

**DeFeo v Lawyers' Fund for Client Protection of the
State of N.Y.**

2010 NY Slip Op 32702(U)

September 21, 2010

Supreme Court, Nassau County

Docket Number: 21209/09

Judge: Roy S. Mahon

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SCAW

SHORT FORM ORDER

SUPREME COURT - STATE OF NEW YORK

Present:

HON. ROY S. MAHON
Justice

AUGUSTINE DEFEO & BARBARA DEFEO,

TRIAL/IAS PART 7

Petitioners,

INDEX NO. 21209/09

for a Judgment Pursuant to Article 78 of the
Civil Practice law and Rules,

- against -

MOTION SEQUENCE
NO. 1

THE LAWYERS' FUND FOR CLIENT PROTECTION
OF THE STATE OF NEW YORK,

MOTION SUBMISSION
DATE: September 7, 2010

Defendant(s).

The following papers read on this motion:

- Notice of Petition X
- Answer X
- Reply Affirmation X
- Memorandum of Law X

Upon the foregoing papers, the motion by the attorneys for the petitioners for an order and judgment (1) vacating the June 19, 2009 determination by the Trustees of Respondent Lawyers' Fund for Client Protection of the State of New York which denied petitioners' requests, pursuant to 22 NYCRR § 7200.9 et seq., "for reimbursement of losses caused by the dishonest conduct of attorneys admitted to practice in the New York State", and (2) directing the Fund to issue the full amount of the reimbursement submitted to the Fund, is **denied**.

This Article 78 proceeding is brought by petitioners Augustine and Barbara DeFeo in their capacity as claimants against now disbarred attorney Stuart P. Moshell ("Moshell") to vacate the determination of the Trustees of The Lawyers' Fund for Client Protection of the State of new York ("The Fund" or "Respondent"). The Fund was established by the Legislature in 1981 to reimburse clients for the theft of law client money and property in the practice of law. The Fund denied reimbursement to petitioners on the grounds that they failed to provide satisfactory evidence of reimbursable losses. Petitioners challenge the denial of their individual applications for reimbursement from The Fund.

Petitioners Augustine and Barbara DeFeo are married and reside in Nassau County. Mr. DeFeo is a businessman who operates his own glass company. Petitioners' relationship with Moshell began in or about December 2003 when petitioners retained Moshell to provide legal services regarding certain franchise agreements and real estate transactions. Petitioners assert Moshell became general counsel for their legal needs; assisted with their estate planning and was a trusted advisor for both family and business purposes.

In December 2005, Moshell solicited a \$300,000 investment from Mr. DeFeo for an alleged short-term bridge loan for one of Moshell's alleged clients who was willing to pay 16 percent interest. The solicitation occurred at Moshell's law office while reviewing his business matters. Moshell told Mr. DeFeo the loan was secure since Moshell would be controlling the matter the loan was needed for. Moshell offered Mr. DeFeo his own promissory note to induce the loan. On December 9, 2005, Mr. DeFeo wire transferred \$300,000 to Moshell's IOLA account for the three-month bridge loan. In March 2006, Moshell returned to him \$30,000 in principal and \$8,000 for two months of interest payments. Mr. DeFeo reinvested the \$30,000 with Moshell. In June 2006, Moshell returned \$100,000 in principal to Mr. DeFeo along with this interest payments. Mr. DeFeo reinvested the \$100,000 with Moshell in August 2006 to keep his loan investment at \$300,000. Moshell provided Mr. DeFeo with a \$300,000 ten-month promissory note dated August 11, 2006 providing for \$4,000 monthly interest payments. This represents 16 percent interest per annum. Mr. DeFeo received from Moshell 16 monthly \$400 interest payments for a total recovery of \$64,000.

In May 2007, Moshell proposed a \$200,000 bridge loan for one of his clients at a shorter term with a higher rate of interest. Mr. DeFeo did not have the money to lend at that time and was reluctant to increase his loans with Moshell. Mr. DeFeo told his wife, Barbara, that Moshell was "offering high return on a \$200,000 loan for some other client of his." Mrs. DeFeo agreed to the loan because she "wanted to make some money on her own."

By check dated May 24, 2007, Mrs. DeFeo paid Moshell \$200,000 for the alleged bridge loan. Moshell supplied Mrs. DeFeo with a promissory note providing for a return of \$211,000 in one month. This represents an interest rate of 66 percent per annum.

Petitioners allege that they were loaning money, not to Moshell, but to clients of Moshell, and that Moshell was playing two roles in the transaction. Petitioners assert Moshell was to guarantee the loan to the third parties through a promissory note and provide the legal representation and legal services to assist in the loan to the third parties. Petitioners contend Moshell was not acting as loan broker or investment adviser, but instead, was acting as petitioners' attorney by providing legal services, including the drafting of the necessary papers and advising petitioners on the legal protection needed to secure the loan. Further, petitioners allege it was agreed that Moshell would represent both petitioners' interests and the interest of his other clients with regard to this arrangement. Petitioners believed Moshell was holding their funds in escrow until he passed those funds onto his other clients, and that it would be secured by promissory notes. The entire transaction was a fraud. Moshell stole the funds. Petitioners made a claim to The Fund. Moshell was disbarred on March 11, 2008. Less than a week before Moshell's disbarment, a criminal judgment was entered against Moshell adjudicating him guilty of wire fraud in violation of 18 U.S.C. § 1343. Moshell was sentenced to seventy-eight (78) months imprisonment and ordered to pay \$8,872,388.62 in restitution, including the amount petitioners have sought The Fund to reimburse.

The Fund conducted an extensive investigation of petitioners' claims, including the review of documentation submitted by the petitioners and obtained by The Fund, conversations with a representative of the FBI and the Assistant United States Attorney, and telephone discussions with petitioners. In June 2009, the Board of Trustees of The Fund evaluated the petitioners' claims, reviewed the documents and evidence submitted in support of their claims, together with a memorandum from The Fund's Executive

Director dated May 22, 2009 and determined that petitioners had not provided satisfactory evidence of eligible losses.

The Fund found that the petitioners failed to provide any evidence to establish that the loan transactions at issue arose out of a specific contemporaneous attorney-client engagement with Moshell. Further, the Trustees determined that the losses arose out of the DeFeos' dealings with Moshell as a loan broker. Pursuant to 22 NYCRR § 7200.10(j), by letter dated June 19, 2009, The Fund's Executive Director and Counsel informed petitioners that the Trustees determined that their claims did not qualify for reimbursement as petitioners had failed to meet their burden and had not provided evidence satisfying the legal standards for reimbursement.

In December 2009, after this Article 78 proceeding was commenced, the Trustees granted petitioners' request for reconsideration of the denial of their claim. In June 2010, the Trustees reconsidered the petitioners' claims. In a memorandum dated June 11, 2010, The Fund's Executive Director, summarized the claims and recommended confirmation of the Trustees' prior determinations denying the claims. Pursuant to § 468-b of Judiciary Law and the Trustees' Regulations, the Trustees confirmed their prior determinations that the claimants had failed to provide satisfactory evidence of eligible losses. Petitioners were informed of these determinations by certified letters dated July 2, 2010.

Based on the evidence presented by the petitioners and the entire record before them, the Trustees again found that in the context of these claims the DeFeos had dealt with Moshell as a loan broker, not as an attorney within an attorney-client relationship and the practice of law. Pursuant to 22 NYCRR § 7200.11 this confirmation of their prior decision rendered the original determination final.

Before the Trustees granted the DeFeos' application for reconsideration, the petitioner commenced this action alleging two causes of action:

1. That the Lawyers' Fund's denial of their claims be vacated because it was affected by an error of law and was therefore irrational, arbitrary and capricious and not based on substantial evidence in the record; and
2. That the Lawyers' Fund be compelled to accept additional evidence from the DeFeos and reconsider their claims. (Although the regulation cited by petitioners in their petition [22 NYCRR § 7200.10(a)] is inapplicable to the reconsideration of a claim, this cause of action is moot because the Lawyer's Fund agreed to reconsider the DeFeos' claims and ultimately confirmed its original determination).

The Court will now consider the petitioners' first cause of action. The gravamen of petitioners cause of action is that the fraud Moshell committed was using his status as an attorney to induce petitioners to allow him to hold funds in escrow on the representation that the loan documents would be forthcoming. The attorney-client relationship they argue does not arise by the creation of documents, but rather, by the agreement of the attorney to provide services to the client. Further, petitioners assert part of the fraud was that the documents were never created. In short, petitioners contend their relationship with Moshell was not a "financial transaction with an attorney," but rather a financial transaction with a third party where the attorney (Moshell) was holding the money in escrow.

The Lawyers' Fund for Client Protection is charged with considering claims for reimbursement of losses caused by the dishonest conduct of attorneys admitted to practice in New York. State Finance Law § 97-t; Judiciary Law § 468-b(2). The Fund is administered by a Board of Trustees composed of seven

members appointed by the Court of Appeals. Judiciary Law § 468-b(1). The Board is empowered to receive, hold, manage, and distribute the funds collected for the purpose of maintaining the integrity and protecting the good name of the legal profession by reimbursing losses caused by the dishonest conduct of attorneys admitted to practice in New York. Judiciary Law § 468-b(2). The Board of Trustees has the sole discretion to determine the merits of claims presented for reimbursement. Judiciary Law § 458-b(4). For the purposes of The Fund, dishonest conduct means misappropriation or willful misapplication of clients' money, security or other property. Judiciary Law § 468. Judiciary Law § 468-b provides, in relevant part, that the Board of Trustees of The Fund has the "sole discretion to determine the merits of claims presented for reimbursement" and to adopt regulations to administer The Fund and the procedures for presentation, consideration, allowance and payment of claims. Judiciary Law § 468-b(2), (3), (4). There must be a sufficient nexus between the dishonest conduct and the practice of law in New York. 22 NYCRR § 7200.8(a)(3). Losses arising from financial transactions with attorneys that do not occur within an attorney-client relationship and the practice of law are not eligible for reimbursement. 22 NYCRR § 7200.8(d).

A claimant bears the burden "to provide satisfactory evidence of an eligible loss." 22 NYCRR § 7200.8(b). Judicial review of determination by The Lawyers' Fund is very limited. CPLR § 7803(3) provides that the standard of judicial review of any administrative action or determination is "whether a determination was made in violation of lawful procedure, was affected by an error of law or was arbitrary and capricious or an abuse of discretion. . ." See, e.g., *Bd. of Ed. of Monticello Central Sch. Dist. v Comm. of Ed.*, 91 NY2d 133, 139. The Court of Appeals has defined arbitrary and capricious as being "without sound basis in reason and . . . with regard to the facts." *Pell v Board of Education*, 34 NY2d 222, 231. Therefore, a determination which is arbitrary and capricious may be set aside by the reviewing court. See, e.g., *N.Y. State Assoc. of Counties v Axelrod*, 78 NY2d 158, 166. This court must rule as to whether the determination is arbitrary and capricious, lacks a rational basis, or an abuse of discretion. See *Matter of Pell v Board of Educ.*, 34 NY2d 222, 232; *Matter of Haskins v Lawyers' Fund for Client Protection*, 286 AD2d 440; *Matter of Saferstein v Lawyers' Fund for Client Protection*, 30 AD3d 653; *Matter of Papas v Lawyers' Fund for Client Protection*, 60 AD3d 1195. A court may not substitute its judgment for that of an administrative agency when there is a rational basis for the agency's determination. *Matter of Diaz v New York State Office of Mental Health*, 188 AD2d 903. Moreover, courts must defer to an agency's construction of the statutes and regulations it administers as long as that construction is not irrational or unreasonable. *Matter of Abbatiello v Regan*, 205 AD2d 1027.

The regulations that have been adopted pursuant to statutory authority establish that losses arising from financial transactions with attorneys that do not occur within an attorney-client relationship and the practice of law are not eligible for reimbursement. 22NYCRR § 7200.8(d). ". . . losses arising from financial transactions with attorneys that do not occur within an attorney-client relationship and the practice of law" are ineligible for reimbursement. 22 NYCRR § 7200.8(d); See *Matter of Haskins v Lawyers' Fund for Client Protection*, *supra*; *Matter of Pappas v The Lawyers' Fund for Client Protection*, *supra*. Petitioners contend that respondent's rejection of their claims on that basis is not supported by the record and, therefore, was arbitrary and capricious. In particular, they contend that the determination is based upon an error of law, specifically, that the loans were made in the context of an attorney-client relationship.

After a comprehensive review of all the evidence, the Trustees stated:

Mr. DeFeo fails to mention in his affidavit the prior successful loan transactions he did have with Moshell. Mr. DeFeo previously told us that he does not recall the details of these loans or have any documentation for the transactions.

Mrs. DeFeo's claim remains clearly not eligible. Her \$200,000

investment did not arise from any attorney-client engagement, and does not involve the practice of law by Moshell. Mrs. DeFeo's loss arises from her dealing with Moshell as a loan broker and from her own greed, not from her trust in Moshell derived from a attorney-client relationship.

Mr. DeFeo's claim also remains ineligible under the statute and Regulations which govern The Fund and the Trustees' policies and precedent. Mr. DeFeo is a sophisticated businessman who was dealing with Moshell as a loan broker.

It can not be said that Mr. and Mrs. DeFeo's investment losses would not have occurred "but for" their attorney-client relationship with Moshell.

The record provides a rational basis for respondent's determination that the transactions took place outside the attorney-client relationship or Moshell's practice of law. *Matter of Saferstein v Lawyers' Fund for Client Protection, supra; DeFalco v Cutaia*, 236 AD2d 358. The petitioners' statements demonstrate that the money Moshell stole was given to him for loans, and not in his capacity as an attorney. Mr. DeFeo had previously made a loan to Moshell who approached him and his wife again for the two loans at issue here. The evidence establishes that they dealt with him solely as a loan broker. Further, respondents could not provide satisfactory proof that the transfer of this money resulted from an "attorney-client relationship and the practice of law." They loaned Moshell money from their personal accounts for an opportunity to receive extraordinarily high interest rates on these loans, 66 percent per annum for Mrs. DeFeo and 16 percent per annum for Mr. DeFeo. (See the two promissory notes attached to Exhibit "F".) The record before this court demonstrates that Moshell was not retained to perform any legal work for these transactions and provided no legal services to the Defeos in connection with these loans. It was rational for The Lawyers' Fund to determine that petitioners' claims were not eligible for reimbursement. The money provided for these loans came from their personal accounts. Petitioners admittedly were making loans to Moshell at a high interest rate. There was no written retainer agreement and Moshell never performed legal services nor billed for legal work involving these loans. It was entirely reasonable to conclude that petitioners' losses from these financial transactions occurred outside of an attorney-client relationship and/or the practice of law and the Trustees' determination is clearly rational and not based on any error of law.

Petitioners' motion is denied. This decision is the order and judgment of the Court.

All proceedings under Index No. 21209/09 are terminated.

SO ORDERED.

DATED:

9/21/2010

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 J.S.C.

ENTERED

SEP 24 2010

NASSAU COUNTY
 COUNTY CLERK'S OFFICE