UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WISCONSIN

In re:

FRANK PIO CRIVELLO, Case No. 92-27252-MDM

Debtor. Chapter 7

KRAVIT, GASS & WEBER, S.C.,
n/k/a Kravit, Gass, Hovel & Leitner, S.C.,

v.

M. SCOTT MICHAEL,
n/k/a IRA BODENSTEIN,
United States Trustee.

AMENDED[1] MEMORANDUM DECISION ON REMAND FROM SEVENTH CIRCUIT COURT OF APPEALS

INTRODUCTION

This matter comes before the court upon a remand from the Seventh Circuit Court of Appeals Decision, *In re Crivello*, 134 F.3d 831 (7th Cir. 1998).

On February 8, 1993, the debtor's employment of Kravit, Gass & Weber, S.C., (KGW) as his attorneys under general retainer was authorized by the bankruptcy court with retroactive effect to November 20, 1992. KGW was awarded $80,000 for interim compensation on December 23, 1993. After hearings before the bankruptcy court on KGW's applications for final compensation, then Chief Bankruptcy Judge Charles N. Clevert revoked KGW's employment

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[1]On September 21, 1998, Kravit, Gass, Hovel & Leitner, S.C., filed a motion to alter or amend the court's September 11, 1998, judgment and to amend the findings of facts. After the parties were given an opportunity to file briefs, the court granted, in part, and denied, in part, that motion. This decision reflects those changes.

order and denied its application for compensation in its entirety. *In re Crivello*, 194 B.R. 463 (Bankr. E.D. Wis. 1996). The court found that KGW was not a disinterested person and that KGW had "willfully failed to disclose critical facts and connections with Frank [Crivello, the debtor]." *Id.* at 469.

On February 18, 1997, the district court affirmed the bankruptcy court. *In re Crivello*, 205 B.R. 399 (E.D. Wis. 1997). The district court concluded that no support in the record exists for the bankruptcy court's conclusions that KGW attempted to thwart the Code's disclosure requirements and that KGW willfully failed to disclose its prior representations. Nonetheless, the district court determined that reversal was not warranted because the bankruptcy court's decision was based upon an independent and adequate finding that KGW was not a disinterested party. The court of appeals reversed the district court's decision because the district court never considered whether the erroneous finding of fact (willful nondisclosure) tainted the bankruptcy court's exercise of discretion in determining fees. The Seventh Circuit remanded the case to this court for a new hearing on whether KGW merits any compensation under 11 U.S.C. § 328(c).

For the reasons stated below, this court declines to award any professional fees or reimbursement of expenses, except for the filing fee, to KGW in this case and will order return to the bankruptcy estate of any excess fees and expenses paid under the interim award.

FACTS[2]

The debtor, Frank Pio Crivello, commenced a voluntary chapter 11 case on November 20, 1992. On December 8, 1992, the debtor filed an application to employ the firm Kravit, Gass & Weber, S.C., as attorneys for the debtor. Frank Crivello's Application to Employ Attorneys Under General Retainer and KGW's Affidavit of Disinterestedness, filed pursuant to Fed. R. Bankr. P. 2014(a), stated that KGW did not hold any interest adverse to Frank Crivello or the chapter 11 estate. The affidavit identified seven current or former clients that appeared on the creditor matrix, whom the firm had represented in matters unrelated to the bankruptcy case. KGW's affidavit further stated that the firm received a $10,000 retainer from National Management, Inc., for legal services rendered or to be rendered in connection with the chapter 11 case. Also on December 8, 1992, KGW filed its Attorneys' Statement Pursuant to Federal Rule of Bankruptcy Procedure 2016(b). By order dated February 8, 1993, the debtor's employment of KGW was authorized by the bankruptcy court with retroactive effect to November 20, 1992.

Subsequently, various connections between the debtor, his creditors, and KGW came to light. KGW had actually begun representing the debtor in various civil matters, which the firm described as unrelated to the bankruptcy proceeding, in early 1991, and it was paid by related parties for that representation. Between November 20, 1991, and June 1, 1992, National Management, Inc., (NMI) made a series of payments to KGW for KGW's pre-petition joint representation of the debtor and Joseph Crivello. Joseph Crivello is a cousin of the debtor and is an "insider" as the term is defined in the Bankruptcy Code. 11 U.S.C. § 101(31). More

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[2]The following facts are taken from a stipulation filed by the U.S. Trustee and KGW and from exhibits that are part of the record before the court of appeals.

importantly, Joseph was the sole stockholder of NMI at all relevant times. The debtor was employed as the executive vice president of NMI from January 1, 1993, through August 9, 1994; that is, during almost the entire time the chapter 11 case was pending. Prior to that time, the debtor was employed by NMI as a consultant.

Before the chapter 11 filing date, KGW had also represented Frank Crivello, Joseph Crivello, and two of the debtor's companies, CP Holdings II, Inc., and FPC Construction, Inc., in matters in which Joseph Crivello and these corporate entities were jointly sued with the debtor. As of the filing date, KGW had an agreement to represent 122 companies, all of which were owned in whole or in part by the debtor, in connection with any criminal investigation of the debtor. (R. 68: Stip. ¶ I.10) All 122 companies are "insiders" of the debtor as that term is defined under the Bankruptcy Code. 11 U.S.C. § 101(31)(a)(i), (iv).

The debtor owed KGW approximately $42,500 for legal services for criminal and nonbankruptcy civil matters before he filed his voluntary petition. This fact was not disclosed by the debtor in his application of employment or by KGW in the affidavit of disinterestedness. When KGW received the $10,000 bankruptcy retainer from NMI, $5,670 was paid for bankruptcy related services, $600 was used to pay the chapter 11 filing fee, and the balance was placed in trust and applied later to interim attorneys' fees. Thus, when the debtor sought to employ KGW as counsel on December 8, 1992, the debtor still owed $36,926 to KGW for pre-petition legal services ($18,823.40 fee for civil matters and $18,103.58 fee for criminal matters). KGW did not disclose this debt to the U.S. Trustee until January 1995, when Attorney Leonard Leverson of KGW informally told Attorney David Asbach that KGW was a creditor of the debtor. Attorney Asbach then disclosed this to the court on February 3, 1995, when he filed a

supplemental objection to the fee application. Attorney Leverson then filed a supplement to his amended affidavit of disinterestedness on March 13, 1995. (R. 56, 57) This supplement to the amended affidavit stated that KGW waived its $18,103.58 claim against the debtor for pre-petition criminal legal services but did not address the civil legal fees. KGW did not file a claim against the estate in the debtor's chapter 11 case.

On December 30, 1992, Attorney Stephen Kravit sent Frank Crivello a letter pointing out a potential conflict of interest pertaining to the firm's representation of Frank in an ongoing criminal investigation. Frank's criminal defense fees were to be paid by Joseph or by a company Joseph owned. Attorney Kravit noted that he had discussed the matter with David Bukey, Joseph's attorney, and they had concluded that there was "no problem from a criminal or ethical standpoint in Joe or one of his companies paying legal fees for criminal representation on your behalf as long as there are no strings attached and you continue to have truly independent counsel." (R. 68, ¶ II.2, Exh. B) Kravit further stated:

> With respect to your present Chapter 11, payment of these fees cannot be from your bankruptcy estate. Having any arrangement with Joe for payback of these monies, or even for use of these monies as part of your compensation, could be a fraud on the bankruptcy court, which would involve Joe. Whether the purpose of payment is because of friendship; because you are his relative; or because you are co-owners of business entities that may be under criminal investigation need not be determined by you now. In other words, the criminal fee payment is a gift to our firm due to Joe's relationship with you, or is a payment of legal fees on behalf of a co-venturer which may have criminal exposure, which co-venturer we represent for this purpose.

(Letter from Steven Kravit dated 12/30/92, R. 68, ¶ II.2, Exh. B)

Assistant U.S. Trustee John Byrnes wrote Attorney Leverson on January 11, 1993, stating that the application for employment should set forth all of the funds KGW had obtained from and for representing Frank and should disclose the source of the funds. Attorney Byrnes also

requested that Leverson clarify the scope of the firm's services, including its representation of Frank in any criminal investigation. (R. 47, Exh. A) Attorney Leverson responded that he did not believe the matters into which the U.S. Trustee inquired were appropriate for disclosure in a Rule 2016(b) statement under his interpretation of 11 U.S.C. § 329(a):

> Section 329(a) of the Bankruptcy Code requires disclosure by any attorney "representing a debtor in a case under this title, or in connection with such a case" of "the compensation paid or agreed to be paid ... for services rendered or to be rendered in contemplation of or in connection with the case by such attorney, and the source of such compensation." The purpose of the statute is to allow judicial review of the reasonableness of pre-petition bankruptcy-related fees. Section 329 does not apply to services that are unrelated to the bankruptcy case. Matter of Hargis, 895 F.2d 1025 (5th Cir. 1990); Matter of Swartout, 20 B.R. 102, 106 (Bankr. S.D. Ohio 1982) (fees for prepetition divorce work were neither "in contemplation of" nor "connected with" debtor's bankruptcy case).
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> Accordingly, I do not believe that the matters into which you inquire in your letter of January 11 are appropriate for disclosure in a Rule 2016(b) statement. If you can point me to any authority holding to the contrary, I might reconsider my views.
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> I can add that this firm is not holding any funds in trust for Mr. Crivello other than the retainer disclosed in our application; nor has it received any funds from the debtor as compensation for legal services rendered or to be rendered.[3]

(Letter from Leonard Leverson dated 2/3/93, R. 47, Exh. B) Mr. Byrnes did not respond to Mr. Leverson's letter.

On February 8, 1993, the bankruptcy court approved the application to employ KGW. KGW then received $20,000 from NMI on March 4, 1993, and $13,000 from NMI on April 30, 1993, in payment for services by KGW for Frank.[4] On April 30, 1993, despite its assertion that it had waived the debtor's $18,103.58 pre-petition debt for criminal legal services, that debt was

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[3]By then, the firm had received an additional $27,933.80 from NMI, in addition to the $10,000 retainer.

[4]These payments were disclosed to the court two years later in the statement of stipulated facts filed on August 30, 1995. (R. 68)

paid when KGW applied a $50,000 flat fee retainer that it had received on December 31, 1992, from Sierra Holding Corporation, an entity wholly owned by Joseph Crivello, to the waived pre-petition debt. (R. 68, ¶ 22, 23, 24, II2, Exh. B) The $50,000 was also applied to an outstanding fee for post-petition services rendered by KGW to the debtor. KGW later asserted that the application of the retainer was inadvertent, but the bookkeeping error was never reversed. Attorney Leverson disclosed the application of payment to the U.S. Trustee on March 10, 1995, and supplemented his affidavit of disinterestedness. (R. 55)

A number of persons and entities, which were insiders of Frank or Joseph Crivello, participated in the debtor's case or were otherwise identified in connection with the case. The following were listed as creditors in the debtor's original chapter 11 bankruptcy schedules: NMI, Joseph Crivello, Fifth Corporation, Cambridge Business Finance Company, Corporate Center Management, Inc., Corporate Computers, Inc., and FPC Construction, Inc. The following persons and entities filed claims against the debtor in his bankruptcy case: NMI, Fifth Corporation, Berkshire Factoring, Inc., I.C.T. II Corporation, Plaza Twenty-Three, Inc., and Cambridge Business Finance Co., Inc. At all relevant times, Joseph Crivello owned the stock, either directly or indirectly, in the following corporations: NMI, Fifth Corporation, Sierra Holdings, Inc., Sierra Finance Co., Berkshire Factoring, Inc., and I.C.T. II Corporation. Joseph Crivello did not personally file a claim in the debtor's bankruptcy case. As early as February 3, 1993, Berkshire Factoring became a creditor of the debtor when it purchased the claims of others. On September 3, 1993, Berkshire paid $45,542 to KGW for legal services provided to the debtor.

On February 22, 1994, Joseph Crivello retained KGW to provide advice regarding a potential "gaming venture." KGW disclosed this representation to the court on January 19, 1995; however, the firm has never disclosed the exact nature of the representation.

KGW first sought interim compensation in the chapter 11 case on October 25, 1993. Over the objection of the U.S. Trustee and other creditors, the bankruptcy court authorized an award to KGW in the amount of $80,000 by order of December 23, 1993. On June 2, 1994, KGW filed an application for final compensation of $334,484.94. The June 2, 1994, application was amended on September 19, 1994. On November 28, 1994, KGW filed a second application for interim compensation pending resolution of its request for final compensation. The U.S. Trustee filed objections to both of KGW's applications. It asserted that KGW was not disinterested, that the firm failed to disclose its connections to insiders adequately, and that the amount of the request was unreasonable.

In the applications for final and interim compensation, KGW acknowledged that it had received funds from NMI for defending nondischargeability actions against the debtor in the chapter 11 proceeding. KGW filed supplemental attorney's statements in accordance with Bankruptcy Rule 2016(b) on October 27, 1994, December 6, 1994, January 17, 1995, and April 19, 1995. The applications disclosed that it received $9,155 from NMI for defense of nondischargeability proceedings after the case was converted to a liquidation proceeding under chapter 7.[5] Finally, the Statement of Stipulated Facts dated August 30, 1995, (R. 68, ¶ 28)

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[5]On August 9, 1994, the bankruptcy court entered an order converting the case to chapter 7 and Frank Crivello was removed as debtor-in-possession of the bankruptcy estate.

disclosed the following payments made to KGW by NMI for bankruptcy and nonbankruptcy services rendered by KGW to the debtor:

Date		Amount
8/3/92		$ 7,258.09
10/1/92		6,910.50
11/2/92		13,765.21
11/20/92		10,000.00
3/4/93		20,000.00
4/30/93		13,000.00
7/15/93		30,000.00
10/20/93		23,150.07
10/21/93		2,179.73
11/19/93		30,000.00
2/15/94		11,171.37
5/10/94		18,030.95
7/20/94		22,478.78
8/18/94		28,142.80
9/6/94		15,000.00
10/12/94		10,000.00
11/22/94		10,000.00
12/27/94		70.82
12/31/94		8,818.61
3/20/95		1,391.20
	TOTAL:	$281,368.13

The funds paid by NMI to KGW on behalf of the debtor were not wages or salary to the debtor. In addition to the NMI payments listed above, in December 1992, the firm applied a $50,000 retainer received from Sierra Holding Corp. on behalf of Sierra Finance Co., both owned by Joseph Crivello, to Frank's prepetition debt. As noted above, Berkshire Factoring, Inc., another corporation owned by Joseph Crivello, paid $45,542 for legal services rendered for Frank. Invoices were sent to Frank personally, not to Joseph or any corporation, and there was no agreement between Frank and KGW that anyone besides Frank was liable for the over $375,000 in paid-for legal services rendered by KGW on his behalf.

KGW also filed an amended affidavit of disinterestedness on January 19, 1995, in connection with a hearing on the second interim fee application. (R. 68) It explained that KGW's original affidavit of disinterestedness did not mention the firm's prepetition representation of Joseph Crivello because his name did not appear on the creditor mailing matrix when the attorneys cross-checked the lists of current and former KGW clients with the mailing matrix of Frank's creditors.

During the period between filing on November 20, 1992, and the date that the case was converted to chapter 7 on August 9, 1994, NMI occasionally paid or advanced personal expenses of the debtor and his spouse which were either reimbursed or treated as gifts. Just prior to the debtor's filing, Fifth Corporation, an entity either directly or indirectly owned by Joseph Crivello, paid KGW an undisclosed amount for services rendered on behalf of Frank, individually, or Frank and Joseph concurrently.[6]

On March 25, 1995, the bankruptcy court revoked KGW's employment order and denied its application for compensation in the entirety. *In re Crivello*, 194 B.R. 463 (Bankr. E.D. Wis. 1996). The court found that KGW was not a disinterested person and that the firm had "willfully failed to disclose critical facts and connections with Frank." *Id.* at 469.

The district court affirmed the bankruptcy court on February 18, 1997. *In re Crivello*, 205 B.R. 399 (E.D. Wis. 1997). The court concluded that no support in the record exists for the bankruptcy court's conclusions that KGW attempted to thwart the Code's disclosure requirements and that KGW willfully failed to disclose its prior representations. Nonetheless,

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[6]In the Statement of Stipulated Facts, KGW claims that Joseph Crivello, Fifth Corporation, and NMI have not consented to KGW disclosing the amount of payments. (R. 68, Stip. ¶ I.3)

the district court determined that reversal was not warranted because the bankruptcy court's decision was based upon an independent and adequate finding that KGW was not a disinterested party. The court of appeals reversed the district court's decision because the district court never considered whether the erroneous findings of fact tainted the bankruptcy court's exercise of discretion. *In re Crivello*, 134 F.3d 831 (7th Cir. 1998). The Seventh Circuit remanded the case to this court for a new hearing on whether KGW merits any compensation under 11 U.S.C. § 328(c). The revocation of the order authorizing employment of KGW as attorneys for the chapter 11 debtor is not at issue.

At a hearing before this court on February 9, 1998, the parties agreed the record was complete and there was no need to present evidence in addition to that before the court of appeals. The U.S. Trustee, the chapter 7 trustee, and KGW filed extensive briefs addressing the bankruptcy court's consideration of the compensation of KGW upon remand from the court of appeals.

DISCUSSION

A. Mandate

The Court of Appeals directed that this court determine whether KGW is entitled to any fees under 11 U.S.C. § 328(c). Under § 328(c), 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).

Employment of professional persons by a debtor-in-possession is governed by 11 U.S.C. § 327(a), which 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).

A disinterested person is one who "is not a creditor, an equity security holder, or an insider" and who "does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, 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 Seventh Circuit pointed out that the latter portion of the definition, commonly referred to as the "catch-all clause," is "sufficiently broad to include any professional with an 'interest or relationship that would even faintly color the independence and impartial attitude required by the Code.'" *Crivello*, 134 F.3d at 835 (quoting *In re BH & P Inc.*, 949 F.2d 1300, 1308 (3d Cir. 1991)).

The Seventh Circuit also noted that the phrase "hold or represent an interest adverse to the estate," is not defined in the Bankruptcy Code. Nevertheless, many courts have adopted the definition of the phrase found in *In re Roberts*, 46 B.R. 815 (Bankr. D. Utah 1985):

> "(1) to possess or assert any economic interest that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant; or
> (2) to possess a predisposition under circumstances that render such a bias against the estate."

Crivello, 134 F.3d at 835 (quoting *Roberts*, 46 B.R. at 827). Thus, the statutory requirements of § 327(a) "'serve the important policy of ensuring that all professionals appointed pursuant to section 327(a) tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities.'" *Id.* at 836 (quoting *Rome v. Braunstein*, 19 F.3d 54, 58 (1st Cir. 1994)).

The procedural mechanism to enforce the employment requirements is found in Bankruptcy Rule 2014, which states that a professional must set forth "to the best of the applicant's knowledge" all known connections of the applicant 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" in both the application for employment and an accompanying verified statement. Fed. R. Bankr. P. 2014(a). The court recognized that this provision "allows the fox to guard the proverbial hen house," but "counsel who fail to disclose timely and completely their connections proceed at their own risk because failure to disclose is sufficient grounds to revoke an employment order and deny compensation." *Crivello*, 134 F.3d at 836.

Because KGW conceded that it was not disinterested, the issue before the court of appeals was "whether a bankruptcy court must deny fees when it subsequently learns that a professional never should have been employed under § 327(a) in the first place or whether it has discretion to deny fees." *Id.* The court rejected the U.S. Trustee's position that the bankruptcy court does not have such discretion.

The court of appeals considered the plain language of § 328, which states that a court "*may* deny allowance of compensation"

> 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) (emphasis added). The court pointed out that the Code contains no explicit language limiting the bankruptcy court's capacity to deny compensation. Therefore, if a bankruptcy court errs in approving a professional person's employment, that person is either "not a disinterested person" or "represents or holds an interest adverse to the interest of the estate" for the entire duration of that person's employment. The court concluded that § 328(c) *permits* a court to deny compensation to professionals found not to be disinterested persons, but does not *require* a denial of fees. *Id.* at 837.

The Seventh Circuit recognized the potential for professionals to intentionally fail to disclose conflicts of interest if they know that a bankruptcy court is not required to deny all fees. However, the likelihood of abuse would be minimized with the appropriate application of the bankruptcy courts' discretion:

> Before a bankruptcy court elects to award partial payment to a law firm or other professional that was improperly employed, it should consider whether the professional's failure to disclose was intentional. If any evidence exists to support an inference of intent, then the court should not fall prey to the professional's story of confusion, miscommunication, or negligence. We believe a bankruptcy court should punish a willful failure to disclose the connections required by Fed. R. Bankr. P. 2014 as severely as an attempt to put forth a fraud upon the court.
>
> Yet, it is not our role to reduce the discretion the Code affords bankruptcy courts by carving out an exception that requires the denial of fees if a professional willfully fails to disclose.

Id. at 839. Thus, the court recognized the wide latitude that bankruptcy courts have regarding such fact-intensive matters as the employment of professionals.

Nevertheless, the Seventh Circuit found that the record did not support Judge Clevert's findings that "KGW willfully failed to disclose information and attempted to thwart the Code's disclosure requirements." *Id.* at 841. Because such erroneous findings may have improperly impacted the bankruptcy court's refusal to award any fees, the case was remanded to this court.

B. Disclosure

KGW acknowledges that it should have disclosed its prior representation of Frank, Joseph, and entities owned in whole or in part by Frank. It should have disclosed it was representing Frank in criminal investigations (although everyone involved with the case was reading the newspapers and knew it was), and it should have disclosed the money it was receiving from NMI and other entities for representing Frank in these various criminal and civil nonbankruptcy matters. It argues that the law interpreting disclosure requirements in bankruptcy cases has developed considerably since 1992, and it should not be penalized by hindsight.

The district court and court of appeals noted that the record does not support a finding that this failure to disclose was willful on KGW's part. They were vigorously protecting the confidences of their clients. Sometimes the clients, notably Joseph Crivello, refused to allow disclosure. KGW argued that it expected a response from the U.S. Trustee justifying his demands for certain information, and receiving none, assumed he assented to its nondisclosure. Furthermore, KGW points out that 11 U.S.C. § 329(a) only requires that the attorney disclose an agreement for or payment of compensation made within a year of filing "in contemplation of or in connection with the case," which limits the "connections" that must be disclosed under Fed. R. Bankr. P. 2014. The firm interpreted this to mean that information concerning, for example,

criminal legal representation of Frank and payment of fees for this purpose, need not be disclosed.

This court accepts the higher courts' determination that the record does not support a finding that KGW's failure to disclose its representation of Joseph Crivello and the debtor's related entities was willful. It was nevertheless amazingly careless. Joseph Crivello was missed by the firm's conflicts check because he was somehow left off the creditor matrix, notwithstanding Frank's possible liability for contribution in cases in which they were jointly sued and jointly represented by KGW shortly before the case was filed. Thus, when a cross check with other clients was made, Joseph was not on the list. If Joseph was not sufficiently prominent in anyone's mind to have warranted inclusion in the list of creditors immediately before the chapter 11 case was filed, someone involved with the case should have remembered a corporation owned by Joseph Crivello, NMI, which had paid KGW a $10,000 bankruptcy retainer. In fact, during 1992, NMI paid over $30,000 to KGW to represent Frank, both for the bankruptcy and other matters. NMI was not liable for these bills, and according to KGW, it had no agreement with NMI or Joseph for such payments. Money continued to pour into the firm from Joseph and his entities throughout 1993, but disclosures were not amended. To forget Joseph and his corporations in preparing the list of creditors and necessary disclosures is, to understate, sloppy.

By the time Joseph was mentioned in an affidavit of disinterestedness, (R 68: Amended Affidavit 1/19/95) over two years had passed. By then, Joseph and his corporations had paid the firm over $300,000. In the amended affidavit, Mr. Leverson stated, "Prior to the filing of the Debtor's petition, but not thereafter, Kravit, Gass & Weber, S.C. represented Joseph Crivello in

several collection actions in which he was sued jointly with Frank Crivello." (R. 68: Amended Affidavit 1/19/95, ¶ 5) This statement appears to be true, as far as it goes. However, the Statement of Stipulated Facts filed later that year disclosed that the firm also represented Joseph in 1994 with respect to a potential gaming venture. (R. 68, ¶ 27) Thus, the statement in the January 19, 1995, affidavit is the truth, but it is not the whole truth.

Similarly, the Rule 2016(b) statement dated December 8, 1992, states that the firm received a retainer of $10,000 from NMI for services to be rendered in connection with the case. Of that amount, $5,670.94 was applied to "prepetition financial advisory services," $600 was applied to the filing fee, and $3,730.06 was placed in the firm's trust account. The naive reader might assume the debtor's entire prepetition bill had been paid; that is why there was money left over to be held in trust. Actually, over $37,000 was owed, but this was not disclosed until much, much later, after some of it was accidently paid. The affidavit was the truth, but again, it was not the whole truth.

Similarly, Mr. Leverson's February 3, 1993, letter to Mr. Byrnes stated, "I can add that this firm is not holding any funds in trust for Mr. Crivello other than the retainer disclosed in our application; nor has it received any funds from the debtor as compensation for legal services rendered or to be rendered." (R. 47, Exh. B) By then, the firm had received an additional $27,933.80 from NMI, plus the retainer. (R. 68, ¶ 28) The funds from NMI were not held in trust, and they were not received from the debtor. By careful phraseology, the statement in the letter was technically the truth, but it does not approach the standard of full disclosure required of bankruptcy counsel.

Of the approximately $37,000 in prepetition legal services owed KGW at filing, about half was for criminal legal matters and the other half was for unspecified civil matters. KGW apparently regarded these civil matters as unrelated to the bankruptcy; otherwise, it presumably would have used the $3,730.06 left over from the retainer to pay down that portion of the bill. The excuse tendered for not disclosing that NMI and other Joseph Crivello entities were amply funding Frank's legal needs while the chapter 11 was pending is not totally outlandish, given KGW's argument that the services giving rise to the fees did not represent "connections" with the case. However, it will not hold up with respect to the prepetition fees. Whether the prepetition services were connected to the bankruptcy or not, they were not paid for before the petition was filed. The firm must also have forgotten about 11 U.S.C. § 101(14)(A), the definition of "disinterested," which includes a creditor. It does not matter how the debt was incurred, KGW was not disinterested from the beginning. To have missed something that important is inexcusable.

The firm's application for interim fees dated October 25, 1993, (R. 71. Exh. B, ¶ 11) shows that fees of $6,600 and $2,555 for the defense of nondischargeability actions were paid by NMI, and the firm was not requesting approximately $4,800 that it had written off. It also stated that NMI paid for nonbankruptcy services, but this statement was nestled inconspicuously in the middle of the paragraph and was not quantified. It was impossible to know at that time that the magnitude was considerable, over $125,000, especially when KGW refused to disclose these figures. The application stated the truth, but not the whole truth.

KGW interpreted very narrowly what the phrase "in connection with the case" entails. We do not know what the unpaid prepetition civil legal services were for, because KGW will not

tell us, but it is highly likely that some may have been for the lawsuits by creditors and foreclosures that were disclosed. If these creditors remained creditors at the time of filing, or if the creditors received preferences, these matters could be interpreted as being "in connection with the case." Criminal matters might be connected, as well. The debtor's disclosure statement reveals that the debtor plead guilty to three counts of lying to banks, 18 U.S.C. § 1014, apparently for business deals, not for consumer loans.[7] (R. 70G, pp. 13-14) The disclosure statement stated that a lengthy term of incarceration would have a negative impact on the debtor's ability to reorganize. There has never been any indication that the criminal representation referred to was for nonbusiness related problems that Frank had, such as drug dealing or drunk driving. Thus, it appears that most of the legal matters for which KGW was hired had everything to do with the business empire Frank Crivello was trying to rebuild. To conclude that such criminal matters are not "connected" with the bankruptcy merely because the bankruptcy court has no criminal jurisdiction (we surmise this is their rationale) requires the use of blinders – not a recommended piece of legal equipment. An attorney cannot withhold information using his/her own interpretation of what is relevant and what is not. *See, e.g., In re National Liquidators, Inc.*, 182 B.R. 186, 196 (S.D. Ohio 1995) ("Attorneys cannot pick and choose which connections to disclose."); *In re B.E.S. Concrete Prods., Inc.*, 93 B.R. 228, 237 (Bankr. E.D. Cal. 1988) ("The burden is on the person to be employed to come forward and make full, candid, and complete disclosure.").

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[7]If news reports are to be given credence, two of Frank's other lawyers (not KGW) also experienced legal problems of a criminal nature related to Frank's business transactions. One of those attorneys described his involvement in some detail in a hearing before this court. It was definitely business related, not personal.

The attorneys in this case determined for themselves that certain information need not be disclosed. Their judgment in this regard was gravely flawed. This is not hindsight; disclosure of connections related to the case was required even in 1992. The fact that Mr. Leverson was not personally aware of some of the firms' financial activities, which this court believes, is unavailing; the firm was appointed debtor's attorneys, and it – everyone – has the duty to make proper disclosures. *See Halbert v. Yousif*, 225 B.R. 336 (E.D. Mich. 1998) (mere fact that attorney may have acted in good faith in failing to disclose certain information in his application for employment did not excuse attorney's disclosure violations). The degree to which KGW breached its duty of disclosure, and continues to do so in some respects, cannot be condoned.

C. Disinterestedness

KGW admits it was not disinterested from the beginning of the case. As such, it should never have been appointed. Nevertheless, it asks this court to exercise its discretion to award it fees for services that benefitted the estate during the pendency of the chapter 11.

Without question, a law firm can be of enormous benefit notwithstanding the fact that it is owed prepetition fees. A number of forces would like to persuade Congress to remove the disinterestedness requirement for the appointment of counsel, since it is often the case that attorneys with a longstanding relationship with the debtor are most familiar with its problems and could provide the most benefit during the bankruptcy. This court is in that camp. Therefore, the lack of disinterestedness must be a consideration in denying fees in this case, but it is a minor one in light of other events that transpired during the case.

D. Loyalties

In a chapter 11 case, the debtor in possession has a fiduciary duty to act not in its own best interest, but rather in the best interest of the entire estate, including secured and unsecured creditors. *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 105 S.Ct. 1986 (1985). The attorney for the debtor in possession is also a fiduciary to the estate.[8] *In re Doors and More, Inc.*, 126 B.R. 43, 45 (Bankr. E.D. Mich. 1991). As one bankruptcy court has explained:

> The unique circumstances which surround insolvency and the filing of a Chapter 11 case place the attorney for the debtor in possession in the unusual position of sometimes owing a higher duty to the estate and the bankruptcy court than to his client. In fact, the status of the client and the attorney may often overlap in a Chapter 11 case, as the debtor's attorney must take conceptual control of the case and provide guidance for management of the debtor, not only to discern what measures are necessary to achieve a successful reorganization, but to assure that, in so doing, compliance with the Bankruptcy Code and Rules is sought rather than avoided. Debtor's attorney's duty as fiduciary of the estate requires an active concern for the interests of the estate and its beneficiaries.
>
> The attorney for a debtor in possession is not merely a mouthpiece for his client. Counsel for the estate cannot close their eyes when the debtor's principals are not acting in the best interests of the estate and its creditors, and certainly cannot aid the adverse activity.

In re Sky Valley, Inc., 135 B.R. 925, 939 (Bankr. N.D. Ga. 1992) (citations omitted).

Several controversial transactions took place during the debtor's bankruptcy, which call into question the attorneys' loyalty to the estate. Three examples should be sufficiently illustrative of how the firm's loyalties to those who were paying it affected the conduct of the case.

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[8]Not all courts agree that the attorney's role is that of a fiduciary. *See, e.g., Hansen, Jones & Leta, P.C. v. Segal*, 220 B.R. 434, 449-68 (D. Utah 1998). However, *Hansen's* characterization of a bankruptcy attorney's duties would not change the result in this case.

On May 10, 1993, KGW filed a motion to compromise the controversy regarding Cambridge Business Finance Company. Previously, in November 1990, Frank executed a promissory note for approximately $3.25 million, payable to First Bank, N.A. (R. 83) Thereafter, First Bank assigned its interest in the note to David Wabick, who sold the note to Cambridge on January 15, 1992. Cambridge, which was incorporated in October 1991, is owned and controlled by Joseph. On February 7, 1992, Cambridge sued Frank in state court. (R. 68) On the same day, Frank executed an admission of service, stipulation and order consenting to entry of judgment against him in the amount of $3.6 million, including the principal and interest due on the First Bank note. A stipulated judgment was entered February 10, 1992, thereby creating a lien in favor of Cambridge on Frank's real estate, including his residence in River Hills, worth approximately $1.25 million. (R. 9, 2) The timing of the debtor's capitulation, plus the identity of the plaintiff's owner, would lead even the most unsophisticated to conclude that the lien was a collusive act to put Joseph in a favored position to protect Frank's property. In January of 1993, the creditors' committee demanded that Frank avoid the Cambridge lien as a preferential transfer to an insider within one year of bankruptcy. (R. 10) On May 10, 1993, KGW filed the motion seeking to compromise the controversy with Cambridge. (R. 9) After a limited objection by the committee (relating to the debtor's claim of a homestead exemption in the property released, and reserving the right to object to the debtor's discharge based on the transfer) and a hearing, the court entered an order approving the compromise on August 8, 1994, *nunc pro tunc* June 17, 1993. (R. 10, 40) Setting aside such a blatant attempt to hinder, delay or defraud creditors should have been one of the debtor's first orders of business, perhaps even prepetition, and it should not have had to come at the behest of the creditors' committee. Five months from the committee's request to take

action is not unreasonable in a case of this size, and the delay would normally not be called into question. However, since Joseph was the holder of the lien and also a client (as yet undisclosed), who was pouring copious amounts of money into the firm on Frank's behalf, the reason for the delay and possible reluctance on the part of the attorneys to act against Cambridge's interest is suspect.

The second example appears in the court's records beginning April 2, 1994. KGW filed a motion to sell the debtor's interest in Richfield Center, a strip mall that was equally co-owned by Frank and Joseph Crivello.[9] (R. 7, 71E) Pursuant to the parties' negotiations, the buyer would assume the mortgage, Frank Crivello's bankruptcy estate was to receive $25,000, and Joseph Crivello was to receive $375,000, less cost of lien releases, brokerage fee, taxes and other expenses of the sale, and to obtain releases of judgment liens. (R. 7) The creditors' committee and the Resolution Trust Corporation objected to the proposed sale due to the unequal division of the proceeds, among other things, and the court denied the motion. (R. 71) The terms of the transaction were revised after a hearing to provide the estate with 50% of the net proceeds of the sale, and the sale was approved. (R. 71)

Attorney Leverson explained in his brief that Frank would not structure the lopsided proposed transaction in any other way. Joseph probably liked it, too. Since he could not convince Frank to structure the sale otherwise, and he knew the deal would not pass muster with the creditors or the court, Attorney Leverson sent notice of the proposal to creditors anyway. The expected objection eventually brought a fair result. But sending out a proposal that is obviously

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[9]Old Columbia had advanced money for materials and services that were not delivered and had commenced a foreclosure action and asserted claims of fraud against Frank and Joseph. The action began in 1990 and was subsequently taken over by the Resolution Trust Corporation.

harmful to the estate and a benefit to the debtor's insider is not the act of a fiduciary; it is the act of a "mouthpiece." *See Sky Valley*, 135 B.R. at 939. While this case had an active, vigilant, and well counseled creditors' committee, many chapter 11 cases do not. Many creditors in chapter 11 cases cannot expect a sufficient dividend to warrant paying an attorney to wage a court battle over a debtor's looting of the estate. The policy of requiring the attorney for the estate to act as a fiduciary, not a no-holds-barred advocate, is firmly grounded in the practicalities of bankruptcy administration and is necessary to maintain the integrity of a system committed to treating all interested parties fairly. The debtor's proposal would have gained $25,000 for the estate; the final deal resulted in almost $100,000 more.[10] (R. 71E, ¶ 2) This was a serious breach of fiduciary duty by both the debtor in possession and the attorney, which fortunately did not work.

This is not to say that the court is not in sympathy with Mr. Leverson in dealing with a strong willed client. We have been there. Nevertheless, a lawyer cannot let a client demand that he/she do something that the attorney knows is wrong, and the Richfield proposal was clearly wrong. What were the alternatives? Jettison the client? This client was bringing in a huge amount of criminal law work to the firm, work that was being regularly paid for, which the firm

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[10]The Order approving the sale of the debtor's interest in Richfield Center provided the following:

> 2. From the gross proceeds to Joseph Crivello and the Debtor of $400,000, there shall be deducted a brokerage commission of no greater than $50,000; ordinary and customary closing costs and prorated expenses (including prorated 1993 real estate taxes); reasonable legal fees incurred by Joseph Crivello in connection with this transaction not the exceed the amount of $12,000; $85,000 to be paid to obtain releases of certain liens against the property initially held by Republic Capital Bank, F.S.B., First Union Bank, and Conditioned Air; and no greater than $12,000 to be paid to the Internal Revenue Service to obtain a satisfaction of a lien it holds against the property. The balance shall be divided equally between Joseph Crivello and the bankruptcy estate of the Debtor. ...

(R. 71E: Order Approving Sale of Debtor's Interest in Richfield Center and Approving Compromise of Controversy, 5/3/93).

no doubt wanted to keep. That these payments were being made by entities owned by someone that had an economic stake in keeping assets that otherwise might go to creditors of the estate only underscores the impropriety of the attorneys' position. Doing nothing about removing the Cambridge lien or selling Richfield Center might have moved the creditors' committee to ask the court for the appointment of an examiner or chapter 11 trustee, which probably would not have been popular with either Frank or Joseph. The situation was untenable for the attorneys, and when these events were taking place, it was undisclosed.

Incident to a third transaction, Frank Crivello had owned 16 corporations, collectively known as the "Plaza Corporations," which owned or ground leased parcels of real estate to Kmart Corporation. (R. 17, 71G) Metro North State Bank held second mortgages on the properties, which were cross-collateralized. By July 1991, the corporations had no equity in their properties due to mortgage defaults. Daiwa Securities America, Inc., provided bridge financing that enabled a newly created entity, First Berkshire Business Trust, to buy the 16 Class A properties from the Plaza Corporations and also to purchase from Kmart, and lease back to it, 27 Class B properties then owned by Kmart.[11] (R. 17) Due to Frank Crivello's financial difficulties and the potential involvement in bankruptcy or other legal proceedings, Daiwa refused to proceed with the transaction if the debtor had a direct ownership stake in First Berkshire. (R. 17) Thus, the debtor established the Irrevocable Children's Trust for the benefit of his children. Joseph Crivello is one of the trustees. The Children's Trust acquired a 99% ownership interest in the

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[11]The sale proceeds to the Plaza Corporation paid off the first mortgages on the Class A properties. A portion of the cross-collateralized second mortgage debt to Metro North was also paid and the bank released its second mortgages. The Daiwa bridge loan was repaid through a private placement of First Berkshire mortgage bonds offered by Daiwa. (R. 17)

Class A properties and a 49.5% interest in the Class B properties, both subject to its mortgage bonds and other debts.[12] The Children's Trust guaranteed other mortgage obligations of the debtor, in the amount of approximately $1,105,179, to Metro North. During the chapter 11 proceedings, the creditors' committee suggested the possibility that the transactions involving First Berkshire and the Children's Trust might be subject to avoidance under 11 U.S.C. § 544 as a fraudulent transfer. The debtor's chapter 11 plan provided that, "upon confirmation, all potential claims of the estate relating to the First Berkshire transaction would be compromised and released in exchange for a payment to the estate in the amount of $475,000 or 20% of the net proceeds to the Irrevocable Children's Trust from the sale of its interest in the Class A Properties of First Berkshire Business Trust, whichever is greater."[13] (R. 71G: Disclosure Statement, p. 35). The plan was to be implemented using these proceeds, plus $350,000 equity in the debtor's house, plus proceeds from avoidable transfers and an interest in Phoenix Business Trust, a highly speculative venture to be set up by the debtor. When the chapter 7 trustee took over, the properties had been sold, and the trustee recovered $2,250,000 in a global settlement. There is no way of knowing how the creditors would have fared with the interests in Phoenix, but the

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[12]Bartlett Hall, Inc., a Massachusetts corporation, 70% of the stock of which is owned by the debtor and 30% by Oscar Plotkin, owns 1% of the beneficial interests in the Class A and Class B properties. Mr. Plotkin owns the remaining 49.5% beneficial interest in the Class B properties. Both classes of properties are subject to approximately $169,000,000 of mortgage bonds which shall not be fully paid until the year 2021. (R. 17)

[13]The creditors' committee endorsed a proposed settlement of those claims for $600,000 on October 12, 1993. (R. 18) The compromise was never approved, however, due to the unresolved objections of other creditors. (R. 71G) Eventually, the chapter 7 trustee reached a global settlement of this and other claims and assets of the estate, which generated $2,250,000 for the estate. (R. 70)

actual dollars negotiated by the trustee with no ties to Joseph Crivello and his entities far surpasses the amount negotiated by the law firm being paid substantial sums by those entities.

A lawyer owes a duty of loyalty to each client, and concurrent representation, even in unrelated matters, poses the danger of divided loyalties and affected judgments. *In re Granite Partners, L.P.*, 219 B.R. 22, 37 (Bankr. S.D. N.Y. 1998). No matter how thoroughly or fairly KGW represented the debtor in possession, "the question will always linger whether it held back, or failed to bite the hand the feeds it quite as hard as the circumstances warranted." *Id.* at 38. KGW was being well fed by Joseph Crivello and his entities, and it showed.

E. Benefit to the Estate

KGW asserts that it deserves substantial compensation for its efforts in the chapter 11 case, including preparing the debtor's schedules, negotiating cash collateral agreements, successfully objecting to claims, dealing with several motions for relief from the automatic stay, bringing motions for § 363 sales of the debtor's real estate, and giving the reorganization process a shot. The firm objected to hundreds of inflated or improper claims and succeeded in reducing claims by millions of dollars, including the negotiation of Principal Mutual's waiver of its $38 million claim.

KGW points out that it disclosed the estate's claims involving the debtor's Children's Trust and the First Berkshire Business Trust, which ultimately generated the majority of the funds currently in the bankruptcy estate. Although the negotiations with counsel for the potential purchaser of First Berkshire's illiquid real estate assets were not fruitful, KGW asserts that the same law firm represented the eventual buyer. KGW further asserts that these disclosures and negotiations assisted both the chapter 7 trustee and buyer's counsel get up speed and achieve

prompt settlement. KGW also negotiated an almost consensual plan of reorganization, which won the votes of a majority in number, but not in amount, of unsecured creditors. KGW claims that the failure of the plan to be confirmed should not preclude the firm from receiving compensation.

Without question, the firm did a great deal of work in administering the chapter 11 case. However, it appears that creditors will receive more, perhaps as much as $1,000,000 more, than they would have under the debtor's proposed plan, due largely to the administration of a chapter 7 trustee. Given the long undisclosed relationship between the firm and other interested parties, and the amount of money flowing into the firm from these parties, this court is persuaded that the attorneys' representation of the estate was so thoroughly contaminated that denial of fees is appropriate, notwithstanding possible benefit.

A review of expenses for which reimbursement is requested reveals most are for legal research, copies, transcripts and the like, which provided similar questionable benefit to the estate. The filing fee of $600 did benefit the estate, however, and the firm shall be reimbursed for that cost.

F. Disgorgement

The chapter 7 trustee has moved this court to disgorge interim compensation of $76,270.94 awarded to KGW by Judge Clevert on December 22, 1993. No prior motion for specifically addressing disgorgement has been presented to the bankruptcy court. The order approving interim compensation for KGW included the following conditions:

> 2. The court will conduct a complete review of all fees and disbursements at the time of the hearing on final fee applications.

3. The payments made pursuant to this order are subject to recoupment in the event the assets of the Chapter 11 estate are insufficient to pay all administrative expenses in full.

(R. 26: Order Approving Interim Compensation, 12/22/93)

The trustee argues that because the appointment of KGW was subsequently vacated, reconsideration of the interim fees is required and disgorgement may be ordered if appropriate. The trustee also contends that the motion for disgorgement should be considered at this time.[14] If this court concludes that KGW is not entitled to any compensation, then judicial economy requires consideration of the disgorgement motion.

KGW, however, claims that Judge Clevert's prior ruling created law of the case which would preclude disgorgement at this time. Judge Clevert discussed the issue of disgorgement during the evidentiary hearing on KGW's fee application:

> If it did not provide for [recoupment], [recoupment] may certainly be considered a part[] of the final decision – I should say [disgorgement] – may be considered or will be considered. Just being straightforward, it will be considered because you have pointed out that [the] U.S. Trustee may be requesting that. That is something that's on the table.

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[14]The trustee notes that at the beginning of the case, to avoid duplication of effort, he deferred to the U.S. Trustee regarding objections to KGW's application for compensation. Accordingly, such deferral did not waive the statutory duty of the trustee to collect assets of the estate, including the disgorgement of fees. KGW claims that the trustee waived his right to be heard on the matter when he chose not to object to KGW's final fee applications. On objections to the trustee's counsel's application to increase fee his cap, this court previously ruled that

> [A]lthough the trustee deferred to the U.S. Trustee during the proceedings in 1995, he did not waive his right to participate in the fee entitlement or disgorgement dispute. The trustee is a party in interest on the remand and is entitled to be heard. Any duplication of efforts resulting in wasted resources will be reviewed when fees are approved by the court.

(Court Minutes, 4/7/98)

(R. 70: Transcript of 8/31/95 hearing, pp. 213-24) Judge Clevert's April 1, 1996, denial of all compensation did not specifically address the interim compensation previously awarded to KGW. Accordingly, because neither the chapter 7 trustee nor the U.S. Trustee cross-appealed that decision, KGW asserts that the issue of disgorgement cannot now be addressed. The trustee argues that because of the appeal and instant remand, the motion for disgorgement was held in abeyance and never considered until this time.

Finally, the trustee asserts that disgorgement of the interim compensation is appropriate in the case. KGW argues that disgorgement is discretionary. Section 330(a)(5) provides that

> The court shall reduce the amount of compensation awarded under this section by the amount of any interim compensation awarded under section 331, and, if the amount of such interim compensation exceeds the amount of compensation awarded under this section, may order the return of the excess to the estate.

11 U.S.C. § 330(a)(5).

This court attaches no significance to Judge Clevert's failure to mention return of funds. Arguments concerning whether the chapter 7 trustee can ask for disgorgement and whether anyone should have cross appealed the original decision are smokescreens. Judge Clevert revoked the appointment of the attorneys and awarded no fees. So does this court, after an independent review of the record pursuant to the instructions of the court of appeals. Without question, the only logical result of those rulings is that KGW cannot keep what it received on an interim basis. Section 330(a)(5) authorizes ordering return of fees in excess of the amount awarded. To claim the firm can keep $80,000 when it should not have been appointed and has no right to any fees would be totally inconsistent and an absurd result. They have to give it back.

CONCLUSION

By separate order, this court will order denial of all professional fees and reimbursement of expenses to Kravit, Gass & Weber, S.C., now Kravit & Gass, S.C., except for the $600 filing fee, and will order the return to the chapter 7 estate of any excess funds received pursuant to the interim order of the bankruptcy court dated December 23, 1993. Payment to the chapter 7 trustee will be due within 60 days of the date of the order.

This memorandum decision is this court's findings of fact and conclusions of law. Fed. R. Bankr. P. 7052.

Dated at Milwaukee, Wisconsin, December 2, 1998.

BY THE COURT

Honorable Margaret Dee McGarity
United States Bankruptcy Judge