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1997 Survey of Rhode Island Law: Cases: Professional Responsibility

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Professional Responsibility. *In re Scott*, 694 A.2d 732 (R.I. 1997). An attorney who receives a loan from a client, provides dual representation in additional loan transactions without disclosing potential conflicts to the clients and receives a security interest adverse to a client's interest is subject to discipline in the form of a public censure.

In *In re Scott*,¹ the Rhode Island Supreme Court Disciplinary Board asked the supreme court to determine an appropriate sanction, if any, for an attorney who had violated the rules of professional conduct in connection with a number of failed financial transactions for his clients.² The court concluded that any sanction would protect the public and maintain the integrity of the profession, rather than punish the attorney. In this case, the court held that those purposes were best served by a public censure, rather than suspension.³

FACTS AND TRAVEL

In 1988, Attorney Joseph Scott (Scott) represented Edgar and Roberta Clark (Clarks) in the sale of some commercial real-estate.⁴ The Clarks received a substantial sum of money for this sale and requested Scott's assistance concerning investment advice and opportunities.⁵ This request began a series of three transactions, all taking place in January of 1988, that ultimately led to the disciplinary action taken in this case.⁶

The first transaction involved a loan in the amount of \$25,000 to Scott from the Clarks, which came out of the proceeds of the Clarks' real-estate sale.⁷ This loan was secured by a mortgage on Scott's real-estate and was payable within one year at twelve percent interest per annum.⁸ Scott prepared the documentation relating to this loan.⁹ He did not disclose to the Clarks the inherent conflicts of interest associated with this transaction. Additionally,

1. 694 A.2d 732 (R.I. 1997).

2. *See id.*

3. *See id.* at 736.

4. *See id.* at 732.

5. *See id.*

6. *See id.* at 732-33.

7. *See id.* at 732.

8. *See id.* at 732-33.

9. *See id.* at 733.

Scott did not advise the Clarks to obtain independent legal advice before entering into the loan transaction. The loan was repaid by Scott within the period specified.¹⁰

The second transaction involved a loan from the Clarks to two of Scott's other clients, Howard Hayes (Hayes) and Joanne Dessaulles (Dessaules).¹¹ Scott had represented Hayes and Dessaules in a separate real-estate purchase and had obtained title insurance for them relative to that transaction. The loan in the amount of \$60,000, arranged by Scott between the parties, supplied additional financing for Hayes's and Dessaules's real-estate purchase. The loan was secured by a second mortgage taken on real estate owned by Dessaules and required interest payments of twelve percent per annum. Scott represented all parties at the closing and again failed to advise any of the clients of the potential conflicts of interests involved.¹² Additionally, Scott did not obtain title insurance for this transaction.¹³

The third transaction involved a loan in the amount of \$30,000 from the Clarks to Jo Ann Pelchat (Pelchat), also a client of Scott, for the purpose of providing Pelchat with financing for a residential-property purchase.¹⁴ The loan terms required principal and interest payments over five years at twelve percent per annum. Again, Scott represented all the parties and did not disclose the conflict-of-interest problem.¹⁵

After these transactions were completed, problems began to occur in regard to repayment of each of the loans.¹⁶ The first problem involved the loan to Hayes and Dessaules, whose payments to the Clarks were timely throughout 1988.¹⁷ In fact, in October of 1988, Hayes and Dessaules paid \$30,000 to the Clarks in order to reduce the principal on the loan. However, in December of 1988, when Hayes and Dessaules decided to sell their property, a title search revealed that there was a pre-existing right of first refusal in a prior owner that may still be valid. Scott had failed to discover this right when he performed the original title search for Hayes

10. *See id.*

11. *See id.*

12. *See id.*

13. *See id.*

14. *See id.*

15. *See id.*

16. *See id.*

17. *See id.*

and Dessaulles.¹⁸ The potential buyer refused to close the sale.¹⁹ Thereafter, Hayes and Dessaulles stopped making payments to the Clarks as well as to the holder of the first mortgage.²⁰

In an attempt to protect the interests of all the parties involved, Scott began to make payments to the holder of the first mortgage on the property and to the Clarks, even though he had no legal obligation to do so.²¹ Scott apparently felt that the failed sale was a result of his negligence. Ultimately, Scott could not continue to make these payments, and the holder of the first mortgage foreclosed upon the property.²²

The next problem involved Pelchat, who had fallen behind in her payments. Although he was under no obligation to do so, Scott once again made payments to the Clarks on Pelchat's behalf.²³ In September of 1990, Scott commenced foreclosure proceedings against Pelchat with the Clarks's authorization, and a foreclosure sale was scheduled for March 1, 1991. However, Pelchat filed for chapter 13 bankruptcy on February 28, 1991, which automatically stayed the foreclosure.²⁴

After he received notice of the stay, Scott "voluntarily signed an unsecured promissory note obligating himself to make payments to the Clarks in the amount of \$60,000 plus annual interest . . . of 8 percent in sixty equal monthly installments."²⁵ Scott had determined that the Clarks had lost this amount as a result of his advice.²⁶ Scott made payments against the note until 1994, when he could no longer make timely payments due to financial difficulties.²⁷

After Scott signed the promissory note, he tried unsuccessfully to get relief for the Clarks in bankruptcy court from the stay of foreclosure on the Pelchat property.²⁸ In November of 1991, Scott informed the trustee in bankruptcy that a potential buyer for the

18. *See id.*

19. *See id.*

20. *See id.*

21. *See id.*

22. *See id.*

23. *See id.*

24. *See id.*

25. *Id.* at 733-34.

26. *See id.* at 734.

27. *See id.*

28. *See id.*

Pelchat property had been found.²⁹ The terms of the purchase-and-sale agreement provided that Scott would hold a first mortgage of \$30,000, with purchase price of \$45,000. The Clarks declined an opportunity to hold a mortgage on the property. On March 23, 1992, they discharged their mortgage on the property by signing a document indicating that they had received full payment for the Pelchat mortgage, which was not true.³⁰ The Clarks received nothing from the sale. A \$32,000 mortgage was recorded on the property in Scott's wife's name, which was paid in full when the property was subsequently sold in 1993.³¹ Scott did not tell the Clarks of the inherent conflict of interest involved in this transaction.³²

After this sale, Pelchat's bankruptcy proceeding concluded.³³ Scott received a payment of \$7,420.93 from the trustee as the Clark's attorney.³⁴ Scott used some of this money to make payments on his promissory note to the Clarks and applied the rest toward his own attorney's fees. In 1994, Scott fell behind in his note payments to the Clarks, and they hired a new attorney to pursue a civil action against him.³⁵ A disciplinary complaint was also filed against Scott.³⁶

Based on the foregoing, the disciplinary board determined that Scott "had violated Disciplinary Rules 5-101(A), 5-104(A), 5-105(B) and 5-105(C) of the Code of Professional Responsibility and Rules 1.7(b) and 1.8(a) of the Rules of Professional Conduct."³⁷

ANALYSIS AND HOLDING

With respect to Scott's loan from the Clarks, the supreme court held that the board had correctly concluded that Scott had violated Rules 5-101(A) and 5-104(a) when he borrowed money from the Clarks.³⁸

29. *See id.*

30. *See id.*

31. *See id.*

32. *See id.*

33. *See id.*

34. *See id.*

35. *See id.*

36. *See id.*

37. *Id.* For a discussion of the relevant portions of these rules, see *infra* notes 38, 44 and accompanying text.

38. *See id.* Rule 5-101(A) provides that:

The court noted that Scott had represented the Clarks in real-estate transactions where sizable profits were realized,³⁹ and these clients had "turned to him as their legal advisor for advice on how to invest those funds."⁴⁰ The court described the obligation arising in that circumstance by stating that when a lawyer receives a loan from a client, the loan "creates an inherent conflict that . . . will impede the attorney's obligation to render independent professional advice to the client."⁴¹ The court acknowledged that the terms of the loan appeared reasonable and that Scott had fully satisfied the loan.⁴² However, Scott's failure to notify the Clarks of the potential conflicts was "dispositive under [the] rules."⁴³

Next, with regard to the loans from the Clarks to Hayes and Dessaulles and to Pelchat, the court found that Scott's lack of full disclosure violated Disciplinary Rules 5-105(B) and 5-105(C).⁴⁴ The court pointed out that Scott represented the borrower and lender in the loan transactions between the parties.⁴⁵ Regardless of how agreeable the terms of the loans may have been, Scott still

Rule 5-101(A). "Except with the consent of his client after full disclosure a lawyer shall not accept employment 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." Model Code of Professional Responsibility DR 5-101(A) (1996-97).

Rule 5-104(A). "A lawyer shall not enter 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.*"

Id. at DR 5-104(A) (emphasis added).

39. *See Scott*, 694 A.2d at 734.

40. *Id.* at 734-35.

41. *Id.* at 735.

42. *See id.*

43. *Id.*

44. *See id.* Rule 5-105(B) provides:

(B) "A lawyer shall not continue multiple employment if the exercise of his independent professional judgment in behalf of a client will be or is likely to be adversely affected by his representation of another client, except to the extent permitted under DR 5-105(C)." Model Code of Professional Responsibility DR 5-105(B).

Rule 5-105(C) provides:

(C) "In the situations covered by DR 5-105(A) and (B), a lawyer may represent multiple clients if it is obvious that he can adequately represent the interest of each *and if each consents to the representation after full disclosure* of the possible effect of such representation on the exercise of his independent professional judgment on behalf of each." *Id.* at DR 5-105(C) (emphasis added).

45. *See Scott*, 694 A.2d at 735.

had an obligation to inform the parties of the potential conflicts and receive their consent to the representation, which he did not do.⁴⁶

Furthermore, in an attempt to keep the loans current by personally assuming responsibility for payment, Scott violated Rule 1.7(b) of the Rules of Professional Conduct.⁴⁷ Scott did not tell any of his clients that they had the right to obtain independent counsel, nor did he investigate whether another client's interest, or even his own interest, may have been adversely affected by his dual representation.⁴⁸

Finally, the board found that Scott had violated Rule 1.8(a) of the Rules of Professional Conduct for receiving a mortgage in his wife's name on the Pelchat property incidental to the sale.⁴⁹ The relevant portion of Rule 1.8(a) provides:

A lawyer shall not . . . 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 which can be reasonably understood by the client;
- (2) the client is given a reasonable opportunity to seek the advice of independent counsel in the transaction; and
- (3) the client consents in writing thereto.⁵⁰

The court concluded that Scott had not complied with the requirements of Rule 1.8(a) with respect to the Pelchat property.⁵¹

46. *See id.*

47. *See id.* The relevant portion of that rule provides:

A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests, unless:

(1) the lawyer reasonably believes the representation will not be adversely affected; and

(2) *the client consents after consultation.*

Model Rules of Professional Conduct Rule 1.7(b)(1), (2) (1996-97) (emphasis added).

48. *See Scott*, 694 A.2d at 735.

49. *See id.*

50. Model Rules of Professional Conduct Rule 1.8(a).

51. *See Scott*, 694 A.2d at 736.

The board's recommendation concerning these violations was that Scott be publicly censured.⁵² Although not bound by this recommendation, the supreme court supported the board's position. The court, in closing, declared that Scott had not intended to harm his clients, and commended him for his extraordinary efforts to rectify the mistakes he made by voluntarily paying more than \$120,000 of his own money. Nonetheless, the court decided Scott should be publicly censured.⁵³

CONCLUSION

In this case, a lawyer was in a position to benefit from relationships with his clients. In the first instance, he received a seemingly harmless loan from one of his clients and promptly paid it back.⁵⁴ Although there may have been no harm done to anyone as a result of this transaction, the supreme court declared that the attorney needed to obtain informed consent from the client before such a transaction could transpire. Absent that consent, a violation arises.⁵⁵ Moreover, in a situation involving loans similar to those made to Hayes and Dessaulles and to Pelchat, if the attorney fails to fully inform his clients of the potential conflicts of dual representation, then he or she is subject to disciplinary proceedings.

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52. *See id.*

53. *See id.*

54. *See id.* at 732-33.

55. *See id.* at 735.