Book

SUPREME COURT OF NEW JERSEY
Disciplinary Review Board
Docket No. DRB 96-082

IN THE MATTER OF	:
JERALD SCHRAGEN	:
AN ATTORNEY AT LAW	:

Decision

Argued: May 15, 1996

Decided: March 10, 1997

Ellen Freiberg Essig appeared on behalf of the District IIA Ethics Committee.

Respondent failed to appear, despite proper notice.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of New Jersey.

This matter was before the Board based on a recommendation for discipline filed by the District IIA Ethics Committee ("DEC"). The formal complaint charged respondent with violations of RPC 1.8(a) (engaging in prohibited business transactions with a client); RPC 2.2(a)(acting as an intermediary between clients); RPC 3.3(a)(1) and (5) (making a false statement of material fact or law to a tribunal and/or failure to disclose to a tribunal a material fact) RPC 7.1(misleading communications concerning a lawyer's service); RPC 7.5(a)(improper letterhead); RPC 8.1(b) (incorrectly designated in the complaint as RPC 1:20-3(g)(3) and (4), failure to cooperate

with disciplinary authorities) and RPC 8.4(c)(conduct involving dishonesty, fraud, deceit or misrepresentation).

Respondent was admitted to the New Jersey bar in 1970. He received a private reprimand in April 22, 1992 for allowing a client to invest $60,000 in a business in which respondent was the principal, without advising the client to seek the advice of independent counsel and without providing security for the loan. On December 12, 1995, respondent was temporarily suspended amid allegations of knowing misappropriation. Respondent remains suspended to date.

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The complaint charged respondent with unethical conduct in three separate client matters: Schultz, Haubner and Arderelli. To at least some degree, all three relate to respondent's involvement with Red Claw Seafood company ("Red Claw").

In or about 1990, respondent was retained by Albert Mittal (since deceased) and Paul Philips, who were principals in Red Claw. Respondent incorporated Red Claw in 1990 and continued to represent the company and its principals. The company was essentially managed by Stuart Schultz, Mittal's nephew. As Mittal passed away shortly before the DEC hearing, Schultz testified as to all transactions between respondent and Red Claw.

Red Claw was a wholesale lobster business. Apparently, the company purchased live lobsters from suppliers in Maine and Canada

and then contracted to supply live lobsters to restaurants and grocery chains. Schultz testified that, during its first year of business, the company grossed over $1,000,000 in sales. That notwithstanding, within the first six months of its operation, Red Claw began seeking additional working capital and financing and involved respondent in its search. Over the course of the next couple of years, respondent had referred several potential investors to Red Claw, without success. Mittal and Schultz, too, were not successful in their quest for additional financing. For that reason, and on respondent's recommendation, Mittal and Schultz decided to file for bankruptcy. Respondent filed Red Claw's petition for discharge under Chapter 7 on or about November 23, 1992, and continued to represent Red Claw in that action.

After the bankruptcy petition was filed, Schultz was approached by several individuals who expressed interest in acquiring Red Claw's assets and clientele, both of which Schultz described as substantial. One such person was Michael Supper, who had entered into negotiations with Schultz in early December 1992. Basically, Mittal and Schultz wanted to walk away from the business, clearly without a profit, but also without sustaining any personal loss. Both had personally co-signed vehicle loans for the business and for at least one creditor, Peter's Seafood. In addition, the IRS had acquired a lien against the company assets for certain tax delinquencies that might not have been discharged in bankruptcy. Michael Supper was willing to assume the payments on the vehicle loans, to satisfy at least those creditors to whom

Mittal and Schultz were personally obligated and to contact the trustee in bankruptcy to purchase the assets of the business in order to satisfy the IRS lien. Schultz testified that Supper was extremely interested in this arrangement. The deal, however, had to be finalized almost immediately because of the rapidly approaching holidays, which would produce substantial business and income.

While Schultz was finalizing his negotiations with Supper, respondent informed him that two of his clients were interested in purchasing the business. When Schultz resisted consideration of these individuals and apprised respondent of his deal with Supper and its attendant time constraints, respondent became indignant. He reminded Schultz that he owed him over $14,000 in fees and told him that he "owed it to him" to at least meet with his clients. Schultz felt pressured by and obligated to respondent. He, therefore, consented to meet with respondent's clients the following day. Present at that meeting were Schultz, Mittal, respondent and respondent's clients, David Haubner and Joe Graf.

David Haubner testified that respondent had represented him in various legal matters since approximately April 1992. He and respondent had entered into a bartering agreement of sorts: Haubner's company would perform landscaping services for respondent in return for certain legal services. Haubner happened to be in respondent's office for a meeting during the first or second week of December 1992. He noticed a file marked "Red Claw" on respondent's desk and commented to respondent that he had heard of

that entity. At that point, respondent "went off on a speel" and began to tell Haubner that the company was in bankruptcy, that he was looking for someone to take over its operations with him and that they could "get the business for nothing." T59-60.[1] That conversation quickly turned into a solicitation by respondent for Haubner to join with respondent and another investor (Haubner's business partner, Joe Graf) to "take over" the business by simply "throwing in" some working capital. Haubner agreed to meet with Red Claw representatives on the following day.

Both Schultz and Haubner testified that the parties discussed at that meeting the company's assets and liabilities, including the IRS lien. All negotiations were between respondent and Schultz. (Respondent was still representing Red Claw in the bankruptcy action.) Essentially, the parties negotiated the same deal Supper had offered: Mittal and Schultz would walk away from the business with no compensation. Haubner and Graf would assume the payments on the two vehicles and also would satisfy their personal obligation to Peter's Seafood. Furthermore, respondent agreed to contact the trustee in bankruptcy to arrange for the purchase of the company's assets to satisfy the IRS lien. Respondent commented that he believed that he would be able to "hold off the trustee" and stall the sale of the company assets for a period of one to two years, thus giving them unhindered use of the company assets without compensation. T61. By this point, respondent had not disclosed to Schultz his proposed interest in the company. In

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[1] "T" refers to the DEC hearing transcript of November 28, 1995.

fact, during the meeting, he specifically represented to Schultz that he was not "benefitting from" the proposal, only Haubner and Graf. T21. It was not until one or two days later, when respondent telephoned Schultz to tell him that Haubner and Graf wanted to assume the company's operations, that respondent disclosed to Schultz that he, too, would "be a part of the deal." T22.

Shortly thereafter, respondent incorporated SGJ (a company consisting of respondent, Haubner and Graf), which, ultimately, took over Red Claw's operations. Essentially, they walked into the plant and assumed operations, using Red Claw's name, its equipment, its customers and everything else that belonged to that company. There were no writings that formalized that transaction, despite Schultz's request and respondent's promise to do so.

In order to assume Red Claw's operations, respondent, Haubner and Graf each contributed $20,000 as working capital. They began their operations on or about December 11, 1992. Shortly after SGJ assumed Red Claw's operations, Schultz's uncle received a telephone call from Ford Motor Credit Corporation complaining that the vehicle payments were past due. Because respondent had agreed to assume responsibility for the loans, Schultz telephoned respondent to ascertain whether there was a problem. At that point, respondent told Schultz that he had not transferred title from Mittal's name because to do so would have required payment of the loan in full at a higher interest rate. Therefore, it was his intention to simply make payments on the loan, which defeated the

purpose of relieving Schultz and Mittal of personal liability on the loans.

Thereafter, in or about November or December 1993, a creditors' meeting was held with the trustee in bankruptcy. Respondent attended that meeting in Red Claw's behalf, along with Schultz. During that meeting, one of the creditors commented to the trustee that the business was still operating and that respondent was running the company. (In fact, that was true, as Haubner had decided to leave SGJ by early September 1993 in return for a buy-out of his interest for $5,000 each from respondent and Graf). However, when the surprised trustee turned to respondent and asked him if that was accurate, to Schultz's shock, respondent denied that he had anything to do with Red Claw. It was at that point that Schultz realized that respondent had not even contacted the trustee to purchase Red Claw's assets so that the IRS lien could be satisfied, as he had promised to do. At the conclusion of the meeting, Schultz confronted respondent with his lie and told him that he had no intention of "getting in the middle of this." T31-32. Respondent assured him, somewhat nervously, that he would call the trustee to straighten things out. A week later, Schultz, bothered by the misrepresentation, telephoned the trustee to advise her of Red Claw's true status.

In addition to misrepresenting to the trustee that he had no interest in Red Claw, respondent filed a statement with the bankruptcy court, pursuant to Rule 2016(b), in which he falsely stated that he had received no transfer, assignment or pledge of

property from the debtor. Although that statement appears to refer to the manner of payment of respondent's fee relative to the bankruptcy petition, respondent did not qualify his statement to make clear that he had received no such transfer, in return for this fee, as opposed to an earlier and unrelated fee.

At some unidentified point, it also became clear to Schultz that respondent had not satisfied Schultz's and Mittal's personal obligation to Peter's Fish Market, as respondent had promised. Haubner testified that that was so because SGJ began to experience financial difficulties by February or March 1993, shortly after they assumed the operation of the business. While they had satisfied a small portion of that $30,000 debt by giving Peter's Fish Market $2,000 worth of lobsters, respondent had made the determination that, so long as they were having cash flow limitations, SGJ simply would not satisfy that obligation. This was especially problematic for Schultz and Mittal because Peter's Fish Market had not been listed as a creditor in the bankruptcy action.

Finally, Schultz testified — and Haubner confirmed — that, at some point during SGJ's operation of Red Claw, and without the trustee's knowledge or authorization, respondent sold a freezer to a third party for $5,000. No one knew what respondent did with the proceeds of that sale and that matter is currently under investigation by the IRS.

Haubner testified that, when SGJ began to experience substantial financial difficulties (around February or March 1993),

the three principals began to look for investors. Graf was able to obtain an additional $20,000 loan from another individual in July 1993, which he ultimately repaid prior to his exit from the venture. In or about March 1993, respondent told Haubner that he had a good-looking, recently widowed female client with some money to invest and that, if he, respondent, "worked" on her, he was sure she would extend them a $20,000 loan. That client was Anna Aldarelli.

Anna Aldarelli first met respondent in 1984, when he represented her and her late husband in the purchase of a townhouse. Subsequently, respondent represented Aldarelli in two mortgage refinancings, prepared her wills and probated her husband's estate. In or about June 1993, respondent wrote to Aldarelli telling her of an investment opportunity in Red Claw. Exhibit C-5. Because Aldarelli had not committed a portion of her finances to any particular investments and because she trusted respondent, she decided to invest $20,000 in Red Claw in the form of a loan. Her decision to do so followed a dinner meeting with respondent during which he told her about the general operations of the company. Respondent did not advise Aldarelli that SGJ did not own any of the company assets, that SGJ had sustained a substantial loss at some point before their meeting (when it lost 1,000 pounds of lobsters in a chiller pump failure) or about the general financial difficulty they were experiencing at that time. During the meeting, respondent also discussed with Aldarelli the terms of the loan. In essence, Aldarelli's loan would be secured by the

company's accounts receivable and would be personally guaranteed by all three SGJ principals "because [we] would never want [you] to get hurt, you know." T96. Within days of their dinner meeting, Aldarelli had presented herself in respondent's office to give him a check, to review and sign an "accounts receivable security agreement" and to review a promissory note.

During her brief inspection of these documents, and just as Aldarelli was poised to sign the security agreement, respondent made an "offhand comment" that he should be advising her to consult with independent counsel. T101. Aldarelli testified that, at that point, she was simply too uncomfortable to take respondent up on that offer because she feared that it would have been misinterpreted by him to mean that she did not trust him.

Aldarelli received no payments of either principal or interest on her $20,000 loan, despite several promises by respondent that she would receive a check shortly. That being so, and because respondent never answered her telephone calls (in spite of the fact that he had begun to represent her in a personal injury action), Aldarelli wrote to respondent on April 12, 1994, proposing certain accommodations for the repayment of the loan. Exhibit C-9. Respondent never replied to that letter.

Ultimately, Aldarelli retained counsel to file suit against respondent and the other principals of SGJ. A judgment was entered against all these individuals. In spite of respondent's representations to the DEC presenter and to Aldarelli's attorney, as of the Board's hearing, respondent had not made any arrangements

to satisfy that judgment.

In his dealings with all three of these clients, respondent never advised of the inherit conflict of interest in entering into a business transaction with him, their attorney. Nor did he advise any of those clients to consult with independent counsel before the entanglement of their business concerns. Furthermore, respondent never obtained his clients' written consent to his continued representation.[2]

Although respondent did provide some documentation to the DEC presenter and filed an answer, he apparently did not satisfy some of the presenter's demands for documents and other requests for information. Respondent did not appear at the DEC hearing.

* * *

The DEC found respondent guilty of all violations charged. The DEC recommended that respondent be disbarred for his misconduct. In reaching that determination, the DEC analogized respondent's actions to those of a "viper who laid in wait for a crippled animal to pass his way...." Hearing panel report at 13.

* * *

[2] Respondent apparently prepared a "conflicts letter" in the case of Schultz and Mittal, which Schultz signed. However, according to all parties, that letter was dated at least eleven days after respondent had already assumed Red Claw's operations.

Following a de novo review of the record, the Board is satisfied that the conclusion of the DEC that respondent was guilty of unethical conduct is fully supported by clear and convincing evidence. In his representations of Schwartz, Haubner and Aldarelli, respondent engaged in behavior that was both unscrupulous and devoid of any sense of morality. The Board need not describe respondent as did the DEC as a viper lying in wait for victims is to conclude that respondent's conduct was so deficient as to merit the sternest of discipline.

The Board concurs with a majority of the DEC's conclusions regarding respondent's violations of the Rules of Professional Conduct. Specifically, the record supports findings of violations of RPC 1.8(a) (prohibited business transactions with a client); RPC 2.2(a)(acting as intermediary between clients); RPC 3.3(a)(1) and (5)(false statements of law or fact to client and failure to disclose material fact to tribunal); RPC 8.1(b)(failure to cooperate with disciplinary authorities) and RPC 8.4(c)(conduct involving dishonesty, fraud, deceit or misrepresentation). The Board did not find support, however, for a finding of violation of RPC 7.1(misleading communications concerning lawyer's service) or RPC 7.5(a)(improper letterhead) and has dismissed those charges.

In the case of Red Claw and its principals, respondent negotiated and entered into a business transaction with his clients without any attempt to comply with the provisions of RPC 1.8(a). That rule requires an attorney to do three things before entering into a business transaction with a client:

> 1) fully disclose and reduce to writing the terms of the transaction, which must be fair and reasonable;
>
> 2) advise the client of the desirability of consulting with independent counsel of his/her choice and give the client a reasonable opportunity to do so
>
> and
>
> 3) obtain the client's written consent to the representation.

Respondent never followed through on his promise to Schultz to reduce the terms of the transaction to writing, nor did he offer other security for his verbal promises to Schultz and Mittal. While respondent may have eventually generated a writing that arguably complied with the requirements of RPC 1.8(a), that occurred long after he had already assumed Red Claw's operations.

Moreover, as noted by the DEC, respondent specifically sought to use his position as Red Claw's attorney to unduly influence Schultz to reject Schultz's own deal with a bona fide purchaser (Supper) and to elect, instead, to enter into the transaction with respondent and his clients. Indeed, Haubner confirmed Schultz's testimony that respondent pressured Schultz into the deal with them on the basis of his outstanding legal bills. Even worse, Haubner confirmed that to be respondent's intention from the very beginning, testifying as to respondent's comments: "Stu owes me $14,000. He is doing this deal with me, I don't care what he says." T67.

Respondent's conduct in the bankruptcy action filed in Red Claw's behalf can be characterized as nothing less than appalling.

Not only did respondent lie to both the court and the trustee, but he did so for his personal advantage and gain, to the detriment of both his clients and his client's creditors, including the IRS. He further defrauded the IRS and other creditors by selling a piece of Red Claw's equipment without notice to or authorization by either the trustee or the IRS. Finally, from the beginning, respondent clearly sought to manipulate the bankruptcy process to suit his own purposes: he took advantage of his resulting opportunity to earn a profit by using Red Claw's assets and resources free of charge.

In the case of Haubner, respondent again made no attempt to comply with the terms of RPC 1.8(a). He did not even verbally advise Haubner of the inherent conflict or direct him to consult with independent counsel. Indeed, Haubner testified that respondent made the resulting dual representation sound like an advantage to SGJ, because respondent would be in a position to manipulate the entire bankruptcy process.

Most egregious, however, was respondent's conduct towards Anna Aldarelli. Haubner testified that respondent specifically targeted this particular client because he knew she had inherited money from her husband's estate. It is clear from the testimony of both Haubner and Aldarelli, as well as from the documentation in evidence, that respondent intended to "wine and dine" the widowed Aldarelli to convince her to lend him $20,000. Indeed, that is exactly what happened, except that respondent did not have to do too much convincing in light of Aldarelli's complete trust in him. She had looked to him for guidance in every legal matter with which

she was confronted. Furthermore, not only did respondent make no attempt to comply with the provisions of RPC 1.8(a), but he also withheld vital information which, if disclosed, would have prompted Aldarelli to refuse his loan request. See, e.g., T106. Perhaps most offensive were the unfair terms afforded Aldarelli: respondent offered her no collateral to secure her substantial loan other than the company's accounts receivable. More meaningless "security" it is hard to foresee.

Respondent's "offhand comment" to his client regarding consultation with an independent attorney, just as she was poised to sign the "security" agreement, did not give her any reasonable opportunity to pursue that option. Moreover, especially in light of respondent's self-interest in the loan, he should have insisted that independent counsel review the transaction as a condition to its consummation. It can only be concluded that respondent did not do so because he knew independent counsel would never have permitted Aldarelli to enter into the transaction as structured.

Overall, respondent failed miserably in his ethics obligations. It is clear, however, that these failures were intentional and motivated purely by greed.

Conflict of interest situations similar to those engaged in by respondent have resulted in discipline ranging from a reprimand to disbarment. See, e.g., In re Hughes, 114 N.J. 612 (1989) (attorney received a public reprimand for extracting a $22,500 loan for his own business venture from a client with whom he shared an intimate personal relationship. Attorney did not either explain to client

the pitfalls of the arrangement or advise her to seek independent counsel. Discipline mitigated in part by age of case); In re Hurd, 69 N.J. 316 (1976) (three-month suspension for, among other things, arranging transfer of title from eighty-year old neighbor to attorney's sister without knowledge of neighbor or sister and for far less than the value of the property); In re Gallop, 85 N.J. 317 (1981) (six-month suspension for trust agreement with attorney's housekeeper concerning transfer of housekeeper's real property without advising her to retain separate counsel. Attorney later exercised option to purchase the property for half of its value, arranged for agreement of housekeeper's son to his actions and failed to hold agreed funds interest for housekeeper's son). In re Griffin, 121 N.J. 245 (1990) (one-year suspension when an attorney persuaded his paramour, an active alcoholic saddled with heavy debts, to obtain a $20,000 mortgage on her house to satisfy her financial obligations and to benefit the attorney. The attorney was to co-sign the mortgage loan, accept primary responsibility for its payment and to purchase life insurance in the amount of the loan. Attorney, however, did not advise the paramour to seek independent counsel and later stopped repaying the loan, to the detriment of the paramour). In re Humen, 123 N.J. 289 (1991) (two-year suspension) and In re Wolk, 82 N.J. 326 (1980) (disbarment). Humen and Wolk supra are most similar to the case at hand. In Humen, the attorney created several serious conflict of interest situations by mixing his business concerns with those of his client, Lillian O'Connell, who was also a longstanding friend.

a third transaction involving O'Connell, the attorney once again mixed his personal affairs with hers. When O'Connell expressed interest in purchasing a $93,000 house, the attorney assured her that he would find a mortgagee to lend her $40,000. Prior to the closing of title, the attorney informed O'Connell that he had obtained some investors who wished to remain anonymous. He then had her sign a mortgage listing the mortgagees as "Peter L. Humen, Receiver." The Court found that the attorney had engaged in a most egregious conflict of interest situation by acting deceitfully and by lending O'Connell $40,000 without disclosing to her that he was the "anonymous" mortgagee. Equally improper was the attorney's failure to provide an accounting to O'Connell, as manager of one of her properties, for a period of five years, particularly in the fact of his misrepresentations to her that the property was operating at a loss. In imposing the two-year suspension, the Court noted that the attorney's conduct had not been confined to a single, aberrant act and that he had repeatedly betrayed O'Connell's confidence and trust in him, as her friend, attorney and advisor.

The Wolk disbarment concerned actions as both an attorney's executor of an estate and, at the request of the widow, an attorney for her husband's estate. Two months after her husband's death, the widow asked the attorney to suggest an appropriate investment for a portion of her inheritance. The attorney suggested that the widow invest $10,000 in a second mortgage on a multi-family dwelling owned by a company of which the attorney was a

stockholder, president and counsel. The attorney testified that he had advised the widow to obtain separate legal counsel before making the loan. It is doubtless, however, that she relied solely on his legal representation. The attorney did not disclose critical information to the widow, including that the mortgage would be subordinated to a new first mortgage on an unlimited amount, that the building had been purchased for less than the mortgage amount and that the taxes were unpaid. Subsequently, an individual who held a $3,000 purchase money mortgage on the property instituted a foreclosure action. The attorney was served as registered agent for the owner/corporation and as agent for the widow, the second mortgagee. Nevertheless, the attorney failed to notify her of the receipt of the summons and complaint and to defend the action in her behalf. A few months later, the widow asked the attorney why the mortgage payments had stopped. He assured her that they would soon resume. He did not mention the foreclosure action. Shortly thereafter, the widow retained new counsel, with whom the attorney spoke on several occasions without informing him of the foreclosure proceeding. In disbarring the attorney, the Court warned that it would "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 outright misappropriation of trust funds." (Citations omitted). In re Wolk, Supra, 82 N.J. at 335.

Although respondent's conduct parallels that of both Humen and Wolk, it most closely resembles Wolk in the pervasiveness of

respondent's misconduct, the particular circumstances of the Aldarelli transaction and the fact that respondent intentionally hoodwinked not only Aldarelli, but Schultz and Haubner as well. In addition, this matter contains the added dimension of fraud on both the bankruptcy court (in submitting a false 2016(b) statement and selling Red Claw property without notice) and on the IRS as well.

The Board has also considered, in aggravation, respondent's prior discipline for failure to comply with RPC 1.8(a).

Convinced that respondent has an irremediable deficiency of character and presents a continuing danger to the public, the Board has unanimously voted to disbar him. Three members did not participate.

The Board further determined to require respondent to reimburse the Disciplinary Oversight Committee for administrative costs.

Dated: 3/10/97

LEE M. HYMERLING
Chair
Disciplinary Review Board