

NEW HAMPSHIRE BAR ASSOCIATION
Ethics Committee Formal Opinion #1992-93/9
Client Funds and Property: Real Estate Settlement Accounts
June 24, 1993

RULE REFERENCES:

*Rule 1.4	*Rule 5.1
*Rule 1.5	*Rule 5.2
*Rule 1.6	*Rule 5.3
*Rule 1.7(b)	*Rule 5.4(a)
*Rule 1.8(a)	*Rule 5.4(b)
*Rule 1.15	*Rule 5.5
*Rule 1.15(a)	*Rule 7.1
*Rule 1.15(a)(1)	*Rule 7.2
*Rule 1.15(a)(2)	*Rule 7.3
*Rule 2.1	*Rule 8.4(a)

SUBJECTS:

- *Business Activities
- *Client Funds and Property
- *Conflict of Interest
- *Division of Fees
- *Dual Practice
- *Real Estate/Realtors
- *Trust Accounts
- *Unauthorized Practice

SUPREME COURT RULE REFERENCES:

*Rule 50

ANNOTATION:

An attorney must place funds received from a client or third party, in "clearly designated" trust accounts, separate from the attorney's own funds or accounts. (Rule 1.15(a))

The term "funds" for purpose of attorney safeguarding under 1.15, includes money held by an attorney as escrow or settlement agent for real estate closings. (Rule 1.15(a))

Stringent record keeping requirements specifically apply to an attorney handling client funds under Rule 1.15(a)(2) and NH Supreme Court Rule. While such rules do not specifically apply to third party funds, basic fiduciary law would indicate prudent adherence to such rules in all cases.

An attorney cannot withdraw and disburse funds from a real estate settlement account & deposit them in the law firm's general operating account. Excess funds collected must be promptly returned to the party entitled to receive them or handled in accordance with the law regarding lost property.

A real estate title company owned or controlled by an attorney performing services typically overseen by an attorney is not considered practicing law as determined by most states addressing the issue. No decision has been reached on this issue by NH courts, but there is concern that the activities of such a title company may constitute, in part, the practice of law, & therefore would be subject to rules restricting the handling of funds. [This question was subsequently addressed In the Matter of Unnamed Attorney and Unnamed Title Co., 138 NH 729 (1994).]

Lawyers involved in ancillary businesses (such as the operation of a lawyer-owned or controlled real estate title company) must consider many troublesome ethical dilemmas. (Rule 1.4; Rule 1.5; Rule 1.6; Rule 1.7(b); Rule 1.8(a); Rule 2.1; Rule 5.1; Rule 5.2; Rule 5.4(a); Rule 5.4(b); Rule 5.5; Rule 7.1; Rule 7.2; Rule 7.3)

It may well be improper for an attorney to refer clients to or represent as clients, persons who are doing business with a real estate title company owned by the lawyer, absent full disclosure & consent of the client. (Rule 1.8)

QUESTIONS:

1. May a lawyer withdraw undisbursed funds from a real estate settlement account and deposit them in the lawyer's general account prior to disbursement for the purposes for which the funds were collected?
2. If a lawyer conducts real estate closings through a title company, of which the attorney is an employee and sole stockholder, are the attorney or the title company subject to the same rules with respect to the handling of settlement accounts as an attorney who handles settlement accounts directly?

BRIEF RESPONSE:

1. A real estate settlement account is a trust account, and a lawyer may disburse funds from the account only for the purposes for which they were collected.
2. A real estate title company is subject to the laws governing fiduciaries and may be subject to the Rules of Professional Conduct or the New Hampshire Supreme Court Rules relative to trust accounting.

RESPONSE:

A law firm serves as settlement agent for real estate closings. At the closing the law firm collects and disburses the funds necessary to close the transaction. The funds are deposited with the attorney by the attorney's client, or by third parties. The funds are disbursed to the lawyer's client or to third parties according to a settlement statement approved by the parties at closing. In some cases, the total amount of recording fees is estimated at the closing. Occasionally months or even years may pass after closing before a mortgage discharge from a lender that has been paid from closing proceeds is received and recorded.

An attorney must segregate the property of clients and third parties that the attorney is holding from the attorney's own property. All funds of clients or third parties must be placed in "clearly designated" trust accounts. New Hampshire Rules of Professional Conduct, Rule 1.15(a). Attorneys must maintain detailed and accurate records of "funds and other property of the client" in their trust accounts for a period of six years after final distribution of the funds. Rule 1.15(a) (2). New Hampshire Supreme Court Rule 50 imposes additional requirements on the creation and administration of lawyer trust accounts into which client funds or property have been deposited. In addition to the rules that govern the legal profession, a lawyer who holds property of others is also governed by "the applicable law relating to fiduciaries." "[A] lawyer should hold property of others with the care required of a professional fiduciary such as a trust company". ABA Model Code Comments to Rule 1.15.

The term "funds" as used in Rule 1.15(a) (1) includes money held by an attorney as escrow or settlement agent for real estate closings. Consequently, funds collected by an attorney as the settlement agent for a real estate closing must be held in a lawyer's trust account.

If client funds are deposited in a lawyer's settlement account, the record keeping and reporting obligations of Rule 1.15(a)(2) and Supreme Court Rule 50 will apply to that account. In addition, while neither Rule 1.15(a)(2) nor Supreme Court Rule 50 specifically impose record keeping and reporting obligations with respect to property or funds of "third parties" that are held by a lawyer, it is the opinion of the Committee that the law relating to fiduciaries requires an attorney to maintain records of a trust account in which no client funds have been deposited in a manner similar to that required by Rule 1.15(a) (2) and New Hampshire Supreme Court Rule 50.

Whether or not a client of the attorney is involved in a transaction, the attorney cannot withdraw undisbursed funds from a real estate settlement account and deposit them in the law firm's general operating account. The attorney can only disburse the funds from the settlement account for the specific purposes for which they were collected and must keep a record of all transactions within the settlement account. If excess funds have been collected by the attorney, the excess funds must be promptly returned to the party entitled to receive them. Funds that cannot be disbursed as planned or returned to the party entitled to receive them must be handled in accordance with the New Hampshire law regarding lost property, NH Op 82-3/9.

The answer to the inquiry is less certain if the closings are conducted by a real estate title company that is owned or controlled by a lawyer or employs a lawyer. (For the purposes of this opinion, it is assumed that a real estate title company undertakes some or all of the following services, all of which are overseen by a licensed attorney: perform title searches, prepare documents, conduct closings, or issue title insurance policies.) While some jurisdictions have held that the review of titles or the preparation of routine closing documents, without legal analysis, by a real estate title company constitutes the unauthorized practice of law, Virginia State Bar, Legal Ethics Opinion #1469 (1992), an apparent majority of jurisdictions have held otherwise. Wolfram, *Modern Legal Ethics*. §15.1.3 (1986). The question has never been addressed in New Hampshire, but there is strong sentiment on the Committee that the activities of a real estate title company constitute, at least in part, the practice of law.

In addition, no decisions have been found that hold that the New Hampshire Rules of Professional Conduct or the New Hampshire Supreme Court Rules relative to trust accounts apply to an entity solely because it is owned or controlled by an attorney or because the entity employs an attorney. It has been observed that:

"An abstract company in which a lawyer is financially interested, whether a sole proprietorship, a partnership, or a corporation, has only a business relationship with its real estate customer, not an attorney-client relationship governed by the [Rules]". New York State Bar Association, Committee on Professional Ethics, Opinion No. 621 (4/1890).

However, it has also been held that a real estate title company must comply with rules of professional ethics so long as the services of the real estate title company to the customer are deemed to constitute the practice of law. Virginia State Bar, Standing Committee on Legal Ethics, Opinion No. 1469 (6/23/92).

If New Hampshire follows the majority rule, it is likely that the real estate title company and not the attorney employee would be deemed to be the settlement agent for the real estate closings, and the real estate title company, as a non-lawyer, would not be subject to the Rules of Professional Conduct or New Hampshire Supreme Court Rule 50 with respect to trust accounting. On the other hand, if New Hampshire follows the minority rule, some or all of the activities of the real estate title company would be deemed to constitute the practice of law. Because the real estate title company is not an attorney or law firm, such activities might be deemed to constitute the unauthorized practice of law, in which case, its illegal activities would have to cease, and issues such as trust account reporting will become moot. It is also possible, that New Hampshire might agree that some activities of the real estate title company constitute the practice of law, but allow it to continue based upon an assumption that an attorney-client relationship exists between the lawyer employed by the organization and the customer. In such case, the Rules of Professional Conduct and the New Hampshire Supreme Court Rules would apply to the trust funds of the real estate title company. In any event, the common law rules relative to the obligations of fiduciaries will always apply to the actions of a real estate title company with respect to the funds of others that it holds.

Though a discussion of the limitations on a lawyer's ancillary businesses is beyond the scope of this opinion, lawyers must remember that the operation of ancillary businesses raise numerous difficult ethical issues. The operation of lawyer-owned or controlled real estate title companies appear to present particularly troublesome issues, such as:

- (a) Reasonableness of Fee (Rule 1.5) - Does the attorney's legal fee when combined with the lawyer's share of the profits of the ancillary business constitute a reasonable fee?
- (b) Fee Splitting with Non-Lawyers (Rule 5.4 (a)) Does the lawyer share fees with the principals of the real estate title company? Are they legal fees?
- (c) Solicitation of Business (Rule 7.3) - Is the real estate title company used as a feeder for business for the lawyer?
- (d) Confidentiality (Rule 1.6) - Do non-lawyers have access to client records in the hands of the real estate title company?
- (e) Partnership with Non-Lawyers (Rule 5.4(b)) Do non-lawyers co-own the real estate title company?

- (f) Aiding the Unauthorized Practice of Law (Rule 5.5) Is the real estate title company engaged in the unauthorized practice of law?
- (g) Advertising (Rule 7.2) - Are the services of the lawyer improperly advertised with the services of the real estate title company?
- (h) Conflict of Interest (Rules 1.7(b), 1.8(a), and 2.1) - Does the lawyer's interest in the real estate title company affect the exercise of the lawyer's independent professional judgment on behalf of the client?
- (i) Disclosure (Rules 1.4 and 7.1) - Has the client hired the real estate title company with the expectation that the lawyer or the lawyer's law firm will actually do the work? Does the client understand that services will be provided by the real estate title company and that the lawyer's liability for the results is limited?
- (j) Supervision of Subordinates (Rules 5.1, 5.2, and 5.3) What is the lawyer-owner's responsibility to properly supervise the activities of the managers and employees of the real estate title company?
- (k) Lawyer's Non-Legal Activities (Preamble to ABA Model Rules of Professional Conduct) "A lawyer's conduct should conform to the requirements of the law, both in professional services to clients and in the lawyer's business and personal affairs."

In most jurisdictions that have addressed the question of lawyer-owned or controlled real estate title companies, it has been held to be improper for a lawyer to refer clients to or to represent as clients, persons who are doing business with a real estate title company owned by the lawyer, without full disclosure and consent of the client. Alabama State Bar Association Opinion 82-702 (undated); Oregon State Bar Opinion 1991-10 (7/91); Virginia State Bar Association Opinion 712 (8/30/85). See Rule 1.8; DR 5 101(A); DR 5-104(A). Even with disclosure, it has been held to be improper for an attorney to pay the attorney's law office expenses with the profits of an affiliated real estate title company, Virginia State Bar Association Opinion 1405 (9/17/91), and at least one jurisdiction has held that it is improper for an attorney to refer clients to a real estate title company owned by the attorney. New York State Bar Association Opinion 621 (4/18/91). Given the extremely difficult ethical issues outlined above, and the application of the "harsh reality test" frequently referred to by this Committee (see New Hampshire Ethics Committee Opinion No. 1988-89/24), the Committee is of the opinion that the situations in which a lawyer can represent a client who is doing business with a real estate title company that is owned or controlled by the lawyer will be rare. Furthermore, both the lawyer and the real estate title company must take steps to assure that third parties who do business with the real estate title company understand that the real estate title company and not the lawyer is providing the contracted services, and that the liability of the lawyer for the services is limited.

Finally, attorneys are reminded that it is unethical for an attorney to violate or attempt to violate the Rules of Professional Conduct through the acts of another. Rule 8.4(a). If an attorney forms a real estate title company for the purpose of evading the record keeping and reporting requirements of Rule 1.15(a) (2), the attorney may be deemed to have violated Rule 8.4(a). Furthermore, it may well be inherently improper for an attorney to form a real estate title company and refer clients to it, for the purpose of shielding the lawyer from the liability or responsibility for services rendered.

[ED NOTE: After the Committee issued this opinion, the Supreme Court decided In the Matter of Unnamed Attorney and Unnamed Title Co., 138 NH 729 (1994). The Court considered whether Rule 1.15 and Supreme Court Rules 50 and 50-A apply to the escrow accounts held by a title company owned jointly by an attorney and the attorney's spouse (a non-lawyer). In order for the Professional Conduct Committee to require the attorney and the title company to submit to an audit of the company's escrow account, the Committee must show that:

- (1) the committee sought to audit records of a New Hampshire lawyer; (2) the audit of the lawyer led to information that there exists financial records maintained by an entity performing services customarily performed by a lawyer; and (3) there is a substantial nexus between the New Hampshire lawyer and the entity in question so that it is reasonable that the committee be permitted to audit the entity's records. Thus, a case such as this is essentially factually driven.

Id. at 733. The Court held that under the facts before it, the financial records of the title company were subject to audit under Supreme Court Rules 50 and 50-A. Id. at 735.]