UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

CIVIL ACTION NO. 06-11444-RWZ

STEPHEN S. GRAY, AS TRUSTEE OF THE
HIGH VOLTAGE ENGINEERING LIQUIDATING TRUST

v.

EVERCORE RESTRUCTURING L.P., EVERCORE RESTRUCTURING L.L.C.,
FRIED, FRANK, HARRIS, SHRIVER & JACOBSON LLP, and
JEFFERIES & COMPANY, INC.

MEMORANDUM OF DECISION AND ORDER

September 19, 2007

ZOBEL, D.J.

I. Introduction

Plaintiff, trustee of the liquidation trust of a debtor company, seeks damages against defendants for gross negligence and breach of fiduciary duty in rendering professional services to creditors and debtor company in connection with a previous bankruptcy filing. For the reasons discussed below, all defendants are entitled to dismissal of plaintiff's claims.

II. Factual and Procedural Background

A. The 2004 Restructuring Agreement

In mid-2003, High Voltage Engineering Corporation ("HVE"), a holding company owning energy and manufacturing companies, had trouble meeting its obligations to its creditors. At the time, the largest group of unsecured creditors were holders of $155 million in 1997 10 ½% Senior Notes (the "Noteholders"). HVE began negotiations with

an unofficial committee of holders of these notes (the "Unofficial Committee"), which retained defendant Jefferies & Company, Inc. ("Jefferies") to serve as its financial advisor in the negotiations. HVE retained defendant Evercore Restructuring L.L.C., successor to Evercore Restructuring L.P. (collectively "Evercore"), as its financial advisor. HVE later retained defendant law firm Fried, Frank, Harris, Shriver & Jacobson LLP ("Fried Frank") as one of several counsel in connection with the restructuring.

In February 2004, HVE reached an agreement (the "Restructuring Agreement") with a majority of the Noteholders to declare Chapter 11 bankruptcy. Under this agreement, trade creditors were to be paid in full and the Noteholders were to exchange their outstanding debt for substantially all the equity in the reorganized company.

B. The 2004 Chapter 11 Bankruptcy Filing

On March 1, 2004, HVE and several of its subsidiaries (the "2004 Debtors") filed for relief under Chapter 11 of the Bankruptcy Code as contemplated by the Restructuring Agreement. The bankruptcy court authorized the continued employment of defendants Evercore and Fried Frank by the 2004 Debtors and Jefferies was retained to advise the Official Committee of Unsecured Creditors (the "2004 Committee").

On July 21, 2004, the bankruptcy court confirmed the Third Amended Joint Chapter 11 Reorganization Plan (the "Plan"). On August 1, 2004, the effective date of the Plan, all of the existing Senior Notes were canceled and the Noteholders received

97% of the common stock of the Reorganized Company. The Reorganized Company retained the exclusive right to enforce any and all causes of action of the 2004 Debtors.

The Plan provided broad release provisions for HVE, the Reorganized Company and its advisors. One hundred percent of the pre-petition Noteholders voted to accept the Plan and all former Noteholders were bound by the terms of the Plan. Jefferies was retained by the Reorganized Company to provide investment banking advice, while Fried Frank and Evercore had no further involvement after the effective date of the Plan.

C. The 2005 Chapter 11 Bankruptcy Filing

The financial projections provided to the court in the 2004 bankruptcy filing proved to be excessively optimistic, and the Reorganized Company quickly found itself back in a cash crisis. Several subsidiaries of the Reorganized Company began delaying payments to suppliers and, as a result, key suppliers refused to ship on credit terms. Barely six months after the approval of the reorganization, on February 8, 2005, the Reorganized Company, including certain subsidiaries (the "2005 Debtors"), sought bankruptcy protection for a second time. The bankruptcy court sua sponte appointed a Chapter 11 Trustee who filed a plan of liquidation. The liquidation plan paid all administrative, secured and unsecured claims in full with interest and anticipated distributing $54 to $56 million to the Equity Holders. The Equity Holders, consisting primarily of the former Noteholders, voted to accept the plan and all claims of the Debtors and the Equity Holders were transferred to the Liquidation Trust. The Liquidation Trustee (the "Trustee") was authorized to pursue all litigation claims and

was deemed “substituted as party in interest in place and stead of the Debtors and/or Chapter 11 Trustee . . . .” (Docket # 55-2 at 17 (internal quotation marks omitted).)

D. The Civil Action Against the Professional Organizations

On August 15, 2006, the Trustee filed the instant complaint against defendants Evercore, Fried Frank and Jefferies to recover damages he alleges were caused by their gross negligence and breach of fiduciary duty. (See Docket # 1.) Plaintiff amended the complaint (the “Amended Complaint” (Docket # 5)) on September 9, 2006.

In the Amended Complaint, plaintiff describes a litany of relevant economic information and flawed financial plans that he alleges were not supplied to or were concealed from the bankruptcy court by the 2004 Debtors with the knowledge and complicity of defendants. As a result, that court was allegedly induced to confirm a plan that left the Reorganized Company with insufficient working capital and caused it to file bankruptcy again a mere six months later.

The Amended Complaint alleges gross negligence by Jefferies on behalf of the 2004 Committee and 2004 Debtors (Count I) and on behalf of the Equity Holders (Count II); breach of fiduciary duty against Jefferies on behalf of the 2005 Debtors (Count III); negligence against Jefferies on behalf of the 2005 Debtors (Count IV); gross negligence (Count V) and breach of fiduciary duty (Count VI) against Evercore on behalf of the 2004 Debtors; and gross negligence (Count VII) and breach of fiduciary duty (Count VIII) against Fried Frank on behalf of the 2004 Debtors. Jefferies asserts several counterclaims alleging breach of contract for failure to make payments and

deliver shares of company stock it claims are due under three separate retention agreements (Counterclaims I - III). (See Docket # 16 ¶¶ 322-30.)

Evercore and Jefferies have each filed motions for judgment on the pleadings (Dockets # 21 and # 45 respectively) under Fed. R. Civ. P. 12(c), and defendant Fried Frank has filed a motion to dismiss (Docket # 47). All three defendants rely on the doctrines of in pari delicto and res judicata, as well as collateral estoppel, indemnification under the terms of the releases in the Plan confirmed by the bankruptcy court and the provisions of their respective engagement letters. They further cite a failure to plead facts adequate to prove gross negligence and breach of fiduciary duty.

E. The Bankruptcy Court's Intervening Ruling on Plaintiff's Rule 60(b) Motion

On November 9, 2005, the Chapter 11 Trustee filed a Rule 60(b) motion in the bankruptcy court to vacate the orders of the court and reconsider the administrative expense claims of the professionals, including a law firm not in the instant case. Once the claims were transferred to the Liquidation Trust, the Trustee filed supplements to the motion to vacate. The motion sought to vacate orders issued after the first bankruptcy awarding compensation (1) to Fried Frank, as counsel to the 2004 Debtors; (2) to Evercore, as financial advisor to the 2004 Debtors; and (3) to Jefferies, as financial advisor to the 2004 Committee. The allegations set forth in support of the motion mirror those of the instant case; that the professionals knew that the financial projections provided to support the first Chapter 11 filing were inaccurate and the funding inadequate, but they failed to notify the court. (See id. at 17-18.) Defendants

asserted substantially the same arguments made here, as well as the doctrine of judicial estoppel.

Shortly before this court held its hearing on defendants' motions, the bankruptcy court denied the Trustee's motion to vacate and reconsider.[1] See In re High Voltage Eng'g Corp., 360 B.R. 369 (Bankr. D. Mass. 2007) (Docket # 55-2). The bankruptcy judge found that the "Liquidation Trustee, whose claims derive from those of the 2004 Reorganized Debtors, b[ore] equal responsibility, by operation of law, for the wrong he s[ought] to address." (Id. at 28-29.) In addition, the court found that equity would not be served by allowing the debtors to recover for the very harm they generated. (Id. at 29-30.) Therefore, it held that the defense of in pari delicto precluded vacating the previous compensation orders. The bankruptcy judge also found that "the release and exculpation provisions set forth in the confirmed Plan bind the Reorganized Debtors and the Liquidating Trustee who stands in their shoes." (Docket # 55-2 at 32.)[2]

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[1] The Trustee has filed an appeal of the bankruptcy court's denial of his motion to vacate. (See Docket 07-cv-10485-RWZ.)

[2] I take judicial notice of the decision of the bankruptcy court. See Kowalski v. Gagne, 914 F.2d 299, 305 (1st Cir.1990) ("It is well-accepted that federal courts may take judicial notice of proceedings in other courts if those proceedings have relevance to the matters at hand."); Rodi v. Southern New England School Of Law, 389 F.3d 5, 12 (1st Cir. 2004) ("[T]he jurisprudence of Rule 12(b)(6) permits courts to consider matters that are susceptible to judicial notice.").

I also take judicial notice of the Third Amended Joint Chapter 11 Plan of Reorganization (Docket # 48-2), the Chapter 11 Trustee's First Amended Plan of Liquidation under Chapter 11 of the Bankruptcy Code, Dated April 5, 2006 (Docket # 48-7) (the "Liquidation Plan") and its accompanying Liquidating Trust Agreement (Docket # 48-8) and the bankruptcy court's confirmation orders for each plan (Order Pursuant to Section 1129 of the Bankruptcy Code Confirming the Debtors' Third Amended Chapter 11 Plan (Docket # 48-3) and Order Confirming the Chapter 11

III. Legal Standard

A motion for judgment on the pleadings pursuant to Fed. R. Civ. P. 12(c) is analyzed under essentially the same substantive standard applied to motions for dismissal under Fed. R. Civ. P. 12(b)(6). See, e.g., Pasdon v. City of Peabody, 417 F.3d 225, 226 (1st Cir. 2005). "[T]he trial court must accept all of the nonmovant's well-pleaded factual averments as true, and draw all reasonable inferences in his favor." Id. (quoting Rivera-Gomez v. de Castro, 843 F.2d 631, 635 (1st Cir.1998)). Judgment on the pleadings "may not be entered unless it appears beyond a doubt that the nonmoving party can prove no set of facts in support of her claim which would entitle her to relief." McCord v. Horace Mann Ins. Co., 390 F.3d 138, 141 (1st Cir. 2004) (internal citations omitted). Thus, I apply the same legal standard to the motions of all three defendants.

IV. Discussion

A. Claims Brought on Behalf of the 2004 Debtors (Counts I, V, VI, VII and VIII)

1. The Application of the Doctrine of In Pari Delicto to Cases Brought by a Bankruptcy or Liquidation Trustee

The doctrine of in pari delicto prohibits plaintiffs from recovering for harm for which they are culpable. See Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S.

Trustee's First Amended Plan of Liquidation Under Chapter 11 of the Bankruptcy Code, As Modified (Docket # 48-8)). See In re Mailman Steam Carpet Cleaning Corp., 196 F.3d 1, 6 n.2 (1st Cir. 1999) ("[i]n deciding a 12(b)(6) motion to dismiss, a court may permissibly refer to matters of public record") (quoting Cinel v. Connick, 15 F.3d 1338, 1343 n. 6 (5th Cir.1994)).

299, 306 (1985). The doctrine discourages wrongdoing by denying judicial relief to parties complicit in the illegal behavior. Id. In addition, it avoids embroiling the "good offices" of the courts in resolving disputes between wrongdoers. Id.

In a series of recent cases, the First Circuit has defined the parameters of the doctrine and its application to cases brought by a bankruptcy or liquidation trustee against the pre-petition professional advisors of the debtor. In Nisselson v. Lernout, 469 F.3d 143 (1st Cir. 2006), Lernout & Hauspie, N.V. ("L & H") acquired the outstanding stock of Old Dictaphone in exchange for 9.4 million shares of the common stock of L & H worth $930 million at the time. Old Dictaphone was merged into a wholly-owned subsidiary of L & H which was subsequently renamed New Dictaphone. New Dictaphone inherited all existing legal claims of the old corporation at the time of the merger. Shortly after the merger, the value of L & H shares plunged due to improperly recorded revenue which overstated net profit by $140 million. As a result, both L & H and New Dictaphone filed for bankruptcy and the stock Old Dictaphone shareholders received in payment for the company was worthless. Nisselson, 469 F.3d at 148.

The approved plan of reorganization transferred any claims arising out of the merger to a Litigation Trust. The trustee of the trust filed suit against the officers and directors of L & H and its investment bankers, attorneys and auditors asserting they knowingly misrepresented the value of L & H's stock. The claims against the third-parties were based on the trustee's allegations that the professionals assisted L & H in promoting misrepresentations about its earnings and stock value even though they

knew the information was false. Defendants moved to dismiss, arguing that the claims were barred under the in pari delicto doctrine. Id. at 149.

The First Circuit affirmed the lower court's dismissal of the claims, inter alia, on the ground that the in pari delicto doctrine barred the claims. It noted that a motion to dismiss may be allowed on the "inevitable success of an affirmative defense" as long as the facts could be determined from allowable sources of information and were sufficient "to establish the affirmative defense with certitude." Id. at 150. The court described the in pari delicto doctrine as applicable to those situations in which "(I) the plaintiff, as compared to the defendant, bears at least substantially equal responsibility for the wrong he seeks to redress and (ii) preclusion of the suit would not interfere with the purposes of the underlying law or otherwise contravene the public interest." Nisselson, 469 F.3d at 152 (citing Pinter v. Dahl, 486 U.S. 622 (1988); Bateman Eichler, 472 U.S. at 310-11).

In analyzing the first prong of the in pari delicto doctrine, the First Circuit said that the trustee could only assert those claims that the debtor could have asserted before the bankruptcy. Id. at 153. Therefore, "the in pari delicto defense must be available to a defendant in an action by a bankruptcy trustee whenever that defense would have been available in an action by the debtor." Id. Because the complaint left no doubt that persons responsible for the fraud controlled L & H, which in turn controlled New Dictaphone, their conduct was imputed to the latter for the purposes of the in pari delicto analysis. Id. Therefore, the court concluded that the first prong of the doctrine had been met, that New Dictaphone "bears at least as much responsibility

for the asserted wrongdoing as any of the defendants." Id. at 157.

In considering the second prong of the doctrine, the court had no difficulty concluding that there was no public policy reason to deny the defense. Indeed, it found that allowing the defense was the preferred course of action because it prevented "creditors with unclean hands [from] profit[ing] equally with innocents." Id. at 158. Those innocent parties, it noted, were not affected by the doctrine and could still recover via individual suits. Id.; see also Official Comm. of Unsecured Creditors of PSA, Inc. v. Edwards, 437 F.3d 1145, 1151 (11th Cir. 2006) (noting that innocent creditors could recover more outside of bankruptcy because the recovery would not be shared with claims by parties barred by the in pari delicto defense).

The First Circuit on an in pari delicto defense similarly affirmed the lower court's dismissal of a suit by the same trustee against the auditors of L & H. Baena v. KPMG LLP, 453 F.3d 1, 10 (1st Cir. 2006). The trustee had brought a claim under Mass. Gen. Laws ch. 93A, § 11, alleging that KPMG had ignored or abetted L & H management's misstatements concerning its financial condition. The court, noting that the trustee stood in the shoes of the pre-filing corporation and that the corporation could act only through its management, concluded that the Massachusetts courts would not allow those managers to sue an accomplice such as the auditors for complicity in the wrong. Id. at 7. It rejected a number of objections to the application of the doctrine by the trustee, including an innocent shareholder limitation. Id. at 8; see also Official Committee of Unsecured Creditors v. R.F. Lafferty & Co., Inc., 267 F.3d 340, 360 (3d Cir. 2001) (dismissing claims of creditors' committee appointed by bankruptcy trustee

against third-party professional because, having status of debtor corporation, it was in pari delicto with the professional it was suing).

2. Application of the Doctrine to the Claims Brought on Behalf of the 2004 Debtors

a. Determining the Standing of the Trustee to Bring Claims for the Purpose of Analyzing the In Pari Delicto Defense

In the instant case, the Trustee claims standing to pursue all causes of action available to the 2005 Debtors as well as certain claims held by the holders of the Reorganized Company's equity. (Am. Compl. ¶ 7.) Counts I, V, VI, VII and VIII all purport to assert claims of gross negligence and breach of fiduciary duty on behalf of the 2004 Debtors. (See Am. Compl. ¶¶ 226-40, 263-92.) The Trustee has standing only to pursue such causes of action as the 2005 Debtors would be able to pursue. See Nisselson, 469 F.3d at 153 (noting that "a trustee in bankruptcy cannot and does not acquire rights or interests superior to, or greater than, those possessed by the debtor"); see also In re Advanced RISC Corp., 324 B.R. 10 (D. Mass. 2005) ("[T]he Bankruptcy Code is clear: the bankrupt estate consists of 'all legal or equitable interests of the debtor in property as of the commencement of the case.'") (citing 11 U.S.C. § 541(a)(1)) (emphasis in original)).

The rights of the Reorganized Company, and thus of the 2005 Debtors, to pursue claims accruing to the 2004 Debtors are determined by the terms of the Plan confirmed by the bankruptcy court on July 21, 2004. That plan included extensive release provisions (Docket # 48, Ex. A § 12) agreed to by the 2004 Debtors, which defendants also invoke. To the extent the 2005 Debtors are barred by these provisions

from asserting a cause of action, the Trustee is similarly barred. The Trustee disputes the applicability of these provisions to the instant claims. All parties agree, however, that the Liquidation Trustee stands in the shoes of the 2004 Debtors for the purposes of analyzing defenses to these claims.[3] Because the 2004 Debtors are at least as culpable for the harm alleged as defendants, see infra Part IV.A.2.b., these counts fail. Therefore, I need not address the releases, as Counts I, V, VI, VII and VIII fail in any event.

b. Complicity of the 2004 Debtors

Plaintiff argues that the in pari delicto defense cannot be applied because the first prong of the defense, relative culpability, cannot be ascertained from the complaint. The Amended Complaint, however, is replete with descriptions of wrongful conduct by the 2004 Debtors comparable to that attributed to defendants and, in some cases, carried out jointly (emphasis added below):

> By mid-June the 2004 Debtors, Evercore, Fried Frank and Jefferies all realized that the $35 million exit financing would be insufficient to fund both the payments required on confirmation and the 2004 Debtors' post-confirmation operations. (Am. Compl. ¶ 77.)
>
> [U]pon information and belief, the cash flow projections on which the 2004 Debtors decided to proceed with the confirmation of the Third Amended Plan allocated only $2.4 million in funding from the 2004 Debtors to [foreign non-debtor subsidiary] ASI SpA in the 120 days after emergence,

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[3] (See Mem. of Law in Supp of Mot. of Evercore Restructuring L.L.C. for J. on the Pleadings Under Fed. R. Civ. P. 12(c) (Docket # 22), 1; Mem. of Law in Supp. of Def. Jefferies & Company, Inc.'s Mot. for J. on the Pleadings Pursuant to Fed. R. of Civ. P. 12(c) (Docket # 46), 8; Fried, Frank, Harris, Shriver & Jacobson LLP's Mem. of Law in Supp. of Mot. to Dismiss the Am. Compl. (Docket # 50), 14; Pl.'s Omnibus Mem. of Law in Opp. to Defs.' Mots. to Dismiss the Am. Compl. and Mots. for J. on the Pleadings (Docket # 51), 21; see also Hr'g Tr. 45:16-24, Jan. 23, 2007.)

far less than the 8 million Euros (approximately $10.2 million) that [Russell] Shade[, the CEO of HVE,] had promised at the ASI SpA board meeting held on June 1, 2004. (Id. ¶ 90.)

The 2004 Debtors and their advisors did not provide ASI SpA's financial projections to either the Bankruptcy Court or the unsecured creditors . . . . (Id. ¶ 93.)

The 2004 Debtors further revised their drafts of the Confirmation Cash Forecasts in the weeks following the continuance of the confirmation hearing, but never submitted the revised Confirmation Cash Forecasts to the Bankruptcy Court. (Id. ¶ 116.)

Upon information and belief, the 2004 Debtors assumed they could force this increase in trade credit on many of their suppliers . . . . The Defendants, therefore, knew or should have known that this assumption was not attainable voluntarily. (Id. ¶ 123.)

On or about July 1, 2004, the 2004 Debtors, Evercore and Fried Frank circulated revised drafts [anticipating a cash deficit after emergence] of the Confirmation Cash Forecasts to, inter alia, Jefferies. (Id. ¶ 127.)

The 2004 Debtors sought to confirm the Third Amended Plan despite the fact that the 2004 Debtors' evidentiary proffer, as described below, in support of confirmation contained information that was out-of-date, inaccurate and incomplete. (Id. ¶ 150.)

The only financial projections submitted to the Bankruptcy Court to support feasability – the Disclosure Statement Forecast – were a summary of the same "preliminary" financial projections prepared by the 2004 Debtors and Evercore in late February 2004 . . . . (Id. ¶ 174.)

In an e-mail sent just one day before the July 21, 2004 confirmation hearing, [Joseph] McHugh[, the chief financial officer of HVE,] informed Shade and the 2004 Debtors post-Effective Date board of directors that the operating projections in the Disclosure Statement Forecast "had underestimated the customers' reaction to the bankruptcy" and that this had materially affected the 2004 Debtors' collections. (Id. ¶ 176.)

Accordingly, the 2004 Debtors and the Defendants knew, or should have known, that the Disclosure Statement Forecast did not accurately depict the 2004 Debtors' financial situation immediately prior to the confirmation hearing. (Id. ¶ 177.)

> Further, at the time of the confirmation hearing, the 2004 Debtors and the Dependants were aware of a number of significant variations from the post-confirmation cash requirements reflected in the Disclosure Statement Forecast that was presented to the Bankruptcy Court. (Id. ¶ 180.)
>
> One major issue [prior to the confirmation hearing] was that by the end of June 2004, the 2004 Debtors' management had discovered material problems with their assumption regarding "Contract Funding," a discrete aspect of the 2004 Debtors' working capital and a critical component of the projections contained in the Disclosure Statement Forecast. (Id. ¶ 181.)
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> Although Fried Frank prepared a revised draft of the Shade Declaration [averring that the Plan satisfied certain requirements for confirmation] "to reflect new proposals for exit financing," the 2004 Debtors never submitted a revised Fitzsimmons Declaration [averring that the Plan satisfied the "best interests" test pursuant to Section 1129(a)(7) of the Bankruptcy Code]. (Id. ¶ 188.)
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> Nor did the 2004 Debtors submit the Confirmation Cash Forecasts and the Bridge Analysis[, an informal variance analysis against cash flow projections in the 2005 Budget,] to the Bankruptcy Court or the voting creditors. (Id. ¶ 189.)[4]

Despite this litany of wrongdoing and complicity by the 2004 Debtors in the

[4] In addition, at the hearing on defendants' motions, counsel for the Trustee described the 2004 Debtors as providing the allegedly inaccurate and misleading information that led to the failure of the Plan:

> In fact, we cited in our complaint an email from one of the attorneys at Fried Frank who expressed frustration with the inability to get accurate or consistent financial information from the debtor. (Hr'g Tr. 49:5-8, Jan. 23, 2007.)
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> The[] [professionals] were not potted plants who were supposed to stand and watch the debtor do what the debtor did. (Hr'g Tr. 49:2-3, Jan. 23, 2007.)
>
> The information which the debtors provided to the professionals should have alerted the professionals to the fact that the information couldn't be trusted. (Hr'g Tr. 50:14-16, Jan. 23, 2007.)

alleged plot to confirm a plan that left the Reorganized Company with insufficient working capital and caused it to file a bankruptcy again a mere six months later, plaintiff argues that the in pari delicto defense is not applicable because the 2004 Debtors "bear no fault for the Defendants' gross negligence and breach of fiduciary duty." (Docket # 51, 21.) In effect, plaintiff tries to separate the 2004 Debtors' wrongdoing in deliberately presenting an unworkable plan to the bankruptcy court from defendants' alleged wrongdoing in not informing the bankruptcy court of the 2004 Debtors nefarious intent. This is an unreasonably narrow interpretation of the doctrine that, if adopted, would nullify its intent to prevent the courts from becoming embroiled in disputes among wrongdoers. See Nisselson, 469 F.3d at 151-52. It is a comparison of the relative responsibility for the overall wrongful conduct that is the subject of the suit, not a comparison of the responsibility for the individual wrongs comprising the greater wrong, that is relevant in the in pari delicto analysis. See id. at 155 ("The first prong of the in pari delicto inquiry focuses on 'the unlawful activity that is the subject of the suit.'") (quoting Pinter v. Dahl, 486 U.S. 622, 636 (1988)); see also Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., Inc., 267 F.3d 340 (3d Cir. 2001) (holding claims against defendant alleged to have fraudulently induced Debtors to issue debt securities leading to insolvency were barred by the defense of in pari delicto due to the conduct of Debtors' management in creating fraudulent enterprise).

Here, the crux of the complaint is that the professionals aided and abetted the 2004 Debtors in presenting a unworkable plan to the bankruptcy court. According to the complaint, both the 2004 Debtors and the professionals knew that the Plan relied

on inaccurate figures, unreasonable assumptions and optimistic projections. They all knew that the Plan would result in a serious cash shortfall, and all concealed the flaws in the Plan from the bankruptcy court in order to obtain its confirmation. As a result, the Reorganized Company was underfunded and was forced to seek protection from the bankruptcy court within months after the company emerged from the first bankruptcy proceeding. (See Am. Compl. ¶¶ 35-179.) The Amended Complaint does not paint a picture of an unsophisticated management relying on the advice of skilled professionals who withheld pertinent information concerning the financial deficiencies of the Plan; rather, it portrays the 2004 Debtors as partners in a conspiracy to obtain confirmation of the Plan by withholding its deficiencies from the bankruptcy court. Cf. Baena, 453 F.3d at 6 (affirming a lower court dismissal based on an in pari delicto defense for what the First Circuit described as "essentially a fraud, knowingly tolerated or abetted by KPMG, but primarily one committed by L & H's own management in misstating its earnings").

Of all the parties on whose behalf the Trustee brings his claims, the 2004 Debtors, i.e., the management of the pre-2004 bankruptcy companies, are the ones described in the Amended Complaint as most directly responsible for the errors and omissions in the Plan. They worked directly with Evercore and Fried Frank in formulating the Plan, they provided figures and information on the operation of the pre-filing company and they were most familiar with the businesses and operations of the organizations being reorganized. Based on the allegations in the Amended Complaint, the first prong of the in pari delicto defense (i.e., that the 2004 Debtors were at least as

responsible for the failure of the Plan as defendants), has clearly been met.

c. Contravening the Public Interest

For the same reasons, precluding the suit against the 2004 Debtors will "not interfere with the purposes of the underlying law or otherwise contravene the public interest." Nisselson, 469 F.3d at 152. Indeed, barring the claims supports the twin goals of the doctrine, discouraging wrongdoing and avoiding involvement by the courts in resolving disputes between wrongdoers. Id. at 151. The 2004 Debtors cannot conspire with third parties to obtain confirmation of a flawed reorganization plan, then enlist the courts, through the Liquidation Trustee, to obtain reimbursement from those third parties for the resulting failure of that plan. The public interest is enhanced by discouraging the actions of the 2004 Debtors, not by providing them an avenue of indemnification when their actions cause damage and injury to the shareholders and creditors of HVE.

Therefore, Counts I, V, VI, VII and VIII brought on behalf of the 2004 Debtors are barred by the doctrine of in pari delicto.

3. Claims Brought Against Jefferies on Behalf of the 2004 Debtors (Count I)

Count I asserts gross negligence against Jefferies on behalf of, inter alia, the 2004 Debtors. The Amended Complaint, however, does not allege that Jefferies was ever retained by the 2004 Debtors in any capacity, and therefore it could not owe them any duty. (See Am. Compl. ¶ 27 (The Unofficial Committee of Noteholders retained Jefferies as its financial advisor . . . .); id. ¶ 49 ([T]he bankruptcy court approved the retention of Jefferies as financial advisor to the [Official] Committee . . . .); id. ¶ 197

(Evercore, Fried Frank and Jefferies, who purported to provide expert restructuring advice to the 2004 Debtors and 2004 Committee, respectively . . .) (emphases added); id. ¶¶ 214-16 ("Prior to the commencement of the 2004 Cases, Jefferies had been retained as financial advisor by the Unofficial Committee of Noteholders. After the commencement of the 2004 Cases, Jefferies was retained by the 2004 Committee as its financial advisor. Following the confirmation of the 2004 Plan, Jefferies was retained by the reorganized debtor . . . to provide investment banking advice.") (emphasis added).)

Indeed, in plaintiff's opposition to Jefferies' motion, the Trustee fails to offer any source for a duty owed by Jefferies to the 2004 Debtors. (See Docket # 51, 13-15.) The only duty he describes is to the pre-2004 confirmation creditors. (Id.) Therefore, the Amended Complaint fails to state a claim against Jefferies on behalf of the 2004 Debtors, even if the in pari delicto defense did not bar claims brought on their behalf.

B. Claims Brought Against Jefferies on Behalf of the 2004 Committee (Count I)

The Amended Complaint also asserts Count I against Jefferies on behalf of the 2004 [Official] Committee [of Unsecured Creditors]. (Am. Compl. ¶¶ 47, 226-40.) However, the Liquidation Plan does not give the Trustee standing to bring claims on behalf the 2004 Committee. (See id. ¶ 7; see also Jefferies' Mem. in Supp. of its Mot. (Docket # 46), 7; cf. Plaintiff's Omnibus Opp. Mem. (Docket # 51), 12 n.11, 13 (appearing to abandon Claim I on behalf of the 2004 Committee: "Count I is asserted against Jefferies on behalf of the 2004 Debtors; . . ." and "Jefferies seeks to dismiss Counts I and II, brought in the right of the 2004 Debtors and the Equity Holders

respectively, . . .") (emphasis added); Docket # 53, 2 n.2.) Therefore, the remainder of Count I against Jefferies is dismissed for lack of standing to bring the claim.

C. Claims Brought on Behalf of the Equity Holders (Count II)

1. Standing of the Trustee to Assert Claims Alleging Harm to the Unofficial Committee of Noteholders on Behalf of the Equity Holders

The Trustee alleges gross negligence (Count II) on behalf of the Equity Holders against Jefferies for its "intentional acts and omissions" as financial advisors to the Unofficial Committee. (Am. Compl. ¶¶ 241-46.) As their successors-in-interest, the Equity Holders have standing to bring causes of actions available to the Noteholders. (See Am. Compl. ¶ 35.) The Equity Holders, in turn, have ceded their rights to any causes of action to the Trustee. (Id. ¶ 7.) Thus, the Trustee stands in the shoes of the Equity Holders, and the Equity Holders are one-and-the-same as the pre-confirmation Noteholders, having exchanged their debt for equity in the Reorganized Company.[5]

Count II, however, does not allege that Jefferies committed acts and omissions against the Noteholders; rather, plaintiff's claims are based on Jefferies' actions as advisor to the Unofficial Committee of Noteholders. (See Am. Compl. ¶¶ 241-46.) The issue is whether the Trustee, on behalf of the Equity Holders, can bring a claim alleging gross negligence where the duty owed was to the Unofficial Committee.

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[5] The Amended Complaint does not allege that, in fact, the Equity Holders in the 2005 bankruptcy are one-and-the-same as the pre-confirmation Noteholders. It is possible that some Noteholders receiving equity after the first bankruptcy could have sold or transferred their equity to third parties prior to the second bankruptcy. Jefferies suggests as much. (See Docket # 53, 4 n.6.) For the purpose of analyzing the present motions, I assume that the Equity Holders, and thus the Trustee, have adequate privity with the Noteholders to bring any claims accruing to them.

The Amended Complaint alleges that an "ad hoc committee of holders of the Senior Notes" retained Jefferies as its financial advisor to "assist it with respect to discussions with the [pre-2004] Debtors concerning a restructure of the Senior Notes." (Am. Compl. ¶¶ 26-27.) These negotiations resulted in the February 2004 Restructuring Agreement between multiple interested parties, including "holders of in excess of 53% of the Senior Notes." (Id. ¶ 34.) Because the Unofficial Committee neither represented nor had power to bind all Noteholders, it is not in privity with all Equity Holders, and the Trustee cannot bring an action on their behalf for a cause of action accruing to the Unofficial Committee. In addition, Jefferies owed a duty to the committee itself and not the Noteholders (and future Equity Holders) represented by the committee. See In re J.F.D. Enterprises, Inc., 223 B. R. 610, 623 (1998) ("[O]nly the committee itself and (perhaps) individual committee members have standing to sue committee counsel; other parties in the case, even unsecured creditors, do not."); 7 Collier on Bankruptcy § 1103.03 (15th ed. rev.1996) ("A professional retained by a committee represents the committee and only the committee, and the professional's fiduciary duty runs solely to the committee.") Therefore, Count II fails to plead a duty owed by Jefferies to either of the entities which the Trustee has standing to represent, the 2004 Debtors or the Equity Holders.

D. Claims Brought on Behalf of the 2005 Debtors (Counts III and IV)

Counts III and IV are the only counts against Jefferies brought on behalf of the 2005 Debtors. (Am. Compl. ¶¶ 247-62.) For these claims, the Trustee stands in the shoes of the 2005 Debtors. See, e.g., Nisselson, 469 F.3d at 153.

Count III alleges that Jefferies breached its fiduciary duties by failing to "properly advise the 2005 Debtors concerning its options to deal with the liquidity crisis that it was confronting." (Am. Compl. ¶ 255.) In particular, the Trustee alleges that Jefferies had a duty to recommend that the 2005 Debtors: "(I) oppose the application for professional compensation being made in the 2004 Cases; (ii) seek revocation of confirmation of the 2004 Plan; and/or (iii) file petitions for Chapter 11 reorganization within 180 days of confirmation of the 2004 Plan." (Id.) Count IV alleges that Jefferies was negligent in not advising the 2005 Debtors to "seek to revoke confirmation of the Third Amended Plan," thus allowing the 2005 Debtors "to expend millions of dollars at a time when they should have been preserving their cash." (Id. ¶ 260.)

Jefferies responds that, under the terms of its agreements with the 2005 Debtors, it was retained solely "to provide general investment banking advice for potential capital raises, and then to provide financial advice with respect to four specific Target Transactions." (Docket # 46, 15 (emphasis in original).) It asserts that the Amended Complaint not only fails to allege a breach of any of these obligations, but a fiduciary duty is expressly disclaimed in the retention agreements between Jefferies and the 2005 Debtors. (Id. at 15-16, 17.)

Jefferies is correct that Counts III and IV fail to plead a cause of action in light of the retention agreements between it and the Reorganized Company.[6] (Docket ## 48-

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[6] These documents are properly before the court on the instant motion for judgment on the pleadings because they are central to plaintiff's claim on these counts. See Beddall v. State St. Bank and Trust Co., 137 F.3d 12, 17 (1st Cir. 1998) ("When . . . a complaint's factual allegations are expressly linked to - and admittedly dependent upon - a document (the authenticity of which is not challenged), that document

12, 48-13.) The September 27, 2004, retention letter between Jefferies and HVE (the "Company") provides for:

> [G]eneral investment banking advice to the Company, including, but not limited to general preliminary discussions or advice relating to (I) a direct or indirect acquisition of a material portion of assets of another person or group of affiliated persons in a transactions or series of related transactions, sale of all or a material portion of the Company's or any of its subsidiaries' assets in a transaction or series of related transactions, merger, consolidation, restructuring, transfer of securities or any similar or related transaction . . . ; (ii) the structuring, issuance and sale of equity and/or debt securities and placement of any bank related obligations . . . ; and/or [(iii)] such other strategic transactions as agreed to between the Company and Jefferies . . . ."

(Docket # 48-12 ¶ 1.) In January 2005, Jefferies signed a second retention agreement with HVE to act as its financial advisor in connection with: (I) the potential sale of "more than 50% of the voting capital stock or all or substantially all of the assets" of two subsidiaries; (ii) the potential sale of the Company's Evans Analytical Group division; (iii) the potential sale of a Dutch subsidiary; and (iv) the potential placing of bank debt or similar credit financing. (Docket # 48-13 ¶ 1.) Under the terms of this agreement, the only compensation Jefferies was to receive was for expenses unless a sale or financing arrangement was consummated.[7] (Id. ¶ 4.)

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effectively merges into the pleadings and the trial court can review it in deciding a motion to dismiss under Rule 12(b)(6)."); Young v. Lepone, 305 F.3d 1, 11 (1st Cir. 2002) (concluding that management letters neither attached to the complaint not incorporated by reference within it were nevertheless properly considered by the lower court in ruling on a motion to dismiss). (See also Am. Compl. ¶¶ 216-17, 219, 248, 254-55, 259-61; Docket # 51 (Pl.'s Mem. of Law in Opp. to Defs.' Mots.), 15.)

[7] Both agreements also expressly stated that Jefferies "shall not be deemed agents or fiduciaries of the Company or its stockholders, and will not have the authority to legally bind the Company." (Docket # 48-12 ¶ 4; Docket # 48-13 ¶ 6.) Similarly, both agreements indemnified Jefferies against any action unless "based primarily upon the

Thus, given the specific purposes for which Jefferies was retained, the Amended Complaint fails to state a cause of action because it alleges no source for a duty owed by Jefferies to perform the alleged additional duties, "(I) oppose the application for professional compensation being made in the 2004 Cases; (ii) seek revocation of confirmation of the 2004 Plan; and/or (iii) file petitions for Chapter 11 reorganization within 180 days of confirmation of the 2004 Plan." (Am. Compl. ¶ 255.) Indeed, there is no allegation in the Amended Complaint that Jefferies failed either to render the services it did contract to provide to HVE "in good faith and with undivided loyalty" (Am. Compl. ¶ 248) or to provide them "with the required degree of care and skill." (Id. ¶ 261.) Therefore, Jefferies' motion for judgment on the pleadings is allowed as to Counts III and IV.

V. Jefferies' Counterclaims Against the Trustee

Jefferies moves for judgment on the issue of liability as to its counterclaims alleging breach of contract by the 2004 Debtors and the Reorganized Company (First Counterclaim) and by the 2005 Debtors (Second and Third Counterclaim). (See Docket # 16.) The Trustee notes that the same claims are the subjects of outstanding proofs of claim in the bankruptcy court. (See Docket # 51, 38.) Jefferies admits it has filed proofs of claim in each of the bankruptcy cases, but included these claims in the instant case over concern they may be compulsory counterclaims and thus lost if not asserted here. See Fed. R. Civ. P. 13(a).

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gross negligence or willful misconduct of Jefferies . . . ." (Id.)

So long as the proofs of claim and the Trustee's objection are pending in the bankruptcy court, that court, not the district court, has jurisdiction over the subject matter. See 28 U.S.C. § 158 ("The district courts of the United States shall have jurisdiction to hear [bankruptcy] appeals from final judgments, orders, and decrees . . . .") (emphasis added); see also Giles World Marketing, Inc. v. Boekamp Mfg., Inc., 787 F.2d 746, 747 (1st Cir. 1986) (holding the appellate court did not have jurisdiction over appeal of lower court allowance to file proof of claim where that proof of claim had not yet been allowed or denied by bankruptcy court). Therefore, Jefferies' counterclaims are dismissed without prejudice for lack of jurisdiction.

Jefferies is not at risk, however, of losing its counterclaim as it "need not state the claim if (1) at the time the action was commenced the claim was the subject of another pending action . . . ." Fed. R. Civ. P. 13(a); see also United States v. Dico, Inc., 136 F.3d 572, 577 (8th Cir. 1998) (concluding that an administrative claim before the Environmental Appeals Board is "another pending action" within the meaning of Rule 13(a)(1)); cf. Ponderosa Dev. Corp. v. Bjordahl, 787 F.2d 533 (10th Cir. 1986) (refusing to bar a claim on the ground that it was compulsory in a prior suit because "the trial judge's denial of the motion to bring [additional parties] in was based in part on lack of personal jurisdiction, a ground which renders Rule 13(a) inapplicable by its own terms").

VI. Conclusion

Accordingly, defendant Evercore's motion for judgment on the pleadings (Docket # 21) is ALLOWED, as is defendant Jefferies' motion for judgment on the pleadings

(Docket # 45). Defendant Fried Frank's motion to dismiss (Docket # 47) is similarly ALLOWED. Jefferies' counterclaims are DISMISSED without prejudice. Evercore's motion requesting the court to take judicial notice of a complaint filed by plaintiff (Docket # 57) is DENIED as moot.

Judgment may be entered dismissing the complaint with prejudice and the counterclaim without prejudice.

September 19, 2007
DATE

/s/Rya W. Zobel
RYA W. ZOBEL
UNITED STATES DISTRICT JUDGE