SUPREME COURT OF NEW JERSEY
Disciplinary Review Board
Docket No. DRB 01-030

IN THE MATTER OF

MAXWELL X. COLBY

AN ATTORNEY AT LAW

Decision

Argued: May 17, 2001

Decided: August 6, 2001

Nitza Blasini appeared on behalf of the Office of Attorney Ethics.

Richard M. Keil appeared on behalf of respondent.

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

This matter was before us based on a recommendation for discipline filed by Special Master Charles H. Mandell. The complaint, filed by the Office of Attorney Ethics ("OAE"), charged respondent with violations of *RPC* 1.15 and *RPC* 8.4(c) (knowing misappropriation

of trust funds), *RPC* 1.15(d) (failure to comply with recordkeeping rules) and *RPC* 8.1(a) (false statement of material fact to disciplinary authorities).

Respondent was admitted to the New Jersey bar in 1975. He has no ethics history.

* * *

This matter involves a shortage in respondent's trust account, which was created when he issued a trust account check against uncollected funds. A client's check had been returned for insufficient funds, thus causing a shortage in respondent's trust account. Respondent did not immediately replenish the account, but waited about seventeen months. The OAE asserted that respondent's failure to replenish the funds, while aware of the shortage in his trust account, constituted "lapping" and knowing misappropriation of trust funds. In turn, respondent contended that, after receiving assurances from his client that he would "make the check good," he simply forgot about the shortage. Respondent claimed that his failure to properly reconcile his trust account contributed to the inadvertent invasion of other clients' funds.

Our review of the record compels us to conclude that respondent's misappropriation of client funds was negligent, not knowing. He also committed several recordkeeping violations.

The facts in this matter are not in dispute. On February 3, 1999, First Union National Bank ("First Union") notified the OAE of an overdraft in respondent's trust account. After the OAE requested an explanation, respondent sent a March 10, 1999 letter indicating that the overdraft had been traced to an October 3, 1997 check for $3,500 that had been returned for insufficient funds. Respondent had represented Personal Computer Consultant ("PCC") in litigation that was settled on April 18, 1997. The settlement required monthly payments to be made to the attorney for the plaintiff, Merisel Americas, Inc. ("Merisel"). PCC made several payments to respondent, who deposited the checks into his trust account and later issued checks to the plaintiff's attorney for disbursement to Merisel. The payments from PCC were not always made on a timely basis, however. As the following shows, respondent waited between seven and ten days from the deposit date before disbursing the payments:

Date Deposited	Date Disbursed	Amount
04/29/97	05/07/97	$4,000
07/11/97	07/21/97	7,000
09/04/97	09/11/97	3,500

According to respondent, PCC was chronically late in complying with the settlement and Merisel's attorney "continually pressed" him for payments from his client. On October 1, 1997, PCC's principal, Peter Granovetter, after again being "pressed" for payment, placed a $3,500 check under the door of respondent's office, with a note directing that the check not be deposited until October 3, 1997. Because of the Rosh Hashanah holiday, respondent did not deposit the check until October 8, 1997. On October 10, 1997, the plaintiff's

attorney "faxed" a note to respondent, asking when he would receive additional funds from PCC. On October 14, 1997, after PCC's check had been in his account for a week, respondent issued a trust account check to the plaintiff's attorney and mailed it on October 15, 1997. It was not until October 27, 1997 that respondent received a letter from his bank, CoreStates (later acquired by First Union), notifying him that PCC's check had been dishonored due to insufficient funds. At respondent's direction, his secretary, Patricia Boettcher, contacted Merisel's attorney, who told her that he had already issued a check to his client.

Boettcher testified that, pursuant to respondent's direction, she contacted Granovetter several times by telephone. Each time, Granovetter indicated that he would reimburse respondent the $3,500. According to Boettcher, although she sent Granovetter a letter asking him to make arrangements to cover the dishonored check, a copy of the letter was not in the file and could be "floating somewhere in the office." She stated that respondent's office is very cluttered and that she was not able to locate the letter. Because Boettcher is not "computer literate," she did not prepare the letter on a computer and, thus, could not reprint a copy. Boettcher added that, during her last conversation with Granovetter, he indicated that, although he had become ill, was unable to work and was having financial difficulties, he would pay respondent the amount owed. Thereafter, when Boettcher attempted to contact Granovetter, she learned that his telephone and the company's telephone had been disconnected.

Granovetter never reimbursed respondent for the returned check. On March 2, 1998, respondent notified the plaintiff's attorney that PCC had consulted Adam Schneider, a bankruptcy attorney. Respondent informed Merisel's attorney that, although he was not certain whether Schneider had been retained, it appeared that PCC was "headed in that direction." Indeed, Schneider testified that he filed a bankruptcy petition for PCC on April 20, 1998 and a personal bankruptcy petition for Granovetter on May 26, 1998. Because respondent had not been listed as a creditor by either debtor, he did not receive notice of the bankruptcy filings.

Respondent, too, testified about his discussions with Granovetter concerning the returned check. Granovetter assured respondent that he would "make good on the $3,500." On December 10, 1997, about two months after PCC's check was returned for insufficient funds, Granovetter left a letter at respondent's office enclosing $1,680 in cash, with instructions for respondent to disburse $1,673.31 as final payment of the undisputed amount owed to the plaintiff's attorney. The letter indicated that the withdrawal depleted PCC's bank account for the week.

At the ethics hearing, the following exchange took place between respondent and his counsel:

Q. Now, did you discuss with [Granovetter] the possibility of putting the $1,600 towards the $3,500 he owed your trust account?

A. I had discussions with Mr. Granovetter during this time frame. He indicated to me that he would make good on the $3,500. In light of his representations and also in light of the fact that again I had an ongoing

obligation to represent him, I certainly did not want to unilaterally take the 1,600 some odd dollars and just summarily offset it against the trust account because that's not why the money was given to me. It was given to me to pay the judgment of the creditor. . . .

Q. What did you think of him saying that this totally depletes the bank account for this week? What does that mean to you?

A. I had no doubt that he basically cleaned out the cookie jar in his office to pay off his judgment creditor [who] if otherwise not paid was prepared to shut him down by way of sheriff's levy. . . .

Q. Did you believe that you would never get the $3,500 from PCC?

A. It didn't -- he indicated just for the week. I think to have discussions with Mr. Granovetter and determine I am morally obligated to pay it entered into the conversation. . . . Again, I am morally obligated to pay it even if I have to pay for it from my own funds. I believe that was part of the conversation.

[T176-179][1]

This testimony is consistent with respondent's answer to the formal ethics complaint, in which he stated the following:

> Mr. Granovetter is a truthful person and a small business man who operates from week to week. Many people live paycheck to paycheck, occasionally bouncing a check, and make it good promptly. This was the corporate bank account. He gave me a promise that he would be personally responsible. I believed him.

According to respondent, although he had been aware of the shortage in his trust account caused by PCC's returned check, at some point, probably in March or April 1998, he simply forgot about the matter and failed to timely replenish the trust account with his own funds. It was not until March 23, 1999 that respondent deposited $3,500 of his own

[1] T refers to the transcript of the September 12, 2000 hearing before the special master.

funds into his trust account to cure the shortage. Respondent testified that, after receiving notice from the OAE about the overdraft in his trust account, he reviewed his records. At first, he claimed, he could not determine the cause of the overdraft; finally, he discovered that the overdraft had been caused by the PCC returned check and deposited $3,500 into his account.

After the scheduled OAE audit prompted respondent to thoroughly examine his trust account, he determined that there were three clients who maintained funds in that account. He, therefore, disbursed funds to each of those clients. Specifically, respondent had been holding funds in behalf of a client named Lecour, because of a dispute over interest on a loan. Once the dispute was resolved, respondent disbursed the funds. In the *Shuler* matter, funds were held in escrow, following a real estate transaction, until it could be determined whether the municipality would tax the property separately or as one unit. Respondent testified that the matter took a long time to resolve. Another client, Joe Goldfajer, a builder, testified as follows:

> There was no reason not to have [the funds] there. When I needed financing, I had the money there so he could handle it. He could send whatever money -- whatever business I would do. Many times I went to Florida and I usually handle my accounts through the telephone. If I needed monies, he just had it in his account. He held it for a long time many times.
>
> [T98]

According to respondent, he had obtained a judgment for Goldfajer. The debtor was making periodic, but sporadic payments. When respondent asked Goldfajer if he wanted the

money disbursed to him, Goldfajer declined. Respondent, thus, maintained the funds in his trust account until Goldfajer instructed him to make periodic disbursements.

It is undisputed that respondent had sufficient funds in his business account to cure the trust account shortage. From October 1997, when the PCC check was returned, until March 1999, when the OAE notified respondent of the overdraft in his trust account, he deposited $115,311.70 in fees into his business account. Moreover, during this period respondent maintained a personal investment account with balances ranging from $170,000, in August 1997, to more than $600,000, in March 1999. Respondent, thus, had the financial ability to cover the shortage. He asserted that he failed to do so because he was not aware that his account was out of trust.

Howard Gluckman, a certified public accountant, submitted a report and testified in respondent's behalf at the ethics hearing. Gluckman reviewed respondent's books, records and computer accounting software and noted that, from 1997 to 1999, there were 1450 transactions in respondent's trust account, involving $11,406,716. He concluded that Easy Soft, the software respondent used, was sufficient for recordkeeping purposes. According to Gluckman, Easy Soft could be set to reject a negative trust account balance, thus alerting the person entering the data that there was a deficiency in the account. In this mode, however, the computer would not print a report with negative balances, since it would not permit the entry. On the other hand, if the software permitted the entry of a negative balance, the report would alert the reader to the negative transaction. Although Gluckman could not

determine whether respondent's computer was set to accept or reject negative balances, he suspected that it rejected negative transactions. Therefore, the computer-generated reports would not have alerted respondent to the negative balance. Gluckman also concluded that, if respondent simply compared bank statements with his records, but did not reconcile his trust account, he would not be aware of the $3,500 shortage.

Gluckman's report rejected the notion that respondent had engaged in "lapping," which he described as follows:

> Lapping is a means of covering up an error or misappropriation by crediting funds to the wrong account. When there is a risk of discovery, the perpetrator credits one account and debits another so that any shortage is only outstanding for a short time. In this manner the perpetrator hopes that no one will ever uncover what exactly is missing. Lapping always includes debiting and crediting of the wrong account over and over again in a cover up utilizing numerous accounts.
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> [Exhibit R-1 at 3]

Gluckman opined that, although respondent's trust account had a shortage, there was no misappropriation. He further stated that respondent's defective reconciliation procedures had led respondent to forget about the shortage.

The charge that respondent had made a misrepresentation to the OAE was based on the following statement, contained in his March 10, 1999 reply to the OAE's inquiry about the overdraft: "I assume full responsibility for the issuance of the above check. I have taken appropriate measures to insure that this is an isolated incident and in no way impairs the integrity of funds that I now hold in trust." Because as of March 10, 1999 respondent had not yet replenished his trust account, the OAE determined that he had made a

misrepresentation of material fact. The OAE, therefore, charged him with a violation of *RPC* 8.1(a). Respondent, in turn, contended that he had not meant to imply that he had reimbursed the trust account funds. He explained that his statement was meant to convey that he had discovered the reason for the shortage and had determined that it was an isolated incident that would not recur. Respondent testified that he currently reconciles his trust account quarterly.

With respect to the charge of failure to maintain proper records, respondent admitted that he (1) kept one client ledger card (PCC) with a debit balance; (2) maintained three inactive trust ledger balances in his trust account for an extended period of time; (3) failed to prepare a schedule of client ledger account balances and to reconcile them quarterly to his trust account bank statements; and (4) caused his trust account to be out of trust by $3,500 for one and one-half years.

Respondent offered the testimony of several "character witnesses," including two attorneys, who testified that he had a reputation as an honest person and that his integrity has never been questioned. They confirmed that respondent's office was very cluttered. Respondent also presented evidence of his *pro bono* work, community activities and service to the bar.

* * *

The special master found no clear and convincing evidence that respondent had knowingly misappropriated client funds, engaged in "lapping" or intentionally misled the OAE in his March 10, 1999 letter. The special master concluded, however, that respondent's recordkeeping was grossly deficient:

> Even though Mr. Colby has an otherwise unblemished 25-year record in the practice of law, is by all accounts, an otherwise competent and honest attorney, and no harm came to his clients, the combination of grossly inadequate record-keeping and failure to act totally responsibly with regard to the initial set of circumstances involving dishonoring of a prior deposit requires severe discipline. As stated by the court in Matter or [sic] Moras, 131 N.J. 163, 164 (1993):
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>> Attorneys must not advance trust funds to accommodate clients. . . . In the future, attorneys who improperly draw against other checks deposited in their trust accounts will run the risk of a more severe penalty, including disbarment.
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> [Report of the special master at 12]

The special master recommended a two-year suspension.

* * *

Following a *de novo* review of the record, we agree with the special master that respondent had failed to comply with the recordkeeping rules. We cannot agree, however, with the special masters' recommendation for a two-year suspension.

The special master correctly found that respondent did not knowingly misappropriate client funds. In October 1997, respondent's client, PCC, issued a check that was returned

for insufficient funds. Respondent deposited this check in his trust account on October 8, 1997. As in the past, respondent waited seven days to mail his trust account check to the plaintiff's attorney. PCC's check was returned for insufficient funds. Unfortunately, rather than call respondent to alert him to the dishonored check, First Union mailed a notice to respondent, which was not received until October 27, 1997, almost three weeks after respondent had deposited PCC's check. Respondent took reasonable steps to rectify the problem. He directed his secretary to contact Merisel's attorney, who reported that he had already issued a check to his client. Respondent also directed his secretary to contact the client, Granovetter, who continually promised to send another payment. Respondent's secretary testified that, in addition to making several telephone calls to Granovetter, she sent him a letter asking that he correct the situation. Although the file did not contain a copy of that letter, there was ample testimony that respondent's office was cluttered and that the letter might have been misfiled.

Respondent, too, had several conversations with Granovetter, who repeatedly assured him that he would resend the $3,500. According to respondent, he had no reason to doubt his client's word. Indeed, respondent testified that, on at least two occasions, his client stated that he was "morally obligated to pay it even if I have to pay for it from my own funds."[2]

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[2] Although the special master interpreted respondent's testimony to mean that respondent was the one who had said he was morally obligated to cure the shortage with his own funds, it appears that respondent had attributed those remarks to his client. This interpretation is consistent with respondent's statement in his answer to the ethics complaint that Granovetter "gave me a promise

It was thereafter that respondent showed lack of diligence in seeking payment from Granovetter. By March or April 1998, according to respondent's testimony, he had forgotten about the shortage in his trust account. Contributing to respondent's failure to discover the shortage was his computerized accounting system. According to Gluckman, respondent's expert witness, respondent's computer software program could be set either to permit the entry of negative balances and, thus, print negative balances in a report, or to reject any attempt to enter a negative balance and, thus, preclude the appearance of negative balances in a report. Although Gluckman could not be certain, he believed that respondent's software did not permit the entry of a negative posting; therefore, no written report would have been produced to alert respondent to a negative balance.

Moreover, because at that time respondent did not perform the required "three-way" trust account reconciliation, he was not reminded of the shortage. Although respondent compared his bank statements with his records, he did not perform the required reconciliation of trust account ledgers and journals.

Based on this unfortunate set of circumstances, respondent allowed the shortage to remain in his trust account for seventeen months. On March 23, 1999, he cured the shortage by depositing $3,500 of his own funds into his trust account.

It is unquestionable that, during the period that respondent's account was out of trust, October 1997 through March 1999, respondent had adequate funds of his own to cure the

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that he would be personally responsible [for the corporate check]. I believed him."

deficiency in his trust account. During that time, he received more than $115,000 in fees. In addition, the balance in his investment account ranged from $170,000 to more than $600,000. Therefore, respondent failed to replenish his trust account not because of financial inability, but allegedly because of his belief that the client would rectify the problem and, later, because he forgot about the problem.

Because respondent maintained other clients' funds in his trust account, the shortage did not immediately cause an overdraft. Respondent explained that he was holding (1) the *Lecour* funds, pending the resolution of a dispute over interest on a loan; (2) the *Shuler* funds, pending the resolution of a property tax issue; and (3) the *Goldfajer* funds, pursuant to his client's instructions, which were confirmed by the client.

An attorney's failure to promptly replenish his trust account, despite his awareness of a shortage, could be found, at times, to be negligent, not knowing, misappropriation of client funds. In *In re Prado*, 159 *N.J.* 528 (1999), the attorney maintained trust and personal accounts at the same bank. When he directed the bank to automatically charge loan payments to his personal account, the authorization erroneously listed his attorney trust account number. During a period of five months, the bank deducted a total of $2,079.18 from his trust account. Although the attorney became aware of the trust account shortage and the ensuing invasion of other clients' funds, he did not replace the monies until eighteen months later, after the OAE began an investigation, based on a random audit. The attorney

stipulated, and we found, that he negligently misappropriated client funds, in violation of *RPC* 1.15(a). Prado received a three-month suspension.

Similarly, in *In re Moras*, 131 *N.J.* 164 (1993), the attorney accommodated the request of a longtime client and friend to issue a trust account check to her, in exchange for which she tendered him a $15,000 personal check. After the attorney issued the trust account check, he called the client's bank and discovered that there were insufficient funds to cover the check. Although the client assured him that she would immediately deposit sufficient funds, she failed to do so. The attorney declined to stop payment on his trust account check. As a result, other clients' funds were invaded. Despite the client's sporadic payments to the attorney over the next several years, the shortage was not cured until almost four years later, when the attorney deposited his own funds into his trust account. Although the OAE contended that the attorney knowingly misappropriated client funds, the Court disagreed. The attorney received a six-month suspension.

In *In re Librizzi*, 117 *N.J.* 481 (1990), after issuing a check from his trust account, the attorney was notified that an $1,800 client check that he had deposited into his trust account had been returned. The client's replacement check was also dishonored. Finally, the client's father agreed to pay the attorney in "dribs and drabs." The trust account was short for more than two years. Because of misdeposits and overpayments in other matters, the attorney was out of trust by $25,000. The Court found that the attorney had negligently, not knowingly, misappropriated funds. He was suspended for six months.

In short, the failure to promptly replenish funds in an attorney trust account, without more, does not necessarily amount to knowing misappropriation of client funds, despite the invasion of monies belonging to other clients. Although the OAE argued that respondent's misconduct was similar to that of the attorney in *In re Brown*, 102 *N.J.* 512 (1986), that case is inapposite to this matter. In *Moras*, the Court summarized the *Brown* case as follows:

> In *Brown*, the respondent deposited a client's check for $20,000 and drew against that deposit without waiting for the check to clear. The check was dishonored, and the client, who subsequently went bankrupt, could not make good on the check. Thus, Brown suffered a $20,000 deficiency in his trust account. Instead of notifying the parties or restoring the funds, Brown embarked on a four-year practice of 'lapping' his trust account by invading the funds of one client to pay another.
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> Two years after the original $20,000 deficiency, Brown's problems worsened. He was indebted to the Internal Revenue Service (IRS) for unpaid personal taxes. The IRS seized an $8,098 interest-bearing escrow account that Brown had opened on behalf of a client. The account, however, was not designated as a trust account and bore Brown's social security number. As with his trust account, Brown resorted to 'lapping' to pay off his client. The result was that 'his trust account was short more than $28,000, rather than the original $20,000." Id. At 515, 509 *A.*2d 176. Although the occasional deposit of legal fees in Brown's trust account 'may have made a dent in the shortage from time to time, it did not come near returning the account to an in-trust condition during the four-year span.' *Ibid.* Additionally, Brown invaded the trust account to pay his monthly rent and his secretary's salary. Based on those facts, we concluded that Brown had knowingly misappropriated trust funds as prohibited by *In re Wilson*, 81 *N.J.* 451, 409 *A.*2d 1153 (1979).
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> [*In re Moras, supra*, 131 *N.J.* at 168]

Here, when respondent issued the $3,500 check to the plaintiff's attorney, he had no way of knowing that the PCC check would subsequently be dishonored. Although he should have waited for the funds to clear before issuing a trust account check, his failure to do so

constituted negligence, not knowing misappropriation. In addition, his initial response was reasonable, as conceded by the OAE. Respondent unsuccessfully tried to prevent the attorney from disbursing the funds to his client. He also contacted Granovetter, who repeatedly assured him that he would make good on the check. Given respondent's prior dealings with his client, it was reasonable for him to believe that Granovetter would honor his commitment. When respondent was reminded of the shortage, he deposited his own funds into the trust account. Whereas Brown engaged in "lapping," there is no evidence that respondent repeatedly took money from one client to pay another or to pay his office expenses. His retention of client funds in his trust account, albeit funds that could or should have been disbursed, did not constitute "lapping."

In sum, while we find that there is clear and convincing evidence that respondent negligently misappropriated client funds, the proofs do not support a finding of knowing misappropriation.

With respect to the charge of a violation of *RPC* 8.1(a), the presenter did not clearly and convincingly demonstrate that respondent misrepresented a material fact. In his March 10, 1999 letter to the OAE, respondent stated that "I assume full responsibility for the issuance of the above check. I have taken appropriate measures to insure that this is an isolated incident and in no way impairs the integrity of funds that I now hold in trust." The presenter interpreted this statement to mean that respondent had replenished his trust account. Respondent, however, testified that he meant to say that he had identified the cause

of the shortage and did not expect any recurrence of that incident. Because there is no clear and convincing evidence that respondent misrepresented that he had replaced the funds, we determined to dismiss the charge of a violation of *RPC* 8.1(a).

Respondent conceded that he had committed recordkeeping violations. He maintained one client ledger card (PCC) with a debit balance, maintained three inactive trust ledger balances (*Lecour*, *Shuler* and *Goldfajer*) in his trust account, failed to reconcile his trust account quarterly and was out of trust for one and one-half years.

On the whole, the record supports a finding that respondent negligently misappropriated client funds and failed to comply with the recordkeeping rules. Suspensions have been imposed when attorneys were aware of the shortage in their trust accounts and failed to promptly replenish the funds. *See, e.g., In re Prado, supra,* 159 *N.J.* 529 (1999) (three-month suspension); *In re Moras, supra*, 131 *N.J.* 164 (1993) (six-month suspension); and *In re Librizzi, supra*, 117 *N.J.* 481 (1990) (six-month suspension).

Here, there are mitigating factors. Respondent has enjoyed an unblemished career spanning twenty-five years. He has provided services to the bar and to the public through his several *pro bono* and community activities. No client suffered any harm. In addition, respondent's recordkeeping, while violative of the rules, was not as deficient as Librizzi's, who did not open his bank statements, maintain receipts and disbursements journals and reconcile his trust account for twelve years.

Based on the foregoing, a seven-member majority voted to impose a three-month suspension. One member voted to impose a reprimand, believing that respondent's genuine forgetfulness about the trust account deficiency warranted a reprimand. One member did not participate.

We further required respondent to reimburse the Disciplinary Oversight Committee for administrative costs.

Dated: 8/06/01

By:
ROCKY L. PETERSON
Chair
Disciplinary Review Board

SUPREME COURT OF NEW JERSEY
DISCIPLINARY REVIEW BOARD
VOTING RECORD

In the Matter of Maxwell X. Colby
Docket No. DRB 01-030

Argued: May 17, 2001

Decided: August 6, 2001

Disposition: Three-month suspension

Members	Disbar	Three-month Suspension	Reprimand	Admonition	Dismiss	Disqualified	Did not Participate
Peterson		X					
Maudsley		X					
Boylan							X
Brody		X					
Lolla		X					
O'Shaughnessy			X				
Pashman		X					
Schwartz		X					
Wissinger		X					
Total:		7	1				1

Robyn M. Hill 10/12/01
Robyn M. Hill
Chief Counsel