PUBLIC MATTER – DESIGNATED FOR PUBLICATION

Filed April 15, 2002

REVIEW DEPARTMENT OF THE STATE BAR COURT

In the Matter of **CHARLES CONNELL McCARTHY**, A Member of the State Bar.	))))))	**96-O-00528** **OPINION ON REVIEW & ORDER TERMINATING INACTIVE ENROLLMENT**

This matter is before this court for review because respondent Charles Connell McCarthy, general partner of Kau-Kona Land Co., a California limited partnership, (the Kau partnership, the partnership, or Kau) was found to have breached his fiduciary duties and misappropriated funds by refusing to distribute to Nazar H. Ashjian, one of the limited partners of Kau, Ashjian's portion of the preliminary distribution of Kau's funds.

The hearing judge recommended disbarment based on her findings of willful misappropriation constituting an act involving moral turpitude (Bus. & Prof. Code, § 6106)[1] and of seeking an agreement or agreeing to have a complaining witness withdraw his State Bar complaint as a condition of settlement (§ 6090.5, subd. (a)(2)).

Respondent contends that the hearing judge erroneously found culpability of the charges and requests dismissal of the entire matter.

Upon our required independent review of the record (Cal. Rules of Court, rule 951.5; Rules Proc. of State Bar, rule 305(a);[2] *In re Morse* (1995) 11 Cal.4th 184, 207) and based on the applicable standards and case law, we find respondent culpable of both charges and

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[1]All further references to sections are to the Business and Professions Code.

[2]All further references to rules are to these Rules of Procedure of the State Bar unless otherwise indicated.

recommend a stayed suspension of four years, a probationary period of three years, and an actual suspension of two years.

I. STATEMENT OF FACTS

Respondent was admitted to the practice of law on June 14, 1949, and has been a member of the California State Bar since that time. He has no record of prior discipline. Effective December 31, 1991, he was placed on inactive status at his request. According to respondent's exhibit A, a letter from a State Bar membership records supervisor, he returned to active status on July 6, 1999, where he remained until August 14, 2000, when he was involuntarily enrolled inactive under section 6007, subdivision (c)(4), incident to the disbarment recommendation we now review.

Procedural Background

The notice of disciplinary charges (NDC) was filed on November 24, 1999. Count one of the NDC charged respondent with violating section 6106, conduct involving moral turpitude, based on respondent's violation of his fiduciary duty[3] and misappropriation of Ashjian's share of a Kau partnership distribution. Count two of the NDC charged respondent with violating section 6090.5, subdivision (a)(2), seeking an agreement to have the complaining witness, Ashjian, withdraw his State Bar complaint. Respondent filed his response to the NDC on December 30, 1999.

Respondent filed a motion to dismiss on May 30, 2000, contending that count one of the NDC should be dismissed because it failed to state a disciplinable offense (rule 262(c)(1)) and was barred by the applicable period of limitations set forth in rule 51 (rule 262(d)). The hearing judge denied the motion to dismiss, determining that count one of the NDC pleads adequate facts

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[3]While the NDC does not specifically state that respondent breached or violated a fiduciary duty, it does specify that respondent was a fiduciary to the limited partners, and respondent himself acknowledges in his opening brief on review that he was charged with breaching his fiduciary duties to Ashjian.

to state a violation of section 6106 and that the charge set forth in count one was not barred by the applicable statute of limitations due to respondent's continuing obligation to disburse the preliminary distribution funds to Ashjian.

Facts

The Partnership

On October 10, 1967, the "Agreement of Limited Partnership of Kau-Kona Land Co." (the Kau partnership agreement or the partnership agreement) was executed. It included respondent and L. M. Prince, Jr., as the only general partners and Ashjian as one of the regular limited partners with an initial capital contribution of $3,000 (1 percent interest). The purpose of Kau was to purchase and hold for investment approximately 1,400 acres of land located in Hawaii. Under the partnership agreement, the regular limited partners were required to make additional capital contributions in the same proportions as their initial contributions for mortgage payments, real property taxes, and various other charges incident to real property ownership. The regular limited partners made capital contributions pursuant to the partnership agreement for approximately five or six years.

Pursuant to the partnership agreement, the general partners, in their absolute discretion, had the power, among other things, to determine whether and when to make distributions to the partners. The partnership agreement specified, however, that the general partners had no authority to do any act in contravention of the partnership agreement or of Kau's certificate of limited partnership.

Under the "Certificate of Limited Partnership of Kau-Kona Land Co.," the partnership was to continue until the earliest of the following events: (1) the sale of all partnership interest in the real property; (2) the death, adjudication of bankruptcy, insanity, or incompetency of the last surviving general partner, unless within 90 days thereafter at least 60 percent of the regular limited partnership interest elected a regular limited partner to act as general partner; or (3)

October 10, 1987.

In 1971, 400 acres of the partnership's 1,400 acres of land were condemned by the State of Hawaii. Kau used the monies realized from this sale to pay off the mortgage on the entire 1,400 acres. Thus, at that time, Kau owned the remaining 1,000 acres of land “free and clear.” The partners were not called upon for further capital contributions and received a distribution in an unspecified amount at that time.[4]

In 1976, Prince breached his fiduciary duties and subsequently lost his authority to act as a general partner in 1983 by court judgement. Nonetheless, Prince retained his equity ownership in Kau.

In 1987, the partnership was extended past the October 10, 1987 termination date.

The Preliminary Distribution

In July 1986, Kau filed a voluntary petition for bankruptcy reorganization under Chapter 11 of the Bankruptcy Code (11 U.S.C. § 1101 et seq.). Kau filed its petition in the United States Bankruptcy Court for the District of Hawaii. Kau sought reorganization under Chapter 11 to prevent the foreclosure on its remaining 1,000 acres for Kau's nonpayment of water facilities charges and of a loan it obtained to purchase water rights for the property.

The bankruptcy court authorized and confirmed Kau's sale of its remaining 1,000 acres of land for $5,250,000. Thereafter, in May 1988, Kau filed a motion for order authorizing payment of all creditors and partial disbursement to equity owners. In an order dated June 9, 1988, the bankruptcy court granted that motion and authorized Kau to pay all of its pre-petition and post-petition claims/debts. In that order, the bankruptcy court also authorized Kau to make a return of capital and a partial distribution of profits to Kau’s partners in the specific amounts listed for each partner on exhibit A of Kau's motion (sometimes referred to as the preliminary distribution).

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[4]This distribution appears to have partially reimbursed the limited partners for their capital contributions. Because no issues are raised in this case pertaining to this initial distribution, we do not discuss it further.

In May 1988, Kau also filed a motion to dismiss its bankruptcy proceedings. Thereafter, in an order dated July 29, 1988, the bankruptcy court found that all of Kau creditors (pre-petition and post-petition) had been paid and granted Kau's motion to dismiss. Then, in an order dated August 31, 1988, the bankruptcy court formally closed Kau's bankruptcy proceeding.

On July 27, 1988, respondent apprised each limited partner by letter that the bankruptcy court had (1) granted Kau's motion to dismiss its bankruptcy proceedings and (2) authorized him to disburse funds to each partner in accordance with the specific amounts listed for each partner on exhibit A to Kau's motion.

Even though the bankruptcy court order did not authorize him to do so, respondent conditioned this disbursement of funds to each of the partners on their executing a warranty, indemnification and release (release or release form). Specifically, respondent stated in the July 27, 1988 letter to each of Kau's partners that he "shall make distribution to you as set forth in Exhibit A of the Motion (copy enclosed), <u>PROVIDED</u> you first sign and return the enclosed [release]." The release respondent enclosed in his letter to the limited partners, among other things, absolved respondent personally from any claims arising from his stewardship of Kau's affairs. Respondent further stated in his July 27, 1988 letter that, if the limited partner did not sign and return the release, he or she should inform respondent of the claims against him, "in which case individual distributions shall be withheld until final resolution of any dispute."

Almost all of the limited partners signed and returned the release and received their monies. Two exceptions were Ashjian and the Estate of Elinor Mayer Bryden, Decedent (the Bryden Estate). These two limited partners refused to execute the release, arguing it was improper for respondent to request that they execute a release before disbursement of their money. However, neither of these two limited partners informed respondent that they had any claims against him.

In 1989, the probate court allowed the executor of the Bryden Estate to execute the release if additional language was included in the release,[5] and the Bryden Estate thereafter received its portion of the court authorized preliminary distribution in the sum of $209,460. Ashjian insisted on a mutual release, but respondent refused to accept it, and to date, Ashjian has still not received his portion of the preliminary distribution in the sum of $20,946, which included $5,156 for a return of capital and $15,790 for his share of the profit distribution. In August 1988, Ashjian signed the requested release without any modification on its face, but his attorney stated, in the cover letter accompanying the release, that the release was, in effect, mutual. Respondent refused to accept this release or disburse the $20,946 to Ashjian.

The preliminary distribution in 1988, which was made to all general and limited partners except Ashjian, left Kau with an undistributed cash balance of at least $332,055, in which sum the limited partners had a 60 percent interest and the general partner, i.e., respondent, had a 40 percent interest.[6] Respondent represented that he was holding this cash balance as a reserve to meet any contingent liabilities and obligations of the partnership.

The Final Distribution

In September 1989, respondent informed the Kau limited partners by letter that a lawsuit had been filed against CitiSavings & Loan (CitiSavings) and its attorneys on behalf of Kau; Charles McCarthy, individually; Leon Daniell, individually; and Larry Lopez, individually, for treble compensatory damages and punitive damages for bad faith dealings with the plaintiffs. Kau sought over $41,000,000 in damages. After several weeks of trial in 1990, the court dismissed the matter when the Resolution Trust Corporation (federal regulators) took over

[5]The additional language to be included in the warranty was set forth in the probate court's order as follows: "'Notwithstanding the foregoing it is understood and agreed that the Release shall not include or prevent any claims the undersigned Estate of ELINOR MAYER BRYDEN may have concerning or with respect to any future partnership distributions.'"

[6]Because respondent did not make the $20,946 distribution to Ashjian in accordance with the bankruptcy court's June 9, 1988 order, this amount should have been $353,001 ($332,055 plus $20,946).

CitiSavings. However, the plaintiffs' cause of action against the attorneys for CitiSavings survived, and it settled for $1,000,000 in November 1992.

On March 30, 1993, respondent informed the Kau partners by letter that the CitiSavings attorneys' lawsuit had settled in November 1992. Kau's share of the settlement was $300,000, less $57,237.50, which was Kau's one-third share of the litigation cost, less approximately $95,000, a repayment to respondent for litigation costs advanced by respondent for about two years, and less $30,000 to be paid to respondent as compensation for making the $95,000 "non-recourse" advance on Kau's behalf. Respondent also informed the partners that $100,000 was paid to co-plaintiff Larry Lopez, but respondent's letter was silent as to the distribution of the balance of the $600,000. We assume that $300,000 was paid to Leon Daniell[7] and $300,000 was paid to respondent, as they were represented to be plaintiffs, individually, sharing equally in the recovery proceeds and in the litigation costs. Finally, respondent stated that he was distributing $80,000 from the net proceeds to the partners as the final distribution but gave no further explanation of how he arrived at this amount of the net proceeds. Respondent made the final distribution in early 1993, and Ashjian received $480 as his proportionate share of the final distribution, without the requirement of a release.

Ashjian's Collection Attempts

After the preliminary distribution of Kau funds in 1988, Ashjian continued to demand his $20,946 share of those funds, and respondent continued to refuse to deliver the funds unless Ashjian signed the unamended release form. Ashjian received IRS Schedule K-1 forms (K-1 form), entitled "Partner's Share of Income, Credits, Deductions, etc.," throughout the life of the partnership. In 1995, the K-1 form he received showed $22,258 in his partnership capital account. For the year 1996, however, his K-1 form showed $22,258 in his capital account at the

[7]Leon Daniell and Larry Lopez were others with whom respondent was attempting to develop the Kau property.

beginning of the year and nothing in his capital account at the end of the year.

In 1994, Ashjian filed a complaint in the Los Angeles Municipal Court for breach of contract and common counts against Kau, respondent in his individual capacity, and respondent's wife in her individual capacity. Said matter was ordered to arbitration, and the arbitrator awarded Ashjian damages from Kau and from respondent in the amount of $20,946, plus interest in the amount of $10,660.22, for a total of $31,606.22. The arbitrator found that there was a fiduciary relationship between respondent as the general partner and Ashjian as a limited partner of Kau and that respondent did not have the discretion or right to require Ashjian to sign a release as a precondition to receiving his share of partnership profits. The arbitrator further found that respondent was under a continuing obligation to hold Ashjian's share of funds in trust and to turn them over to Ashjian. He also found that the K-1 form provided to Ashjian in 1994 constituted an acknowledgment of indebtedness and obviated the statute of limitations issue proffered by respondent. The award was subsequently confirmed as a municipal court judgment[8] on December 19, 1995. Thereafter, Ashjian levied on a bank account of respondent and collected $4,113.28. All other attempts to collect on the judgment were and remain unsuccessful.

On May 21, 1996, respondent filed a voluntary petition in the United States Bankruptcy Court for the Central District of California. In this petition, respondent sought to have personal debts, including Ashjian's municipal court judgment against him, discharged under Chapter 7 of the Bankruptcy Code (11 U.S.C. § 701 et seq.).

On August 22, 1996, Ashjian initiated an adversarial proceeding in respondent's personal bankruptcy to determine, as relevant here, the dischargeability of his municipal court judgment

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[8]Code of Civil Procedure section 1287.4 provides: "If an [arbitration] award is confirmed, judgment shall be entered in conformity therewith. The judgment so entered has the same force and effect as, and is subject to all the provisions of law relating to, a judgment in a civil action of the same jurisdictional classification; and it may be enforced like any other judgment of the court in which it is entered, in an action of the same jurisdictional classification."

against respondent. In a memorandum of decision filed on July 29, 1997, the bankruptcy court found, among other things, that Ashjian's municipal court judgment against respondent was nondischargeable under the Bankruptcy Code. Specifically, the court found the municipal court judgment nondischargeable under 11 United States Code section 523(a)(4) because it is based on a debt that arose from a defalcation while respondent was acting in a fiduciary capacity.[9] In light of its finding that Ashjian's judgment was nondischargeable, the bankruptcy court entered judgment in favor of Ashjian for $27,493.22, which was the uncollected balance remaining on Ashjian's municipal court judgment of $31,606.22 after Ashjian recovered $4,113.28 by levying on respondent's bank account. The bankruptcy court also awarded Ashjian prejudgment and postjudgment interest thereon in accordance with federal law.

Respondent testified in the hearing department that the Kau partnership was dissolved in 1996 upon his filing for bankruptcy, as per the partnership agreement. However, we note that according to both the partnership agreement and the certificate of limited partnership, the partnership was dissolved when it sold the remaining 1,000 acres of its original 1,400 acres of land in Hawaii under the bankruptcy court's authorization in 1988.

<u>Settlement Discussions as to the Bankruptcy Adversary Proceeding</u>

During the pendency of respondent's personal bankruptcy, respondent and Ashjian engaged in negotiations regarding a possible settlement of Ashjian's adversarial proceeding. On March 7, 1997, James R. Felton, attorney for respondent, directed a fax and a letter to Ashjian

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[9]Because under California law partners are trustees (1) for each other (*Leff v. Gunter* (1983) 33 Cal.3d 508, 514) and (2) over the assets of the partnership (*Ragsdale v. Haller* (9th Cir. 1986) 780 F.2d 794, 796), partners are fiduciaries for purposes of determining the dischargeability of a debt under 11 United States Code section 523(a)(4) (*Ragsdale v. Haller*, *supra*, 780 F.2d at pp. 796-797). Moreover, in the Ninth circuit, defalcation under section 523(a)(4) "'includes the innocent default of a fiduciary who fails to account fully for money received.' [Citations.] . . . An individual may be liable for defalcation without having the intent to defraud." (*Lewis v. Scott* (*In re Lewis*) (9th Cir. 1996) 97 F.3d 1182, 1186-1187, fn. omitted; *F.D.I.C. v. Jackson* (9th Cir. 1998) 133 F.3d 694, 704.)

confirming their settlement in the matter. (That letter was admitted into evidence in this proceeding as exhibit 20.) In the letter, Felton stated to Ashjian that his client (respondent) "has agreed to pay you the sum of $25,000.00 in full and complete settlement . . . ." Payment was to have been made approximately two weeks later. That letter further stated that Ashjian was to execute a full release of any and all claims against respondent and contact the State Bar to withdraw any claims, i.e., complaints, he had made. Felton further stated in his letter that a settlement agreement and mutual general release would be forwarded to Ashjian. Felton sent Ashjian a second fax and letter modifying the agreement later that same day. (That letter was admitted into evidence in this proceeding as exhibit 12.) This second letter specified that payment of $25,000 was to be made to Ashjian on or before March 20, 1997, and that the mutual general release would be signed by Ashjian, respondent, and respondent's wife. Felton explained the two letters in his letter to the State Bar dated March 25, 1997: "The first letter, faxed to [Ashjian] at approximately 9:15 a.m. that day, confirms my understanding of the terms of the settlement. The second letter, faxed to him at approximately 10:03 a.m., confirms our telephone conversation and the two changes that he requested and that Mr. McCarthy agreed to regarding the settlement."[10]

Hearing Judge's Determination of Culpability

Based on the above, the hearing judge found respondent culpable of misappropriating Ashjian's share of the preliminary distribution, which misappropriation constituted conduct involving moral turpitude and therefore violated section 6106. She further found respondent culpable of conditioning the civil settlement agreement upon the withdrawal from the State Bar of a disciplinary complaint in violation of section 6090.5, subdivision (a)(2).

II. DISCUSSION

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[10]The record does not reveal the reason for the failure of this settlement. Such failure appears particularly inexplicable in view of respondent's agreement to a mutual release, which Ashjian had earlier offered but respondent had rejected.

In this case, we must determine whether respondent is subject to discipline (1) for breaching his fiduciary duty and misappropriating funds to which Ashjian was entitled, thereby committing an act involving moral turpitude, and (2) for seeking or agreeing to Ashjian's withdrawal of his complaint to the State Bar as a condition of a settlement agreement as outlined in attorney Felton's March 7, 1997 faxes and letters to Ashjian.

Culpability as to Count One

It is well established, contrary to respondent's position, that respondent, as a general partner, owed to Ashjian, a limited partner, fiduciary obligations, including the duty of good faith and fair dealing (*Wortham & Van Liew v. Superior Court* (1987) 188 Cal.App.3d 927, 932) and that respondent was not permitted to take unfair advantage (*Cagnolatti v. Guinn* (1983) 140 Cal.App.3d 42, 48). "Partnership is a fiduciary relationship, and partners are held to the standards and duties of a trustee in their dealings with each other." (*BT-I v. Equitable Life Assurance Society* (1999) 75 Cal.App.4th 1406, 1410.) With respect to Ashjian's share of the distribution funds, at the time such funds were distributed among the other Kau partners, respondent had a fiduciary duty to safeguard the money to which Ashjian was entitled. "An attorney who accepts the responsibility of a fiduciary nature is held to the high standards of the legal profession whether or not he acts in his capacity of an attorney. He must maintain proper books of account and records of transactions, and he may not commingle client's funds or use them for personal purposes. [Citations.]" (*Worth v. State Bar* (1976) 17 Cal.3d 337, 341.) Further, "[w]hen an attorney assumes a fiduciary relationship and violates his duty in a manner that would justify disciplinary action if the relationship had been that of attorney and client, he may properly be disciplined for his misconduct. [Citations.]" (*Clark v. State Bar* (1952) 39 Cal.2d 161, 166; *Lewis v. State Bar* (1973) 9 Cal.3d 704, 713; *In the Matter of Hultman* (Review Dept. 1995) 3 Cal. State Bar Ct. Rptr. 297, 307.) Thus, respondent is subject to discipline if he misappropriated Ashjian's share of the distribution funds or breached his fiduciary duty by failing to distribute funds to which Ashjian was entitled.

Respondent argues that he is absolved of any wrongdoing because his action is supported by Corporations Code section 15684, regarding distribution of assets, which indicates that creditors shall be paid first. However, that section is part of the California Revised Limited Partnership Act, operative July 1, 1984, and that statutory scheme is inapplicable to the Kau partnership. Instead, the provisions of the Uniform Limited Partnership Act apply to Kau. Corporations Code section 15523, part of the latter act, provides as relevant regarding the distribution of partnership assets as follows: "(1) In settling accounts after dissolution the liabilities of the partnership shall be entitled to payment in the following order: [¶] (a) Those to creditors, in the order of priority as provided by law, except those to limited partners on account of their contributions, and to general partners, [¶] (b) Those to limited partners in respect to their share of the profits and other compensation by way of income on their contributions, [¶] (c) Those to limited partners in respect to the capital of their contributions, [¶] (d) Those to general partners other than for capital and profits, [¶] (e) Those to general partners in respect to profits, [¶] (f) Those to general partners in respect to capital."

Moreover, the partnership agreement provides, as relevant, that among partners, "[d]istributions when made . . . shall be made as hereinafter provided. [¶] A sum equal to the total of all capital contributions made by the Regular Limited Partners, without interest thereon, shall be paid to them, out of the first cash available for distribution, in the same proportions to which they made such contributions. . . . There shall be no disbursement of cash to the General Partners, or to the Special Limited Partner, until all Regular Limited Partners and/or their successor(s) in interest, have been paid sums equal to the total of all their capital contributions as hereinabove provided."

Thus, the applicable statute, as well as the provisions of the partnership agreement, provide that limited partners are to receive their capital contributions before a general partner receives a share of the profits. In addition, the statute provides that limited partners are to receive both capital contributions and profits before a general partner receives profits. Here, contrary to the applicable statute and the partnership agreement, respondent received his share of profits in two different distributions without having first distributed to Ashjian his capital contribution and share of profits. We therefore conclude that respondent breached his fiduciary duty to Ashjian.

We additionally determine that the evidence establishes that respondent misappropriated funds which Ashjian was entitled to receive. In *Edwards v. State Bar* (1990) 52 Cal.3d 28, 36-37, misappropriation was found based on evidence that the attorney withdrew a client's funds from his trust account and spent such funds for his own benefit without his client's authorization. In *Baca v. State Bar* (1990) 52 Cal.3d 294, 304, the court held that "an attorney's failure to use entrusted funds for the purpose for which they were entrusted constitutes misappropriation. [Citation.]" In *Brody v. State Bar* (1974) 11 Cal.3d 347, 349-350, the attorney was found culpable of commingling client funds with his own and misappropriating client funds to his own use. The attorney argued that due to an inadvertent mathematical error, he had been unaware of any financial obligation to his client, and therefore he was not culpable of willful misappropriation. (*Id*. at p. 350.) The Supreme Court found, however, that evidence of Brody's persistent refusal to account to his client in the face of repeated demands to do so justified the finding of willful misappropriation. (*Ibid*.)

In each of the above cases, the conclusion that misappropriation occurred was based upon a finding that the attorney utilized client funds for his own use. In the present case, as we will discuss, we conclude (1) that Ashjian was entitled to receive his share of the preliminary distribution funds, whether or not he was entitled to receive them at the time of the preliminary distribution in 1988, and (2) that respondent committed a misappropriation by taking Ashjian's share of those funds for his own use.

The record reflects that in 1988, when the preliminary distribution was announced by the general partner and all limited partners were informed of their respective shares of the distribution, each partner's share was earmarked and recorded in an individual account. The record additionally reflects that respondent, as general partner, took his portion of the preliminary distribution of profits of over $1 million dollars without having paid Ashjian his $20,946 share.

Even assuming, without deciding, that respondent was entitled to retain Ashjian's share of funds at the time of the preliminary distribution in 1988 because Ashjian did not execute the release which respondent requested, then at the very least, respondent was required to disburse to Ashjian his $20,946 share of the preliminary distribution no later than early 1993, when respondent made the final distribution. At that time, respondent disbursed all remaining partnership funds without requiring any release, and he should therefore have been able to release all of the funds to which Ashjian was entitled at that time. Instead, respondent disbursed to Ashjian only his $480 share of the final distribution and still took his own $22,400 share of the final distribution. Because respondent was not entitled to take his share of the final distribution before paying Ashjian his capital contribution and profits, respondent effectively took Ashjian's $20,946 share of the preliminary distribution for his own use no later than this time.[11]

However, we need not and do not decide in this case whether the funds which respondent took belonged to Ashjian or to Kau, as it is clear that respondent took funds he did not own and

[11]*Fretz v. Burke* (1967) 247 Cal.App.2d 741, discussed the propriety of a general partner holding certain limited partners' share of profits in a suspense account, although distribution of profits had been made to other limited partners. A preliminary injunction was obtained by the limited partners requiring the general partner to disburse their share of profits to them. In holding the injunction to be proper, the appellate court held (1) that the injunction "simply directs that the part *which belongs to [the limited partners]* shall be paid to them now, and shall not be held by [the general partner] in suspense;" (2) that the injunction "merely prevents [the general partner] from putting funds *which belong to [the limited partners]* into a suspense account, purportedly as security for possible costs, a security which the law does not allow him;" and (3) that the injunction corrected "an overbearing assumption by [the general partner] of superiority and domination over *the rights and property of [the limited partners]*." (*Id*. at pp. 745-746, italics added.) We look to *Fretz v. Burke*, *supra*, only as support for our conclusion that, regardless of who owned the funds, Ashjian was entitled to receive them.

to which Ashjian was entitled. Because the evidence establishes that respondent took his share of the final distribution without ever having paid Ashjian his share of the preliminary distribution, we conclude that at the time of the final disbursement, at the very latest, respondent was culpable of willfully misappropriating funds to which Ashjian was entitled.

To support his assertion that he was entitled to take his share of the preliminary distribution before disbursing Ashjian's share, in his reply brief respondent points to the provision of the partnership agreement that allows the general partners a disbursement of 50 percent of their portion of the cash and 25 percent of their portion of the capital gain income for federal income tax purposes.[12] However, there is no evidence that respondent, as general partner, received only 50 percent of the cash and 25 percent of the capital gain income and only for income tax purposes. Instead, as indicated, the evidence shows that respondent received his portion of the preliminary distribution but did not disburse to Ashjian his portion of this distribution at any time.

Notwithstanding respondent's assertion, noted above, that he simply used Ashjian's share of the preliminary distribution to pay creditors first, as required under the Corporations Code, respondent has nevertheless failed to explain why he took his own share of the preliminary and final distribution before disbursing Ashjian's share of the preliminary distribution. In arguing the propriety of paying creditors of the partnership, respondent misses the point. As discussed, respondent was not entitled to take his share of partnership profits until after Ashjian had been paid, and by taking his share of distribution funds first, respondent used Ashjian's share to pay

[12]The partnership agreement provides as relevant: "If prior to payment of the Regular Limited Partners, of sums equal to the full amounts of their contributions to capital, ordinary income or capital gain income, as defined for federal income tax purposes, is attributable to the General Partners and Special Limited Partner as of the end of any tax year, then notwithstanding the foregoing, General Partners and Special Limited Partner shall be entitled to a disbursement of cash equal to 50% of any such ordinary income and 25% of any such capital gain income, less 50% of any cummulative [sic] loss attributable to them."

himself. This payment to respondent prior to payment to Ashjian constituted a misappropriation of Ashjian's share of distribution funds.

Respondent relies on *Wyler v. Feuer* (1978) 85 Cal. App.3d 392, 402-403; *Wallner v. Parry Professional Bldg., Ltd.* (1994) 22 Cal.App.4th 1446, 1451, fn. 6; and *Baldwin v. Marina City Properties, Inc.* (1978) 79 Cal.App.3d 393, 411, to support his position that requiring the release before distribution was a discretionary act made in the exercise of his honest business judgment as general partner. However, in each of these cases the discussion of a general partner's exercise of business judgment pertained to the general partner's liability for business losses sustained in managing the partnership's businesses. In the present case, we are not concerned with respondent's management of the partnership and partnership funds. Rather, this case involves respondent's ethical duties as an attorney when acting as a general partner and payment to himself of funds which, at least at the time of the final distribution, a limited partner was entitled to receive. Moreover, respondent's decision to require the limited partners to execute a release as a condition of distribution was not a decision made purely in the exercise of his honest business judgment in managing the partnership. Instead, the release was intended to exonerate respondent personally, not just the partnership, from all liabilities. Therefore, respondent cannot escape responsibility by claiming he was simply carrying on the business of the partnership when he sought to condition the preliminary distribution on the execution of the releases by the limited partners.

We also conclude that this willful misappropriation and violation of respondent's fiduciary duties to Ashjian involved moral turpitude. In *Johnstone v. State Bar* (1966) 64 Cal.2d 153, the Supreme Court found moral turpitude under similar circumstances. There, Johnstone negotiated a $3,000 settlement for personal injuries his client suffered in an industrial accident. As part of the settlement, Industrial Indemnity Company (Industrial) agreed to accept $1,000 of the $3,000 settlement funds from the third-party tortfeasor in place of its workers' compensation benefit lien in the amount of $4,945.57. (*Id*. at pp. 154-155.) After Johnstone deposited the settlement funds in his trust account, he delivered to Industrial a $1,000 check drawn on his trust account, but the check was returned by the bank for insufficient funds. Johnstone never paid Industrial the money to which it was entitled. (*Id*. at p. 155.) The Supreme Court determined that Johnstone held the money in trust for Industrial, that Johnstone breached that trust by failing to pay such money to Industrial and instead taking the money for his own use, and that such breach was an act involving moral turpitude: "The wilful violation of [the] trust herein, as found by the [State Bar], clearly constitutes an act involving moral turpitude and dishonesty within the meaning of section 6106 of the Business and Professions Code, as that section has been applied even in the absence of an attorney-client relationship." (*Id*. at p. 156, fn. omitted.)

Similarly, respondent's misappropriation of Ashjian's share of the distribution funds in this case, which act was also a breach of respondent's fiduciary duties to Ashjian, constituted an act involving moral turpitude. In sum, upon our independent review, we conclude that the State Bar has proved respondent culpable of violating of section 6106 by clear and convincing evidence.

Respondent's Contentions on Review as to Count One[13]

Motion to Dismiss Count One

In his opening brief on review, respondent asserts that the hearing judge erred in denying his motion to dismiss count one of the NDC and argues that the review department should now correct that error by dismissing count one. In requesting such dismissal, respondent repeats his arguments that: (1) the NDC failed to allege specific facts in support of the charge set forth in count one; (2) respondent was entitled to rely upon a probate court order approving of respondent's requirement that the Kau limited partners sign a release prior to receiving their

[13]We address respondent's principal points of error on review. Any points of error or supporting arguments that are not expressly addressed in this opinion have been considered and rejected.

respective shares of the preliminary distribution; (3) the NDC relied upon an underlying municipal court judgment that is void; and (4) the NDC was barred by the applicable period of limitations.

Respondent brought his motion to dismiss under rule 262(c) and (d). Rule 262(c)(1) provides as relevant that "[a] proceeding may be dismissed . . . for failure of the initial pleading to state a disciplinable offense . . . ." Rule 262(d) provides that "[a] proceeding may be dismissed on the ground that it is barred by any applicable statute or rule."

As previously indicated, all of respondent's arguments set forth in the motion to dismiss, except the argument based on the period of limitations, were encompassed within his contention that the NDC was defective because it failed to state a disciplinable offense. In reviewing such a contention, "we treat the factual allegations of the notice as true, but draw our own independent conclusions regarding the legal import of those facts. [Citations.]" (*In the Matter of Tady* (Review Dept. 1992) 2 Cal. State Bar Ct. Rptr. 121, 124.)[14] "Both at hearing and on review, the court considering a motion to dismiss of this type should disregard all factual matters outside the ambit of the notice . . . , since *the purpose of the motion is to test the sufficiency of the notice, not to contest the charges*. [Citation.] However, judicially noticeable facts outside the scope of the notice are an exception to this rule, and are cognizable. [Citations.]" (*Ibid*., italics added.)

Respondent never explained, and we fail to understand, how the probate court order and the municipal court judgment result in the failure of the NDC to state a disciplinable offense. In making these arguments, rather than presenting grounds for dismissal as a result of the insufficiency of count one, respondent is contesting the substance of the charges and apparently requesting a sort of pretrial summary judgment. (See Code Civ. Proc., § 437c.) However, no such procedure is available in State Bar disciplinary proceedings. "Assuming the notice . . .

[14]We note that *In the Matter of Tady*, *supra*, 2 Cal. State Bar Ct. Rptr. 121, was decided before the effective date of rule 260 and so does not affect our interpretation of rule 260(d).

properly charges a disciplinable offense, the appropriate time for respondent to present evidence in defense or mitigation [is] at the hearing on the merits . . . ." (*In the Matter of Tady*, *supra*, 2 Cal. State Bar Ct. Rptr. at p. 125.) We therefore conclude that respondent's assertions as to these matters did not warrant pretrial dismissal.

As to the general question of whether count one states a disciplinable offense, we note that respondent was charged in that count with violating section 6106. That section provides in relevant part that "[t]he commission of any act involving moral turpitude, dishonesty or corruption, whether the act is committed in the course of his relations as an attorney or otherwise, and whether the act is a felony or misdemeanor or not, constitutes a cause for disbarment or suspension." Respondent was specifically charged with violating section 6106 by misappropriating funds to which Ashjian was entitled. Moreover, as noted above in footnote 3, we conclude that the NDC adequately charged respondent with violating his fiduciary duties to Ashjian.

We have already discussed that respondent, as a general partner, had a fiduciary duty to Ashjian and was statutorily required, upon the dissolution of the partnership, to pay Ashjian his share of capital contributions and partnership profits before respondent took his own share of profits. (*Wortham & Van Liew v. Superior Court*, *supra*, 188 Cal.App.3d at p. 932; Corp. Code, § 15523.) As we have also discussed, respondent, having accepted fiduciary responsibilities, "is still held to the same fiduciary duties . . . as if there were an attorney-client relationship. [Citations.]" (*In the Matter of Lilly* (Review Dept. 1992) 2 Cal. State Bar Ct. Rptr. 185, 191.) A breach of such fiduciary responsibilities can constitute an act involving moral turpitude where such breach involves more than simple negligence. (*Ibid*; *In the Matter of Hagen* (Review Dept. 1992) 2 Cal. State Bar Ct. Rptr. 153, 169.)

As to the charge that respondent misappropriated funds, the terms "misappropriation" and "willful misappropriation" are often used interchangeably, and neither of them appear in either the Rules of Professional Conduct or the State Bar Act. These terms are defined by many court decisions, as we have discussed *ante*, which have held that the terms cover a wide range of conduct involving the conversion of client or other trust funds. (See *Edwards v. State Bar*, *supra*, 52 Cal.3d at p. 38.) When an attorney's misappropriation involves at least gross carelessness or gross negligence, the misappropriation involves moral turpitude. (*Lipson v. State Bar* (1991) 53 Cal.3d 1010, 1020-1021.) Moreover, "'[t]he fact that the balance in an attorney's trust account has fallen below the amount due his client will support a finding of wilful misappropriation.' [Citation.]" (*Id*. at p. 1020.)

In summary, count one of the NDC alleged that respondent, as general partner of Kau having a fiduciary duty to Ashjian, a limited partner, made preliminary distributions of partnership profits in July 1988; that Ashjian's share of this preliminary distribution was $20,946; and that because Ashjian refused to sign the release of liability which respondent requested prior to making the preliminary distribution, respondent refused to disburse Ashjian's share. Count one further alleged that despite Ashjian's repeated requests for the funds, respondent never released the funds to Ashjian and informed Ashjian in or about January 1997 that he no longer had the funds. These allegations were sufficient to state a disciplinary offense: by failing to distribute to Ashjian his share of the preliminary distribution funds, respondent breached his fiduciary duty to Ashjian and misappropriated funds to which Ashjian was entitled, and such conduct constituted an act of moral turpitude.[15]

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[15]In some respects respondent's arguments in both the motion to dismiss and his opening brief on review appear to involve arguments regarding insufficient notice of the charge set forth in count one. To the extent that respondent attempts to make such an assertion, however, such assertion was required to be made "no later than the date on which the moving party's response is to be filed, or, if no response is provided for, no later than twenty (20) days after the service of the initial pleading." (Rule 262(c)(2).) Because respondent's motion to dismiss was filed later than the date his response to the NDC was due, however, the assertion was waived as a basis for dismissal of the charge in count one. (Rule 262(c)(2) ["Failure to file a timely motion under this subparagraph shall preclude the party from a later assertion of the alleged inadequate notice of

As to the assertion that the NDC was barred by the applicable period of limitations, respondent relies upon rule 51(a). That rule provides: "A disciplinary proceeding based solely on a complainant's allegation of a violation of the State Bar Act or Rules of Professional Conduct shall be initiated within five years from the date of the alleged violation." Rule 51(b) goes on to provide: "For purposes of paragraph (a) of the rule, a violation of the State Bar Act or the Rules of Professional Conduct is deemed to have been committed when every element of the alleged violation has occurred, except where the alleged violation is a continuing offense, in which case the violation is deemed to have been committed at the termination of the entire course of conduct." Moreover, rule 51(c)(4) provides that the five-year limitations period in rule 51(a) is tolled during the time that "[t]he member conceals facts constituting the violation." The State Bar does not dispute, and we agree, that rule 51(a) applies in this case. The State Bar argues, however, that the five-year limitations period was tolled for various reasons.

We need not address each of the reasons for tolling advanced by the State Bar. As already indicated, in reviewing a pretrial motion to dismiss, we treat the factual allegations of the NDC as true. (*In the Matter of Tady*, *supra*, 2 Cal. State Bar Ct. Rptr. at p. 124.) According to these allegations, respondent did not inform Ashjian that Ashjian's share of the preliminary distribution funds were gone until approximately January 1997. Under these facts, either the funds were not gone, and therefore the charged breach of fiduciary duty and misappropriation did not occur, or continued, until that date, or respondent concealed the breach of fiduciary duty and misappropriation until that date. Either way, under rule 51, the five-year limitations period did not commence to run until that date. Therefore, the NDC, filed on November 24, 1999, was timely.

Respondent's argument that the NDC was untimely is based upon his incorrect assertion that the moral turpitude charge arose from respondent's alleged breach of fiduciary duty

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the charges as a ground for dismissal of the proceeding . . . ."].)

occurring in 1988, when respondent initially refused to distribute Ashjian's funds until Ashjian signed the release.[16] However, while the NDC refers to the 1988 date, the NDC specifies that the moral turpitude charge is based upon respondent's breach of fiduciary duty and misappropriation resulting not only from his initial failure, but from his ultimate failure to distribute the preliminary distribution funds, even after Ashjian obtained with respect to these funds a municipal court judgment and a bankruptcy court finding of nondischargeability of the judgment.

Motion to Dismiss for Failure to Meet Burden of Proof

Respondent next contends that the hearing judge erroneously denied his motion brought pursuant to rule 219. Rule 219(a) provides as relevant that "[d]uring a trial, after the party with the burden of proof has rested, and before the proceeding is taken under submission by the Court, an opposing party may make an oral or written motion for a determination that the party with the burden of proof has failed to meet that burden . . . ." Rule 219(b) provides that in ruling upon such a motion, the court is to "consider all of the evidence introduced, weigh the evidence and make determinations of credibility." We apply a de novo standard of review to a hearing judge's ruling on a rule 219 motion. That is, "[b]ased upon our independent review of the evidence before the hearing judge at the time the motion was made, we must determine whether clear and convincing evidence was presented of each element of the charged offenses. In deciding these issues, we must give great weight to the hearing judge's credibility determinations. [Citation.]" (*In the Matter of Chesnut* (2000) 4 Cal. State Bar Ct. Rptr. 166, 171.)

We note briefly that our conclusion regarding respondent's culpability as to count one, discussed previously, was based upon evidence presented in the State Bar's case-in-chief. Thus,

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[16]We note additionally that in his opening brief, respondent erroneously relies upon his trial testimony in arguing that Ashjian's funds were "exhausted as of early 1993" and that therefore the charged breach of fiduciary duty and misappropriation occurred more than five years before the NDC was filed. However, as indicated, the NDC alleges that the relevant breach of fiduciary duty and misappropriation occurred or continued after that date, or at least that respondent concealed such misconduct until a later date.

the evidence in the record at the time respondent made his motion established respondent's culpability under count one.

As to this motion, respondent specifically argues in his brief on review with respect to count one that (1) respondent cannot be found culpable of an act involving moral turpitude because his actions were based upon his exercise of reasonable business judgment; (2) the State Bar failed to establish that respondent took Kau money and used it for his personal gain; and (3) respondent's conduct did not rise to the level of moral turpitude.

As we discussed in determining culpability, we are not concerned with respondent's management of the affairs of the partnership but with respondent's ethical duties as an attorney acting as a general partner. Thus, we reject respondent's arguments regarding his exercise of reasonable business judgment.

We also reject respondent's next argument, that the State Bar failed to produce any evidence establishing that he took Kau money and used it for his personal gain. As we previously discussed in determining respondent's culpability as to count one, although respondent relies upon Corporations Code section 15684 to support his use of Ashjian's $20,946 share of the preliminary distribution funds to pay creditors, respondent has failed to explain why, at the time of the final distribution, when respondent no longer required a release, respondent failed to disburse Ashjian's share of the preliminary distribution but nevertheless took his own share of the final distribution. This payment to himself, a general partner, prior to payment of a limited partner violated both the applicable Corporations Code section and the partnership agreement and constituted a breach of fiduciary duty and a misappropriation of Ashjian's share of the funds for respondent's own use.

In our discussion of culpability as to count one, we have already resolved adversely to respondent his assertion that his conduct did not rise to the level of moral turpitude. In the cases upon which respondent relies, the attorneys were impliedly found not to have acted intentionally or with gross negligence, and therefore no moral turpitude was involved. Here, as we have indicated, we find, consistent with the hearing judge's finding, that respondent's use of Ashjian's share of the preliminary distribution funds to benefit himself involved moral turpitude, as it resulted from at least grossly negligent conduct.

<u>Hearing Judge's Culpability Findings After Trial</u>

Respondent next contends with respect to count one that in finding him culpable after trial, the hearing judge erred in (1) determining that the funds earmarked for Ashjian at the time of the preliminary distribution became Ashjian's funds; (2) determining that respondent breached his fiduciary duty to Ashjian by requiring a release from all limited partners before disbursing funds pursuant to the preliminary distribution; (3) assuring respondent that his plan for preliminary distribution was proper, then concluding otherwise in the decision; (4) applying the doctrine of collateral estoppel and ignoring the State Bar's heavier burden of proof in disciplinary proceedings; (5) refusing to consider respondent's defense that he relied upon the advice of counsel regarding the propriety of the release and Ashjian's refusal to sign it; and (6) determining that respondent concealed the absence of Ashjian's share of the preliminary distribution funds by sending Ashjian K-1 forms reflecting that his share of the funds were available.

With respect to respondent's first two contentions, upon this independent review, we need not determine whether the funds earmarked for Ashjian at the time of the preliminary distribution became Ashjian's funds or whether respondent breached his fiduciary duty to Ashjian by requiring a release from all limited partners before disbursing funds pursuant to the preliminary distribution plan. As we have stated, even assuming for the sake of argument that respondent was entitled to withhold the funds at the time of the preliminary distribution due to Ashjian's refusal to sign the release, respondent was precluded from receiving respondent's share of profits at the time of the final distribution, when no release was required for disbursal of funds, prior to disbursing Ashjian's share of distribution funds. Moreover, regardless of whether

Ashjian or Kau owned the funds earmarked for Ashjian at the time of the preliminary distribution, it is clear that respondent did not own the funds, and respondent was statutorily required to pay the $20,946 to Ashjian at the time the partnership was dissolved and before taking his own share of the final distribution. Because respondent paid to himself funds that should have been paid to Ashjian, respondent breached his fiduciary duties to Ashjian and misappropriated the funds.

Moreover, with respect to the hearing judge's assurances that respondent's plan for preliminary distribution was proper, it appears from the record that the hearing judge was merely stating that no one was challenging respondent's decision to preliminarily distribute funds to the partners, the fairness of the amounts distributed, or the way respondent ran the partnership in general. Each time the hearing judge made these assurances, however, she correctly added that the issues being questioned were respondent's failure to disburse Ashjian's share of the preliminary distribution and possibly the requirement of a release prior to making this distribution.[17] In making each of the statements to which respondent refers, the hearing judge was appropriately attempting to expedite the trial proceedings by excluding evidence which was only marginally relevant to the issues raised in this case. (See Evid. Code, § 352; *People v. Hart* (1999) 20 Cal.4th 546, 607 [a court has discretion to exclude evidence on collateral matters].) We conclude that the hearing judge's statements to respondent during trial were correct and cannot have misled respondent into believing he did not need to explain the actions he took which are at issue in this case.

We disagree with respondent's statement that the "inescapable inference" from the record

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[17]As previously indicated, we need not resolve in this case the propriety of respondent's requirement of a release at the time of the preliminary distribution, since we have concluded that, even if it were proper, respondent could not continue to withhold the preliminary distribution funds from Ashjian at the time of the final distribution, when respondent no longer required any release prior to disbursing funds.

is that the hearing judge applied the doctrine of collateral estoppel in this case, giving preclusive effect to the municipal court judgment and ignoring the State Bar's heavier burden of proof in disciplinary proceedings. Rather, because the hearing judge never stated she was applying the doctrine of collateral estoppel or indicated in the decision that she was in any way bound by the municipal court judgment, we decline to interpret her statement in the decision as an application of collateral estoppel. In such statement, the hearing judge specifically ruled that the release requirement was improper "in the court's view," and only parenthetically noted that the arbitrator in the municipal court action held the same view. We therefore find no error in this respect. In any event, we have not applied collateral estoppel in our de novo review.

Respondent also asserts that the hearing judge erroneously refused to consider his defense that he relied upon the advice of counsel regarding the propriety of the release and Ashjian's refusal to sign it. However, because, as we have discussed, we need not decide in this case whether requiring a release at the time of the preliminary distribution was appropriate, we need not determine whether the hearing judge should have allowed respondent's attorney to testify regarding this advice to respondent.[18]

Respondent's final contention in his opening brief is that the hearing judge erred in determining that respondent concealed the absence of Ashjian's share of the preliminary distribution funds by sending Ashjian K-1 forms reflecting that the funds were available. Respondent argues in his reply brief that because (1) the K-1 form is simply an accounting tool and (2) Ashjian testified that he understood that a capital account does not necessarily represent cash, the K-1 forms could not have misled Ashjian regarding the availability of the preliminary distribution funds. Respondent's arguments in this respect are essentially that, based on the evidence presented at trial, these disciplinary proceedings were barred by the period of

[18]We note additionally that the record does not establish that respondent made an offer of proof in order to give the hearing judge notice of the substance, purpose, and relevance of the proposed testimony. (See Evid. Code, § 354.) Accordingly, respondent has waived any error.

limitations. As we previously stated, the hearing judge determined that respondent concealed the breach of fiduciary duty and misappropriation until 1996 by issuing to Ashjian K-1 tax forms which showed an amount equal to Ashjian's share of the preliminary distribution funds in Ashjian's capital account until the year 1995. The 1996 K-1 form showed for the first time a zero balance in Ashjian's capital account.

Respondent argues as to this issue that the hearing judge's determination set forth above "appears particularly far fetched and unsupported by any evidence," that "this inference from the evidence presented is simply not reasonable," and that "the only reasonable . . . explanation for the 1996 K1" is that the1996 K-1 simply reflected "an 'accounting decision' that any positive capital accounts would be reduced to zero and show an ordinary loss that could be used as a deduction." However, we disagree with respondent's characterization of the hearing judge's determination and agree with the hearing judge's interpretation of the evidence.

As we found, Ashjian received K-1 forms throughout the life of the partnership. His 1995 K-1 form showed $22,258 in his partnership capital account, and his 1996 K-1 form showed $22,258 in his capital account at the beginning of the year but nothing at the end of the year. Respondent gave no explanation as to why the accountant would continue to send the K-1 forms through these years and then suddenly show "0" at the end of the year in 1996, except to say that it was a joint decision of respondent and the accountant and that it occurred in 1996 because Kau had no further assets, and Ashjian could use the loss as a deduction. Respondent testified that Ashjian's share of the preliminary distribution had remained in the general account and that the general account had been depleted in 1993 for litigation costs, but there is no evidence showing that Ashjian knew of this alleged fact. On May 11, 1993, respondent's attorney wrote to Ashjian's attorney and stated in reference to the settlement of CitiSavings lawsuit: "With the settlement of this lawsuit, all of the business and affairs of the Kau Partnership have been completed." Respondent argued earlier in his opening brief on review that this statement should have alerted Ashjian at that time that the partnership had no assets. Alternatively, respondent argues that Ashjian "was on notice of his claim as early as August 1988" when respondent informed the partners that they must sign a release in order to receive their shares of the preliminary distribution.

However, we agree with the hearing judge's conclusion that in providing the K-1 forms to Ashjian through 1996, respondent concealed from Ashjian the availability of funds remaining in Kau and, consequently, respondent's misappropriation of Ashjian's share of the preliminary distribution funds. It is clear that on March 30, 1993, there were sufficient funds in the partnership account from the CitiSavings settlement to pay Ashjian his $20,946, but respondent chose to pay himself and the other limited partners, depleting all of the funds available to pay Ashjian.[19] We determine that this concealment of respondent's breach of fiduciary duty and misappropriation is the more reasonable explanation for additional K-1 forms showing funds in Ashjian's capital account after the time of the final distribution.

Respondent additionally argues in his reply brief that he cannot be found culpable of moral turpitude as set forth in count one because he was entitled to rely upon a probate court order approving of the requirement that the Kau limited partners sign a release prior to receiving their respective shares of the preliminary distribution. However, because we need not address the propriety of the release in this case, we do not further address this issue.

Culpability as to Count Two

Respondent contends that the State Bar failed to prove that he is culpable of conditioning settlement on the withdrawal of Ashjian's complaint from the State Bar, and therefore this charge should be dismissed. He argues that he was not in direct contact with Ashjian and that his attorney discussed the withdrawal of the State Bar complaint without his knowledge. The

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[19]As we previously indicated, respondent testified at the trial in this matter that all partnership funds had been depleted by 1993.

hearing judge found this to be incredible and found that respondent, at the least, ratified his attorney's position as to the proposed settlement, since he was more than aware of the complaint filed by Ashjian. We give substantial weight to the credibility determinations made by the hearing judge, who saw and heard the parties testify. (Rule 305(a) [review department gives great weight to hearing judge's findings resolving issues of credibility]; *Franklin v. State Bar* (1986) 41 Cal.3d 700, 708.)

Section 6090.5, subdivision (a), provides that it is a disciplinable offense for an attorney "to agree or seek agreement" that "[t]he plaintiff shall withdraw a disciplinary complaint" from the State Bar. While the record reflects that respondent's attorney handled the settlement negotiations with Ashjian in the bankruptcy adversarial proceeding, respondent acknowledged, while testifying at trial in this matter, that he received copies of the letters his attorney sent to Ashjian and was on notice that one term of the proposed settlement was that Ashjian withdraw his State Bar complaint. Moreover, in his letter to the State Bar dated March 25, 1997, respondent's attorney, Felton, indicated that respondent had specifically agreed to the terms of the settlement set forth in Felton's second letter to Ashjian dated March 7, 1997. Although respondent asserted during his trial testimony that in his view, the withdrawal of the State Bar complaint was not a condition of the settlement, in his declaration in the bankruptcy court dated July 15, 1997, respondent stated that the withdrawal of the State Bar complaint was one of the terms of settlement.

Respondent asserts that his attorney had no authority to discuss the withdrawal of Ashjian's State Bar complaint and that he never ratified his attorney's unauthorized settlement negotiations. First, however, as we noted above, Felton's letter to the State Bar indicates that respondent himself agreed to all terms of the settlement, including the term that Ashjian withdraw his complaint to the State Bar. Second, "[a]s a general proposition . . . 'the client as principal is bound by the acts of the attorney-agent within the scope of . . . his apparent or ostensible authority . . . .' [Citations.]" (*Blanton v. Womancare, Inc.* (1985) 38 Cal.3d 396, 403.) Ostensible authority can include "such authority as the *principal*, either intentionally or by want of ordinary care, causes or allows a *third person* to believe the agent possesses. [Citations.]" (2 Witkin, Summary of Cal. Law (9th ed. 1987) Agency and Employment, § 93, p. 92, original italics; *Thompson v. Occidental Life Ins. Co.* (1973) 9 Cal.3d 904, 913-914.) Here, respondent admitted at trial that upon receiving notice that his attorney had discussed Ashjian's withdrawal of his complaint to the State Bar, respondent did nothing to inform either his counsel or Ashjian that his counsel lacked authority to discuss such a settlement term on his behalf. In view of respondent's failure to take any action, we conclude that respondent's attorney had apparent authority to enter into such settlement discussions for respondent.[20]

Respondent also asserts that he relied in good faith upon the advice of his counsel, which reliance constitutes a defense to the charge in count two. Respondent cites *Kaplan v. State Bar* (1991) 52 Cal.3d 1067 (*Kaplan*). There, upon Kaplan's misappropriation of funds which Kaplan's firm held for a client in bankruptcy, the Hearing Panel of the State Bar Court found a trust account violation under former rule 8-101(A) of the Rules of Professional Conduct but did not find that the misappropriation involved moral turpitude. This refusal to find moral turpitude was based on the facts that the fees had been earned by the firm, that Kaplan did not realize that the bankruptcy court had to approve the withdrawal of the earned fees, and that an experienced bankruptcy attorney had told Kaplan that the funds were available for withdrawal. (*Id*. at p. 1070 & fn. 3.)

Respondent's reliance on *Kaplan* is misplaced. First, *Kaplan* demonstrates that reliance on counsel is not a complete defense to a charge, as Kaplan was still found culpable of failing to

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[20]Concurrently with the filing of this opinion, we refer to the Office of the Chief Trial Counsel of the State Bar for appropriate investigation and action the issue of respondent's counsel's conduct in negotiating this settlement for respondent. (See rule 218; *In the Matter of Respondent X* (Review Dept. 1997) 3 Cal. State Bar Ct. Rptr. 592, 595, fn. 6.)

maintain client funds in a client trust account. Second, there is no evidence in the present case that respondent's attorney was experienced in disciplinary matters, such that respondent could reasonably rely upon his expertise regarding the propriety of agreeing to a withdrawal of a complaint to the State Bar. Finally, there is no evidence here that respondent had any discussion with his attorney regarding the propriety of such an agreement; therefore, respondent cannot be deemed to have relied upon counsel.

Respondent's final assertion with respect to count two is that there was neither evidence nor a finding below that he willfully violated section 6090.5 as charged in the NDC. Because we have concluded, based on our de novo review of the evidence, that respondent intended to agree to Ashjian's withdrawal of his State Bar complaint as a term of the civil settlement agreement, we find that respondent's violation was willful, "even applying the somewhat more specific level of wilfulness required for violations of the State Bar Act, as opposed to violations of the Rules of Professional Conduct. [Citations.]" (*In the Matter of Respondent X*, *supra*, 3 Cal. State Bar Ct. Rptr. at p. 603.)

In sum, our independent review of the facts leads us to conclude that clear and convincing evidence establishes respondent's culpability of willfully violating section 6090.5.

III. DISCIPLINE

To properly assess the discipline to be recommended, we must first consider evidence in mitigation and in aggravation.

Mitigating Factors

The hearing judge found respondent's long and unblemished career to be a strong mitigating factor. (Rules Proc. of State Bar, tit. IV, Stds. for Atty. Sanctions for Prof. Misconduct (standards), std. 1.2(e)(i).) We agree. Further, the hearing judge found the character testimony of two associates and respondent's wife to be mitigating factors but did not find this evidence to be an extraordinary demonstration of good character. (Std. 1.2(e)(vi).) We also so find.

Respondent additionally presented evidence of community service activities, which are to be considered as mitigating circumstances. (*In the Matter of Spaith* (Review Dept. 1996) 3 Cal. State Bar Ct. Rptr. 511, 521.)

Also in mitigation, respondent presented evidence that before requiring the signing of the release as a condition of receiving preliminary distribution funds, he consulted a financial manager, who advised him that requiring a release before distributing the funds was proper. We find respondent's good faith action under these circumstances to be a mitigating factor (std. 1.2(e)(ii)), although we give such mitigation very little weight in view of the fact that we did not determine whether the requirement of the release by respondent was improper.

However, respondent's claim in mitigation that he acted in good faith toward Ashjian is unpersuasive. His refusal to resolve the issue, even after the apparent settlement of March 7, 1997, is proof that respondent, for whatever reason, had no intention of delivering Ashjian's $20,946 share of the preliminary distribution funds to him.

Aggravating Factors

In aggravation, we find, as did the hearing judge, that respondent's conduct was surrounded by concealment. (Std. 1.2(b)(iii).) By providing Ashjian with K-1 forms that showed a positive balance until 1996, he misled Ashjian to rely on the fact that funds were available, even though respondent testified that the funds had been depleted by 1993. Further, respondent significantly harmed Ashjian in that he has been deprived of funds to which he was entitled no later than 1993, the time of the final distribution. (Std. 1.2(b)(iv).)

Respondent has demonstrated indifference toward rectification of or atonement for the consequences of his misconduct by refusing to resolve the matter and deliver the funds even after Ashjian obtained a municipal court judgment and a bankruptcy court finding of non-dischargeability of the judgment. (Std. 1.2(b)(v).) In addition, as the hearing judge aptly noted, respondent does not appear to exhibit any remorse or even recognition of his wrongdoing. (See *McKnight v. State Bar* (1991) 53 Cal.3d 1025, 1036-1037; *In re Rivas* (1989) 49 Cal.3d 794, 802.) Although respondent argues that he should not be criticized for his lack of remorse, since he is simply asserting his right to due process, we note that he failed to assert his right to request a trial de novo after the arbitration award or to file an appeal from the municipal court judgment. In view of respondent's failure to assert his rights at that time, we conclude that his argument in this respect is disingenuous and lacks credibility. Further, as to respondent's assertion that he lacks the ability to repay Ashjian, the record reflects that respondent had the ability to pay Ashjian for quite some time after Ashjian first obtained the municipal court judgment and during the bankruptcy court adversarial proceedings, since respondent through his attorney at that time offered to pay Ashjian $25,000 to settle the matter. And, in any event, respondent has not shown that he has made restitution/payment to Ashjian in accordance with his purported limited ability.

Level of Discipline

The hearing judge recommended disbarment pursuant to standard 2.2(a), which provides that willful misappropriation of entrusted funds shall result in disbarment subject to certain exceptions.

The primary purposes of the disciplinary proceedings are the protection of the public, the courts, and the legal profession; the maintenance of high professional standards by attorneys; and the preservation of public confidence in the legal profession. (Std. 1.3; *In re Morse*, *supra*, 11 Cal.4th at p. 205.) As previously stated, when an attorney assumes a fiduciary relationship and violates his duty in a manner that would justify disciplinary action if the relationship had been that of attorney and client, he may properly be disciplined for his misconduct. (*Clark v. State Bar*, *supra*, 39 Cal.2d at p. 166.)

In our search to recommend the proper discipline, we consider the standards, which serve as guidelines, as well as prior decisions imposing discipline based on similar facts. (*In re Morse*, *supra*, 11 Cal.4th at pp. 206-207; *In the Matter of Taylor* (Review Dept. 1991) 1 Cal. State Bar Ct. Rptr. 563, 580.) By far the most serious of respondent's offenses was his grossly negligent or intentional breach of fiduciary duty and misappropriation of over $20,000, which conduct involved moral turpitude. Standard 2.2(a) sets forth disbarment as the discipline to be imposed for willful misappropriation unless either the amount misappropriated is insignificantly small or the most compelling mitigating circumstances clearly predominate. That standard further provides that if disbarment is not imposed, the discipline shall include an actual suspension of at least one year, irrespective of mitigating circumstances. In this case, the amount involved is not insignificantly small, nor do mitigating circumstances clearly predominate. Nevertheless, no fixed formula applies in determining the appropriate level of discipline. (*In the Matter of Brimberry* (Review Dept. 1995) 3 Cal. State Bar Ct. Rptr. 390, 403.) Instead, we determine the appropriate discipline in light of all relevant circumstances. (*Gary v. State Bar* (1988) 44 Cal.3d 820, 828.)

The Supreme Court has stated that misappropriation generally warrants disbarment in the absence of clearly mitigating circumstances. (*Kelly v. State Bar* (1988) 45 Cal.3d 649, 656; *Cain v. State Bar* (1979) 25 Cal.3d 956, 961.) Disbarment is most frequently imposed where there are several instances of misappropriation of large sums, involving multiple clients. (See *Rosenthal v. State Bar* (1987) 43 Cal.3d 658.) However, the Supreme Court has even imposed disbarment on an attorney with no prior record of discipline in a case of a single misappropriation even though there was substantial mitigation. (*In re Abbott* (1977) 19 Cal.3d 249 [misappropriation of $29,500 of client funds, display of remorse, showing of manic-depressive condition with uncertain prognosis].)

Disbarment has also been imposed where, although the misappropriation appears to be an isolated instance of misconduct, additional aggravating circumstances are present. In *Chang v. State Bar* (1989) 49 Cal.3d 114, Chang was found culpable in one client matter of misappropriating approximately $7,900 in client funds, failing to render an accounting to his client, and making misrepresentations to his client and to the State Bar. (*Id*. at pp. 123-124, 127-128.) As in the present case, in mitigation, Chang had no prior disciplinary record, yet he never acknowledged the impropriety of his conduct. (*Id*. at pp. 128-129.) In determining that Chang should be disbarred, the court focused upon his lack of candor to the State Bar's investigator and the State Bar Court, the seriousness of the misconduct, and the lack of either remorse or restitution. (*Ibid*.)

However, the Supreme Court has indicated in other misappropriation cases that discipline of less than disbarment is warranted where extenuating circumstances show that the misappropriation of entrusted funds is an isolated event and other mitigating circumstances are present. (See *Lawhorn v. State Bar* (1987) 43 Cal.3d 1357 [misappropriation of $1,355.75 of client funds resulting from negligence and inexperience, full restitution made with interest prior to State Bar investigation, two years' actual suspension].) In *Boehme v. State Bar* (1988) 47 Cal.3d 448, 451-452, 455, Boehme misappropriated $1,901.32 in client funds. In imposing a discipline of less than disbarment, the Supreme Court focused on Boehme's lack of prior discipline in over 20 years of practice, which the court found to be "an important mitigating circumstance" (*id*. at p. 454), and gave Boehme mitigating credit for a life-threatening medical emergency which occurred less than one month after the misappropriation occurred (*id*. at pp. 451, 454).

Respondent's breach of his fiduciary duties and misappropriation constitute serious misconduct. Moreover, as a result of such misconduct, respondent has harmed Ashjian by depriving him, for several years, of over $20,000, far from an insignificant sum. We are troubled by respondent's lack of recognition of wrongdoing, lack of remorse, and failure to make any restitution, particularly after Ashjian obtained a municipal court judgment with respect to the $20,946 and a bankruptcy court finding of nondischargeability of the judgment. Finally, respondent's misappropriation and concealment of the misappropriation through the issuance of K-1 forms for several years "violated ' " 'the fundamental rule of [legal] ethics–that of common honesty–without which the profession is worse than valueless in the place it holds in the administration of justice' . . . ." ' [Citation.]" (*In re Menna* (1995) 11 Cal.4th 975, 989.)

However, based on the cases cited above, we do not believe disbarment is needed in this case. First, this matter appears to have been an isolated instance of misconduct, as all of the misconduct found resulted from a single failure to distribute funds to Ashjian. Second, respondent has had no prior record of discipline in over 40 years of practice. Thus, although the record does not provide a justifiable explanation for the misconduct, the misconduct appears to be aberrational. In view of these two factors, combined with respondent's evidence of good character and community service, we decline to adopt the hearing judge's disbarment recommendation and instead conclude that a lengthy period of actual suspension will adequately serve the disciplinary goals of these proceedings.

RECOMMENDATION

We recommend that respondent Charles Connell McCarthy be suspended from the practice of law in the State of California for four years, that execution of the four-year suspension be stayed, and that respondent be placed on probation for three years on the following conditions:

1. Respondent shall be actually suspended from the practice of law in the State of California during the first two years of probation and until: (a) respondent pays restitution to Nazar H. Ashjian, or the Client Security Fund if it has paid, in the amount of $27,493.22, plus 10 percent simple interest per annum from December 19, 1995, until paid, and provides satisfactory proof of such payment to the State Bar's Probation Unit in Los Angeles; and (b) if respondent's actual suspension extends for more than two years, respondent shows proof satisfactory to the State Bar Court of respondent's rehabilitation, present fitness to practice, and present learning and ability in the general law, in accordance with standard 1.4(c)(ii) of the Standards for Attorney Sanctions for Professional Misconduct. We recommend that respondent be given credit for the period of his involuntary inactive enrollment under Business and Professions Code section 6007, subdivision (c)(4) towards this recommended two-year period of actual suspension.

2. Respondent shall comply with the provisions of the State Bar Act, the Rules of Professional Conduct of the State Bar of California, and all the terms and conditions of

this probation.

3. Respondent shall report, in writing, to the State Bar's Probation Unit in Los Angeles no later than January 10, April 10, July 10 and October 10 of each year or part thereof in which respondent is on probation (reporting dates). However, if respondent's probation begins less than 30 days before a reporting date, respondent may submit the first report no later than the second reporting date after the beginning of his probation. In each report, respondent shall state that it covers the preceding calendar quarter or applicable portion and certify by affidavit or under penalty of perjury under the laws of the State of California as follows:

   (a) in the first report, whether respondent has complied with all the provisions of the State Bar Act, the Rules of Professional Conduct of the State Bar, and all other terms and conditions of probation since the beginning of probation; and

   (b) in each subsequent report, whether respondent has complied with all the provisions of the State Bar Act, the Rules of Professional Conduct of the State Bar, and all other terms and conditions of probation during that period.

   During the last 20 days of this probation, respondent shall submit a final report covering any period of probation remaining after and not covered by the last quarterly report required under this probation condition. In this final report, respondent shall certify to the matters set forth in subparagraph (b) of this probation condition by affidavit or under penalty of perjury under the laws of the State of California.

4. Subject to the assertion of applicable privileges, respondent shall fully, promptly, and truthfully answer any inquiries of the State Bar's Probation Unit and any assigned probation monitor referee that are directed to respondent, whether orally or in writing, relating to whether respondent is complying or has complied with the terms and conditions of this probation.

5. During the period of respondent's actual suspension, respondent shall attend and satisfactorily complete the State Bar's Ethics School and provide satisfactory proof of such completion to the State Bar's Probation Unit in Los Angeles. This condition of probation is separate and apart from respondent's California Minimum Continuing Legal Education (MCLE) requirements; accordingly, respondent is ordered not to claim any MCLE credit for attending and completing this course.

6. Respondent's probation shall commence on the effective date of the Supreme Court order imposing discipline in this matter. And, at the end of the probationary term, if respondent has complied with the terms and conditions of probation, the Supreme Court order suspending respondent from the practice of law for four years shall be satisfied, and the suspension shall be terminated.

Professional Responsibility Examination

We further recommend that respondent be ordered to take and pass the Multistate Professional Responsibility Examination administered by the National Conference of Bar

Examiners within one year after the effective date of the Supreme Court order in this matter or during the period of respondent's actual suspension, whichever is greater, and to provide satisfactory proof of such passage to the State Bar's Probation Unit in Los Angeles during the same period.

Rule 955

We further recommend that respondent be ordered to comply with rule 955 of the California Rules of Court and to perform the acts specified in subdivisions (a) and (c) of that rule within 30 and 40 calendar days, respectively, after the effective date of the Supreme Court order in this matter.

Costs

We further recommend that the costs incurred by the State Bar in this matter be awarded to the State Bar in accordance with Business and Professions Code section 6086.10 and that such costs be payable in accordance with Business and Professions Code section 6140.7.

Order

Finally, because we reject the hearing judge's disbarment recommendation, we order that respondent's involuntary inactive enrollment under Business and Professions Code section 6007, subdivision (c)(4) be terminated, effective immediately. This order does not affect respondent's ineligibility to practice law that has resulted or may hereafter result from any other cause.

WATAI, J.

We concur:

STOVITZ, P. J.

OBRIEN, J.[*]

[*]Judge Pro Tem of the State Bar Court, appointed by the State Bar Board of Governors under rule 14 of the Rules of Procedure of the State Bar.

Case No. 96-O-00528

In the Matter of Charles Connell McCarthy

Hearing Judge

Nancy Roberts Lonsdale

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