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To Disgorge or Not: 11 U.S.C. § 726(b) and Disgorgement of Interim Fee Awards

I. INTRODUCTION

"[I]n this world, nothing is certain except death and taxes." [1] As most practitioners know, professional compensation in a Chapter 11 [2] case is no exception—particularly if the case later converts to Chapter 7. Chapter 7 conversion injects an added layer of uncertainty and can have dire consequences for the Chapter 11 professional, including, for example, the possibility that outstanding (pre-conversion) fees will be paid partially or even go unpaid entirely. Worse still, administrative insolvency following a Chapter 7 conversion could lead to an order requiring the Chapter 11 professional to disgorge interim fee awards.

The propriety of such disgorgement, however, is itself the subject of some uncertainty. Courts have split (to varying degrees) on the issue, and the Supreme Court has not offered any guidance. Accordingly, this Article examines the two, main competing views on post-conversion disgorgement, as set forth in *Specker Motor Sales Co. v. Eisen* [3] and *In re Headlee Mgmt. Corp.* [4] After first discussing the relevant provisions of the Bankruptcy Code with respect to professional compensation and conversion and then the holdings of these two cases, this Article determines that *Headlee* reached the correct conclusion: Disgorgement of Chapter 11 interim fees solely due to post-conversion administrative insolvency is inappropriate and contrary to the plain language of the pertinent sections of the Bankruptcy Code.

II. PROFESSIONAL COMPENSATION UNDER THE BANKRUPTCY CODE

A. Professional Compensation in Chapter 11 [5]

For the most part, and as relevant here, Sections 330 and 331 govern Chapter 11 professional compensation. Section 331 provides for interim fee awards. [6] That section states, in relevant part:

> [P]rofessional person[s] employed under section 327 … may apply to the court not more than once every 120 days after an order for relief in a case under this title, or more often if the court permits, for such compensation for services rendered before the date of such an application or reimbursement for expenses incurred before such date as is provided under section 330 of this title. [7]

Because section 331 authorizes the payment of interim compensation more often than every 120 days "if the court permits," bankruptcy courts in some Chapter 11 cases enter orders authorizing professionals to apply for interim compensation on a monthly basis. [8] This procedure typically involves a 20% fee holdback until approval of the interim fees under Section 331. [9]

Section 331 thus strikes a delicate balance between the needs of the professional and the debtor. On the one hand, it empowers professionals to seek periodic payment of accrued fees and expenses during the pendency of the Chapter 11 case. [10] Without such express authority, professionals could be forced to wait until the conclusion of the Chapter 11 case—years, potentially—

to receive any compensation whatsoever. [11] On the other hand, Section 331 protects the debtor's interests by subjecting interim fee awards to final review and approval under Section 330. [12]

Section 330 governs final fee awards. [13] It begins by providing simply that the bankruptcy court "may award … reasonable compensation for actual, necessary services" and expenses. [14] The Bankruptcy Code does not, however, delineate the amount of compensation that is "reasonable." [15] Instead, Section 330(a)(3) leaves this determination to the bankruptcy court's discretion; provided, the bankruptcy court must consider "all relevant factors" when making an award, including "whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case." [16]

Section 330 further constrains the bankruptcy court's discretion by forbidding fees outright in certain limited circumstances and requiring a reduction of the award in others. [17] Section 330(a)(4)(A) prohibits fees on account of "unnecessary duplication of services," services that were not "reasonably likely to benefit the debtor's estate," and for services that were "[un]necessary to the administration of the case." [18] In addition, Section 330(a)(5) provides that the final fee award must be reduced by the amount of any interim awards under Section 331. [19] Once granted, a final fee award is classified as an administrative expense of the estate pursuant to Section 503(b)(2) and is entitled to second-highest priority pursuant to Section 507(a)(2). [20]

Thus, in an ordinary Chapter 11 case, professional compensation is a routine—albeit detailed—matter. Once every 120 days (unless an order permits more frequent filing), the professional submits to the bankruptcy court a request for fees for the services performed prior to the application. [21] Assuming the bankruptcy court has no cause to reduce, deny, or withhold payment on the fee request, the bankruptcy court grants the interim request, and the estate remits the fees to the professional. This process repeats for the duration of the Chapter 11 case. At or near the conclusion of the Chapter 11 case, the professional then submits a final fee application. The final fee application generally requests an award consisting of all interim compensation plus any fees and expenses not yet paid. [22] Once granted, the debtor typically pays the balance of the award as an allowed administrative expense claim under the terms of a Chapter 11 plan. [23]

B. Chapter 11 Professional Compensation after Conversion to Chapter 7

Of course, not all Chapter 11 professionals are paid their fees and expenses on a final basis under the terms of a Chapter 11 plan—because not all Chapter 11 cases conclude with a plan. Some Chapter 11 cases end instead with a conversion to Chapter 7. In this scenario, Section 726(b) upends typical payment priority rules and subordinates Chapter 11 administrative expenses—including, as relevant here, professional fees—to Chapter 7 administrative expenses, often somewhat morbidly termed "burial expenses." [24]

Section 726(b) provides, in relevant part:

> Payment on claims of a kind specified in paragraph (1), (2), (3), (4), (5), (6), (7), (8), (9), or (10) of section 507(a) of this title … shall be made pro rata among claims of the kind specified in each such particular paragraph, except that in a case that has been converted to this chapter under section 1112, 1208, or 1307 of this title, a claim allowed under section 503(b) of this title incurred under this chapter after such conversion has priority over a claim allowed under section 503(b) of this title incurred under any other chapter of this title or under this chapter before such conversion … [25]

Thus, under the subordination scheme in Section 726(b), Chapter 7 burial expenses must be paid in full before there can be any distribution on unpaid Chapter 11 professional fees. [26] After (or if) burial expenses are paid in full, Chapter 11 professionals are paid outstanding fees; however, if there are insufficient funds to pay all unpaid Chapter 11 administrative expenses in full, Chapter 11 professionals are paid *pro rata* with all other Chapter 11 administrative claimants. [27]

The policy behind this reshuffling in payment priority is intuitive. "It is evident that the super-priority status for 'burial expenses' was intended to encourage capable trustees and other professionals to partake in liquidation to maximize the benefit for those who seek satisfaction of their claims against the estate." [28] Chapter 7 trustees and professionals, in other words, would have little incentive to liquidate and administer a converted estate without (reasonable) assurance of payment. [29] Nonetheless, Section 726(b) can have serious repercussions for Chapter 11 professionals.

III. SECTION 726(b) AND PRE-CONVERSION FEES

Two undesirable outcomes for Chapter 11 professionals are readily apparent from Section 726(b). The first potential outcome is that outstanding Chapter 11 professional fees will go completely unpaid. This occurs when burial expenses equal or exceed the cash available for distribution in the converted case. If, for example, the converted estate has $100.00 in available funds, but Chapter 7 administrative fees and expenses come out to $200.00, then the unpaid Chapter 11 professional is out of luck. Section 726(b) bars any distribution on Chapter 11 administrative claims if burial expenses are not paid in full. [30]

The second potential outcome under Section 726(b) is a partial payment on unpaid Chapter 11 fees. This occurs when the estate has enough cash to pay burial expenses in full but lacks the funds to pay all Chapter 11 administrative expenses in full. Returning to the example above, suppose the converted estate now has $300.00 in available funds, with Chapter 7 fees and expenses remaining the same. After payment in full of the burial expenses, the Chapter 7 trustee is left with $100.00 to distribute among the Chapter 11 administrative claimants, of which there are two: (i) a Chapter 11 attorney owed $500.00 in unpaid fees; and (ii) a Chapter 11 accountant owed $100.00 in unpaid fees. Because there are insufficient funds to pay both claimants in full, Section 726(b) dictates that the attorney and accountant receive *pro rata* payments on their respective claims—*viz*., $83.33 to the attorney and $16.67 to the accountant. [31]

Each of these two outcomes is a clear and uncontroversial—if unpleasant—possibility for Chapter 11 professionals subjected to the terms of Section 726(b). Less clear, however, is the question of whether and to what extent Section 726(b) affects interim Chapter 11 fee awards in the event of post-conversion administrative insolvency. In other words, does Section 726(b) require—or even permit—disgorgement of Chapter 11 interim fees solely to achieve *pro rata* distribution on Chapter 11 administrative claims in an administratively insolvent Chapter 7 case?

Courts have split on the answer. [32] Two of the most divergent views, set forth in *Specker* and *Headlee*, are discussed below.

A. *Specker Motor Sales Co. v. Eisen*

In *Specker*, the debtor filed a voluntary petition for relief under Chapter 11. [33] Thereafter, the bankruptcy court authorized the employment of Mr. Donald Bays as debtor's counsel and further authorized the payment of a $10,000 retainer to Mr. Bays. [34] Within the year, however, the debtor's run at Chapter 11 petered out, and the bankruptcy court converted the case to Chapter 7. [35] Several years after conversion, Mr. Bays submitted "his final request for fees." [36] The bankruptcy court "approved Bays's final application for total fees in the amount of $17,343.10 … [and] permitted him to keep the $10,000 [retainer] as interim compensation." [37]

Shortly thereafter, the Chapter 7 trustee submitted his final report. [38] The report indicated, among other things, that the estate was hopelessly insolvent with respect to Chapter 11 administrative expenses. [39] Chapter 11 administrative claims totaled $194,799.74, but the estate had only $1,494.67 to distribute after payment of allowed Chapter 7 administrative claims. [40] As a result, the bankruptcy court ordered Mr. Bays to disgorge $9,026.59 of his $10,000.00 retainer to allow for *pro rata* distribution amongst the Chapter 11 administrative claimants. [41]

Mr. Bays moved the bankruptcy court to reconsider. [42] The bankruptcy court denied Mr. Bays's motion, finding that disgorgement was proper and, in fact, required under Section 726(b). [43] Emphasizing that Section 726(b) contains the mandatory language "shall," the bankruptcy court held that "§ 726(b) requires disgorgement of interim compensation in every case of administrative insolvency in order to achieve the 'pro rata' disbursement described in the section." [44]

Accordingly, Mr. Bays appealed—ultimately to the Sixth Circuit.[45] The Sixth Circuit, however, affirmed the judgment below, holding "we find that interim compensation must be disgorged when necessary to achieve *pro rata* distribution of a Chapter 7 bankruptcy estate."[46] The Sixth Circuit rested this conclusion on both the mandatory language of Section 726(b) and the interlocutory nature of an interim fee award.[47]

Beginning with the text of Section 726(b), the Sixth Circuit determined that "[t]he use of the word 'shall'" in conjunction with the *pro rata* requirement establishes that "similarly situated … creditors must … receive a *pro rata* share of the estate by the plain terms of § 726(b)."[48] Creditors are "similarly situated" if they share the same position in the "hierarchy of creditors" set forth in Section 726(b).[49] Administrative claimants, or those "whose claims are 'administrative expenses allowed under § 503(b),'" sit at the top of this hierarchy.[50] Since Mr. Bays and the remaining claimants all had administrative claims (*i.e.*, were "similarly situated"), the Sixth Circuit concluded that each could receive "only a *pro rata* share of the estate."[51]

Mr. Bays, however, argued that the $10,000 retainer—paid as an interim award pre-conversion—"should not be subject to this mandatory *pro rata* distribution because the money [w]as already paid out of the estate."[52] In response, the Sixth Circuit noted that an interim award is "subject to re-examination and adjustment" and, therefore, the $10,000 retainer "was always subject to disgorgement."[53] The Sixth Circuit further stated that "Bays's claim, like other approved administrative claims on the estate, at all times remained subject to the statutory *pro rata* distribution scheme in § 726(b)."[54] Accordingly, the Sixth Circuit decided that Section 726(b) compelled the disgorgement of Mr. Bays's $10,000 interim compensation award.[55]

B. *In re Headlee Mgmt. Corp.*

The bankruptcy court in *Headlee* confronted facts substantially similar to those in *Specker* but came to the opposite conclusion. In *Headlee*, like *Specker*, the debtor originally filed a voluntary petition for relief under Chapter 11.[56] During the Chapter 11 case, estate professionals received a combined $294,576.69 in interim fee awards.[57] Ultimately, however, the Chapter 11 case was unsuccessful, and it eventually converted to Chapter 7.[58] The Chapter 7 estate had enough cash to pay for Chapter 7 administrative claims but was "woefully insolvent" with respect to unpaid Chapter 11 administrative expenses.[59]

The Chapter 7 estate was so insolvent, in fact, that—in the absence of fee disgorgement—non-professional Chapter 11 administrative claimants were estimated to receive only 6.5% of their respective claims.[60] If, however, interim fees were disgorged, the Chapter 7 trustee estimated that all Chapter 11 administrative claimants would receive approximately 32% of their claims.[61] As a result, the Chapter 7 trustee sought to compel disgorgement of the Chapter 11 interim fee awards to permit a *pro rata* distribution under Section 726(b), arguing that it was the only equitable result.[62]

The *Headlee* Court denied the trustee's motion, finding that Section 726(b) does not mandate disgorgement of pre-conversion interim fees to affect a *pro rata* distribution.[63] The *Headlee* Court, like the Sixth Circuit in *Specker*, based its conclusion on the language of Section 726(b); however, the *Headlee* Court went further and determined that fee disgorgement is proper only within the framework of Section 330.[64]

Starting first with the argument that Section 726(b) contains a disgorgement mandate, the *Headlee* Court analyzed carefully the text of Section 726(b) and noted that it is "silent as to any remedies" and does not "dictate[] the source of payments" made pursuant to its terms.[65] Therefore, the *Headlee* Court rejected *Specker*'s construction of Section 726(b) and determined that "[t]he better reading … is that [Section 726(b)] mandates that any 'payment' made by the trustee is made pursuant to the order of distribution provided."[66]

The *Headlee* Court turned next to the argument that, absent a statutory mandate under Section 726(b), it could nonetheless exercise discretion and order disgorgement of interim fees under Section 105(a). Citing *Law v. Siegel*,[67] the *Headlee* Court determined that it was not free to "use § 105(a) to fashion a remedy"—order disgorgement—because "the Bankruptcy Code provides one."[68] "Section 330(a)(5) provides clear authority to disgorge interim fees. The authority is only given, however, if the interim compensation exceeds the actual final award of fees under § 330."[69] Given that the United States Trustee and the Chapter 7 trustee both agreed that the Chapter 11 professionals earned the fees at issue and declined to challenge the reasonableness of the fees, the *Headlee* Court found that disgorgement under Section 330(a)(5) was unwarranted.[70]

As a result, the *Headlee* Court determined that it lacked both a statutory mandate for disgorgement under Section 726(b) and the facts to support disgorgement under Section 330(a)(5).[71] The *Headlee* Court thus concluded that the Chapter 7 trustee could "comply with § 726(b) by distributing [the estate's current assets] (and any others he recovers) in accordance with the distribution scheme therein without the need to disgorge professional fees."[72]

IV. THE BETTER VIEW

Specker and *Headlee* both set forth arguments for and against the disgorgement of interim fees under Section 726(b). Nonetheless, *Headlee* provides a better, more cogent reading of Section 726(b) for the following reasons.

First, *Headlee*'s construction of Section 726(b) is more faithful to the text of Section 726(b) and its plain meaning. "[W]here … the statute's language is plan, 'the sole function of the courts is to enforce it according to its terms.'"[73] Here, the operative language of Section 726(b) is unambiguous: "[p]ayment on claims … shall be made pro rata."[74] Read plainly, Section 726(b) requires only that the trustee distributes what assets he or she has in accordance with the priority scheme in Section 726(b).[75] After all, nothing in Section 726(b) gives the trustee or the bankruptcy court the power to augment the assets available for distribution—and, at the risk of circularity, a trustee cannot distribute what he or she does not have.[76]

Moreover, Section 726(b) speaks only to payment (which must be made *pro rata*), not ultimate recovery (which need not be). The difference is critical to a correct interpretation of the statute. A Chapter 11 administrative claimant who is paid partially prior to conversion will—absent disgorgement—ultimately recover a higher percentage on his or her claim than a Chapter 11 administrative claimant who is unpaid at conversion.[77] But this will not result in a malapportioned payment under Section 726(b). Accordingly, the ultimate inequality in recovery should not offend Section 726(b). *Headlee* recognizes and maintains this distinction, but *Specker* does not.

Second, *Headlee*'s interpretation of Section 726(b) prevents Section 330(a) from becoming surplusage. Courts should avoid "interpreting any statutory provision in a manner that would render another provision superfluous."[78] This canon is "strongest when an interpretation would render superfluous another part of the same statutory scheme."[79] *Headlee*'s reading of Section 726(b) preserves, among other things, Section 330(a) by ensuring that interim fees are disgorged only in accordance with Section 330(a)(5), i.e., if the professional received more on an interim basis than it was entitled to receive on the final award, regardless of post-conversion administrative (in)solvency.[80] *Specker*, on the other hand, establishes a *per se* rule that is not faithful to Section 330(a) in the event of post-conversion administrative insolvency.[81] Under *Specker*'s construction, Section 726(b) overrides Section 330(a) entirely if the converted estate is insolvent: interim fees must be disgorged, full stop.[82] Given that *Headlee* harmonizes what *Specker* does not, *Headlee*'s interpretation is the better view.

Finally, *Headlee* presents the better choice because the *Specker* rubric is highly impractical. Carried to its logical conclusion, it would require the Chapter 7 trustee to unwind the entire Chapter 11 case to fulfil the purported mandate of Section 726(b). After all, professionals are not the only administrative claimants who can (and do) receive payments during the Chapter 11 case.[83] Under *Specker*'s reading of Section 726(b), all Chapter 11 administrative claimants who were paid during the Chapter 11 case are subject to Section 726(b)'s disgorgement mandate.[84] Clearly, this cannot be the intended result of Section 726(b).[85]

V. CONCLUSION

In sum, *Headlee* offers a sound and practical construction of Section 726(b). Using this analysis, both the bench and the bar can apply Section 726(b) consistently and intelligibly after every conversion—regardless of administrative insolvency. If Chapter

11 professionals are awarded interim fees (pre-conversion), and the bankruptcy court has no reason to reduce the final award, then the professionals should be permitted to keep the interim award post-conversion and to share pro rata in the distribution of the then-remaining assets. This construction better comports with the language and purpose of Section 726(b) within the broader context of the Bankruptcy Code.

Until the issue is finally settled, however, there are at least two protective measures that a Chapter 11 professional can employ to temper the potential effects of Section 726(b). First, and perhaps most importantly, the Chapter 11 professional should try and obtain a prepetition security retainer. Even among the courts that find disgorgement to be appropriate under Section 726(b), most recognize that a prepetition security retainer is beyond Section 726(b)'s reach. [86] Although there are varying theories, the common rationale is that Section 726(b) affects distribution priorities between unsecured claims only. [87] Thus, a professional with a security retainer is secured—and safe from Section 726(b)—to the extent of the retainer. [88]

Second, and in addition to a prepetition security retainer, the Chapter 11 professional should negotiate an appropriate carveout from the debtor's secured lender. "[A] carve-out is essentially an agreement pursuant to which a secured creditor allows post-petition proceeds otherwise subject to its secured claim to be exclusively earmarked to pay professionals." [89] Professional payments under a carveout, in other words, are made from a secured creditor's collateral. It is important, however, to ensure that the carveout language is sufficiently broad and covers post-conversion insolvency. [90] Assuming appropriate language, bankruptcy courts often find that the "existence of a valid carve-out precludes disgorgement" [91] of professional fees (to the extent of the carveout) solely because of administrative insolvency.

In the end, a Chapter 11 professional's retention of compensation post-conversion in an administratively insolvent case is unlikely to ever become as certain as death and taxes; however, bankruptcy courts can take a step in the right direction by adopting *Headlee*'s construction of Section 726(b).

Footnotes

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1 Letter from Benjamin Franklin to Jean-Baptiste Le Roy (Nov. 13, 1789).

2 "Chapter" or "Section" as used herein refer to the appropriate provisions of 11 U.S.C.A., §§ 101, et seq. (the "**Bankruptcy Code**"), unless otherwise specified.

3 Specker Motor Sales Co. v. Eisen, 393 F.3d 659, 44 Bankr. Ct. Dec. (CRR) 12, Bankr. L. Rep. (CCH) P 80243, 2005 FED App. 0081P (6th Cir. 2004) (cited hereinafter as "***Specker III***").

4 In re Headlee Management Corp., 519 B.R. 452, 60 Bankr. Ct. Dec. (CRR) 78 (Bankr. S.D. N.Y. 2014).

5 Proper retention under the Bankruptcy Code is of course a prerequisite to compensation; however, that discussion is beyond the scope of this Article, which assumes for all relevant purposes that the Chapter 11 professional has been duly employed under Sections 327 or 1103.

6 See generally 11 U.S.C.A. § 331.

7 11 U.S.C.A. § 331.

8 See, e.g., In re Ensequence, Inc., Case No. 18-10182-KG (Bankr. D. Del. Feb. 21, 2018) [Docket No. 80].

9 See In re Ensequence, Inc., Docket No. 80 at ¶ 2(a), (g).

10 See 11 U.S.C.A. § 331.

11 The legislative history of Section 331 notes that, while interim payments were a part of pre-Code practice, they were "subject to some question." S. Rep. No. 95-989, at 42 (1978).

12 See 11 U.S.C.A. § 331.

13 See generally 11 U.S.C.A. § 330.

14 11 U.S.C.A. § 330(a)(1). Notably, however, the bankruptcy court also has the discretion to "award compensation that is less than the amount of compensation that is requested." 11 U.S.C.A. § 330(a)(2).

15 See 11 U.S.C.A. § 330.

16 11 U.S.C.A. § 330(a)(3).

17 See 11 U.S.C.A. § 330(a)(3), (4), (5).

18 11 U.S.C.A. § 330(a)(4)(A). The statute technically bars compensation in those circumstances; however, the result—a fee reduction—is the same. Notably, the reasonableness/necessity inquiry is assessed as of the time the professional performed the service, not after. See In re Woerner, 783 F.3d 266, 273, 60 Bankr. Ct. Dec. (CRR) 240, Bankr. L. Rep. (CCH) P 82808 (5th Cir. 2015). This prospective outlook eliminates reductions of fee awards based on a post-hoc benefit analysis. In other words, the inquiry is not (or should not be) whether the professional's actions ultimately resulted in a material benefit to the estate; the inquiry is whether, at the time, the services were reasonably likely to produce a benefit. See 783 F.3d at 276 ("Under this framework, if a fee applicant establishes that its services were 'necessary to the administration' of a bankruptcy case or 'reasonably likely to benefit' the bankruptcy estate 'at the time at which [they were] rendered … then the services are compensable.").

19 11 U.S.C.A. § 330(a)(5). Curiously, the bankruptcy court has the discretion—but is not required—to "order the return of the excess" to the extent the total interim awards exceed the amount of the final award. See 11 U.S.C.A. § 330(a)(5). ("[I]f the amount of such interim compensation exceeds the amount of compensation awarded under this section [330], [the bankruptcy court] ***may*** order the return of the excess to the estate.") (emphasis added).

20 See 11 U.S.C.A. § 503(b)(2) ("After notice and a hearing, there shall be allowed, administrative expenses … including … compensation and reimbursement awarded under section 330(a) of this title."). See also 11 U.S.C.A. § 507(a)(2) ("The following expenses and claims have priority in the following order … administrative expenses allowed under section 503(b) of this title.").

21 As set forth above, bankruptcy courts often enter orders permitting monthly compensation awards with a 20% holdback. See supra notes 8, 9.

22 A final fee application under this scenario would not request payment of the entire award requested because the debtor already would have paid the majority pursuant to the interim orders. Instead, the application would seek final approval of the interim awards, along with an award (and payment) of those fees and expenses not yet approved.

23 See 11 U.S.C.A. § 1129(a)(9)(A).

24 See, e.g., In re Hers Cosmetics Corp., 114 B.R. 240, 245, 23 Collier Bankr. Cas. 2d (MB) 305 (Bankr. C.D. Cal. 1990) ("The super-priority status for the so-called 'burial expenses' after conversion …") (quoting In re Codesco, Inc., 18 B.R. 225, 227, 8 Bankr. Ct. Dec. (CRR) 1089, 6 Collier Bankr. Cas. 2d (MB) 395 (Bankr. S.D. N.Y. 1982)) (internal quotations omitted).

25 11 U.S.C.A. § 726(b).

26 11 U.S.C.A. § 726(b).

27 11 U.S.C.A. § 726(b).

28 Hers Cosmetics, 114 B.R. at 246 (internal citations and quotations omitted).

29 See 114 B.R. at 246. See also H.R. Rep. No. 95-595, at 186–87 (1977) ("Those who must wind up the affairs of a debtor's estate must be assured of payment, or else they will not participate in the liquidation or distribution of the estate.").

30 See 11 U.S.C.A. § 726(b) ("[I]n a case that has been converted to this chapter under section 1112 … a claim allowed under section 503(b) of this title incurred under this chapter after such conversion

has priority over a claim allowed under section 503(b) of this title incurred under any other chapter of this title …").

31 See 11 U.S.C.A. § 726(b). ("Payment on claims … shall be made pro rata …").

32 See, e.g., In re ACI Concrete Placement of Kansas, LLC, 604 B.R. 400, 404 n.29 (Bankr. D. Kan. 2019) (noting *Specker* and its adherents and stating that "several courts have been critical of *Specker*").

33 In re Specker Motor Sales Co., 289 B.R. 870, 871, 40 Bankr. Ct. Dec. (CRR) 283, 49 Collier Bankr. Cas. 2d (MB) 1128 (Bankr. W.D. Mich. 2003).

34 289 B.R. at 871.

35 289 B.R. at 871.

36 Specker III, 93 F.3d at 661. The reason for the delay is not specified. 93 F.3d at 661.

37 93 F.3d at 661.

38 Specker Motor, 289 B.R. at 871. Although Mr. Bays's fee application is described as "final," it appears that the Specker bankruptcy court granted the award on an interim — not final — basis. See Specker III, 393 F.3d at 662 ("[T]here are no disputed facts. […] We conclude that the $10,000 of ***interim compensation*** that Bays was authorized to keep on February 4, 2002 …") (emphasis added).

39 289 B.R. at 871.

40 Specker Motor Sales Co. v. Eisen, 300 B.R. 687, 688, 50 Collier Bankr. Cas. 2d (MB) 1402 (W.D. Mich. 2003) (hereinafter, "***Specker II***").

41 300 B.R. at 688.

42 300 B.R. at 688.

43 Specker Motor, 289 B.R. at 873.

44 289 B.R. at 872.

45 Mr. Bays appealed first to the Western District of Michigan (resulting in *Specker II*) but lost.

46 Specker III, 393 F.3d at 664–65.

47 See generally Specker III, 393 F.3d 659.

48 393 F.3d at 662.

49 393 F.3d at 662.

50 393 F.3d at 662.

51 393 F.3d at 662.

52 393 F.3d at 662.

53 393 F.3d at 662–63.

54 393 F.3d at 663.

55 393 F.3d at 664–65.

56 Headlee, 519 B.R. at 454.

57 519 B.R. at 454.

58 519 B.R. at 454.

59 519 B.R. at 454.

60 519 B.R. at 454.

61 Id519 B.R. at 454

62 519 B.R. at 454.

63 See 519 B.R. at 453.

64 See 519 B.R. at 460 ("§ 330(a)(5)[] only allows for the recovery of interim fees to the extent the exceed the final fee award.").

65 519 B.R. at 458.

66 519 B.R. at 460.

67 Law v. Siegel, 571 U.S. 415, 134 S. Ct. 1188, 188 L. Ed. 2d 146, 59 Bankr. Ct. Dec. (CRR) 43, Bankr. L. Rep. (CCH) P 82592 (2014).

68 Headlee, 519 B.R. at 549.

69 519 B.R. at 548.

70 519 B.R. at 461.

71 519 B.R. at 461. See also 519 B.R. at 459–60.

72 519 B.R. at 461.

73 U.S. v. Ron Pair Enterprises, Inc., 489 U.S. 235, 241, 109 S. Ct. 1026, 103 L. Ed. 2d 290, 18 Bankr. Ct. Dec. (CRR) 1150, Bankr. L. Rep. (CCH) P 72575, 89-1 U.S. Tax Cas. (CCH) P 9179, 63 A.F.T.R.2d 89-652 (1989) (quoting Caminetti v. U.S., 242 U.S. 470, 485, 37 S. Ct. 192, 61 L. Ed. 442 (1917)).

74 11 U.S.C.A. § 726(b).

75 See 11 U.S.C.A. § 726(b). See also In re Next Generation Media, Inc., 524 B.R. 824, 830, 60 Bankr. Ct. Dec. (CRR) 153 (Bankr. D. Minn. 2015) ("Section 726 does not provide for collection of property of the estate, as it lacks the words 'avoid,' 'disgorge' and 'turnover.'").

76 See In re Hyman Freightways, Inc., 342 B.R. 575, 578, 46 Bankr. Ct. Dec. (CRR) 164, 56 Collier Bankr. Cas. 2d (MB) 364 (Bankr. D. Minn. 2006), order aff'd, 57 Collier Bankr. Cas. 2d (MB) 393, 2006 WL 3757972 (D. Minn. 2006) ("Primarily, the trustee relies on 11 U.S.C.A. § 726 for his motions. While that is a good place to start, he reaches a very wrong conclusion. That section is all about how a trustee is to *distribute* property of the estate, it says nothing about *collecting* property.") (emphasis in original).

77 See, e.g., Headlee, 519 B.R. at 456 ("The problem, as illustrated by this case, is that some professionals may receive interim fees that prove to be more than the professional would be entitled to receive under § 726(b).").

78 Bilski v. Kappos, 561 U.S. 593, 608, 130 S. Ct. 3218, 177 L. Ed. 2d 792, 95 U.S.P.Q.2d 1001, 2010-1 U.S. Tax Cas. (CCH) P 50481 (2010).

79 Marx v. General Revenue Corp., 568 U.S. 371, 386, 133 S. Ct. 1166, 185 L. Ed. 2d 242, 84 Fed. R. Serv. 3d 1486 (2013).

80 Headlee, 519 B.R. at 460.

81 See Specker III, 393 F.3d at 664–65 ("[W]e find that interim compensation must be disgorged when necessary to achieve pro rata distribution of a Chapter 7 bankruptcy estate.").

82 See 393 F.3d at 664–65.

83 Those holding Section 503(b)(9) administrative claims, for example, can be paid during the Chapter 11 case immediately upon allowance of the claim. Cf. In re Bookbinders' Restaurant, Inc., 47 Bankr. Ct. Dec. (CRR) 187, Bankr. L. Rep. (CCH) P 97757, 2006 WL 3858020at *6–7 (Bankr. E.D. Pa. 2006) (noting that it is within the bankruptcy court's discretion to order immediate payment but declining to do so).

84 See Specker III, 393 F.3d at 663 ("Bays's claim, like other approved administrative claims on the estate, at all times remained subject to the statutory pro rata distribution scheme in § 726(b).").

85 Cf. In re St. Joseph Cleaners, Inc., 346 B.R. 430, 444, 46 Bankr. Ct. Dec. (CRR) 241 (Bankr. W.D. Mich. 2006) ("[T]he Bankruptcy Code guarantees through Section 363(c) and the limitations of Section 549 that absolute equality of distribution will not be realized as soon as the Chapter 11 debtor uses the first dollar of estate property to pay for a post-petition good or service.").

86 See, e.g., In re Dick Cepek, Inc., 339 B.R. 730, 737–38, 46 Bankr. Ct. Dec. (CRR) 82, 56 Collier Bankr. Cas. 2d (MB) 24 (B.A.P. 9th Cir. 2006) (collecting cases). Of course, to the extent it is estate property, the prepetition retainer may be vulnerable to turnover. See Next Generation Media, 524 B.R. at 829.

87 See Dick Cepek, 339 at 737–38.

88 But cf. Specker Motor, 289 B.R. at 871 ("Counsel for the Debtor … was paid a retainer of $10,000."). As the Bankruptcy Appellate Panel for the Ninth Circuit noted in *Dick Cepek*, however, the pre- or

postpetition status of Mr. Bays's retainer is unclear. See Dick Cepek, 339 B.R. at 739 n.9 ("In other words, the Sixth Circuit indicates that the retainer was postpetition, not prepetition (although, as the US Flow court notes, the record shows that the retainer was paid prepetition)."). In any event, "[n]either the Sixth Circuit (nor the district court nor the bankruptcy court) [in Specker] considered the issue of whether the professional held a security interest in the retainer funds thereby protecting from section 726(b) disgorgement." 339 B.R. at 739. Therefore, *Specker III* should not be used as a basis to challenge a prepetition security retainer.

89 ACI Concrete, 604 B.R. at 405 (internal citations and quotations mitted).

90 See generally In re Chieftain Steel, LLC, 2019 WL 1225716 (Bankr. W.D. Ky. 2019). In *Chieftain Steel*, the bankruptcy court denied a motion by the professionals seeking to force the secured lender to pay unpaid professional fees under a carveout. 2019 WL 1225716 at *2. In doing so, the bankruptcy court distinguished several of the cases on which the professionals relied, noting that the language in the carveout at issue was too dissimilar. See 2019 WL 1225716 at *11 ("This case lacks the precise terms used … in the *Licking River* case."). The bankruptcy court emphasized that the carveout lacked language providing for the payment of professional fees "at any time" and the continuance "in any superseding chapter 7 cases under the Bankruptcy Code." 2019 WL 1225716 at *10–11 (internal citations and quotations omitted). The Bankruptcy Appellate Panel for the Sixth Circuit docketed an appeal of the *Chieftain Steel* decision on March 27, 2019. See BAP No. 19-8005. As of February 11, 2020, briefing and oral arguments had been completed, but no decision has yet been issued.

91 ACI Concrete, 604 B.R. at 407.

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