PCB 76

[09-Sep-1994]

STATE OF VERMONT

PROFESSIONAL CONDUCT BOARD

In re: PCB Files No. 92.29 and 92.29A

FINAL REPORT OF THE PROFESSIONAL CONDUCT BOARD

DECISION NO. 76

The parties stipulated as to certain findings of fact, recommended conclusions of law and sanctions, and waiver of certain procedural rights. The hearing panel, consisting of Edward R. Zuccaro, Esq., Chair, J. Garvan Murtha, Esq., and Ms. Anne K. Batten, held a sanctions hearing on April 4, 1994 and issued its report to the Board on June 20, 1994. The hearing panel concluded that Respondents violated DR 5-101(A) and DR 5-104(A) and recommended that the Supreme Court publicly reprimand Respondents.

We held a hearing on July 15, 1994 to review the matter pursuant to Rule 8(D) of Administrative Order 9. All parties appeared. After due consideration of the arguments, the majority agreed to adopt as its own the hearing panel's findings of fact and conclusions of law. However, we reject the recommended sanction and, for the reasons set forth below, impose a private admonition.

FACTS

Both Respondents have been members of the Vermont bar for over 15 years and are partners in a small law firm where they have done substantial real estate work. One of their clients filed a disciplinary complaint against them resulting in the instant disciplinary action.

The complainant, hereinafter referred to as the "Developer", was a small scale real estate developer who, beginning in 1985, was represented by the Respondents in the sale of various lots.

In August of 1987, Developer approached Respondents and asked them to invest $12,000 in one of his ventures. Respondents agreed. They represented Developer at the closing and received a 25% return on their investment.

In the summer of 1988, Respondents' firm represented Developer in the purchase of land from a person who will be referred to here as "Smith". Neither Respondents had any financial interest in this transaction.

About a year later, Developer approached Respondents and asked them to invest in another real estate venture. Developer had agreed to purchase additional land from Smith for $60,000. Developer expected that he could subdivide the land into two lots and sell one of the lots at a substantial profit.
Developer hoped to find a purchaser and close on the Smith conveyance to him at the same time he closed on his conveyance of one lot to the prospective buyer. However, Developer needed $7,500 toward the deposit which he wanted Respondents to contribute.

Respondents told Developer they were not interested in investing as they thought the proposal was too risky.

When Developer was unable to put together the purchase capital, he returned to the Respondents and asked for a loan of $7,500. He told Respondents that he was unable to find the funding elsewhere, but that he knew of several people interested in purchasing the subdivided lots.

At this point, Respondents agreed to loan Developer the requested sum. No party recalls the terms of the agreement, and the transaction was not documented.

At the time of this transaction, neither of the Respondents were representing Developer in any pending matter, although Developer considered them to be his lawyers.

A formal purchase and sale agreement was executed on December 15, 1989 between Smith and Developer's wife who was Developer's surrogate in this transaction. The actual contract price was not $60,000 as orally agreed, but $75,000. The contract provided that the $7,500 deposit would be forfeited if the sale was not closed by January 30, 1990.

Contrary to his expectations, the Developer was unable to find a purchaser and so advised the Respondents in mid-January. Respondents asked Developer to obtain the $7,500 from some other source so that they could simply be paid back and withdraw from the transaction. Developer told them he could not do

that.

In order to avoid losing the deposit, the parties obtained an agreement from Smith to extend the closing date by 90-days. In consideration for this concession, the parties agreed to a $5,000 increase in the purchase price and an additional $5,000 deposit.

One of the Respondents drafted a written agreement which contained his understanding of the terms of his and his partner's involvement in this venture. The agreement stated that Respondents would assist the Developer in the purchase and subsequent sale of the land by providing financing and legal expertise. The contract also specified the rate at which Respondents would recoup their investment. Although the contract was never executed and its terms were never enforced, the contract demonstrates that Respondents were, in fact, acting both as lawyers and investors in the project.

Throughout the first half of 1990, as the real estate market rapidly cooled, the project went from bad to worse. Additional extensions of time were secured while Developer continued to search for buyers. Finally, Developer secured one purchase and sale contract, but at an amount less than he had anticipated. The contract price was only $55,000. After the sale of the subdivided parcel at this price, there would be insufficient proceeds to cover the purchase price of the entire parcel from Smith. An additional $18,700 was needed to complete the transaction, and neither Developer nor Respondents had the necessary funds.

In order to keep the project afloat, one of the Respondents arranged for one

of his personal friends, referred to here as "Investor", to invest in the project. Investor supplied the additional money in exchange for a mortgage deed on the subject property in his favor. Respondents' law firm prepared the deed and one of the Respondents witnessed it.

The sale from Smith to Developer and from Developer to his buyers were completed simultaneously in early July, 1990. On the same day, the Developer (through his surrogate) executed a promissory note to Investor for $40,519, which amount included all of the capital contributed by the Respondents along with a 23% return on their investment. The note was drafted by Respondents' law office and witnessed by one of the Respondents.

The note was due in 90 days or else title to the property would be transferred to Investor. Developer was allowed to continue to market the property for a price determined by him. Developer understood the agreement and its terms when it was executed on his behalf.

The 90-day time period came and went without a sale of the remaining subdivision and without repayment of the note. Investor granted an informal extension of the note's deadline without any change in the terms of the agreement, and Developer continued to market the lot.

About six months after the note was first executed, Developer's wife moved to New York state and began receiving social services. She assigned any proceeds realized from any future sale of the remaining lot to that state's Department of Social Services. This assignment was recorded in the local town records.

By May of 1991, Developer still had not sold the subdivided lot. At this point, Developer (through his surrogate) agreed to deed the property over to Investor, consistent with the promissory note she had executed. A deed to Investor in lieu of foreclosure was recorded. No effort was made by any of the interested parties to address the New York state lien at this time. Despite the conveyance, Investor allowed Developer a final opportunity to market and sell the property until September 15, 1991. The parties agreed that if the remaining parcel was sold by that date, Investor would be paid only $40,000, with no interest accruing on the outstanding amounts already disbursed. Developer would receive any of the remaining proceeds. If the lot was not sold by that date, the agreement would terminate.

The lot did not sell by the September 15 deadline, and thereafter, Investor assumed control over marketing the lot. About three months later, Developer filed his complaint with the Professional Conduct Board.

In the meantime, no offers to purchase the lot were received by Investor for several years. Finally, in the Spring of 1994, the lot was finally sold for $42,500. Taxes and brokerage fees were $3,735. New York state claimed a lien of approximately $19,000 on any proceeds generated by the sale.

The sale proceeds were placed in escrow pending resolution of the New York lien. Initially, Developer refused to execute a limited release permitting counsel for Respondents to attempt to negotiate a resolution of the New York lien. However, after the sanctions hearing in this matter, the proceeds were disbursed and Developer received his pro-rata return on his investment.

While the Complainant initially alleged that his lawyers were trying to cheat him, we find no evidence to support this charge. We find that neither Respondent ever intended that Developer's right to share in any profits generated by the eventual sale of the lot would be extinguished. Respondents always intended to share any such proceeds with him on an equitable basis.

CONCLUSIONS

Initially, Respondents took the position that the Disciplinary Rules concerning business relations with one's clients did not apply to this situation because they did not consider Developer a client. They have since conceded, however, that this is not the case.

Respondents agreed to assist Developer in the purchase and subsequent sale of the land by providing both financial and legal expertise. Respondents entered into limited business transactions with Developer by advancing loans to him in 1987 and 1990. At all times in the latter instance, Developer considered Respondents to be his attorneys and expected that they were representing his best interests, although Developer never told this to Respondents.

We specifically find that Respondents and Developers had an attorney-client relationship at all material times. Therefore, they had an ethical duty to comport with the requirements of Canon 5 of the Code of Professional Responsibility.

DR 5-101(A) requires that an attorney not accept employment, except after full disclosure and client consent, "if the exercise of his professional judgment on behalf of his client will be or reasonably may be affected by his own financial, business, property, or personal interests."

DR 5-104(A) prohibits an attorney from entering "into a business transaction with a client if they have differing interests therein and if the client expects the lawyer to exercise his professional judgment therein for the protection of the client, unless the client has consented after full disclosure."

Neither of the Respondents disclosed to Developer the potential conflicts of interest or obtained a fully informed consent. Neither Respondent advised Developer to consult other counsel at any point during the above series of transactions. Respondents have admitted, and we so conclude, that they violated DR 5-101(A) and DR 5-104(A).

SANCTION

In determining what sanction should be imposed, we are guided by the ABA Standards for Imposing Lawyer Discipline. Standard 3.0 recommends that we consider:

(a) the duty violated;

(b) the lawyer's mental state;

(c) the actual or potential injury caused by the misconduct; and

(d) any aggravating or mitigating factors.

We do so serially.

(A) The Duty Violated

The duties outlined in the ABA Standards include duties owed to clients, the public, the legal system, and the profession.

The duty to the client to avoid conflicts of interest is a basic duty of which all lawyers should be aware.

Because there are a myriad of ways in which a lawyer's business interests might directly or indirectly conflict with those of the client, business transactions between lawyers and clients are greatly disfavored. 51 ABA/BNA Lawyer's Manual on Professional Responsibility 501(1988). Rather than an outright ban on client-lawyer business dealings, "[f]ull disclosure is an unqualified mandate in both the Code and the Model Rules, and a lawyer's failure to make it cannot be excused on the ground of negligence or ignorance of the requirement." Wolfram, Modern Legal Ethics, Sec. 8.11.4, p. 484 (1986).

(B) The Respondents' Mental State

Counsel for one of the Respondents represented to us at the Rule 8(D) hearing

that while Respondents were aware of their duty to refrain from business dealings with clients without full disclosure and informed consent, they simply did not consider this to be an attorney-client relationship. This was an error on their part. Surely by January of 1990, when Respondents began drafting a formal agreement to protect their divergent interests, Respondents should have realized that there was an ethical problem. Respondents acted with gross negligence.

It is also clear to us that Respondents never intended to hurt Developer and always intended to deal with him equitably. This is not a case where the lawyers purposefully set out to exploit their knowledge of their client's business by suggesting that they be allowed into a "hot" deal. It was, after all, the client who first solicited the lawyers. Good intentions, however, did not prevent an ethical problem from arising here, which is perhaps why intent to cause harm is not an element of DR 5-104(A). Unlike many other disciplinary rules, there is no scienter requirement whatsoever in DR 5-104(A).

The evident intent of DR 5-104(A) is not merely to deter and punish actual fraud against clients. That is already proscribed by other rules. Rather it is to ensure that clients get full disclosure on which to base their decisions in every case involving differing interests, including those in which the attorney is acting in good faith.

Matter of James, 452 A.2d 163, 167 (D.C. App. 1982), cert. denied 460 U.S. 1038, 103 S. Ct. 1429, 75 L.Ed.2d 789 (1983)(emphasis in original).

Although a lack of intent to cause harm to a client is irrelevant to whether the Code has been violated, it is not irrelevant to the issue of what sanction should be imposed. We believe it should be considered in mitigation and do so here. See Florida Bar V. Jameison, 426 So.2d 16, 20 (Fla. 1983)(actions of attorney which result not from a corrupt motive but from failure to foresee potential conflict of interest, lack of proper record keeping and failure to act properly in response to client's wishes warranted only suspension for 90 days, not disbarment).

(C) Actual or Potential Injury

Developer has suffered emotional hardship because this real estate deal went badly for him. He lost his business, he has substantial debts, and is presently receiving general relief. While he suffered certain emotional problems prior to the failure of this particular deal, there is no question that these problems have been exacerbated and that Developer is extremely - and understandably - distraught and bitter over the financial reversals he has suffered. Developer expected that his attorneys were going to look after his best interests; he feels that Respondents betrayed his trust.

While the Board is sympathetic to Developer's situation, it cannot conclude by clear and convincing evidence that the financial losses he suffered were the result of the conduct of the Respondents. Developer was a small, under capitalized real estate developer who, while successful in the 1980's, could not weather the rapid decline in the real estate market which began in 1990. His financial losses were due to market pressures outside of the control of either Developer or the Respondents.

We can and do conclude, however, that Respondents actions exposed their client to potential injury. That is, Respondents left their client without any document to evidence their agreement with "Investor". Had Investor decided that he did not wish to honor their agreement to split the proceeds of the sale of the land with the investors, Developer - as well as the Respondents - would have been significantly damaged.

It is of no comfort to Developer that the Respondents were similarly situated. Fortunately, no financial injury occurred because Developer received his pro rata return on his investment. It is highly unlikely that Respondents would have provided such inadequate counsel in an arms length transaction. It appears that their own personal stake in the deal blinded them to the problems they were creating for themselves and for Developer, which only further illustrates the wisdom of refraining from business dealings with clients.

(D) Aggravating and Mitigating Factors

We find in mitigation that Respondents had no intention to harm Developer. Neither Respondent has any prior disciplinary record. Both Respondents have made full and free disclosure to Bar Counsel and have evidenced a co-operative attitude toward these disciplinary proceedings. Respondents have acknowledged that they violated the Code and have expressed remorse for their actions. Both Respondents are of good character with excellent reputations in their communities as honest and professional lawyers. Finally, both Respondents have made a good faith effort to rectify the

consequences of their misconduct by including Developer in efforts to recover the investment in the property.

In aggravation, we find that both Respondents have substantial experience in the practice of law. Their failure to recognize their ethical duty to fully apprise Developer of the ethical dangers in joint business dealings is difficult to understand in light of their experience.

(E) Applicable Standards

The ABA Standard most applicable to this case is Standard 4.3, Failure to Avoid Conflicts of Interest, which states, in relevant part:

Absent aggravating or mitigating circumstances, upon application of the factors set out in Standard 3.0, the following sanctions are generally appropriate in cases involving conflicts of interest: ...

4.33 Reprimand is generally appropriate when a lawyer is negligent in determining whether the representation of a client may be materially affected by the lawyer's own interests, or whether the representation will adversely affect another client, and causes injury or potential injury to a client.

4.34 Admonition is generally appropriate when a lawyer engages in an isolated instance of negligence in determining whether the representation of a client may be materially affected by the lawyer's own interests, or whether the representation will adversely affect another client, and causes little or no potential injury.

Because of the mitigating circumstances here, we think the balance tips in favor of a private admonition. Respondents are now well apprised as to the definition of a client and, by publication of this opinion, the Bar will be similarly warned to consider carefully their professional relationship with anyone with whom they plan to have personal financial dealings. No public policy will be served by publishing the identities of the Respondents in light of our belief that there is no likelihood that these Respondents will repeat this misconduct. They have practiced for many, many years without any previous complaints. We expect them to practice for many more without further ethical problems.

We direct the Chair to issue a private letter of admonition.

Dated at Montpelier, Vermont this 9th day of September, 1994.

/s/	/s/
Deborah S. Banse, Esq., Chair	Joseph F. Cahill, Esq.
Rosalyn L. Hunneman	Nancy Corsones, Esq.
/s/	/s/
Donald Marsh	Ruth Stokes
/s/	
Karen Miller, Esq.	

DISSENTING OPINION

We would rely upon Standard 4.33 and recommend imposition of a public reprimand.

This was not an isolated instance of misconduct. Respondents also invested money with the Developer in 1987 in connection with a real estate matter which they were handling for him. While this does not constitute a pattern of misconduct, it does constitute multiple offenses over a significant, protracted period of time. Surely during that time period, lawyers of this level of experience should have recognized that there were ethical constraints upon them that they were failing to follow. We are particularly disturbed by Respondents failure to appreciate the ethical problem in light of the fact that their office generated all of the legal documents used among themselves, Investor, and Developer. It appears that Respondents acted with disregard for their ethical obligations. The duty violated is an important one which should not have been so casually overlooked by experienced lawyers.

Public reprimand is also dictated by the decision in In re Fucci, 139 Vt. 654, 433 A.2d 695(1981)(mem.) where Mr. Fucci was publicly reprimanded for violating the same Disciplinary Rules as were violated here. According to Board records, Mr. Fucci, while acting as the executor in a probate estate, purchased five items of personal property at their appraised and inventoried value, instead of selling the items at auction as directed by the will, causing potential injury to the estate. See also Matter of James, 452 A.2d 163 (D.C.App. 1982)(court held that conduct warranted discipline short of suspension where lawyer who engaged in real estate transaction with client

drew up contract which did not adequately protect clients rights, even though the contract was never carried out because of other intervening causes).

Dated at Montpelier this 9th day of September, 1994.

/s/ /s/

Edward Zuccaro, Esq. J. Garvan Murtha, Esq.

/s/

Robert F. O'Neill, Esq.

The following Board Members were recused from this case: Robert Keiner, Nancy Foster, George Crosby and Jane Woodruff.

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