DISCIPLINARY REVIEW BOARD

OF THE

SUPREME COURT OF NEW JERSEY

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April 3, 2019

Heather Joy Baker, Clerk
Supreme Court of New Jersey
P.O. Box 970
Trenton, New Jersey 08625-0962

Re: **In the Matter of Lawrence S. Schwartz**
Docket No. DRB 19-015
District Docket No. XIV-2016-0403E

Dear Ms. Baker:

The Disciplinary Review Board reviewed the motion for discipline by consent (censure or such lesser discipline as the Board shall deem appropriate) filed by the Office of Attorney Ethics (OAE), pursuant to R. 1:20-10(b).[1] Following a review of the record, the Board determined to grant the motion. In the Board's view, a censure is the appropriate measure of discipline for respondent's violations of RPC 1.15(b) (failure to promptly deliver funds to a third party) and RPC 5.3(a), (b), and (c) (failure to supervise nonlawyer staff).

This matter was originally before the Board as a disciplinary stipulation under Docket No. DRB 12-070. On August 27, 2012, the Board voted to impose a reprimand for respondent's violation of RPC 1.15(b) and RPC 5.3(a) and (b).

On September 24, 2012, Diane Pereira, the original grievant and a former employee of respondent's law firm, Schwartz, Simon, Edelstein and Celso (SSEC) wrote to the OAE criticizing its investigation and claiming that SSEC's alleged misuse of employee 401(k) funds had not been addressed. The matter was pending before the Court. On March 8, 2013, the OAE opened a new investigation under District Docket No. XIV-2013-0107E to address Pereira's concerns.

[1] Bonnie C. Frost, Chair at the time the Board considered this matter, was recused.

In light of the new OAE investigation, on July 17, 2013, the Court vacated the Board's decision in DRB 12-070, remanded the matter to the OAE for consolidation with XIV-2013-0107E, "and for further investigation, including but not limited to determine the precise circumstances and timing of respondent's discovery [that] employee withholding taxes were not being collected, segregated or remitted in a timely manner."

Once the combined investigation was completed, the parties entered into a second, more comprehensive disciplinary stipulation, incorporating by reference the original stipulation and containing additional, previously undisclosed facts.

On June 22, 2016, in DRB 16-039, the Board rejected the second stipulation, and remanded the matter to the OAE for the filing of a complaint and a hearing, cautioning that it would not entertain a third stipulation. The Board itemized numerous issues to be addressed on remand, and identified eleven individuals who should testify at the hearing. Almost two years later, in May 2018, the parties submitted letters requesting that the Board resolve the matter without the necessity of a hearing. Among the reasons given were that two key witnesses had passed away, and another critical witness, nonlawyer office manager Doreen Formato, had ceased cooperating with the OAE. The Office of Board Counsel sent a letter to the parties, stating that: (1) cases may not be resolved via letter request; (2) in light of the parties' shared view that a hearing was not necessary, they should submit the matter via an approved procedure under the Rules; and (3) they should explain the efforts made to interview the remaining witnesses whom the Board had identified in its remand letter.

On January 10, 2019, the parties submitted a motion for discipline by consent.

At all relevant times, respondent served as the managing director of SSEC. ADP processed the law firm's payroll, but employee withholdings were handled by office manager Formato, who signed, filed, and paid the quarterly returns to the Internal Revenue Service (IRS) in 2008 and 2009.

In early 2008, SSEC was not generating revenue sufficient to pay all of its obligations. Formato unilaterally ceased paying and filing employee federal withholding taxes on a timely basis. Instead, she diverted those funds to pay ordinary expenses of the law firm, including payroll and utilities, in order to "keep SSEC operational." Other firm expenses, including partners' draws, fell behind.

SSEC's accountant, Steven Katz, had general oversight of the law firm's finances at the time. Katz made quarterly visits to the office and prepared SSEC's annual tax returns, Schedule K-1 tax forms and financial statements, but had no role in the withholding of taxes or the filing of quarterly tax returns. In 2008, however, Katz fell ill and frequented the office less often, until his death in 2009. The law firm did not hire Katz's replacement until 2010. In the interim, Formato handled the financial aspects of SSEC.

The procedural history of this case was complicated by the fact that the Board and Court were seeking a definitive answer as to when respondent became aware that Formato

was diverting funds from required payments to satisfy ordinary business expenses. In a September 29, 2015 interview with the OAE, respondent asserted that Formato had alerted him to problems with the employee withholding taxes in about September 2009. Prior to that time, he had very little role in the day-to-day operations of the law firm. He claimed he never signed attorney business account checks or reviewed issued checks or SSEC's bills. Rather, he believed that the law firm's finances had "run smoothly with no problems from the time Formato started in 1995 through 2008."

During initial questioning by the OAE, Formato had been unsure when she had told respondent about the law firm's financial problems. Her answer evolved, beginning with 2006, then 2008, and ending with 2009. Subsequent to the Board's June 22, 2016 remand, which sought a definitive statement on the issue, Formato ceased cooperating with the OAE. In turn, the OAE determined that Formato's credibility was so negatively affected by her decision to cease cooperating that investigators determined not to issue a subpoena for her testimony.

Thus, the parties stipulated that the OAE was unable to determine precisely when Formato told respondent that SSEC was experiencing cash flow problems and was not timely remitting employee withholding taxes to the IRS. The parties also stipulated that respondent "has been continuously cooperative with the OAE's investigation," through all three OAE investigations.

Consistent with respondent's position that he was informed, in September 2009, he admitted that he and Formato concentrated on collecting accounts receivable to generate funds with which to pay the government. Taxes continued to be filed and paid sporadically or untimely through the end of 2009.

In November 2009, the IRS sent a deficiency notice requiring SSEC to pay $550,086.67 for the trust fund portion of the outstanding withholding tax obligation. Respondent immediately instructed Formato to pay the IRS, which she did, in December 2009.

Early the following year, the IRS placed a levy on SSEC's payroll account, which prompted the firm to make monthly IRS payments of $5,000 to $10,000 on account of tax withholding deficiencies. In June 2010, SSEC and the IRS entered into an installment agreement requiring $20,000 monthly payments until all of the outstanding withholding tax obligations for 2008 and 2009, which then totaled $2,045,339.37, were paid.

In November 2013, SSEC obtained a $1.6 million bank loan and retained outside counsel to represent the firm before the IRS for deficiencies totaling $1,642,887 at the time. By November 21, 2013, the IRS was paid in full and respondent was no longer responsible for any of the law firm finances.

In addition to the IRS improprieties, Formato ceased making timely payments to other entities for which employee funds were escrowed, including New Jersey 927 withholding

taxes. For the years 2008 through 2010, quarterly payments were deficient and amounted to arrearages as large as $54,081 for 2009. Again, Formato used the funds to pay law firm expenses.

In August 2012, SSEC executed an installment agreement with New Jersey taxing authorities for all outstanding tax deficiencies. The terms of the agreement were satisfactorily completed in September 2013.

Additionally, Formato failed to promptly pay funds owed to the Social Security Administration (SSA). In 2008, at least one SSEC employee, Jeannie Depete, met with human resource manager, Patricia Sheehan, complaining that SSEC had deducted funds from her salary for SSA taxes, but her SSA statements showed no earnings. In 2008, Sheehan brought the issue to respondent, who referred her to Formato. Formato told the employee to check her statements again in a few months. Formato did not recall ever having informed respondent of SSA issues or having discussed the matter with Sheehan. The OAE was unable to reach Depete to conduct an interview. For his part, respondent asserted that, after Depete informed him of a problem with her SSA statement, he alerted Formato, who explained that it must have been an error, and represented that she would rectify it.

In respect of 401(k) plan withholdings, SSEC had an established, voluntary 401(k) plan for employees. Respondent was the plan administrator, but he disclaimed any day-to-day involvement with the plan. Rather, Formato performed the functions of setup, payroll deductions, transfers of funds to AXA (SSEC's investment firm), and handling distributions to employees, when necessary. Formato did not have signatory authority on either of SSEC's 401(k) accounts. Rather, she presented checks to respondent, who signed them.

In 2008 and 2009, when SSEC experienced cash flow problems, Formato delayed sending employee 401(k) funds to AXA, and began to use those funds for law firm expenses. She told the OAE, "it was a cash flow issue." In her September 2015 interview, Formato admitted that she "decided to not remit employee withholding timely." Yet, when the OAE asked Formato whether respondent had that knowledge at the same time that she did, Formato replied, "Yes." Respondent denied that Formato's 2015 statements were accurate. The parties now have stipulated the "OAE is unable to determine by clear and convincing evidence as to whether Formato's statement is accurate."

Formato also mishandled 401(k) partner contributions. She claimed that Katz had told her that she could send partner contributions to AXA once a year, in October, when SSEC filed its annual tax return. Therefore, when a partner provided her with a personal check representing a 401(k) contribution, she would deposit it into SSEC's payroll or business account. Sometimes, she forwarded the funds to AXA, but other times she used the funds to pay law firm expenses. Formato did not have written authorization from partners to hold their funds and failed to notify them that their funds were not being invested timely.

The Employee Benefit Security Administration (EBSA) conducted an investigation into SSEC's 401(k) plan for 2009 and 2010, and concluded that SSEC's payments had been

untimely. The EBSA calculated the amount due to each affected employee, which SSEC paid to the employee. Respondent and Formato were aware of the EBSA's investigation and findings.

During its initial investigation, the OAE interviewed the following former SSEC employees who had approached Formato about her handling of their 401(k) accounts: Gregory Dennison, Burton Zitomer, Melissa Natale, Lisa Wood, Michael Cohen, and Patricia Sheehan. In summary, in 2007 and 2008, these employees complained to Formato or Sheehan that funds had been taken from their salaries for 401(k) contributions but were not reflected in their 401(k) account statements. In its June 22, 2016 remand letter, the Board questioned whether respondent had been made aware of these employees' concerns earlier than he had claimed. The OAE contacted those witnesses, except Cohen, who was deceased, and confirmed that the statements that the OAE had attributed to them in its initial investigation were correct, thereby satisfying the Board's earlier concerns about those witnesses' statements.

In his March 31, 2017 post-remand interview, respondent stated that employees had occasionally told him that their 401(k) contributions were not being recorded properly, and that he would tell Formato "there's some issues please take care of this right away." He admitted that at a partnership dinner meeting in late 2008 or early 2009, respondent discussed with his partners a problem with SSEC's 401(k) contributions but stated that the problem was being addressed. That dinner, however, marked the first time that he was aware of a "major problem" with the 401(k) plan that Formato had not rectified. To the extent that he had been aware of 401(k) problems prior to 2009, respondent had simply passed the employees' complaint along to Formato.

In December 2010, at respondent's urging, SSEC's equity partners terminated the 401(k) plan for fear of another EBSA audit. The OAE determined that SSEC had failed to remit 401(k) funds timely in 2008, 2009, and 2010.

Formato and AXA informed all employees about their 401(k) options upon termination of the plan and, on December 31, 2010, SSEC terminated the 401(k) plan and all funds had to be distributed. AXA started issuing checks payable to SSEC for the benefit of employees. Between July 12, 2011 and March 27, 2015, Formato transferred a total of $599,389.30 in employee 401(k) funds from the firm's 401(k) bank account to either its business account or its payroll account, "as the funds were needed," to cover law firm expenses. The OAE also found evidence of frequent transfers in and out of the 401(k) account during this period, with total transfers of $502,719.47 back into SSEC's 401(k) account over this time period, leaving a "balance of $96,669.83 ($599,389.30 - $502,719.47)." Presumably, the stipulation's reference to a "balance" should reference a "shortage" because AXA remitted $599,389.30 to SSEC to reimburse its employees for their 401(k) contributions, but SSEC had only $502,719.47 in its 401(k) plan bank account, and, therefore, was short $96,669.83

Although the law firm did not seek the use of her funds, Formato informally loaned $87,374.95 of her own 401(k) funds to SSEC. She did so because she knew that "SSEC was in financial trouble and [she] wanted to help." The OAE concluded that $9,294.88 of employee funds had not been replenished in the 401(k) account. But for Formato's loan, that amount would have been much higher.

The parties stipulated that no SSEC employee ever gave Formato permission to use his or her 401(k) funds for a purpose other than to contribute them to the 401(k) program. Formato had made these transfers without signatory authority on the payroll and 401(k) accounts. Rather, she accessed those accounts using online banking services, transferring funds as she saw fit for business expenses and to meet payroll obligations. Formato told the OAE that she "decided on her own to use the employees' funds for firm expenses." The law firm, however, had no internal policies or controls in place regarding the accounts to prevent Formato's online access.

Formato kept track of the funds that AXA returned for each employee and, whenever she received instructions from an employee to roll over or cash out plan funds, she attempted to ensure that the 401(k) account held funds sufficient to cover that employees' investment, before issuing a check to be signed by respondent.

From November 2011 through April 2015, SSEC failed to safeguard employee 401(k) funds. The largest shortage, $76,147.68, occurred in February 2012. For example, on December 15, 2011, a check issued from the 401(k) account to "A. Brown" for $139,869.77 was presented to the bank, and the 401(k) account became overdrawn. Nevertheless, the bank honored the check. The OAE's forensic analysis confirmed that employee 401(k) funds had been transferred to SSEC's business account to cure negative balances, and to SSEC's payroll account to cover payroll obligations.

When Formato and AXA were winding down the 401(k) account, Formato could not locate several former employees to disburse their remaining funds. The OAE determined that, from February 29, 2014 through April 29, 2015, SSEC failed to safeguard 401(k) funds in respect of eight former employees who were owed between $52.99 and $3,298.75. From February 29, 2014 through March 27, 2015, the 401(k) account had a shortage of $9,510.45. As of April 30, 2015, a shortage of $6,910.45 remained.

Respondent never instructed or authorized Formato to make these transfers. However, because he did not review bank statements, deposits, or withdrawals, he was unaware that Formato was moving funds from SSEC's 401(k) account to the business and payroll accounts as she saw fit. Beyond his act of signing the 401(k) checks alongside Formato's assurances that all employee funds were properly handled, no controls were in place to prevent Formato's misuse of funds.

Respondent did not provide the OAE with proof that the missing employees' 401(k) funds were ever returned to them. Formato told the OAE that she did not know what

happened to the funds representing that $6,910.45 shortage. Respondent stipulated that he had not properly safeguarded them.

Respondent stipulated that, during 2008, 2009, and 2010, the deficiency to the IRS and AXA at times exceeded $1 million, even though employee W-2 statements indicated that funds had been deducted from their salaries.

Although the stipulation does not resolve all of the Board's concerns, the Board is reluctant to reject this third submission from the parties and must rely on the OAE's position that it could not support additional charges by clear and convincing evidence.

Respondent acknowledged that, as SSEC's managing director and Formato's supervisor, he failed to take reasonable steps to ensure that her conduct as a nonlawyer to promptly remit the IRS withholdings, SSA taxes, New Jersey 927 taxes, and 401(k) funds, was compatible with his obligations as a lawyer, in violation of RPC 5.3(a) and (b).

In addition, respondent stipulated that he violated RPC 5.3(c)(3), which holds a lawyer responsible for the conduct of a nonlawyer, if the lawyer fails to make reasonable investigation of circumstances that would disclose past instances of conduct by the nonlawyer incompatible with the professional obligations of a lawyer.

Once respondent was made aware that Formato had not been paying withholding taxes timely, he failed to investigate her handling of 401(k) funds. Formato's improper use of employees' 401(k) funds continued after he became aware of her propensity to misuse funds for employee withholding taxes. Even a cursory review would have disclosed Formato's rampant misuse of employee funds to cover law firm shortages, and her propensity to do so in the future with similar funds at her disposal. Due to respondent's disinterest in SSEC's business operations, Formato was able to continue misusing employee 401(k) funds for a time after he learned about issues involving her handling of them. Respondent's misconduct was a clear violation of RPC 5.3(c)(3).

Additionally, respondent failed to safeguard employee funds in various contexts. He was charged with the responsibility of ensuring that Formato promptly delivered employee withholding taxes to the IRS, to promptly disburse 401(k) funds to employees and entities such as AXA, to ensure that New Jersey 927 tax withholdings were properly handled, and to properly remit withholdings for SSA contributions and he failed to do so. Further, $6,910.45 of former employees' 401(k) funds were and continue to be unaccounted. Respondent is guilty of having violated RPC 1.15(b).

In support of the motion for discipline by consent, the parties relied on In re Hofing, 139 N.J. 444 (1995); the attorney received a reprimand. Like respondent, Hofing failed to supervise a bookkeeper, who embezzled almost $500,000 in client funds. Formato did not embezzle funds but used large sums of employee funds to keep the law firm solvent. Like respondent, Hofing was unaware of his employee's improprieties, and was found liable because he had assigned all bookkeeping functions to one person. Both respondent and

Hofing failed to review law firm trust account bank statements – for years. Similar mitigation was presented in both cases, including the attorneys' lack of knowledge of the staff's misconduct, an unblemished disciplinary record of many years, cooperation with the OAE, and swift action to correct the wrongs committed by the employee. Hofing received a reprimand. Ibid.

In aggravation, Formato, over whom respondent had sole supervisory authority, falsely indicated that appropriate sums had been deducted from employees' salaries, and either had been or would be paid to the IRS and other payees. The parties stipulated that the Board may consider those misrepresentations as an aggravating factor for purposes of imposing discipline.

In further aggravation, the amounts involved in this matter were staggering – far in excess of one million dollars when the shortages and misuse of funds are combined.

The Board found the following significant mitigation: respondent's fifty-four years at the bar without prior discipline; his cooperation with the OAE in three investigations, including his entry into this consent; steps taken at SSEC to repay all taxes due the IRS; and changes at SSEC to divide supervisory functions among others in the firm, while relieving respondent of all responsibility for the firm's finances.

With the reprimand in Hofing as the baseline sanction, the Board determined that enhanced discipline is warranted for the presence of countless misrepresentations contained in statements given to employees, and for the extraordinary degree of ignorance that respondent paid to his fiduciary duties while serving as SSEC's managing director.

Enclosed are the following documents:

1. Notice of motion for discipline by consent, dated January 9, 2019.
2. Stipulation of discipline by consent, dated January 7, 2019.
3. Affidavit of consent, dated December 14, 2018.
4. Ethics history, dated April 3, 2019.

Very truly yours,

Ellen A. Brodsky
Chief Counsel

EAB/paa
encls.
See attached list

c: w/o enclosures
Bruce W. Clark, Chair
Disciplinary Review Board (e-mail)
Charles Centinaro, Director
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