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Two Masters— Ethics for Real Estate Lawyers

The Bible tells us, "No servant can serve two masters . . ."

When it comes to the practice of splitting title insurance premiums between attorneys and title insurance companies, the New York State Bar Association's Committee on Professional Ethics takes the same position.

This article will examine the *recent* ethics opinions concerning attorneys who refer their real estate clients to title insurance agencies in which they have a financial interest.

The focus will be twofold: what do the opinions say about the practice, and what do the opinions mean to lawyers.

A review of the relevant opinions by the Committee shows an increasing disfavor with the practice of attorneys receiving part of the title insurance premium paid by their client. Ultimately, it has been declared to be completely unethical as a conflict of interest that can't be remedied by disclosure.

The theme of the various opinions is conflict of interest.

"The lawyer who represents conflicting interests acts at his peril and should realize that the thrust of Canon Six is to discourage acceptance of such representation."[1]

It is important to note the changing standards of the Committee in viewing both representation and an attorney's rendering of non-legal services to clients.

Opinion 595—11-2-88

Topic: Conflict of Interest, Dual Practice as an Abstract Company

Digest: Improper for law firm that represents real estate clients, and that has formed and is a principal in an abstract company, to refer clients to the title company except for purely ministerial title searches.

Code: DR 1-102 (A) (2)
2-106 (A), 3-101 (A),
3-102 (A), 3-103 (A),
5-101 (A), 5-104 (A),
5-105 (A), (C)
EC 2-17, 3-5, 5-2

The Committee is clear in stating that it does not render opinions on questions of law, but goes on to say that if a practice does violate a law such as RESPA, 12 U.S.C., N.Y. Insurance Law section 6409, and N.Y. Judiciary Law section 479, "any association with such an illegal scheme would be, perforce unethical."[2]

The view expressed in 1988 is clear. Splitting title premiums comes dangerously close to or actually does violate one or all of these laws in the eyes of the Committee.

The U.S. Attorney for the Western District of N.Y., Roger P. Williams, saw it in the same way. In a letter dated May 8, 1987, to the N.Y. State Bar Association he wrote: "Unearned fees are in violation of the law. If an attorney does not perform actual services for the title company, a receipt of any portion of the title insurance premium would be improper."

As title insurance professionals, the conflict of interest is startling. "Clearing" a title involves clear negotiation between attorney and title company. If a defect in title is discovered by the title examiner, the clearance officer employed by the title agent has a duty to except, not insure, that defect from coverage in the policy. The attorney for the buyer must make every effort to have the defect omitted, and have the defect covered by the policy.

What if the same person is functioning in both roles?

How would he negotiate with himself?

This Opinion, N.Y. State 595, reverses the Committee's view in N.Y. State 576 where the conflict inherent when an attorney placing title insurance for a client and then receiving a portion of that premium could be cured by appropriate disclosure, informed consent, *and* a crediting to the client of the fee received from the title company. (Such a disclosure form never became popular enough for Blumberg to add it to its list).

Opinion 621—4-18-91

Topic: Conflict of Interest; referral of real estate clients to attorney-owned abstract company.

Digest: Improper for attorney to refer real estate client to abstract company in which he has ownership interest.

Code: DR 5-101 (A), 5-105,
5-105 (C), EC 5-2

The Real Property Law Section of the New York State Bar Association asked the Committee to review its conclusion in N.Y. State 595 prohibiting premium splitting.

Here the "obviousness" test is examined. DR 5-105 (C) permits dual representation only "if it is *obvious* that the lawyer can adequately represent the interest of each *and* if each client consents to the representation after full disclosure . . ."

Again the Committee emphasized the incurable ethical dilemma of the attorney for the buyer negotiating title exceptions with "his or her own abstract company i.e. with himself . . ."

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After a full day of hearings, and receiving testimony of the bar and title industry the Committee affirmed N.Y. State 595, and again prohibited the practice of an attorney referring real estate clients to a title company with which that attorney has a financial interest.

Opinion 738—4-16-01
Topic: Conflict of interest: referral of clients to title abstract company owned by attorney's spouse.
Digest: Improper for attorney to refer real estate clients to title company in which the attorney's spouse has an ownership interest for other than purely ministerial work.
Code: DR 5-101 (A), 5-105 (C)

The Committee apparently frowns on this practice so much they extended it here to companies owned by spouses of attorneys.

Again, the Committee affirmed N.Y. State 595 where they opined that "a prohibited conflict of interest arises that may not be cured by the consent of those concerned with the transaction."

In this opinion the Committee replaces the "obviousness" test for judging conflicts with that of a "disinterested lawyer" test. DR 5-101 (A) now states that "a client's informed consent after full disclosure is insufficient to cure a conflict of interest where the exercise of professional judgment on behalf of the client will be or reasonably may be affected by the lawyer's own financial, business, property, or personal interests . . ." unless "a disinterested lawyer would believe that the representation of the client will not be adversely affected thereby."

The Committee concluded stating, "An attorney may not refer a real estate client to a title abstract company . . . where the lawyer's spouse has an ownership interest in the abstract company."

There is no doubt the Committee has an unswerving opinion that it is ethically impermissible for an attorney to refer real estate clients to a title abstract company in which the attorney has a financial interest.

The Lawyers Code of Professional Responsibility of the New York State Bar Association includes Canons, Ethical Considerations, and Disciplinary Rules. It is evident that the Canons are general in nature and the Ethical Considerations are more aspirational. The Disciplinary Rules, however, are mandatory and represent the minimum standard of conduct expected from lawyers. Behavior below that level can subject an attorney to disciplinary action. The Ethics Opinions cited above discuss Disciplinary Rules and as such mandate a standard of conduct required for attorneys. It is clear that standard prohibits a lawyer from referring his real estate clients to a title agency in which that lawyer or their spouse has a financial interest.

1. N.Y. State Bar Association Op. 38 (1966)
2. N.Y. State Bar Association Op. 595 (1988)

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Escrow Account Reconciliation: Outsourcing Your Balancing Act

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A "Disinterested" Third Party

Outsourcing your agency's escrow account reconciliations has the benefit of a neutral set of eyes looking at your accounts. An outside expert is likely to notice problems that your staff members will not either because they are too close to the operation or are fearful of being held responsible for mistakes.

The involvement of an objective third party is becoming increasingly attractive to underwriters and state auditors for safety and fraud prevention since it eliminates the possibility of internal manipulation of funds. For example, escrow accounting best practices indicates that the person reconciling the account should not be a signer or a disburser on the account. Unfortunately for small agencies, this more or less disqualifies everyone that works there.

Cost, Convenience, and Coaching

For most agencies, hiring a professional service to perform account reconciliations is an affordable solution to the challenges they currently face in this competitive market. As a rule, subscribing to a reconciliation service runs at well below the cost of maintaining a full-time person on staff.

For your convenience, most companies offer onsite services at your place of business or remotely using internet-based access methods. Scheduling usually depends on the availability of your agency's bank statements. Many offer evaluation services of unreconciled escrow accounts on a case-by-case basis to determine if a consultation would be advantageous.

Escrow accounting problems sometimes result from poor accounting practices or simply a lack of training or knowledge in escrow accounting procedures. Some reconciliation service companies offer basic and advanced reconciliation classes or Webinars to assist your in-house staff with escrow reconciliation concepts such as fixing out-of-balance errors, researching reconciliation discrepancies, and correcting complex item issues. This type of training should be reserved for staff members who have the acumen and time to devote to solving reconciliation issues.

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