Conflict of Interest In A Real Estate Transaction

By the NHBA Ethics Committee
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Lawyers are frequently asked to represent more than one party to real estate transactions, including every combination of seller, buyer, borrower, and lender. Even more frequently, lawyers are asked to perform limited real estate tasks (such as deed or mortgage drafting or title searching) for parties other than their principal clients in a transaction. Clients and real estate brokers often favor such practices, on the grounds that such practices promote economy and speed in the completion of the transaction.

However, the potential for conflicts of interest is vast. Full disclosure and consent are minimum, not maximum, requirements for ethical compliance. Even if consent is obtainable, the lawyer should decline to represent the general interests of both a buyer and a seller, or a lender and a borrower, absent unusual circumstances. Even if consent is obtainable, the lawyer should decline to represent the general interests of a secondary client in a transaction for which the lawyer represents the interests of a primary or original client, absent circumstances in which the lawyer and the parties reasonably believe that there is no likelihood of material disadvantage to either party.

Avoidance of impermissible conflicts in the performance of specific tasks, particularly in the closing of standard residential transactions, is generally much easier. However, the lawyer’s performance of specific tasks for a secondary client still raises important issues of whether the lawyer can reasonably believe that such performance will not materially adversely affect either client. With this limited exception, the difficulty of the questions raised, and the ease in identifying the alternative - namely, separate representation - raise a presumption that the lawyer should generally decline multiple representation when there is any question of a potentially damaging conflict or appearance of impropriety. The presumption should be applied as a rule of reason, not a rigid formula; in applying the rule the lawyer should keep in mind the harsh realities of other peoples’ hindsight if the transaction goes wrong.

Applicable rule

Rule 1.7 of the Rules of Professional Conduct incorporates two vital components. First is the “directly adverse” component, which generally pertains to litigation. Second is the “materially limited” adversity component:

“(b) A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer’s responsibilities to another client or to a third person, or by the lawyer’s own interests, unless:

(1) the lawyer reasonably believes the representation will not be adversely affected; and

(2) the client consents after consultation and with knowledge of the consequences. When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved.”

Both consent and reasonable belief are thus required before multiple representation may be undertaken; consent alone is not sufficient. As a threshold matter, the lawyer should consider that declining multiple representation offers the advantage of avoiding the issue entirely.

Application: reasonable belief

A. General representation

Any analysis by a lawyer facing proposed multiple representation in real estate transactions must begin with two simple questions: whom am I proposed to represent here? and who feels that I am looking after their interests here? If the answer is more than one party, and the lawyer does not immediately recommend separate representation for the proposed clients, the lawyer must go on to analyze whether the lawyer can reasonably believe that there is no likelihood of material limitation of the lawyer’s responsibilities to all proposed clients, and if there is material limitation, whether any proposed client will be adversely affected.

Parties to real estate transactions traditionally view conscientious lawyers as nay-sayers standing in the way of “getting the deal done.” The parties want that lawyer to define transactional expectations, which is an important function of the lawyer, but, as unpopular as the concept generally is for the parties, the other and usually more important function of legal representation in real estate transactions is to define defaults, and to provide for the protection of the interests of the lawyer’s client after default occurs. The lawyer must consider possible injury to, and possible protection for, the client when a contest does somehow later arise.

In addition to keeping an eye on the client’s transactional expectations, the conscientious lawyer will keep an eye on the client’s representational expectations. It is useless for the lawyer to understand and believe that only one party is being
represented if a second party believes that the lawyer is also serving the second party. If there is any possibility of a question about representation, a good lawyer will ensure that all parties are clear about the lawyer’s role. A wise lawyer will ensure that there is evidence of such clarity.

Analyzing beliefs in lights of future contests is consonant with the “harsh reality” test the Ethics Committee used in a recent opinion on conflicts in municipal representation. “Under this test, a lawyer attempting to resolve such an issue should ask himself or herself whether, if a disinterested lawyer were to look back at the inception of this representation once something goes wrong, would that lawyer seriously question the wisdom of the first attorney’s requesting the client’s consent to this representation or question whether there had been full disclosure to the client prior to obtaining the consent . . . If this ‘harsh reality’ test may not be readily satisfied by the inquiring attorney, the inquiring attorney and other members of the inquiring attorney’s firm should decline representation of the [second client].” Ethics Opinion 1988-9/24.

For example, the lawyer is unlikely to believe that her or his representation of both sides of a proposed purchase and sale agreement will pass the test, even if the parties think they already agree on the terms of the agreement. The lawyer is obliged to explore that proposed transaction, to raise issues the parties may not have explored, and to propose alternative terms, all the more if the parties profess to wish to use “form” documents. Similarly, such reasonable belief is unlikely where the lawyer is asked to represent both sides of a non-standard residential loan transaction, for similar reasons. A lawyer representing both parties is simply less likely to push any one party’s interests quite as hard as the same lawyer properly representing only the one party. And when those interests lead to a conflict, the lawyer-client privilege is threatened in litigation following multiple representation, while it unarguably remains intact following single representation.

The unusual circumstances in which the lawyer may find no adverse effect from multiple general representation are quite limited. In most cases they will amount to a finding that the secondary client really needs no general representation, for example if the secondary client is a residential buyer/borrower already signed on to a purchase and sale agreement and /or borrowing on a standard secondary market mortgage. The lawyer should then disclose the lack of need for the lawyer’s services, and charge accordingly. (The lawyer may provide and charge for such specific services, as an owner’s title insurance policy or drafting of a deed without generally representing the secondary client. Other issues are raised in the performance of these task, which are discussed below.)

The same analysis applies, for another example, when a borrower’s lawyer is asked by the lender to prepare commercial loan documentation, in which case the lawyer should disclose that the lawyer proposes to prepare the documentation from the borrower’s perspective, and insure that the lender understands that fact and adequately consents. In the few circumstances in which genuine multiple representation may be permissible, it will almost always be because of extreme economic circumstances.

As the New Jersey Supreme Court found in In the Matter of Edward J. Dolan, 76 NJ 1, 384 A2d. 1076 (1978), where the buyer/borrower was a law income residential consumer, “the stark economic realities are that were an unyielding requirement of individual representation to be declared, many prospective purchasers in marginal financial circumstances would be left without representation. That being so, the legal profession must be frank to recognize any element of economic compulsion attendant upon a client’s consent to dual representation is a real estate purchase and to be circumspect in avoiding any penalization or victimization of those who, by force of these economic facts of life, give such consent.” Id. at 1081. That, as the dissent (which would ban all multiple representation per se) make clear, is a tall order.

No matter what the circumstances may be, there is a consensus, with which this committee agrees, that a developer’s lawyer may not represent buyers in their purchase of the developer’s product. The likelihood of conflicts being resolved in favor of the consumer is too small.

B. Specific tasks

The presumption that impermissible risk will arise from multiple representation applies less consistently to the performance of specific tasks for a secondary client. There is a lesser, but still real, potential for damaging conflict when the lawyer’s role for the secondary client is limited to specific tasks. For example, lawyers for mortgagees or buyers are frequently asked to provide deeds for sellers. The lawyer must be sensitive to the pressure of the buyer’s need for completeness and specificity in the deed. If the record description does not fully meet title insurance standards, warranty issues must be fully aired before a lawyer asks a seller to sign a deed which is different from that to sign a deed which is different from that which the seller originally received. Similarly, lawyers for borrowers are frequently asked to provide title insurance policies for lenders. The potentially adverse effects of an encumbrance or of a title irregularity must be fully disclosed, especially if not insured over, as must the degree to which a survey might be advisable to assure that the mortgagee is obtaining all that is necessary, even if the borrower has accepted the title as is.

Beyond documentation, in the handling of even the simplest closing there is ample room for potential conflicts.
Frequently, closing costs involve more discretion than parties recognize. Also, the perennial question of the handling of the deed and of closing proceeds during the “gap” - the time between closing and recording - is sometimes answered with “gap insurance,” which is fine for the lender but which may not be adequate for the buyer. Lender’s lawyer should be particularly careful to affirmatively inform the borrower that the lawyer is not looking after borrower’s interests. See Rule 4.3.

While this article has primarily been concerned with raising consciousness about potential problems, the fact that a huge number of residential transactions occur with some degree of multiple representation, and without ethical lapse, should not be obscured. After examination of the risks, and satisfaction of the harsh reality test, the lawyer may in such circumstances reasonably conclude that neither party’s representation will be materially adversely affected, and proceed to deal with consent.

Application: consent

Consent is of little use if the lawyer cannot properly provide the representation consented to. Only once the lawyer has cleared the hurdle of reasonable belief under the “harsh reality” test may the lawyer proceed to analyze the issues of consent to multiple representation. Reasonableness of consent will vary, as the rule makes clear, not only according to the substance of the representation being consented to, but according to the quality of the lawyer’s consultation with the consenting party.

The Dolan case again presents an excellent overview of the considerations allowing consent. The majority opinion deserves quotation at length:

“In a real estate transaction, the positions of vendor and purchase are inherently susceptible to conflict. [citation omitted]. This is likewise the case with borrower-lending relationship. [citation omitted] . . . [quoting from the same court’s opinion in In re Kamp, 40 NH 588, 194 A.2d 236 (1963)]: ‘Full disclosure requires the attorney not only to inform the prospective client of the attorney’s relationship to the seller, but also to explain in detail the pitfalls that may arise in the course of the transaction which would make it desirable that the buyer have independent counsel. The full significance of the representation of conflicting interests should be disclosed to the client so that he or she may make an intelligent decision before giving consent. If the attorney cannot properly represent the buyer in all aspects of the transaction because of the relationship to the seller, full disclosure requires that the attorney inform the buyer of the limited scope of the intended representation of the buyer’s interest and point out the advantages of the buyer’s retaining independent counsel. A similar situation may occur, for example, when the buyer of real estate utilize the services of the attorney who represents a party financing the transaction. To the extent that both parties seek a marketable title, there would appear to be no conflict between their interest. Nevertheless, a conflict may arise concerning the terms of the financing, and therefore at the time of the retainer the attorney should make clear to the buyer the potential area of conflict. In addition, if the buyer’s interests are protected only to the extent that they coincide with those of the party financing the transaction, the attorney should explain the limited scope of this protection so that the buyer may act intelligently with full knowledge of the facts.” 384 A.2d at 1080.

“ . . . [W]here dual representation is sought to be justified on the basis of the parties’ consents, this Court will not tolerate consents which are less than knowing, intelligent and voluntary. Consents must be obtained in such a way as to insure that the client has adequate time . . . to reflect upon the choice, and must not be forced upon the client by the exigencies of the closing. This applies with equal force to the dual representation of mortgagor and mortgagee.” Id. at 1081-1082.

In the real estate context, the lack of knowing, intelligent, voluntary consent does not narrowly refer to legal incapacity: even a consent by a sophisticated commercial borrower or lender may be insufficient if the lawyer could not reasonably request it. If the use is closer, the lawyer should notify the original client in writing of the lawyer’s proposed dual role. This should be done in addition to the telephone of live consultation which the lawyer should employ at the outset to be satisfied that the original client full understands the issues. The lawyer would notify the secondary party in similar fashion (generally, but not always, after the original client so consents). The frequent claim by parties that such sensitivity to the niceties of consent is unwarranted and/or wastes time does not excuse the lawyer from a more detached view. Whether a consent needs to be obtained in writing will depend on the circumstances. The lawyer may decide that the formality of a written consent helps impress on a particular client that the consent is not a minor step. The lawyer may also decide that a written consent - coupled with a written disclosure - will help impress specific risks on the client’s consciousness.

Many lawyers already use form disclosures for standard multiple representation tasks. The classic example is the standard form for notice to the borrower by the lender’s counsel that title has been examined solely for the benefit of the lender, and informing the borrower of the availability of owner’s title insurance. The standard form for divulging the owner’s title policy premium split, and the potential conflict between lender, buyer, and title insurer, is another. (As it has been some time since these forms have been generally published, samples are appended to this article). Lawyers should consider sending such forms to the parties in advance to maximize the potential for reasonable consent.

The disclosure and consent issues are similar when the lawyer is asked to serve as an intermediary (see Rule 2.2) and when the lawyer is asked to perform specific tasks for an otherwise unrepresentated client (see Rule 4.3).
In summary, the committee feels that it is likely that the general representation of multiple clients in real estate matters will result, in most instances, in an improper division of loyalty or an impairment of representation. The representation of a secondary party for specific tasks is more likely to be able to overcome such risks, but does require close examination under the “harsh reality” test. This article serves, not to provide solutions for all such specific real estate situations, but rather to provide a means of analysis for the application of the rule. This analysis, with a recognition that the lawyer may not undertake representation of multiple parties to a real estate matter is consent cannot reasonably be requested or obtained.

Suggested Real Estate Transaction Forms
RE: How To Avoid Potential Conflict of Interest Issues

DATE: __________________________________________________________

BORROWER(S): _____________________________________________________

PREMISES: __________________________________________________________

BORROWER(S) AFFIDAVIT

The undersigned (jointly and severally, if more than one), being duly sworn, hereby depose and say that the undersigned owns or is purchasing the Premises.

The undersigned acknowledges that (I) no title evidence has been provided to the undersigned relative the said premises and (ii) no certificate or opinion of title has been issued to the undersigned by [lawyer].

[Lawyer], attorney for (Lender), Lender, have explained to the undersigned that owner’s title insurance, through ____________________________ Title Insurance Company, is available, and said attorneys have explained the general purposes and costs of owner’s title insurance.

The undersigned further understands that the lender’s coverage is for the protection of the lender ONLY and that unless the undersigned purchases owner’s title insurance, the undersigned may have no protection relative to the title on said premises. The undersigned hereby acknowledges that [lawyer] bears no responsibility for any damage to the undersigned which may occur relative to said title. The undersigned does not wish to purchase owner’s title insurance.

BORROWER:

________________________________________________________

STATE OF NEW HAMPSHIRE
COUNTY OF ______________________________________

The foregoing instrument wa s acknowledge before me, this _____ day of ________________, 2______, by

__________________________________________. Before me,

__________________________________________
Justice of the Peace
Notary Public
My Commission Expires:

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AGENT’S DISCLOSURE TO PURCHASER AS TO OWNER’S TITLE INSURANCE PREMIUM

The undersigned has requested the opportunity to purchase owner’s title insurance from ____________________________ Title Insurance Company. [Lawyer] is acting as agent for said title insurance company in this transaction. The premium for said policy is $ ______________________, of which [lawyer] will be paid __________% by said company to compensate for services, costs and expenses as agent. [Lawyer] has no ownership interest in said title insurance company.

[Lawyer] is also issuing lender’s title insurance to [Lender]. There is thus a possibility of a conflict between the undersigned, the Lender, the title insurance company, and [lawyer] in the event of a claim on the owner’s policy.

The undersigned has read and understands the above disclosure, and consents to the facts described above.

Dated: _________________________________________________________

PURCHASER(S)

________________________________________________________

________________________________________________________