ADVISORY ETHICS OPINION 2001-02

SYNOPSIS ONE:

The Committee revises its prior position on the propriety of an attorney representing a lender and a borrower in the same transaction. An attorney may represent a lender and a borrower in a real estate transaction if the attorney satisfies the requirements of Rule 1.7 of the Rules of Professional Conduct (the "Rules") by concluding that: (a) the representation of the lender and borrower in the same transaction will not adversely affect the relationship with either client; (b) that the attorney's judgment will not be materially limited by responsibilities to either client or to a third party; and, (c) that each client agrees to the dual representation after consultation. The consultation must occur sufficiently before the closing to allow either client to obtain separate representation if desired. The consultation must also include a discussion of the implications of the common representation and the risks and benefits of the common representation.

The Committee continues to believe that it is not appropriate to represent a seller and buyer in a real estate transaction.

SYNOPSIS TWO:

An attorney or law firm may form a title and escrow company to provide title and escrow services, but such services constitute law related services and the Rules apply to each attorney involved in providing these related services.

See also Advisory Ethics Opinions 90-8, 94-8, 95-03 and 95-09

FACTS:

The attorney requesting this opinion acts as a closing agent for a lending institution. The lending institution is changing its closing procedures. Under the old closing practices, the attorney was responsible for collecting and reviewing information related to the closing and for preparing the closing documents. The new procedure includes searching the title to the subject property for the lender. The attorney believes that borrowers will be asked to sign a disclosure during the closing process which will provide, in essence, that the closing attorney represents the lending institution and that the borrower may retain separate counsel if he or she so chooses. The request letter does not indicate (i) when the disclosure will be presented to the prospective borrower; or, (ii) what type of report on the state of the title will be issued as a result of the title search conducted by the closing attorney; or, (iii) to whom the title report will be addressed. The closing agent's fee, including the cost of the title search, will be posted as an expense to the borrower on the closing statement.

In a supplemental request, the attorney inquires whether a firm, or members of a firm may create a separate entity to perform title services for the firm, without the title entity being engaged in the practice of law.

OPINION ONE:

This committee has issued four prior opinions on similar subjects:

In Opinion 90-8 the Committee considered whether an attorney could represent the borrower and the lender in the same transaction. Our conclusion was that such representation constituted a conflict of interest under DR-5-105 of the Code of Professional Responsibility (the "Code") and that the conflict of interest was of such a nature that it could not be waived effectively.

In Opinion 94-8 the Committee considered whether an attorney was free to represent only the lender in a loan transaction if the buyer/borrower was unrepresented. The Committee concluded that an attorney could do so.

In Opinion 95-03 restated the proposition that an attorney could not simultaneously represent the lender and the borrower/buyer in a single transaction. At that time, the Code was still in effect.

In Opinion 95-09 provided guidance to the lenders' attorneys for dealing with unrepresented borrowers.

On September 1, 1999, the Vermont Supreme Court adopted the Rules and the Code's relevance was limited to activities occurring prior to that date.

In deciding Opinion 90-8, the Committee's intention was to provide a framework to protect the borrower/buyer by limiting the possibility of having the judgment of the borrower's/buyer's attorney encumbered by divided loyalties. The Committee is now represented with an opportunity to reconsider its earlier position and provide a framework, consistent with the Rules, within which the borrower and lender may both be represented by the same attorney. In reaching its conclusion, the Committee has considered (1) the language of the relevant provision of the Rules; (2) the evolution of closing practices in the State of Vermont; and (3) the impact of the Vermont Supreme Court decisions in Hunter Broadcasting v. City of Burlington, 164 Vt 391 (1995) and Bianchi v. Lorentz, 166 Vt 555 (1997) and Estate of Fleming v. Nicholson, 168 Vt. 495 (1998).

Beginning in the mid-to-late 1980's new lenders began to enter the Vermont market. In response, local lending institutions began to change closing practices to remain competitive. One of the significant changes was to reassign tasks from the lender's employees to the borrower's attorney, including the preparation of the closing documents. The lender would send the borrower's attorney a package of blank or partially completed documents along with a set of closing instructions detailing how the attorney should complete the forms and what was required before the closing could occur. The borrower's attorney was responsible for completing the forms, determining when the requirements of the closing instructions were satisfied and disbursing the money from the attorney's trust account.

For a time thereafter the borrower in a typical transaction would retain counsel to perform the title work and review the closing paperwork prepared by the lender's attorney. The lender's attorney would close the loan. Under these circumstances the borrower usually paid the attorney fees for both attorneys.

By the mid-1990's the process for closing loans had changed. The common practice involved the selection of several attorneys to close loans for a particular financial institution. Many firms developed a sophisticated process for closing loans and related purchases for lenders. These attorneys, if asked, would identify the lender as their client. The attorneys became skilled at preparing and processing the lender's real estate closing forms. Most firms would close loans for several lending institutions. Due to their greater efficiency, the same firms were able to close loans for mortgage companies and other non-bank lenders effectively. A substantial proportion of the real estate closing business flowed to these firms. In many cases the closing attorney would examine the title, provide a title report which might be delivered to both the lender and the borrower, and arrange for or issue the title insurance policy for the lender and, if desired, the buyer or owner in a refinancing. The work completed by the attorneys was not significantly different than the scope of work completed by an attorney representing the borrower, except now the lender was generally assumed to be the client. In many such cases, buyers opted to proceed without counsel.

The lender's attorney would prepare some or all of the loan documents, which over time became standard FNMA/FHLMC forms which were essentially non-negotiable in any meaningful way. The lender's attorney would also prepare a closing statement, checks and disburse the funds from the closing. Most of the interaction between the lender's attorney and the borrower/buyer occurred almost exclusively at the closing table. The lender's attorney might have five or more closings scheduled in the same day. The time available to explain the process, the documents, and most important, the nature of any title issues was limited. As a practical matter some borrowers and purchasers did not feel or understand the need for separate representation, and most closings occurred without issues. When there were significant title issues, the lender's attorney would either work out a resolution or work with other attorneys who may have been brought into the process when the problem came to light to resolve the issues. Most issues were sufficiently resolved so that the closing could occur. Most borrowers/buyers were satisfied with the process and the closing costs related to attorney representation were generally reasonable. Problems and errors occurred but were generally resolved sufficiently satisfactorily that no "hue and cry" was raised against the process. Hundreds of millions of dollars of real estate closings occurred under these circumstances.

These changes in circumstances may not yet be universal throughout the State, but the course is set. The process of closing residential real estate transactions in Vermont is becoming more like the rest of the United States. Previously a person might stay in the same property for most of his or her life, and the characteristics of the property were important to the client. The current trend assumes that people will stay in the same property for seven to ten years. Property turns over faster, and may be more fungible than in the past. In many areas of the State, residential developments are growing in size while becoming homogenized. The individual characteristics of a specific property may not be the most important element of the transaction. It would appear that in many areas of the State, the practice of law as it relates to the typical residential real estate transaction is less a function of counseling the client about legal rights and responsibilities than about processing the paper required to close the transaction as fast and effectively as possible. The typical client in a residential closing may not be interested in meeting with his or her attorney to review the title opinion in detail. The client is often less interested in the lawyer's counsel than the quick and inexpensive processing of the transaction.

Moreover, the Hunter, Bianchi and Fleming decisions significantly added to pre-closing due diligence, greatly increasing costs incurred by borrowers even in routine real estate transactions. Those new burdens coupled with our decision in Opinion 90-8 have resulted in many borrowers proceeding to closing without an attorney. It is the Committee's view that a borrower/buyer

who shares an attorney with the lender is better off than a borrower who has no attorney. The Rules now provides enough flexibility to make that possible.

There are several constants that remain in place, even as the practical process of closing a real estate transaction appears to change. There are three parties, each of whom is entitled to the separate and vigorous representation of a qualified attorney acting without outside influence. Whether the nature of the real estate closing has in fact changed to the point where it is really a paper moving exercise, or not, an attorney who chooses to represent a party in a real estate transaction is bound by the Rules.

When a lawyer represents the lender in a real estate closing and also provides services to the buyer/borrower, there is a conflict of interest. The real question is whether the conflict of interest is of such a nature that it can not be waived under the applicable Rules. At the time that Opinion 90-8 was issued, there was a significant concern that a lawyer would learn information such as permitting issues that would be relevant to the lender in underwriting the decision to make the loan. If the lawyer represented both clients the lawyer could not disclose the information to the lender without the Borrower's consent. Permitting issues were generally regarded as being outside the scope of the title certification required by lenders. As a result of the decisions in Hunter Broadcasting, Bianchi and Fleming the requirements of title certification have been substantially broadened. Conversely, the risk of violating a client's confidence with respect to permitting issues has been substantially reduced.

Rule 1.7 establishes the constraints on representing more than one person. The rule is stated as a prohibition. An attorney shall not represent a client if the representation of that client is adverse to the interest of another client (Rule 1.7(a)) or if the representation of the client will be materially limited by the attorney's responsibilities to another client, a third party or the lawyer's own interest (Rule 1.7(b)). There is an exception where the attorney makes a determination that the representation of one client will not adversely affect the representation of another client, or that the representation of the client will not be adversely affected by the attorney's responsibilities to another client, a third party or the attorney's own interest. Also, in each case the client(s) must consent to the representation, after "consultation."

The essential elements of the lawyer's assignment for the lender and borrower are similar. In each case, both clients want to be sure that (i) in the case of a purchase, the transfer documents are correct and complete; (ii) the bank loan documents are completed properly and accurately reflect the transaction as approved by the Lender and understood by the purchaser/borrower; (iii) that all closing proceeds are properly accounted for and disbursed to the correct parties; (iv) that a complete and appropriate title report is prepared and delivered to the client, and (v) that appropriate title insurance is procured for both the lender and borrower/buyer. Where the goals and desires of the two clients are similar, the conflict of interest can be waived by well informed clients.

The provisions of DR5-105 of the Code specified that an attorney could undertake multiple representation only when it was "obvious" to the attorney that the attorney could adequately represent the interests of both parties. The Committee concluded in Opinion 90-8 that it would never be obvious that the attorney could adequately represent the interest of both parties. The adoption of the Rules invokes a different test. The provisions of Rule 1.7 require that the attorney reasonably believe that the dual representation will not adversely affect the attorney's obligation with respect to either client. The softening of the standard from "obvious" to "reasonable belief" widens the possibility that dual representation can work in the proper cases, particularly in light of the changes discussed above.

Once the attorney has formed the conclusion under the first part of the test, the attorney must then consult with each client to explain the implications of the common representation and the advantages and risks involved. Disclosure should not occur at the closing table. The consultation should occur sufficiently in advance of the closing to give each client the opportunity to determine whether that party would prefer independent representation. Disclosure in a real estate matter should include a discussion of the potential different interests of borrower and lender. For example, the borrower may have a potential desire to waive what may appear to lay people as minor matters on the title or irregularities in the documents in order to close, whereas the lender may be constrained by underwriting requirements to correct the problems prior to the closing. The lender may insist that certain documents be signed as part of the closing which obligate the borrower to a course of action the borrower does not wish to take. There may come a time in a closing where the attorney learns something about the property or the borrower which should be disclosed to the lender. If the borrower client will not authorize the disclosure of the information, an irreconcilable conflict may arise and the attorney will be precluded from representing either party. It is only after such disclosures are made that a client may give an informed waiver of the conflict inherent in the dual representation.

After the disclosure, the attorney must obtain the consent to the dual representation. Prudence suggests that the conflict waiver be in writing and include the essential elements of the consultation as well. The committee has tried to list some points that could be incorporated in a waiver as a preliminary guidance. The Committee believes that each waiver should address the specific transaction and the relative sophistication of the clients. It may not always be sufficient to use a standard form.[1]

Should a conflict between the two clients arise during the course of the representation, the attorney representing the two parties must withdraw from representation. The provisions of Rule 1.9 describe the circumstances in which the attorney may continue to represent one of the parties. The withdrawing attorney must be careful to consider the situation and the information that has come into the attorney's possession and the impact of knowing the information on the party who the attorney will no longer represent. It is likely that continuing to represent one party over another in this situation will be the rare case.

This opinion does not conclude that it is appropriate for attorneys to represent both the lender and the buyer/borrower in every circumstance. The attorney's judgment regarding the relative sophistication of the clients and the issues presented by the specific transaction is critical.

If a dispute arises between the parties about the subject of the representation, the attorney will have to withdraw from the representation and will not be able to represent either party in the dispute.

In the circumstance where a client retains an attorney for the specific transaction, either because the client is concerned about some aspect of the particular transaction or because the client wants individual representation, then the lawyer must be more careful in making the determination that the attorney "reasonably believes" that the attorney can represent the lender also. The attorney must factor into the decision the specific reasons the client retained the attorney in the first case.

In those circumstances where an attorney is interacting with an unrepresented party the Rules also allow the lawyer a broader opportunity for communication. Under the Code, the attorney was prohibited from communicating with an unrepresented person other than to encourage that person to obtain counsel. That made the process of representing the lender and closing a loan a difficult experience. The attorney could not represent the lender and interact with the borrower in any meaningful way, without going beyond the scope of the allowed communication. Under the Rules, the attorney is allowed a greater scope of communication with an unrepresented person, as long as the attorney does not misrepresent who the attorney is representing. Rule 4.3. Where an attorney is representing only a lender, and the borrower is not represented, the attorney should consider whether it would be appropriate to provide some form of written disclosure for the un-represented person(s) describing the attorney's role.

OPINION TWO:

As a supplemental question, the attorney making the request asks whether the formation of a title and escrow company owned and controlled by one or more members of the firm would alter the impact of the Rules of Conduct as they apply to representing lenders and borrowers in real estate closings. To the extent the title and escrow company was owned by attorneys and provided legal services, the attorneys are bound by the Rules in providing such services, and the organization of a business separate from a law firm does not insulate the attorneys or lessen the attorneys' obligations under the applicable provisions of the Rules.

An attorney may provide law-related services outside the practice of law. The applicable Rule is Rule 5.7 which sets out the responsibility of an attorney providing law-related services. A law related service is a service that may be performed in conjunction with and in substance are related to the provision of legal services, and which are not prohibited as unauthorized practice of law when provided by a non-lawyer. Rule 5.7(b).

The Committee is of the opinion that the closing of loans, including specifically the preparation of legal documents related to the acquisition and financing of real estate and the issuing of title reports or title insurance commitments signed by an attorney on behalf of a the title company (where the effect and purpose is to satisfy the requirements that the title to the property be marketable) generally would not fit the last part of the definition of law related services as those services constitute the practice of law. A non-lawyer would not be allowed to perform either of those services without the supervision of an attorney who would be responsible for the person's conduct. The Committee notes that the issuing of title insurance policies is listed as a law related business in the comments to Rule 5.7 and acknowledges that employees of title insurance companies may be

[1] Guidelines for Disclosure

The attorney will be representing two parties. The attorney owes each party an equal duty of loyalty and maintaining confidentiality of the information provided by each client.

If either party provides information to the attorney that cannot be disclosed to the other party, then an irreconcilable conflict arises and the attorney must withdraw.

Such disputes may include differences as to the significance of title issues, differences as to loan conditions.

licensed to issue title insurance policies. The Committee is of the opinion that the process of searching the title and determining which matters constitute encumbrances on the title to the property constitutes the practice of law.

CONCLUSION:

For the reasons set forth above the Committee now concludes that an attorney may allow for the representation of the lender and the borrower/buyer when the attorney reasonably believes that (a) the representation of two parties in the same transaction will not adversely affect the relationship with either client; and, (b) that the attorney's judgment will not be materially limited by responsibilities to either client or to a third party; and, finally each client agrees to the dual representation after consultation. The consultation must be meaningful in terms of timing by occurring sufficiently before the closing to allow either client to obtain separate representation if desired. The consultation must also include a discussion of the implications of the common representation and the risks and benefits of the common representation.

In responding to the related question, the Committee also concludes that an attorney or a law firm may form a title and escrow company to provide title and closing services, but because those services are law related services, the Rules of Conduct apply to the attorneys working in or for the title and escrow company.