

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1 *In re John Q. Hammons Fall 2006, LLC*, --- F.4th ----, 2021 WL 4535285 (10th Cir. Oct. 5, 2021); *In re Clinton Nurseries, Inc.*, 998 F.3d 56 (2d Cir. 2021); *see also* "Second Circuit Finds 2017 Fee Increase for Chapter 11 Debtors Unconstitutional, Awards Debtors a Refund" at https://www.paulweiss.com/practices/transactional/restructuring/publications/second-circuit-finds-2017-fee-increase-for-chapter-11-debtors-unconstitutional-awards-debtors-a-refund?id=40555.

2 *See In re Circuit City Stores, Inc.*, 996 F.3d 156 (4th Cir. 2021); *Matter of Buffets, L.L.C.*, 979 F.3d 366 (5th Cir. 2020).

3 *See John Q. Hammons*, 2021 WL 4535285, at *8.

4 *St. Angelo* v. *Victoria Farms, Inc.*, 38 F.3d 1525 (9th Cir. 1994).

5 *See Matter of Buffets*, 979 F.3d at 371 (discussing the Congressional response to *St. Angelo*).

quarterly fees that large corporate debtors must pay in chapter 11.[6] Congress did not amend the statutory provision addressing Bankruptcy Administrators at the same time, and the Judicial Conference did not increase those fees until late the next year.[7] Controversy and litigation soon followed. In 2020, Congress addressed this problem by once again amending the relevant statute, this time to provide for uniform fees across districts overseen by both the UST Program and Bankruptcy Administrators.[8] But constitutional challenges to the disparate fees some debtors paid between January 1, 2018 and October 1, 2018 remained outstanding.

Circuit Courts Have Split on the Constitutionality of Disparate Fees to Support the UST Program

The Bankruptcy Clause authorizes Congress to enact "uniform Laws on the subject of Bankruptcies throughout the United States."[9] Debtors that paid higher quarterly fees to support the UST Program have argued that the 2017 statutory amendment providing for those higher fees violated this provision by creating a clear geographic discrepancy between similarly situated debtors. In districts administered by the UST Program, debtors began paying higher fees on January 1, 2018; similarly situated debtors in districts overseen by Bankruptcy Administrators, by contrast, did not begin paying these fees until October 1, 2018.

In late 2020, the Fifth Circuit became the first appellate court to address the constitutionality of these divergences in fee structures.[10] Reasoning that the disparities created by these two parallel systems resulted from differences in usage, rather than arbitrary geographical favoritism, a divided panel found no constitutional infirmity.[11] Earlier this year, a similarly divided panel of the Fourth Circuit—which includes all three judicial districts in North Carolina—reached the same conclusion.[12] But a decision from a unanimous panel of the Second Circuit more recently held that the constitutional requirement for "uniformity" demanded like treatment for like debtors, such that the 2017 amendment could not withstand judicial scrutiny.[13]

The Tenth Circuit Joins the Second Circuit in Striking Down the 2017 Fee Increase

In *John Q. Hammons*, a divided panel of the Tenth Circuit deepened this nascent circuit split by expressly endorsing the Second Circuit's conclusion.[14] The Tenth Circuit first addressed the US Trustee's threshold argument that the fee statutes could not violate the Constitution's requirement for "uniform" bankruptcy laws because the statutes did not fall under the ambit of "bankruptcy laws" in the first instance. Much like the three other appellate courts to have confronted this question, the Tenth Circuit rejected the US Trustee's contention, noting that "[a]ny fee increase reduces what creditors receive," and thus falls under the rubric of the "bankruptcy laws" subject to the Bankruptcy Clause.[15]

Having concluded the fee increases *do*, in fact, implicate the Constitution's requirement for "uniform" bankruptcy laws, the court then turned to the US Trustee's two alternative arguments in defense of the statute's constitutionality: (1) the statutory provisions for fees paid to support the UST Program and Bankruptcy Administrators *already* required uniform fees; and (2) the

6 *See Clinton Nurseries*, 998 F.3d at 60-61 (describing Congressional actions in 2017).

7 *See id.*

8 *See id.* at 62 (restating Congressional actions in 2020).

9 U.S. Const. art I, § 8, cl. 4.

10 *See Matter of Buffets*, 979 F.3d at 370 (noting flood of nationwide litigation).

11 *Id.* at 377-78.

12 *Circuit City Stores*, 996 F.3d at 159-60.

13 *Clinton Nurseries*, 998 F.3d at 67-69.

14 *John Q. Hammons*, 2021 WL 4535285, at *7 ("[W]e agree with the Second Circuit's well[-]reasoned and unanimous ruling . . .").

15 *See id.* at *5.

fee increase for large debtors in districts administered by the UST Program satisfied the Constitutional standard for "uniformity" because it applied with equal force to all large debtors in all districts overseen by the UST Program.[16]

The court disposed of the first argument with straightforward tools of statutory interpretation. Until 2020, when Congress amended the statutory provision addressing fees paid to Bankruptcy Administrators, this section read that the Judicial Conference *may* require fees equal to those in districts overseen by the UST Program. The court posited that the purposeful use of the term *shall* within the same statutory provision compelled the inference that different terms carried different meanings.[17] The court also observed that Congress' amendment in 2020—from *may* to *shall*—did not, as the US Trustee claimed, contravene the term's ordinary meaning by reflecting a longstanding intention to ensure uniformity.[18]

The Tenth Circuit grappled more extensively with the US Trustee's second argument, which repurposed the reasoning of favorable decisions from the Fourth and Fifth Circuits in contending that fees paid to Bankruptcy Administrators simply reflected the geographical reality that usage remained lower in those districts. Following the Second Circuit, the court instead held that the Bankruptcy Clause required any law to "apply uniformly to a defined class of debtors."[19] Since large debtors presumably existed in districts overseen by both the UST Program and Bankruptcy Administrators, the court concluded the parallel systems did not meet this standard.[20] The Tenth Circuit accordingly remanded the case to the bankruptcy court to determine and refund to the debtors at issue the amount of quarterly fees the debtors had paid in excess of the amount of fees they would have owed to a Bankruptcy Administrator during the relevant period.[21]

Conclusion: Refunds for Some; Potential Supreme Court Review

Because Congress has already amended the relevant statutory provisions to address whatever defects may have existed, the Tenth Circuit's decision—like the others before it—will likely impact only the small cohort of large debtors that filed for chapter 11 bankruptcy protection during the relevant period and paid fees in excess of those they would have owed to a Bankruptcy Administrator. Such fees, however, may be substantial depending on the size of the case and number of jointly administered debtors affected. Of course, some possibility likewise remains that the even circuit split between four federal appellate courts may prompt the Supreme Court to expound on the scope and the significance of the Constitution's little-explored provisions for "uniformity" in bankruptcy.

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16 *Id.* at *6.

17 *See id*.

18 *Id.*

19 *See id.* at *7 (internal quotation marks and citations omitted).

20 *Id.*

21 *Id.* at *8.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content.

Jacob A. Adlerstein
+1-212-373-3142
jadlerstein@paulweiss.com

Paul M. Basta
+1-212-373-3023
pbasta@paulweiss.com

Brian Bolin
+1-212-373-3262
bbolin@paulweiss.com

Robert A. Britton
+1-212-373-3615
rbritton@paulweiss.com

Kelley A. Cornish
+1-212-373-3493
kcornish@paulweiss.com

Alice Belisle Eaton
+1-212-373-3125
aeaton@paulweiss.com

Brian S. Hermann
+1-212-373-3545
bhermann@paulweiss.com

Kyle J. Kimpler
+1-212-373-3253
kkimpler@paulweiss.com

Alan W. Kornberg
+1-212-373-3209
akornberg@paulweiss.com

Elizabeth R. McColm
+1-212-373-3524
emccolm@paulweiss.com

Andrew M. Parlen
+1-212-373-3141
aparlen@paulweiss.com

Andrew N. Rosenberg
+1-212-373-3158
arosenberg@paulweiss.com

Jeffrey D. Saferstein
+1-212-373-3347
jsaferstein@paulweiss.com

John Weber
+1-212-373-3656
jweber@paulweiss.com

Martin J. Salvucci contributed to this Client Alert.