UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW HAMPSHIRE

In re:

R & R Associates of Hampton, Bk. No. 91-10983-MWV
Debtor Chapter 7

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*
Dennis Bezanson, Trustee *
Plaintiff *
v. * Adv. No. 98-1090-MWV
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Thomas J. Thomas, Jr.; Mitchell P. Utell; *
Marc Van De Water; Glenn C. Raiche; *
Thomas & Utell; Thomas, Utell, Van De Water & Raiche; *
Thomas, Utell, Van De Water & Raiche, P.A. *
Defendants *
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Dennis Bezanson, Trustee *
Plaintiff *
v. * Adv. No. 98-1136-MWV
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Thomas J. Thomas, Jr.; Mitchell P. Utell; *
Marc Van De Water; Glenn C. Raiche; *
Thomas & Utell; Thomas, Utell, Van De Water & Raiche; *
Thomas, Utell, Van De Water & Raiche, P.A. *
Defendants *
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Dennis Bezanson, Trustee, *
Plaintiff *
v. * Adv. No. 98-1174-MWV
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Reginald L. Gaudette; *
Thomas J. Thomas, Jr.; Mitchell P. Utell; *
Marc L. Van De Water; Glenn C. Raiche; *
Thomas & Utell; Thomas, Utell, Van De Water & Raiche; *
Thomas, Utell, Van De Water & Raiche, P.A. *
Defendants *
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Thomas, Utell, Van De Water & Raiche, P.A.

MEMORANDUM OPINION

The Court has before it three adversary proceedings brought by the Chapter 7 Trustee in the case of R & R Associates of Hampton, Bk. No. 91-10983-MWV. Adversary 98-1090 was brought against Richard Choate, Choate-related entities and Thomas P. Thomas Jr., Mitchell P. Utell, Marc Van De Water, Glenn C. Raiche, Thomas & Utell, Thomas, Utell, Van De Water & Raiche and Thomas, Utell, Van De Water & Raiche, P.A. (hereinafter referred to, collectively, as the "Law Firm Defendants"). Adversary 98-1136 was brought against the Law Firm Defendants. Adversary 98-1174 was brought against various Gaudette-related entities and the Law Firm Defendants. By previous order of the Court, the complaints against Choate, his related entities and the related Gaudette entities have been dismissed, leaving only the Law Firm Defendants. Gaudette filed an individual Chapter 7 proceeding resulting in the stay of any action against him, individually. Adversary 98-1136 seeks damages for negligent misrepresentation and breach of fiduciary duties, and adversaries 98-1174 and 98-1090 each contain a count based on fraud on the Court. All counts seek damages arising out of the same factual pattern and, thus, were consolidated for trial. In adversary 98-1136, the Law Firm Defendants counterclaimed for indemnity and contribution to which the Trustee counterclaimed for malicious defense. The trial of these adversaries commenced on September 10, 2001 and continued on September 11, 12, 13, 14, 20 and 21,

2001. In preparing this opinion, the Court has thoroughly reviewed the transcripts of these trial days and the exhibits placed into evidence during the course of trial.[1]

JURISDICTION

This Court has jurisdiction of the subject matter and the parties pursuant to 28 U.S.C. §§ 1334 and 157(a) and the "Standing Order of Referral of Title 11 Proceedings to the United States Bankruptcy Court for the District of New Hampshire," dated January 18, 1994 (DiClerico, C.J.). This is a core proceeding in accordance with 28 U.S.C. § 157(b).

FACTS

R & R Associates of Hampton ("R & R Associates"), a partnership, filed an original petition under Chapter 11 of the Bankruptcy Code on April 5, 1991. The partnership consisted of two partners, Reginald L. Gaudette and Richard V. Choate. The 2016(b) statement attached to the schedules indicated that the attorney for the Debtor was Thomas J. Thomas Jr. of Thomas & Utell. Trustee's Ex. 1A. Also accompanying the schedules was an application to hire Thomas & Utell as counsel to the Chapter 11 Debtor signed by Choate, which included as an attachment an affidavit signed by Thomas J. Thomas, Esquire. Paragraphs 4, 5 and 6 of the application read as follows:

> (4) Said attorney is familiar with the Bankruptcy Code and Rules and the Local Rules of the United States Bankruptcy Court for the District of New Hampshire.
>
> (5) Applicant has selected this attorney because he has had considerable experience in matters of this character and Applicant believes it is will qualified to represent it as Debtor-in-Possession in this case.
>
> (6) To the best of Applicant's knowledge, this Law firm [sic] has no connection with the Debtor, the Creditors or any other party in interest, or their respective attorneys or accountants, nor does this attorney represent or hold any interest adverse to the Debtor-in-Possession or the estate herein in the matters upon which he is to be engaged, and his employment would be in the best interest of the estate and its creditors.

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[1] Unless otherwise noted, all statutory section references herein are to the Bankruptcy Reform Act of 1978, as amended, 11 U.S.C. § 101, *et seq.*

Trustee's Ex. 2B at 2. The Thomas affidavit reads as follows:

> Before me, the undersigned authority, on this day personally appeared Thomas J. Thomas, Jr., Esquire, who being by me duly sworn, on oath states he is a practicing attorney and a member of the law firm of Thomas & Utell with offices at 633 Second Street, Manchester, New Hampshire 03102, and he has read the application of R&R Associates of Hampton for authority to employ and retain counsel, Thomas J. Thomas, Jr., Esquire and the law firm of Thomas & Utell have no connection with the debtor in this matter, nor with the creditors or any party in interest, nor with their respective attorneys or accountants; that Thomas J. Thomas, Jr., Esquire and the firm are disinterested persons as defined in 11 USC 101(13) and represent no interest adverse to the Debtor-in-Possession or bankruptcy estate in matters upon which he is to be engaged, and believes he and the law firm can undertake representation of the Debtor-in-Possession in this case without any type of restriction.

Trustee's Ex. 2C.

Thomas & Utell continued to represent the Debtor in Possession through the course of its Chapter 11 proceedings. For a variety of reasons, the Debtor was unable to formulate a plan of reorganization, and the Chapter 11 case was converted to Chapter 7 on June 10, 1992. During the course of the Chapter 11, the R & R Associates case was consolidated with the case of 81 Ocean Boulevard Corporation, a related entity that filed for bankruptcy protection on the same day as R & R Associates. The cases continued under the R & R Associates case number.

The Plaintiff herein, Dennis Bezanson, was appointed Trustee on August 26, 1992.[2] Subsequent to his appointment, the Trustee testified that he requested from Thomas personal financial statements of the partners, Choate and Gaudette, and did receive them. The Gaudette financial statement was as of December 31, 1991 and showed a negative net worth of $4,013,000. Trustee's Ex. 1(i). In April 1997, the Court allowed the Thomas & Utell law firm fees in the amount of $18,887 and expenses in the amount of $221.30.

The testimony at trial showed that prior to and after the filing of the R & R Associates petition, Attorney Thomas, the Thomas & Utell law firm, its members and employees, performed legal services for Reginald and Louise Gaudette, individually, and for entities controlled by the Gaudettes, including the

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[2] A previously appointed trustee resigned on July 29, 1992 because of a conflict.

formation of family limited partnerships, the transfer of assets into these partnerships, and the participation in various state court litigation issues.

DISCUSSION

The gravamen of the Plaintiff's complaint and the counterclaim thereto are:

1. The Law Firm Defendants misrepresented or failed to disclose their relationships to the Gaudette entities when applying to be allowed as counsel to the Chapter 11 Debtor and while acting as counsel to the Chapter 11 Debtor.

2. During the course of the proceedings, they breached their fiduciary duties by these misrepresentations as well as by not bringing actions against the individual partners for the debts of the partnership.

3. When they provided the Trustee with the financial statement of the partners, they had a duty to verify its accuracy.

4. All of the above constitute fraud on the Court.

5. The counterclaim alleges that the Trustee was negligent in not prosecuting claims against the general partners under section 723 of the Bankruptcy Code and asks for contribution and indemnification if the Court awards damages against the Law Firm Defendants.

6. The Trustee's counterclaim to the counterclaim entitled "Malicious Defenses" speaks for itself.

The First Circuit has held that "[a]bsent the spontaneous, timely and complete disclosure required by section 327(a) and Fed. R. Bankr. P. 2014(a), court-appointed counsel proceed at their own risk. Rome v. Braunstein, 19 F.3d 54, 59 (1st Cir. 1994). Section 327 provides, in relevant part, that:

> 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) (2003). Further, section 328 sanctions a "'penalty'" for failing to avoid such a disqualifying conflict of interest in providing that:

> Except as provided in section 327(c), 327(e), or 1107(b) of this title, the court may deny allowance of compensation for services and reimbursement of expenses of a professional person employed under section 327 or 1103 of this title if, at any time during such professional person's employment under section 327 or 1103 of this title, 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) (2003); Rome v. Braunstein, 19 F.3d at 59 (*citing* S. Rep. No. 989, 95th Cong., 2d Sess. 39 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5825). Lastly, Federal Rule of Bankruptcy Procedure 2014 ("Fed. R. Bankr. P. 2014") states that:

> 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, or 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.

Fed. R. Bankr. P. 2014(a) (2003). "The duty of professionals is to disclose all connections with the debtor, debtor-in-possession, insiders, creditors, and parties in interest as well as fee arrangements. They cannot pick and choose which connections are irrelevant or trivial." Smith v. Marshall (In re Hot Tin Roof, Inc.), 205 B.R. 1000, 1004 n. 3 (B.A.P. 1st Cir. 1997) (*quoting* In re EWC, Inc., 138 B.R. 276, 280 (Bankr. W.D. Okla. 1992)); see also Rome v. Braunstein, 19 F.3d at 59 (recognizing the duty to disclose and the obligation of counsel to self-police).

If one thing is clear from the record before this Court, it is that Attorney Thomas and the law firm of Thomas & Utell had relationships that may have been adverse to the Debtor and creditors of the Debtor and should have been disclosed pursuant to the various provisions of the Bankruptcy Code. This case was filed on April 5, 1991. At least during the period July 1990 through April 30, 1991, Attorney Thomas and the law firm assisted in the formation of three family limited partnerships for Reginald and Louise Gaudette. Not only did they assist in the formation of these partnerships, but more importantly, they assisted in the transfer of personal assets, including real estate, cash, notes and securities into these limited partnerships. In return for these transfers, the limited partners, including Reginald L. Gaudette, were assigned limited partnership interests in the limited partnerships. While the Trustee argues that these transfers were fraudulent conveyances because of the fact that the limited partnerships, by their terms, were unfriendly to creditors, the Court, for purposes of this opinion, does not have to reach that issue. It is clear that Attorney Thomas and the law firm, Thomas & Utell, represented Reginald Gaudette, a general partner of the Debtor, his wife, Louise Gaudette, and three family limited partnerships in which the Gaudettes were either general or limited partners. The representation of the Debtor partnership and its general partner is, by itself, almost always a conflict of interest, and the representation of a material adverse interest. See e.g. In re Sixth Ave. Car Care Center, 81 B.R. 628, 630-31 (Bankr. D. Colo. 1988); In re 765 Associates, 14 B.R. 449, 451 (Bankr. D. Haw. 1981). This, coupled with the representations of the limited partnerships, which limited partnerships' interest held by Reginald Gaudette became his major asset, just adds to the conflict.

Despite this conflict, the Defendants have raised the issue that the approval of the fees in the bankruptcy case is res judicata with respect to the issue before the Court, citing Iannochino v. Rodolakis (In re Iannochino), 242 F.3d 36 (1st Cir. 2001). This Court disagrees. The facts of Iannochino are distinguishable from the present case in several respects. In that case, the debtors brought suit for malpractice against their bankruptcy attorney. See 242 F.3d at 49. The issue before the court in a fee application hearing is whether the work was performed, whether it benefitted the estate and whether it was reasonable. See id. at 47. This is a different case. The issue before this Court is not whether the legal services were performed properly, but whether the law firm failed to disclose adverse interests as required by section 327. Stated differently, the issue before this Court is whether the Law Firm Defendants complied with the requirements of sections 327 and 328, not whether the legal services performed were adequate, an inquiry which would properly be the subject of a subsequent malpractice suit. Further, it is not the Debtor who is complaining in the instant case, but the Trustee, a functionary of the Court in a relevant issue before the Court.

Additionally, the Court is authorized to order the disgorgement of fees, even if paid. See In re Independent Eng'g Co., Inc., 232 B.R. 529, 532 (B.A.P. 1st Cir. 1999); Hot Tin Roof, 205 B.R. at 1003; In re Guard Force Mgmt., Inc., 185 B.R. 656, 664 (Bankr. D. Mass. 1995) ("failure to make required disclosures warrants the denial of all compensation requested and the disgorgement of all sums received"). "Where the professional maintains any connections proscribed by § 327(a) and does not disclose those connections, the attorney should expect nothing more than the denial of compensation requested and disgorgement of fees received." See Hot Tin Roof, 205 B.R. at 1003.

Finally, in defense of his application and affidavit, Attorney Thomas testified that this was his first Chapter 11 case, that he used a form utilized by Attorney Van De Water in another case and that he interpreted section 327 to apply only to the adverse interest of a creditor. However, while the Court has no reason to doubt what Attorney Thomas thought, it is legally insufficient to protect him and the law firm of Thomas & Utell from failing to properly disclose. See Hot Tin Roof, 205 B.R. at 1004 n. 3 (fact that case was the attorney's first Chapter 11 case was insufficient to overturn the court's findings in light of the disclosure requirements of § 327(a) and Fed. R. Bankr. P. 2014(a)). Even absent some specific finding of ill will or wrongful intent, failure to disclose is a sufficient basis for disgorgement. See Independent Eng'g Co., 232 B.R. 529, 532 (citations omitted).

For all the above reasons, Attorney Thomas and the law firm of Thomas & Utell, or their successors, are ordered to disgorge the sum of $19,108.30. As to the other issues raised by the Trustee, the Court finds for the Defendants.

First, as to the duty to bring suit against the general partner while acting as general counsel to the Debtor partnership, the Court finds that there is no such duty. By definition, section 723 does not apply to a case under Chapter 11 of the Bankruptcy Code. See 11 U.S.C. 103(b). There is no similar provision in Chapter 11. The Court also finds credible the testimony of Attorney Thomas. Until the collapse of New Hampshire banks and the ensuing collapse of the New Hampshire real estate market, he believed the Debtor would be able to confirm a viable plan of reorganization. Almost for the same reasons, he testified that he believed the general partners, especially Gaudette, were persons of substantial financial wealth based on transactions they had been involved in as counsel in prior years. The Court finds that the Defendants did not breach any fiduciary duty by not bringing suit against the general partners or by otherwise guaranteeing that assets of the general partners would be available for general creditors of the partnership.

The Trustee next claims that the Law Firm Defendants breached their fiduciary duty or misrepresented facts to the Chapter 7 Trustee when they provided him with the general partners' financial statements, particularly Gaudette's. Once again, the Court disagrees. There is insufficient evidence in the record that the financial statements provided were false or misleading. The Trustee argues that the Debtor didn't disclose the transfers to the limited partnerships. First, a financial statement would not necessarily disclose transfers to those limited partnerships. These financial statements were prepared by a CPA. On Schedule H to the December 1991 financial statement, it shows three limited partnership interests. While the schedule does not indicate that they are family limited partnerships which the Gaudettes controlled, the uncontradicted evidence is that the Trustee reviewed the financial statements and made no further inquiry into the details. He then, based on these financial statements, made a judgment not pursue the 723 claims. The Trustee now wants this Court to find that counsel submitting his client's financial statements has some duty to guarantee their accuracy. Absent specific evidence that counsel knew they were false, this Court will not place such a burden on counsel. There is no such specific evidence in this case.

Finally, the Trustee alleges that the evidence before the Court is sufficient to find that the Defendants committed fraud on the Court. This Court, in its April 18, 2001 memorandum opinion in Adversary Proceedings 98-1174 and 98-1090 denying the Defendants' motion to dismiss the fraud on the Court count on the grounds of failure to state a claim, indicated that the Plaintiff had the burden to "prove fraud on the court by clear and convincing evidence," citing Aoude v. Mobil Oil Corp., 892 F.2d 1115, 1118 (1st Cir. 1989). The Court finds that the Trustee has not met his burden.

The Court recognizes that fraud on the court is interpreted narrowly. Gekas v. Pipin (In the Matter of Met-L-Wood Corp.), 861 F.2d 1012, 1018 (7th Cir. 1988), cert denied 490 U.S. 1006, 109 S.Ct. 1642 (1989). The First Circuit has adopted the following standard of fraud on the court: "[a] 'fraud on the court' occurs where it can be demonstrated, clearly and convincingly, that a party has sentiently set in motion some unconscionable scheme calculated to interfere with the judicial system's ability impartially to adjudicate a matter by improperly influencing the trier or unfairly hampering the presentation of the opposing party's claim or defense." Aoude v. Mobil Oil Corp., 892 F.2d at 1118 (citations omitted) (service station operator's conduct in fabricating a purchase agreement, and in allowing his counsel to annex bogus agreement to complaint seeking to force franchisor to accept his operation of station, constituted "fraud on the court," warranting dismissal of action).

In this case, the Trustee principally argues that the Law Firm Defendants' failure to disclose their prepetition connections with the Debtor, the general partners, and the limited partnerships set in motion a scheme to defraud the Court. While it is clear from the record that Attorney Thomas and the law firm of Thomas & Utell had relationships that should have been disclosed pursuant to section 327(a) and Fed. R. Bankr. P. 2014, and that such a failure to disclose warrants disgorgement of fees received, the Trustee has not demonstrated that the failure was the result of some corrupt intent on the part of the Law Firm Defendants. Although the Aoude court recognized that fraud on the court can take many forms because "corrupt intent knows no stylistic boundaries," there is insufficient evidence of bad faith in the present case. Aoude v. Mobil Oil Corp., 892 F.2d at 1118.

Other than ordering the disgorgement of fees, the Court has awarded no other damages to the Plaintiff. Accordingly, the counterclaims for contribution and indemnity are denied. Likewise, the counterclaim to the counterclaim is also denied. The Court further dismisses all claims against Thomas Utell, individually, Marc Van De Water, individually, and Glenn Raiche, individually, there being no evidence presented at trial against them, individually.

CONCLUSION

The order of disgorgement in the sum of $19,108.30 shall apply to Attorney Thomas, individually, and Thomas & Utell, and the successor to Thomas & Utell, namely, Thomas, Utell, Van De Water & Raiche, and Thomas, Utell, Van De Water & Raiche, P.A. As to all other issues raised by the Trustee, the Court finds for the Defendants.

This opinion constitutes the Court's findings and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052. The Court will issue a separate final judgment consistent with this opinion.

DONE and ORDERED this 31st day of January, 2003, at Manchester, New Hampshire.

/s/ Mark W. Vaughn
Mark W. Vaughn
Chief Judge