

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

Konrad Material Sales LLC,

File No. 21-cv-786 (ECT)

Appellant,

v.

Randall L. Seaver, *Chapter 7 Trustee*; Upper
Midwest Sealcoat Manufacturing, LLC;
Michael Knight, *Former Chapter 11
Trustee*; and Fredrikson & Byron, P.A.,
Chapter 11 Administrative Claimant,

ORDER

Appellees.

Cameron A. Lallier, Foley & Mansfield, PLLP, Minneapolis, MN, for Appellant Konrad Material Sales LLC.

Matthew D. Swanson, Fuller, Seaver & Swanson, P.A., Burnsville, MN, for Appellee Randall Seaver.

Will R. Tansey, Ravich Meyer Law Firm, Minneapolis, MN, for Appellee Upper Midwest Sealcoat Manufacturing, LLC.

Ryan T. Murphy and Emily Muirhead McAdam, Fredrikson & Byron, PA, Minneapolis, MN, for Appellees Fredrikson & Byron and Michael Knight.

Konrad Material Sales LLC appeals the Bankruptcy Court's order approving the Chapter 7 Trustee's final report. App. at 244 [ECF No. 11 at 245]. The appeal raises a question of statutory interpretation, and no facts are disputed. Therefore, the Bankruptcy Court's order is reviewed de novo. *Tri-State Fin., LLC v. First Dakota Nat'l Bank*, 538 F.3d 920, 923–24 (8th Cir. 2008). The statutory-interpretation issue is whether 11 U.S.C.

§ 726(b) requires disgorgement of amounts approved and paid to Chapter 11 administrative claimants when a case is converted to one under Chapter 7 and the debtor is administratively insolvent. Neither the Supreme Court nor the Eighth Circuit has addressed this issue, but many other courts have. These courts' holdings fall into three categories.

(1) Some courts hold that § 726(b) requires disgorgement of such amounts “when necessary to achieve *pro rata* distribution of a Chapter 7 bankruptcy estate[.]” *Specker Motor Sales Co. v. Eisen*, 393 F.3d 659, 664–65 (6th Cir. 2004); *see In re Lockwood Corp.*, No. BK93-80133, 2006 WL 2038660, at *1–2 (Bankr. D. Neb. Apr. 26, 2006) (citing cases and holding that § 726(b) “may require disgorgement from interim payments to professionals in order to equalize the distribution” and that “the statute’s clear and specific articulation of priorities represents a mandate from Congress, preventing the exercise of judicial discretion”); *see also In re Bravco, Inc.*, No. BKY 00-60413, slip op. (Bankr. D. Minn. Nov. 1, 2005) [ECF No. 16-1 at 2–9] (following *Specker*).

(2) Some courts hold that the Bankruptcy Code forbids disgorgement of such amounts merely to satisfy § 726(b)’s *pro-rata*-distribution requirement. *See, e.g., In re Santa Fe Med. Grp., LLC*, 557 B.R. 223, 231 (Bankr. D.N.M. 2016) (holding “that Congress did not intend to give bankruptcy courts authority to order disgorgement upon insolvency[.]”); *In re Next Generation Media, Inc.*, 524 B.R. 824, 828–30 (Bankr. D. Minn. 2015) (same); *In re Headlee Mgmt. Corp.*, 519 B.R. 452, 458–59 (Bankr. S.D.N.Y. 2014) (same); *In re Hyman Freightways, Inc.*, 342 B.R. 575, 578–80 (Bankr. D. Minn. 2006) (same), *aff’d*, No. 06-cv-2607 (PAM), 2006 WL 3757972 (D. Minn. Dec. 20, 2006).

(3) Some courts suggest that bankruptcy courts possess discretion to order (or not order) disgorgement of such amounts to satisfy § 726(b)'s *pro-rata*-distribution requirement. *In re NETtel Corp.*, No. 00-01771, 2020 WL 2047965, at *22–26 (Bankr. D.D.C. Apr. 28, 2020); *see In re Home Loan Serv. Corp.*, 533 B.R. 302, 307–310 (Bankr. N.D. Cal. 2015) (citing and criticizing cases taking this approach).¹

With no controlling authority and a large volume of thorough persuasive authorities, the task is not to write anything new (that seems impossible), but to choose between competing positions. Based particularly on the thoughtful statutory interpretation and analysis in *Headlee Management Corp.*, the critiques of the mandatory-disgorgement approach in that case and *Santa Fe Medical Group*, and Bankruptcy Judge Robert J. Kressel's analysis in *Hyman Freightways* (which *Headlee Management Corp.* and *Santa Fe Medical Group* cite approvingly), the better conclusion is that the Bankruptcy Code precludes disgorgement of amounts approved and paid to Chapter 11 administrative claimants when a case is converted to one under Chapter 7 and the debtor is administratively insolvent merely to satisfy § 726(b)'s *pro-rata*-distribution requirement.

¹ In *Hyman Freightways*, the district court concluded that “the bankruptcy court reexamined the interim fee awards, considering the particular circumstances of this case in order to reach an equitable result[] . . . [and] did not abuse its discretion in denying the trustee’s motion for a refund of professional fees.” 2006 WL 3757972, at *3. In light of the court’s prior discussion of 11 U.S.C. § 726(b), and especially its conclusion that “[t]he statute’s plain language simply does not speak to the remedy of disgorgement[,]” the court’s discussion of discretionary disgorgement seems to have occurred as an alternative to a holding that the Bankruptcy Code does not authorize disgorgement.

Therefore, based on the foregoing, and all of the files, records, and proceedings herein, **IT IS ORDERED** that the Bankruptcy Court's Order dated March 10, 2021, approving the Chapter 7 Trustee's final report is **AFFIRMED**.

LET JUDGMENT BE ENTERED ACCORDINGLY.

Dated: July 19, 2021

s/ Eric C. Tostrud

Eric C. Tostrud

United States District Court