Garden State CLE presents:

"We're in Business":

The many dangers of entering into business transactions with clients

Lesson Plan

Part I. The Five-step disciplinary process:

The New Jersey attorney disciplinary system has one purpose – protecting the public. Its goals are not founded in punishment, but in preserving the confidence of the public in the integrity and trustworthiness of lawyers in general while preventing a re-occurrence of unethical behavior in the offending attorney.

In order to accomplish these goals, except in mandatory disbarment cases, the Court uses a 5-step analysis to determine the appropriate level of discipline:

1. What happened? Inquiry here is highly fact-sensitive. It is generally limited to violations of the RPC's as proved by clear and convincing evidence);

2. How have cases involving these RPC violations been adjudicated in the past by Supreme Court precedent or through DRB;

3. What has been the attorney's individual prior disciplinary history;

4. What was the extent of harm to clients, members of the public or the administration of justice;

5. Are there issues of attorney rehabilitation, sincere contrition, payment of restitution, efforts to make the victim whole or other general mitigation of discipline?

Part II. Requirements of RPC 1.8(a)
In general

a.) RPC 1.8.

Conflict of Interest: Current Clients; Specific Rules
(a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

(1) the transaction and terms in which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner that can be understood by the client;

(2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel of the client's choice concerning the transaction; and

(3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

b.) Foundational case law guidelines stemming from RPC 1.8(a)

1. Lawyers are required to maintain the highest professional and ethical standards in their dealings with clients. *In re Smyzer,* 108 *N.J.* 47, 57 (1987) (Disbarment)

2. At all times, an attorney's duty of loyalty is to the client, and not the lawyer's personal financial interests.

3. The Supreme Court has repeatedly warned attorneys of the dangers of engaging in business transactions with their clients. When a lawyer has an economic stake in a business transaction with a client, self-interest can undermine the attorney's objectivity. *In re Doyle,* 146 *N.J.* 629, 643 (1996). (6-month suspension)

4. Self-interest from a business transaction can also impair the undivided loyalty that lawyers owe their clients. *In re Wolk,* 82 *N.J.* 326, 333 (1980). (Disbarment)

5. Accordingly, business transactions with a client are subject to close scrutiny and the burden of establishing fairness and equity rests upon the attorney." *In re Gallop,* 85 *N.J.* 317, 322, (1981). (6-month suspension)

Part III. Seminal Case – In re Torre, 223 NJ 538 (2015)

a.) Outline of case

This disciplinary matter involves an attorney who borrowed $89,250 from an elderly, unsophisticated client the attorney had known for many years. [Client was 86 years old, legally blind, trusted the attorney.] The loan amounted to about seventy percent of the client's life savings. The debt was unsecured, and counsel repaid only a fraction of it during the client's lifetime.

Counsel prepared a promissory note to record the loan's sparse and unfair terms, but he did not advise his client in writing beforehand that it was desirable to seek independent legal advice about the transaction. Counsel admits that he violated the Rules of Professional Conduct [RPC 1.8(a)] and does not challenge the Disciplinary Review Board's determination that he be censured. The Office of Attorney Ethics (OAE) requests that a three-month suspension be imposed.

Because of the egregious circumstances this case presents, we impose an even lengthier period of suspension. Respondent caused substantial harm to a vulnerable, eighty-six-year-old victim. A one-year suspension is warranted to protect the public and guard against elder abuse by lawyers, and to help preserve confidence in the bar. We also note that misconduct of this nature will result in serious consequences going forward.

b. Critical Issues in In re Torre, 223 NJ 538 (2015)

1. First case that discusses the Court's concern over elder abuse by attorneys

We consider respondent's conduct against the backdrop of the serious and growing problem of elder abuse. The State's population is steadily aging. From 2000 to 2010, the number of people in our State age sixty-five and older grew by 6.5 percent—faster than the total population. As of 2012, seniors accounted for 14.1 percent of the State's total population, or 1.25 million. The Department of Labor and Workforce Development projects that the State's elderly population will grow to 21.8 percent of the total population by the year 2032.

As the population ages, and more people suffer health problems, it is not uncommon for family members to seek the appointment of a guardian to oversee the finances of an incapacitated loved one. In recent years, judges in New Jersey have appointed more than 2,000 guardians annually, a number that is expected to grow. Others, like [the elderly victim in this case], turn to family or professionals for help and execute powers of attorney in favor of a relative, friend, or trusted lawyer.

In those situations, the vast majority of attorneys performs honorably and acts in a manner consistent with the highest ethical standards. But regrettably, as more seniors have needed help to manage their affairs, allegations of physical and financial abuse have also increased.

2. Announces new rule of disciplinary law in Elder Law cases

Because the conflict in this case resulted in substantial harm to a vulnerable, elderly victim, we find that respondent should be suspended from the practice of law for one year. In doing so, we take into account that respondent has no prior disciplinary history and consider the favorable character evidence presented by four witnesses at the DEC hearing.

Until now, few reported disciplinary cases have involved harm to vulnerable, elderly victims. As with all matters, each case of this type must be decided on its own merits. Some may call for less discipline; others will justify an even longer suspension or disbarment. Indeed, in a case like this, if there were clear and convincing proof that an attorney knew at the time he borrowed money from a trusting client that he would not repay it, disbarment would be appropriate. The discipline imposed today is meant to provide notice to attorneys that serious consequences will result from this form of misconduct.

3. Analysis of discipline imposed.

The one-year suspension in this case could have been avoided.

DRB asked for a censure (as did Respondent)
OAE sought 3-month suspension

Court ordered a 1-year suspension

Note aggravating factors:

No demonstrable remorse by respondent
Bad attitude before DRB and Court
No repayment of loan balance
Substantial harm to the victim (emotional distress and loss70% of life savings)
Victim vulnerable due to age, blindness, lack of sophistication
Breach of trust in attorney-client relationship
Late Introduction of potentially fraudulent evidence

Note: the admission of RPC 1.8(a) violation, coupled with full repayment and sincerely expression of remorse would have changed level of discipline.

Part IV. Other RPC 1.8(a) Cases

a.) Cases decided under the former Disciplinary Rules

Justice Jacobs in In re Carlsen, 17 N.J. 338, 346 (1955), observed: "An attorney who enters into business ventures with his client does not, in the eyes of his client or the public generally, shed in chameleon fashion his professional standing and obligation and there is no just reason why he should be permitted to do so." We continue to adhere to that view.

It is well settled that all transactions of an attorney with his client are subject to close scrutiny and the burden of establishing fairness and equity of the transaction rests upon the attorney. Ellenstein v. Herman Body Co., 23 N.J. 348 (1957); Dwyer v. Anderson, 113 N.J.Eq. 210 (Ch.1933).

If the burden is not satisfied, equity has regarded such transactions tainted so as to constitute a constructive fraud. Bolte v. Rainville, 138 N.J.Eq. 508, 48 A.2d 191 (E. & A. 1946).

b.) Cases decided using RPC 1.8(a)

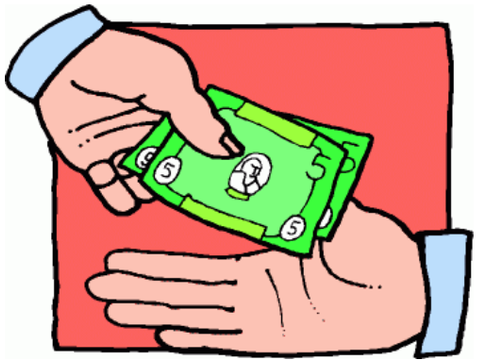
In re Wolk, - The Court disbarred an attorney who misled a client by counseling her to invest in a building in which the attorney had an interest. In so holding, the Court admonished that it will no more tolerate the hoodwinking of helpless clients out of funds in a business venture that is essentially for the benefit of the lawyer than it will outright misappropriation of trust funds.

In re Smyzer -The Court disbarred an attorney who entered into fraudulent and deceptive business transactions with clients, failed to protect their investments, failed to fully explain investments to the clients, and failed to disclose his interests in the companies. The Court found that the attorney had deceived his clients in order to protect his investment in a company whose financial condition was rapidly deteriorating. The Court also was troubled by the lack of independent consultation concerning those investments. In that respect, the Court cautioned that "a passing suggestion that the client consult a second attorney [will not] discharge the lawyer's duty when he [or she] and his [or her] client have differing interests." Thus, "a lawyer must take every possible precaution in ensuring that his [or her] client is fully aware of the risks inherent in the proposed transaction and of the need for independent and objective advice."

In re Frost, 171 N.J. 308 (2002) (Disbarment) - In the present case, respondent participated in a business transaction with his client without the appropriate safeguards and without disclosing a conflict of interest. Respondent drafted the loan agreement and all of its terms, made misrepresentations in respect of the alleged collateral to induce his client to participate in the transaction, and did not perform title or lien searches or prepare security agreements in respect of the property.

Although the agreement stated that respondent owned two properties and that respondent's law firm was worth in excess of $2,500,000, respondent did not give his client a security interest in those assets and did not provide his client with documentation of those assets. Indeed, respondent did not own the six acres of land identified as unencumbered in the loan agreement he prepared. As stated by the Special Master, there was no discussion of payment of more than the compromise amount to the worker's [sic] compensation carrier ... no discussion of what would happen if [respondent] went bankrupt.

Simply put, there was no discussion of the financial issues that affected Hagerman because the lawyer in the transaction was acting in dual capacities as both lawyer and business partner. Respondent's subsequent failure to repay Hagerman and CNA, even after CNA filed suit seeking payment of its lien, highlights the worthlessness of the loan agreement. In sum, respondent took advantage of an unsophisticated client whose trust he gained through the attorney-client relationship.



In re Servance, 102 NJ 296 (1986) (Disbarment) - Respondent accepted substantial sums of money from clients for investment in what can only be described as a "get rich quick" scheme. Respondent would accept cash from clients with the promise that the investment would double in about a month's time. In the three matters before this Board, the clients failed to receive their expected profit. Respondent failed to communicate with them when they inquired about the status of their investments. Respondent maintained that his full time occupation was that of an insurance agent and that he did not practice law either in Pennsylvania or New Jersey. However, each of the three complainants trusted Respondent with their money because Respondent was an attorney and not because he was an insurance agent.

In re Berkowitz, 136 N.J.148 (1994) (Reprimand)
Since 1994, it has been a well-established principle that a reprimand is the measure of discipline imposed on an attorney who engages in a conflict of interest, absent egregious circumstances or serious injury to clients.

In re Mott, 186 N.J. 367 (2006) (reprimand for conflict of interest imposed on attorney who prepared, on behalf of buyers, real estate agreements that provided for the purchase of title insurance from a title company that he owned; notwithstanding the disclosure of his interest in the company to the buyers, the attorney did not advise buyers of thedesirability of seeking, or give them the opportunity to seek, independent counsel, and did not obtain a written waiver of the conflict of interest from them);

In re Poling, 184 N.J. 297 (2005) (reprimand imposed on attorney who engaged in conflict of interest when he prepared, on behalf of buyers, real estate agreements that pre-provided for the purchase of title insurance from a title company that he owned – a fact that he did not disclose to the buyers, in addition to his failure to disclose that title insurance could be purchased elsewhere). Whenever a conflict involves egregious circumstances or results in serious economic injury to the clients involved, discipline greater than a reprimand will be warranted.

In re Guidone, 139 N.J.272, 277 (1994) (reiterating *Berkowitz*
and noting that, when an attorney's conflict of interest causes economic injury, discipline greater than a reprimand is imposed; the attorney, who was a member of the Lions Club and represented the Club in the sale of a tract of land, engaged in a conflict of interest when he acquired, but failed to disclose to the Club, a financial interest in the entity that purchased the land, and then failed to (1) fully explain to the Club the various risks involved with the representation and (2) obtain the Club's consent to the representation; the attorney received a three-month suspension because the conflict of interest "was both pecuniary and undisclosed").

Garden State CLE presents:

"We're in Business":

The many dangers of entering into business transactions with clients

Lesson Plan