FOCUS: BANKRUPTCY LAW

United States Supreme Court, Bankruptcy Update

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The United States Supreme Court decided a bankruptcy case this year that all bankruptcy practitioners should be aware of. The Supreme Court also granted certiorari to hear an additional bankruptcy case and denied review of another.

Siegal v. Fitzgerald: The United States Supreme Court Declares Bankruptcy Fee Hike Under the U.S. Trustee Program Unconstitutional

In *Siegal v. Fitzgerald,* the United States Supreme Court resolved the issue of fee disparities imposed by a 2017 statute that increased U.S. Trustee fees in forty-eight states but not in Alabama or North Carolina. The Supreme Court reversed the Fourth Circuit's ruling and held that the Office of the U.S. Trustee fee hike mandated by the Bankruptcy Judgeship Act of 2017 (the "2017 Act") violated the uniformity requirement of the U.S. Constitution's Bankruptcy Clause.[1]

The dispute involved the disparity of U.S. Trustee fees and how they apply in bankruptcy proceedings. In 1978, the U.S. Trustee Program was created. This program transferred administrative functions of the bankruptcy courts to U.S. Trustees.[2] In 1986, Congress enacted the "U.S. Trustee Program" in all federal judicial districts except those in Alabama and North Carolina. A different program named the "Bankruptcy Administrator Program" was adopted in these two states.[3]

In 2017, the Office of the U.S. Trustee dealt with a shortfall of funding, and as a result, Congress passed the 2017 Act, which raised fees payable by Chapter 11 debtors in the forty-eight states using the U.S. Trustee Program.[4] The 2017 Act raised the fees payable to the U.S. Trustee starting in the first quarter of 2018 from a maximum of $30,000 to a maximum of $250,000. This fee hike was not applied in Alabama or North Carolina.[5]

Siegel arose from the Circuit City Stores Chapter 11 case, which was filed in the U.S. Bankruptcy Court for the Eastern District of Virginia (a U.S. Trustee Program district). While the case was pending, the 2017 Act took effect. As a result, Circuit City paid $632,542.00 in trustee fees across the first three quarters of 2018. If the 2017 Act had not taken effect, the debtor would have paid $56,400.00. The debtor then challenged the fee increase as unconstitutional because it did not apply uniformly in all fifty states.[6]

Siegel filed for relief against the Acting U.S. Trustee, and in the Bankruptcy Court for the Eastern District of Virginia. Siegel asserted that the 2017 Act did not apply uniformly in the U.S. Trustee Program Districts and the Administrator Program Districts. In 2019, the Bankruptcy Court ruled the 2017 Act was unconstitutional because it violated the uniformity requirement imposed by the Bankruptcy Clause, which requires Congress to establish "uniform Laws on the subject of Bankruptcies throughout the United States."[7]

The acting U.S. Trustee appealed this decision to the Fourth Circuit. The Fourth Circuit reversed and ruled that the 2017 Act was constitutional. At this time several circuits were split over the issue, as the Fifth and Eleventh Circuits found the 2017 Act to be constitutional, while the Second and Tenth Circuits disagreed. The Supreme Court granted certiorari to resolve the circuit split over the constitutionality of the 2017 Act.

In June 2022, the Supreme Court unanimously held, in an opinion written by Justice Sotomayor, that the 2017 statutory increase to U.S. Trustee Fees violated the uniformity requirement of the Constitution's Bankruptcy Clause. Justice Sotomayor explained that the "the bankruptcy clause offers Congress flexibility but does not permit arbitrary geographically disparate treatment of debtors."[8] The Supreme Court found that the 2017 Act was not "geographically uniform."

Certiorari Petition Granted in Another Bankruptcy Case- October Term 2022-2023

Bartenwerfer v. Buckley: United States Supreme Court to Consider Whether a Debtor Can be Held Liable for Partner's Fraud

The Supreme Court has agreed to hear a case to resolve the issue of whether a debtor can be held liable for a debt incurred by fraud committed by the debtor's partner or agent. The Bankruptcy Code offers debtors a "fresh start" and affords debtors the opportunity to discharge past debts. Certain debts, such as debts that are incurred by false pretenses, false representations, and/or actual fraud, are not dischargeable.[9]

In *Bartenwerfer v. Buckley*, debtors (a married couple) renovated a home in San Francisco. After the renovations, the couple sold the house to Mr. Buckley. Before the sale of the home, the debtors signed disclosure statements regarding the property's condition. The debtors made representations regarding water leaks, the condition of the roof and windows, and whether any additions or alterations were made to the home without necessary permits or in violation of the building codes.[10]

After the home was sold, Mr. Buckley, the new owner, discovered significant defects. As a result, Mr. Buckley filed a lawsuit against the debtors. Mr. Buckley asserted several claims in his action, including that the debtors failed to disclose material facts about the home. The jury ultimately sided with Mr. Buckley, found the debtors liable for not making material disclosures, and awarded Mr. Buckley damages of $444,671.[11]

Subsequently, the debtors filed their Chapter 7 bankruptcy case. Mr. Buckley filed a non-dischargeability action alleging that the State Court judgment should not be discharged because it was based on the debtors' concealment of material information regarding the home.

Kate Bartenwerfer, one of the debtors, alleged that she did not know of her husband's fraud. The Bankruptcy Court entered a judgment in her favor, finding that her husband's fraud should not be imputed to her. The Ninth Circuit reversed and argued that the Bankruptcy Court applied the incorrect "knew or should have known" legal standard for imputing liability.

On May 2, 2022, the Supreme Court granted certiorari. The question presented to the Supreme Court is whether an individual may be subject to liability for the fraud of another that is barred from discharge under 11 U.S.C. §523 (a)(2)(A), by imputation, without any act, omission, intent or knowledge of her own. Arguments are scheduled for December 6, 2022.

PHH Mortgage Corp. v. Sensenich (In re Gravel), 6 F.4th 503 (2d Cir. 2021): United States Supreme Court Denies Certiorari in Bankruptcy-Related Matter

On June 13, 2022, the Supreme Court denied certiorari on a matter that involved punitive sanctions imposed on a secured creditor in three independent Chapter 13 cases in Vermont (these three cases were later consolidated on appeal). In *PHH Mortgage*, a sub-servicer of residential mortgages faced a series of fines for violating the notice provisions of Federal Rule of Bankruptcy Procedure 3002.1.[12]

Rule 3002.1 requires secured creditors with claims secured by the debtor's principal residence to provide notice to the debtor, debtor's counsel, and interested parties of any changes in the debtor's monthly payment amount, including any post-petition expenses, fees, and charges.[13] To comply with this rule, secured parties must file a notice of any change of post-petition mortgage fees within 180 days of when the fees were incurred.

As a result of violating Rule 3002.1, the Bankruptcy Court imposed punitive sanctions on PHH Mortgage. These punitive sanctions ($75,000 each) were applied in three independent Chapter 13 bankruptcy cases where PHH Mortgage was a secured creditor. PHH Mortgage appealed the order. The Second Circuit went on to hold that the bankruptcy court erred in imposing punitive sanctions on PHH Mortgage in three independent matters because Rule 3002.1 did not allow punitive fines.[14]

Several issues were presented in the petition for a writ of certiorari; however, the Supreme Court has denied review of the petition.

1. *Siegel v. Fitzgerald*, 142 S.Ct 1170 (2022).
2. *Id.* at 1172.
3. *Id.* at 1176.
4. *Id.* at 1172.
5. *Id.*
6. *Id.* at 1177.
7. U.S. Const. art. I, §8, cl. 4.
8. *Id.* at 1780.
9. 11 U.S.C. § 523(a)(2)(A).
10. *In re Bartenwerfer*, No. AP 13-03185, 2017 WL 6553392 (B.A.P. 9th Cir. Dec. 22, 2017).
11. *Id.* at 2.
12. *In re Gravel*, 6 F.4th 503 (2d Cir. 2021), cert. denied sub nom. Sensenich v. PHH Mortg. Corp., 142 S. Ct. 2829 (2022).
13. Fed. R. Bankr. P. 3002.1.
14. *In re Gravel*, 6 F.4th at 503.

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