

**IN THE UNITED STATES BANKRUPTCY COURT FOR THE
EASTERN DISTRICT OF TENNESSEE**

In re

Case No. 01-30528

ACUSA.com, INC.

Debtor

MAURICE K. GUINN, TRUSTEE

Plaintiff

v.

Adv. Proc. No. 01-3056

VICTOR E. GATTO, JR.,
JAMES B. MARSHALL, JR.,
MARK C. SHAW, JOY JACKSON
and THE NORTHLAND GROUP

Defendants

**MEMORANDUM ON DEFENDANTS' MOTION
TO DISQUALIFY PLAINTIFF'S COUNSEL**

APPEARANCES: KENNERLY, MONTGOMERY & FINLEY, P.C.
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The Northland Group

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

The court has before it the Defendants' Motion to Disqualify Plaintiff's Counsel filed on November 20, 2001, by Victor E. Gatto, Jr. (Gatto), James B. Marshall, Jr. (Marshall), and Mark C. Shaw (Shaw) (collectively, the Defendants).¹ The Defendants seek disqualification of the Plaintiff's counsel, Craig J. Donaldson, pursuant to Disciplinary Rule 5-102 and Canon 9 of the Tennessee Code of Professional Responsibility.² In opposition, the Plaintiff, Maurice K. Guinn, Trustee, filed a Response of Plaintiff to Defendants' Motion to Disqualify [Plaintiff's] Counsel on December 17, 2001. Each side has briefed its position to the court. Additionally, the Defendants have submitted numerous documents, affidavits, and deposition excerpts in support of their motion.

To the extent the Plaintiff's action involves issues that are noncore but are otherwise related to the Debtor's case under title 11, all parties to this adversary proceeding have consented to the entry of final judgments and orders by the bankruptcy judge. See 28 U.S.C.A. § 157(c)(2) (West 1993).

I

On December 21, 2000, eight shareholders commenced a shareholder derivative action on behalf of the Debtor against the five Defendants by filing a Complaint in the Chancery Court for Anderson County, Tennessee. Pursuant to § 323 of the Bankruptcy Code,³ the Trustee became

¹ The remaining Defendants, Joy Jackson and The Northland Group, are represented by separate counsel and did not join in the Motion to Disqualify.

² The Tennessee Code of Professional Responsibility has been adopted by this court. See E.D. Tenn. LBR 2090-2.

³ (a) The trustee in a case under this title is the representative of the estate.

(continued...)

the real party in interest upon the February 5, 2001 filing of the Debtor's Voluntary Chapter 7 Petition.⁴ The Defendants' action was removed from the state court to this court on April 25, 2001.

The Defendants were officers and/or directors of the Debtor. By his Complaint, the Trustee seeks damages for various acts of alleged mismanagement and self-dealing. The largest allegation of harm, for which the Plaintiff seeks damages of \$2,000,000.00, is based on the Defendants' purported failure to sell the Debtor's subsidiary, eCommerce Technical Services (eTS), to prospective purchaser John Baugues (Baugues).

The Defendants' Motion to Disqualify is based upon the involvement of the Plaintiff's attorney, Craig J. Donaldson, in the Baugues negotiations. While Donaldson never formally represented either party,⁵ he acknowledges that his role in the extended eTS talks was that of a "mediator" or "go-between"⁶ for Baugues and the Debtor's officers and directors.

³(...continued)

(b) The trustee in a case under this title has capacity to sue and be sued.

11 U.S.C.A. § 323 (West 1993).

⁴ Craig J. Donaldson represented the original shareholder plaintiffs and was retained by the Trustee.

⁵ Donaldson once proposed formally representing the Debtor in the eTS matter, but the relationship never reached fruition. However, at all times relevant to the present motion, Donaldson was instead representing three shareholders and/or employees of the Debtor. One of those shareholders was Jerry Eledge. Donaldson's client records show that his eTS "mediation" work was billed to "Jerry Eledge / Shareholders of ACUSA.com." Donaldson denies accepting any payment from Baugues, the Debtor, or the Defendants, but acknowledges receiving a loan of at least \$2,400.00 from Baugues that has not yet been repaid.

⁶ Illustrative of the depth of Donaldson's involvement is a document drafted by BMP Capital Resources, an entity related to Baugues. In a draft Confidentiality/Non-Circumvention Agreement dated August 8, 2000, BMP referred to Donaldson as "an attorney representing ACUSA.com, Inc."

Donaldson states that he relayed at least one offer and counteroffer between the parties and that he put in writing, for the Defendants' benefit, an oral offer by Baugues. Donaldson also recommended to the Defendants that they accept one of Baugues' offers. This recommendation was purportedly made on behalf of Donaldson's three original shareholder clients.

In defense of the Trustee's eTS claim, the Defendants assert that Baugues never made a *bona fide* purchase offer. The terms of Baugues' purported offers - and whether he in fact made an offer at all - will therefore be critical issues at trial. Because Baugues has testified to a lack of memory regarding much of the eTS negotiations, the Defendants contend that Donaldson's supplemental testimony will be necessary to both parties.⁷

II

Motions to disqualify are "very sensitive" and require the court to balance a number of competing interests. *See Bartech Indus., Inc. v. International Baking Co., Inc.*, 910 F. Supp. 388, 392 (E.D. Tenn. 1996).⁸ The present Motion to Disqualify is rooted in three separate provisions

⁷ For example, in addition to his involvement and communications with both sides throughout the negotiations, Donaldson once advised Baugues that a proposed offer was "unacceptable" and "not an offer." Also, according to the Defendants, Donaldson's billing records evidence frequent changes in position by Baugues. Further, Marshall and Shaw contend that Donaldson made a comment to them indicating that Baugues was not serious about purchasing eTS. Donaldson denies making the statement.

⁸ Those interests include:

1. upholding the highest ethical standards of the profession;
2. protecting the interest of the litigants in being represented by the attorneys of their choosing;
3. protecting the loyalty and confidences a prior client may have placed in a law firm or an attorney;

(continued...)

of the Tennessee Code of Professional Responsibility. First, DR 5-102(A) provides that an attorney must withdraw from pending litigation when he “learns or it is obvious” that he “ought” to be called as a witness on behalf of his client. TENNESSEE CODE OF PROFESSIONAL RESPONSIBILITY DR 5-102(A) (2001). The aim of Rule 5-102 is “to protect the attorney’s client in the event his attorney’s testimony is needed at trial.” *Coakley v. Daniels*, 840 S.W.2d 367, 371 (Tenn. Ct. App. 1992). Rule 5-102(A) contains an exception for instances where the attorney’s withdrawal would “work a substantial hardship on the client because of the distinctive value of the lawyer or the lawyer’s firm as counsel in the particular case.” TENNESSEE CODE OF PROFESSIONAL RESPONSIBILITY DR 5-101(B)(4).

The Defendants are also proceeding under DR 5-102(B). That rule provides that an attorney who “learns or it is obvious” that he may be called as a witness by a party other than his client must withdraw if “it is apparent that the testimony is or may be prejudicial to the client.” TENNESSEE CODE OF PROFESSIONAL RESPONSIBILITY DR 5-102(B). Unlike DR 5-102(A), Rule 5-102(B) does not incorporate the “substantial hardship” exception. *See id.*

Lastly, the Defendants argue that Donaldson’s continued representation of the Debtor would create an “appearance of impropriety” forbidden by Canon 9 of the Code of Professional Responsibility. *See Clinard v. Blackwood*, 46 S.W.3d 177, 186-89 (Tenn. 2001); *see also*

⁸(...continued)

4. the overriding societal interests in the integrity of the judicial process; and

5. guarding against such motions being used to secure a tactical advantage in the proceedings[.]

Bartech, 910 F. Supp. at 392.

Steinberg v. Morton (In re Buchanan), 25 B.R. 162, 170-71 (Bankr. E.D. Tenn. 1982). Ethical

Consideration 9-6 specifically provides:

Every lawyer owes a solemn duty to uphold the integrity and honor of the profession; to encourage respect for the law and for the courts and the judges thereof; to observe the Code of Professional Responsibility; to act as a member of a learned profession, one dedicated to public service; to cooperate with other lawyers in supporting the organized bar through the devoting of time, efforts, and financial support as professional standing and ability reasonably permit; to act at all times so as to reflect credit on the legal profession and to inspire the confidence, respect, and trust of clients and of the public; and *to strive to avoid not only professional impropriety but also the appearance of impropriety.*

TENNESSEE CODE OF PROFESSIONAL RESPONSIBILITY EC 9-6 (emphasis added). Disqualification based solely on an appearance of impropriety is “ordinarily unjustifiable” but may be warranted in situations where an attorney “switches sides.” *See Clinard*, 46 S.W.3d at 187-88.

Although the appearance of impropriety standard has received some criticism and is based upon a nonmandatory Ethical Consideration, the Supreme Court of Tennessee recently reaffirmed this basis for attorney disqualification. *See Clinard*, 46 S.W.3d at 186. The *Clinard* court’s analysis did not incorporate the “substantial hardship” defense, *see id.* at 186-89, nor is the defense mentioned within Canon 9.

III

After careful review, the court finds ample cause for Donaldson's disqualification in the present action. DR 5-102(B) is clearly implicated as it is "obvious" that Donaldson may be called as a witness by a party other than his client. Based on his unique position and Baugues' limited recollection of the eTS negotiations, Donaldson will likely be needed to provide relevant testimony that cannot be obtained from any other witness. At least some of that testimony will be, at a minimum, "prejudicial to [his] client."⁹

Additionally, the appearance of impropriety in this case is apparent. Donaldson, who previously acted as a *de facto* mediator for the Defendants, now represents the Defendants' opponents in litigation regarding the very subject of his prior mediation. See *Clinard*, 46 S.W.3d at 188 ("To analogize to baseball, [Donaldson] has not only switched teams, he has switched teams in the middle of the game after learning the signals."). That Donaldson never *formally* represented the Defendants does little to remove the taint of impropriety from this litigation.

In explaining the conflicting roles of advocate and witness, the Code of Professional Responsibility provides:

An advocate who becomes a witness is in the unseemly and ineffective position of arguing the advocate's own credibility. The roles of an advocate and of a witness are inconsistent; the function of an advocate is to advance or argue the cause of another, while that of a witness is to state facts objectively.

TENNESSEE CODE OF PROFESSIONAL RESPONSIBILITY EC 5-9. Were he not disqualified, Donaldson would be placed in the "unseemly and ineffective position" of: (1) arguing, as counsel,

⁹ See, e.g., *supra* n 7.

that Baugues indeed made a *bona fide* offer and that the Defendants breached their fiduciary duties to the alleged extent of \$2,000,000.00 by not accepting that offer; (2) stating, as a witness, that Baugues' offer was genuine and that Donaldson previously, as a mediator, advised the Defendants to accept it; (3) explaining, as a witness, his notations that Baugues' purported offer was "unacceptable" and "not an offer"; and (4) denying, as a witness, that he made a disparaging comment as to Baugues' seriousness regarding the eTS negotiations, all the while remembering that Baugues is a former *de facto* mediation client to whom he owes \$2,400.00.

The appearance of impropriety in this litigation is both real and objective. See *Clinard*, 46 S.W.3d at 187 (Appearance must be both real and objective as viewed through the eyes of a fully informed layperson.). Donaldson's transformation from mediator to opposing counsel "creates an unsavory appearance of conflict of interest that is difficult to dispel in the eyes of the lay public" or this court. *Id.* at 188 (quoting *Analytica, Inc. v. NPD Research, Inc.*, 708 F.2d 1263, 1269 (7th Cir. 1983)).

Having found ample grounds for disqualification under DR 5-102(B) and Canon 9, the court need not address the Defendants' DR 5-102(A) disqualification theory. However, were a Rule 5-102(A) analysis to occur, the court is compelled to note that it would reject the Trustee's "substantial hardship" defense. That defense is limited to substantial hardships caused by "the distinctive value of the lawyer or the lawyer's firm as counsel in the particular case." TENNESSEE CODE OF PROFESSIONAL RESPONSIBILITY DR 5-101(B)(4). Donaldson's "distinctive value" to the Trustee results first and foremost from his intimate familiarity with this case. As previously discussed however, Donaldson's intimate familiarity, while undoubtedly valuable to the Trustee,

is simply too intimate. Any hardship to the Trustee resulting from Donaldson's disqualification is outweighed by the "materiality of [Donaldson's] testimony[] and [the potential ineffectiveness caused by Donaldson's] personal involvement." TENNESSEE CODE OF PROFESSIONAL RESPONSIBILITY EC 5-10 ("[D]oubts should be resolved in favor of the lawyer testifying and against becoming or continuing as an advocate.").

For the reasons discussed herein, the Defendants' Motion to Disqualify Plaintiff's Counsel must be granted. An appropriate order will be entered.

FILED: January 2, 2002

BY THE COURT

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

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VICTOR E. GATTO, JR.,
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MARK C. SHAW, JOY JACKSON
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Defendants

ORDER

For the reasons stated in the Memorandum on Defendants' Motion to Disqualify Plaintiff's Counsel filed this date, the court directs the following:

1. The Defendants' Motion to Disqualify Plaintiff's Counsel filed November 20, 2001, by Defendants Victor E. Gatto, Jr., James B. Marshall, Jr., and Mark C. Shaw is GRANTED.
2. The Plaintiff's attorney, Craig J. Donaldson, is disqualified from representing the Plaintiff in the prosecution of this adversary proceeding.

SO ORDERED.

ENTER: January 2, 2002

BY THE COURT

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE