

**UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
WINSTON-SALEM DIVISION**

In re:)	
)	
ACTION VIDEO, INC.,)	Case No. 02-52402
)	
)	
Debtor.)	
_____)	

ORDER

This matter came on before this Court on April 30, 2003 for a status hearing regarding payments made to Breslow, Starling, Frost, Warner & Boger, CPA ("Breslow Starling").

Appearing before the court was James Talcott, attorney for the Action Video, Inc. (the "Debtor"), Michael Boger, for Breslow Starling, and Michael D. West, Bankruptcy Administrator. After considering the record in the case and the arguments of counsel, the Court makes the following findings of fact and conclusions of law pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure:

FINDINGS OF FACT

On September 10, 2002, the Debtor filed a voluntary petition under Chapter 11 of the Bankruptcy Code. Pursuant to 11 U.S.C. §§ 1107 and 1008, the Debtor has retained possession of its assets and continues to operate its business as a debtor-in-possession. The Debtor is engaged in the sale and lease of movies at fourteen various locations in and around Winston-Salem, North Carolina.

Breslow Starling was a creditor of the Debtor on the date of the petition. The Debtor's Schedule F reflects an indebtedness in the amount of \$22,658.05 owed to Breslow Starling for

accounting services. Prior to the petition date, Breslow Starling had provided accounting services to the Debtor consisting solely of the preparation of required federal and state income tax returns for the fiscal years ending November 30 of 2000 and 2001.

On or about December 20, 2002, counsel for the Debtor contacted Breslow Starling for the preparation of tax returns for the 2002 fiscal year. Counsel for the Debtor requested services limited to the preparation of federal and state tax returns. Breslow Starling issued a retainer letter dated January 10, 2003 and, shortly thereafter, the Debtor paid approximately \$3,000 of the anticipated charge for preparing the returns. Michael B. Boger ("Mr. Boger") was the accountant responsible for the engagement. Mr. Boger prepared the tax returns, and the Debtor paid the remaining balance of the full amount owed in the amount of \$3,145, for a total post-petition payment of \$6,145. Breslow Starling provided no other services to the Debtor.

The Debtor did not seek authorization from the court to employ Breslow Starling for professional services prior to the engagement, nor has the Debtor requested such authorization *nunc pro tunc*. The Debtor listed the payment in the amount of \$3,000 to Breslow Starling in its monthly report filed on February 25, 2003. The Debtor listed the payment in the amount of \$3,145 to Breslow Starling in its monthly report filed on March 28, 2003. The court requested a status hearing in response to the Debtor's disclosure of fees paid to Breslow Starling for accounting services in the absence of an order authorizing employment. Finally, on May 5, 2003, the Debtor filed a Supplemental Report with the attached Affidavit of Mr. Boger, which factually sets forth Breslow Starling's involvement with the Debtor.

CONCLUSIONS OF LAW

11 U.S.C. §1107 provides that a debtor-in-possession shall perform all the functions and duties of a trustee serving in a case under Chapter 11 of the Bankruptcy Code. Section 1106 sets forth the duties of the trustee, including the duty to file income tax returns and pay taxes on the income attributable to the debtor. 11 U.S.C. § 1106(a)(6); see also Holywell Corp. v. Smith, 503 U.S. 47, 112 S.Ct. 1021 (1992).

Recognizing that a trustee, or a debtor-in-possession, might require the services of professionals in order to carry out the required duties, Section 327 provides:

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). Section 328 allows for the compensation of professionals employed pursuant to § 327 and provides a penalty for professionals who fail to satisfy the requirements of § 327 by authorizing the bankruptcy court to deny compensation for services and reimbursement of expenses. 11 U.S.C. § 328. Specifically, § 328 provides that a court "may deny allowance of compensation" rendered by a professional person employed under § 327 "if, at any time during such professional person's employment ... such professional person is not a disinterested person, or represents or holds an interest adverse to the interest of the estate with respect to the matter on which such professional person is employed." 11 U.S.C. § 328(c). In addition, under sections 330 and 331, a professional person may be paid only after making an application for allowance of compensation and having that compensation approved by the court.

Professionals assisting a debtor-in-possession in carrying out the duties required under Chapter 11 may not be compensated for services performed without court approval of the section 327 application. See, e.g., In re Harold & Williams Development Co., 977 F.2d 906 (4th Cir.1992); In re Computer Learning Centers, Inc., 285 B.R. 191, 206 (Bankr. E.D.V.A. 2002); Binswanger Companies v. Merry-Go-Round Enterprises, Inc., 258 B.R. 608 (D. Md. 2001); In re Tidewater Memorial Hosp., Inc., 110 B.R. 221 (Bankr.E.D.Va.1989).¹

A person is disinterested if he or she "is not a creditor" or "does not have an interest materially adverse to the interest of the estate or of any class of creditors ... by reason of any direct or indirect relationship to, connection with, or interest in, the debtor ... or for any other reason." 11 U.S.C. § 101(14)(A), (E). The purpose of the "disinterestedness requirement in 11 U.S.C. § 327 was to prevent even the appearance of a conflict irrespective of the integrity of the person or firm under consideration. In re Rabex Amuru of North Carolina, 198 B.R. 892, 895 (Bankr. M.D.N.C. 1996) (quoting In re Codesco, Inc., 18 B.R. 997, 999 (Bankr.S.D.N.Y. 1982)). In this case, as a prepetition creditor, Breslow Starling is not a "disinterested person." Therefore, as a prepetition creditor, Breslow Starling could not have been appointed as a professional pursuant to section 327.

Counsel for the Debtor contends that the Debtor was not required to seek authorization prior to the employment of Breslow Starling because Mr. Boger did not act as a professional as

¹ There is some disagreement between courts as to whether § 328(c) is only applicable to professional persons who are *validly* employed under § 327(a); however, there is no dispute that, at minimum, § 328 requires a professional to apply for employment under § 327 before he or she may receive compensation. Compare In re Crivello, 134 F.3d 831, *838 (7th Cir. 1998) with In re Federated Department Stores, Inc., 44 F.3d 1310, 1319-20 (6th Cir.1995).

contemplated by section 327(a) of the Bankruptcy Code. If Mr. Boger is not a professional, court approval pursuant to section 327(a) is not required and the issue of disinterestedness never arises. The Debtor relies primarily on In re Seatrain Lines, Inc., 13 B.R. 980 (Bankr. S.D.N.Y. 1981), in which the court held that maritime engineers were not “professional persons” for the purposes of section 327(a). The court held:

In the context of a debtor proceeding, persons in occupations ordinarily considered professions are not necessarily professionals whose retention by the estate requires court approval. For the purposes of section 327(a), "professional person" is limited to persons in those occupations which play a central role in the administration of the debtor proceeding. Court approval is required for the retention of attorneys, accountants, appraisers, auctioneers and persons in other professions intimately involved in the administration of the debtor's estate.

In re Seatrain Lines, Inc., 13 B.R. at 981. The Debtor contends that Breslow Starling did not play a central role or otherwise affect the reorganization or administration of the case and, therefore, is not a “professional” within the meaning of section 327, or as defined by Seatrain.

In further support of its position that court approval was not required, the Debtor argues that Breslow Starling was retained in the ordinary course of business. The Debtor relies upon In re Johns-Manville Corp., 60 B.R. 612 (Bankr. S.D.N.Y. 1986), in which a debtor-in-possession employed nonattorney lobbyists in the ordinary course of business. Using the Seatrain definition of “professional person,” the Johns-Manville court held that section 327 was not applicable because the lobbyists were not involved in the case administration and were retained to perform the same activities that had been performed in the ordinary course for many years prepetition.²

² Because the Debtor does not believe that Mr. Boger acted as a professional, the Debtor does not contend that Breslow Starling falls under the purview of 327(b), which provides that if a debtor has regularly employed attorneys, accountants, or other professional persons on salary, the

The cases upon which counsel for the Debtor relies are factually distinct from the present matter, and do not support the Debtor's position. The scope of § 327 specifically encompasses those professionals necessary to assist the debtor-in-possession in carrying out its duties under the Bankruptcy Code. One of those duties, as set forth in 11 U.S.C. § 1106, includes the filing of tax returns. Therefore, § 327 is applicable to those professionals that assist the debtor-in-possession in that endeavor. Even under the reasoning presented in Seatrain, the accountant in this case enabled the debtor-in-possession to fulfill one of its statutory duties, and, as such, was a "professional" involved with the reorganization and administration of the case.

In fact, an accountant is generally considered a professional under § 327, though it is an accountant's role in the bankruptcy, rather than his or her status as an accountant which controls. See In re Wake, 222 B.R. 35 (Bankr. W.D.N.Y. 1998) (accountant that prepared personal and partnership tax returns was not entitled to be compensated for his services in absence of prior approval pursuant to § 327); In re Biocoastal Corp., 149 B.R. 216 (Bankr. M.D. Fl. 1993) (holding that an accountant hired to manage pension plan assets was a "professional person" within the meaning of § 327). In contrast, an accounting firm retained solely as an expert witness in collateral litigation is not a professional under § 327. In re That's Entertainment Marketing Group, Inc., 168 B.R. 226, 230 (N.D.Cal., 1994).

In this case, Mr. Boger performed services that directly related to the administration and

trustee (or debtor-in-possession) may retain or replace such professional persons if necessary in the operation of such business. This section allows the debtor-in-possession to forgo court approval for the retention of persons that are necessary in the daily operation of the debtor's business and is generally limited to minor transactions in the ordinary course. In re Bartley Lindsay Co., 137 B.R. 305, 309 (D.Minn., 1991).

operation of the Debtor. His services required a great deal of skill, expertise, judgment and discretion. Mr. Boger was not a regular employee hired by the Debtor in the ordinary course of business. The court finds that Mr. Boger acted as a professional person within the meaning of §327(a) and that the Debtor was therefore required to seek court approval prior to his employment and compensation. Because Breslow Starling was not employed in accordance with § 327(a), it must disgorge the fees it received after the filing of the bankruptcy petition and remit those funds to the Debtor.

Based on the forgoing, it is ORDERED ADJUDGED AND DECREED that any fees and costs paid to Breslow Starling after September 10, 2002, the date of the petition, shall be disgorged and repaid to the Debtor within 10 days of the entry of this Order.

This the 9th day of June 2003.

CATHARINE R. CARRUTHERS

Catharine R. Carruthers
United States Bankruptcy Judge