

**FILED**

Samuel L. Kay, Clerk  
United States Bankruptcy Court  
Augusta, Georgia  
By jpayton at 2:56 pm, Jun 28, 2011

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE

SOUTHERN DISTRICT OF GEORGIA  
Dublin Division

IN RE:	)	Chapter 7 Case
	)	Number <u>10-30055</u>
HLJ ENTERPRISES, INC.	)	
	)	
Debtor	)	
_____	)	
	)	
DONALD F. WALTON,	)	
UNITED STATES TRUSTEE, REGION 21	)	
	)	
Movant	)	
	)	
v.	)	
	)	
HLJ ENTERPRISES, INC.	)	
	)	
Debtor	)	
_____	)	
	)	
CORDELL LUMBER COMPANY, INC.	)	
	)	
Movant	)	
	)	
v.	)	
	)	
HLJ ENTERPRISES, INC.	)	
	)	
Debtor	)	
_____	)	

ORDER

Before the Court is Freeman Daniel & Co., LLC's ("Accounting Firm") Second Application for Compensation for Accounting Services of Marion R. Freeman, Jr., CPA ("Freeman"), and

objections thereto filed by Donald F. Walton, United States Trustee, Region 21 ("Trustee") and Cordell Lumber Co., Inc. ("Cordell"). The Trustee and Cordell argue two facts make Freeman not disinterested as required by 11 U.S.C. §327(a) and therefore they argue Freeman is ineligible to serve as the accountant for the debtor-in-possession. First, they contend Freeman is an insider and therefore is not disinterested. Second, they contend the Accounting Firm is a creditor of the bankruptcy estate and therefore not disinterested. The objectors further argue fees paid to date to the Accounting Firm should be disgorged. For the reasons discussed below, I agree.

This is a core proceeding under 28 U.S.C. §157(b)(2)(A) and the Court has jurisdiction pursuant to 28 U.S.C. §1334.

**FINDINGS OF FACT**

Pursuant to 11 U.S.C. §327(a), HLJ Enterprises, Inc. ("Debtor") submitted an application to employ Freeman as the accountant for the debtor-in-possession. As part of the application, and in accordance with Bankruptcy Rule 2014, Freeman submitted an affidavit attesting "[t]hat to the best of his knowledge [he] has had no relation to, nor had any connection with the Chapter 11 proceeding filed by the Debtor" other than "prior services performed" in the capacity of an accountant. (Aff., Dckt. No. 26, p. 1.) Initially, no objection was made to Freeman's appointment, and an order appointing him was entered. (Order, Dckt.

No. 46.)

Thereafter, Freeman's firm was awarded \$5,370.60 for his accounting services in response to his first application for fees. (Order Allowing Interim Comp., Dckt. No. 127.) A Second Application for Compensation in the amount of \$13,395.65 was submitted on December 8, 2010. On the following day, Trustee filed an objection to this application based "[u]pon information and belief" that "Freeman may have business . . . relationships with Debtor's principal." (Obj. to Second App. for Comp., Dckt. No. 164.) Later, Cordell also filed an objection to this application based on the same information. (Obj. to Second App. for Comp., Dckt. No. 183.)

At the hearing on the objections, it was established that Freeman owns 25 percent, and is the managing member, of FJ Holdings, LLC ("FJ Holdings"), and that 50 percent of FJ Holdings is owned by Hilton Joiner ("Joiner"). Joiner is the sole owner of Debtor, HLJ Enterprises, Inc.

Debtor's bankruptcy schedules identify both FJ Holdings and the Accounting Firm as pre-petition creditors. (Hr'g Tr., Dckt. No. 217, pp. 9-10.) At the hearing, Freeman agreed to waive Debtor's pre-petition debt owed to the Accounting Firm, which would result in the Accounting Firm no longer being a creditor of the bankruptcy estate. (Hr'g Tr., Dckt. No. 217, p. 48.) He also agreed to "recommend" that FJ Holdings waive its pre-petition debt.

(Hr'g Tr., Dckt. No. 217, p. 57.)

At the hearing, it also was established that Debtor's schedules identify FJ Holdings as "creditor who [was] or [is an] insider," and identified at least four different monetary transactions between Debtor and FJ Holdings made within a year of the petition date. (Trustee Ex. 2A, Statement of Fin. Affairs, Item No. 3(c) and attachment, pp. 4, 6, 8 and 9.) One of those transactions reflects money due Debtor from FJ Holdings.

According to the testimony, Freeman and Joiner are guarantors on conventional debt owed by FJ Holdings to third parties. (Hr'g Tr., Dckt. No. 217, p. 35.) Debtor is not obligated on any of FJ Holdings' debt. However, the four transactions show that Debtor was making Joiner's payments on FJ Holdings' debt. (Hr'g Tr., Dckt. No. 217, p. 17-18.) In addition, to this conventional debt, Joiner's mother also loaned money to FJ Holdings, and money was paid to her each month.<sup>1</sup> (Hr'g Tr., Dckt. No. 217, p. 78.)

With this background, the Trustee and Cordell aver Freeman is not "disinterested" and therefore he is not qualified under §327(a) to serve as the accountant for the debtor-in-possession. In addition, they contend the conduct merits denial of the current fee

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<sup>1</sup> It is unclear whether the payments reflected in Debtor's Statement of Financial Affairs include payments to Joiner's mother.

application and disgorgement of fees paid to date. In the post-hearing brief, Freeman acknowledges that he is the insider of an affiliate, but argues an interested professional may still be appointed in the discretion of the court based upon the specific facts and circumstances of each case.

Subsequent to the hearing, it has come to the Court's attention that Freeman, the Accounting Firm, Marilyn Freeman Daley, Debtor and Joiner have been sued in the Superior Court of Treutlen County, Georgia. ("Lawsuit"). See Dckt. No. 279. Ms. Daley is Freeman's sister. At Joiner's direction, she performs clerical work for Debtor, including preparing checks for Debtor's accounts payable. At one point she worked in Debtor's office. When Debtor began having financial difficulties, she began to work out of the Accounting Firm's office. She still provides the clerical services to Debtor, and she also prepared Debtor's necessary financial reports required of chapter 11 debtors. She testified that she keeps time records so Debtor can be billed appropriately.

#### CONCLUSIONS OF LAW

Pursuant to 11 U.S.C. §327:

(a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that

are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

11 U.S.C. §327(a) (emphasis added). According to §101(14)(A) a "disinterested person" cannot be "a creditor, an equity security holder, or an insider." An "insider" under §101(31)(E) is an "affiliate, or insider of an affiliate as if such affiliate were the debtor." An "affiliate" under §101(2) is, among other things, a

(B) corporation 20 percent or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote by the debtor, or by an entity that directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor. . . .

11 U.S.C. §101(2)(B). "Entity" includes individuals, such as Joiner. See 11 U.S.C. §101(15).

"Rule 2014<sup>2</sup> plainly states that, where a debtor submits an

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<sup>2</sup> Bankruptcy Rule 2014 provides:

An order approving the employment of attorneys, accountants, appraisers, auctioneers, agents, or other professionals pursuant to §327, §1103, or §1114 of the Code shall be made only on application of the trustee or committee. The application shall be filed and . . . a copy of the application shall be transmitted by the applicant to the United States trustee. The application shall state the specific facts showing the necessity for the employment, the name of the person to be employed, the reasons for the selection, the professional services to be rendered, any proposed arrangement for compensation, and, to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and

application for employment of a [professional], the burden of disclosing all connections between the [professional] seeking employment and [debtor] lies squarely with the client and the professional in its verified statement." Jennings v. Maxfield, 199 Fed. Appx. 845, 847 (11th Cir. 2006) (emphasis in the original). This duty of full disclosure is a continuing responsibility. Id. at 848.

In the post-hearing brief, Debtor's counsel acknowledges that Freeman is an affiliate of an insider, but argues the existence of a potential conflict merely renders the appointment voidable in the court's discretion based upon the specific facts of the case. The Trustee disagrees and argues because Freeman is an insider he was never qualified to serve as the debtor-in-possession's accountant and cannot serve.

The majority of courts interpret the provisions of 11 U.S.C. §327(c) strictly and hold that non-disinterested professionals cannot serve. See In re First Am. Health Care of

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accountants, the United States trustee, or any person employed in the office of the United States trustee. The application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee.

Georgia, Inc., 1996 WL 33404562 (Bankr. S.D. Ga., April 18, 1996) ("Section 327(a) sets a stringent no-creditor status requirement for professionals hired by trustees" and by drafting that rule "Congress clearly intended to eliminate from the bankruptcy process the reality, or the appearance, of a conflict."); See also In re Motel Properties, Inc., 2004 WL 3670589 (Bankr. S.D. Ga. March 19, 2004). While the Accounting Firm and Freeman may waive their pre-petition fees to eliminate their creditor status, they cannot eliminate the insider status. See In re Middleton Arms, Ltd. P'ship, 934 F.2d 723, 725 (6th Cir. 1991) ("By forbidding employment of all interested persons, section 327 prevents individual bankruptcy courts from having to make determinations as to the best interest of the debtors in these situations. Section 105(a) cannot be used to circumvent the clear directive of section 327(a).").

Furthermore, even if the more lenient approach is adopted, Freeman cannot qualify because an actual conflict exists. Debtor's payment of Joiner's portion of FJ Holding's debt most likely is a voidable transfer, and the Lawsuit requests a judgment against the named defendants of not less than \$1,000,000.00. See 11 U.S.C. §546 and Dckt. No. 279, respectively. Without addressing the merits of the allegations in the Lawsuit, such claims raise concerns of possible contribution claims among the defendants. This relationship is an actual conflict. Debtor's assets have been

depleted to pay the debts of an insider and an insider of an affiliate. Freeman, as a guarantor of FJ Holdings' debts, benefitted from these insider payments. Freeman and Joiner testified that Joiner lacks the skills to maintain proper books and records without outside assistance. (Hr'g Tr., Dckt. No. 217, p. 27, 52.) For these reasons, I find actual conflicts exists and Freeman is ineligible to serve as the debtor-in-possession's accountant.

Turning to the issue of fees and disgorgement, given the particular facts and circumstances of this case, I find disgorgement is appropriate. Electro-Wire Products, Inc. v. Sirote & Permutt, P.C. (In re Prince), 40 F.3d 356 (11th Cir. 1994); Jennings v. Maxfield, 199 Fed. Appx. 845, 847 (11th Cir. 2006). Under §328(c), a Court "may deny allowance of compensation for services and reimbursement of expenses of a professional person employed under section 327 . . . if, at any time during such professional persons employment" the Court finds that "person is not a disinterested person." 11 U.S.C. §328(c). As previously discussed, I find Freeman is not a disinterested person as required by 11 U.S.C. §327(a).

Furthermore, Freeman's affidavit fails to disclose the relationships. He contends he fully informed Debtor's counsel of his relationship with Joiner and FJ Holdings. He argues he relied on counsel to determine what was statutorily required to be

disclosed. He further contends he has never hidden the relationship. At the hearing, Debtor's counsel acknowledges this relationship should have been disclosed but argues the error was unintentional and not designed to mislead parties in interest. (Hr'g Tr., Dckt. No. 217, p. 91.) This explanation does not excuse the failure to disclose this relationship, or the failure to update the application to disclose the Lawsuit, nor does it alleviate the conflict. Freeman acknowledges he has been appointed to provide accounting services for other debtors-in-possession, so he is, or should be, familiar with the disclosure requirements. (Hr'g Tr., Dckt. No. 217, p. 63.) In addition, the Lawsuit was filed after the hearing on Freeman's qualifications, and yet, Freeman never updated his affidavit to disclose the Lawsuit. "Bankruptcy courts are not obligated to hunt around and ferret through thousands of pages in search of the basic disclosures required by Rule 2014." Jennings, 199 Fed. Appx. at 848.

For these reasons, it is therefore ORDERED that: the Accounting Firm's Second Application for Compensation for Accounting Services is DENIED; the Trustee's Motion to Reconsider Order Approving Employment of Freeman and Request of Disgorgement of Fees is GRANTED; the Order Appointing Freeman as the Accountant is VACATED (Dckt. No. 46); and the Order Allowing Interim Compensation

of \$5,370.60 is VACATED (Dckt. No. 127). It is furthermore ORDERED that the Accounting Firm shall instanter disgorge to Todd Boudreaux, (as chapter 7 Trustee for Debtor) the \$5,370.60 previously awarded in the Interim Compensation Order. The remittance to Mr. Boudreaux shall be by check with reference to "HLJ Interprises, Inc., case No. 10-30055 - Refund of Acct. Fees" mailed by first class mail to: 7013 Evans Town Center Blvd., Suite 303, Evans, Georgia 30809.



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SUSAN D. BARRETT  
CHIEF UNITED STATES BANKRUPTCY JUDGE

Dated at Augusta, Georgia

this 28<sup>th</sup> Day of June 2011.