

L.E.I. 89-01
CONFLICTS OF INTEREST IN REAL ESTATE PRACTICE

It has come to the attention of the Committee on Legal Ethics of the West Virginia State Bar that there is a need among West Virginia Attorneys for a formal opinion regarding conflicts of interest in residential real estate practice.¹ To this end, an Ad Hoc Committee on Real Estate was formed from members of the Bar who practice real estate law, and are geographically located about the state. With the advice and aid of that Ad Hoc Committee, the Committee on Legal Ethics promulgated the following Formal Opinion. The Opinion directs attorneys to first determine who is being represented, consider the appropriate Rules of Professional Conduct, then consider the individual circumstances of representation.

I. DETERMINING WHOM THE ATTORNEY REPRESENTS

Because West Virginia is a small, somewhat rural state, real estate transactions between private individuals tend to be handled by one attorney. Frequently, there is no clarification as to whom this attorney represents. Conflict questions, however, cannot be resolved without determining on whose behalf the attorney is acting. As a general proposition, the client is the person or entity whose interests the attorney is hired to protect and advance.

Without specific clarification as to whom the attorney represents, courts have often imposed upon attorneys a duty of care towards a person who reasonably believed the attorney was acting on his behalf. Disqualification for conflict of interest, liability for malpractice, and the imposition of confidentiality requirements have all resulted from these court findings. Factors courts have considered, are as follows:

- (1) Who initially contacted the lawyer for a particular real estate transaction;
- (2) Whether the lawyer had a prior relationship with any of the participants;
- (3) Who paid the lawyer's fee;
- (4) Whether payment was made directly or indirectly as part or costs or the purchase price;
- (5) With whom the lawyer had actual communication or personal contact; and,
- (6) What documents the lawyer prepared.

¹The apparent custom and practice in commercial real estate transactions is for each party to be represented by separate counsel and, therefore, no opinion is rendered at this time.

Because it is the subjective belief of the client, not the attorney, which is most often controlling in the establishment of the attorney/client relationship, it is imperative that attorneys protect both themselves and the public by obtaining written informed consent from parties to real estate transactions. An informed consent form or pamphlet can be provided as an additional form at the time loan application is made with the bank, in the event the transaction is bank-financed. The Committee recommends a personal meeting with, or a letter directed to the client/s at the outset of the real estate transaction. Obtaining informed consent at the time of closing is to be avoided.

II. CONFLICT PROVISIONS OF THE RULES OF PROFESSIONAL CONDUCT

The newly-adopted Rules of Professional Conduct are generally thought to relax the conflict of interest prohibitions found in the Code, to allow an informed consumer to consent to representation in conflict situations. Wernz, Ethics Considerations at Real Estate Closings under the Code and proposed New Rules of Professional Conduct, Minnesota Real Estate Law Journal.

The following would include but do not necessarily represent all those Rules which apply in real estate transactions.

Rule 1.7(a) states:

A lawyer shall not represent a client if the representation of that client will be directly adverse to another client unless:

- (1) the lawyer reasonably believes the representation will not adversely affect the relationship with the other client, and,
- (2) each client consents after the consultation.

Rule 1.7(b) states:

A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibility to another client or a third person, or by the lawyer's own interest, unless:

- (1) the lawyer reasonably believes the representation will not be adversely affected, and
- (2) the client consents after consultation. When representation of multiple clients in a single matter is undertaken, the consultation shall include an explanation of the implication of the common representation, and the advantages and risks involved.

Rule 1.8(a) states:

A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

- (1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which can be reasonably understood by the client;
- (2) the client is given a reasonable opportunity to seek the advice of independent counsel in the transaction; and
- (3) the client consents in writing thereto.

(2)

Rule 1.9 states:

A lawyer who has formerly represented a client in a matter shall not thereafter:

- (a) represent another person in the same or substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client consents after consultation; or
- (b) use information relating to the representation to the disadvantage of the former client except as Rule 1.6 or Rule 3.3 would permit or require with respect to client or when the information has become generally known.

Rule 2.2 (a) and (b) states:

A lawyer may act as intermediary between clients if:

- (1) the lawyer consults with each client concerning the implications of the common representation, including the advantages and risks involved, and the effect on the attorney-client privileges, and obtains each client's consent to the common representations;
 - (2) the lawyer reasonably believes that the matter can be resolved on terms compatible with the client's best interest, that each client will be able to make adequately informed decisions in the matter and that there is little risk of material prejudice to the interests of any of the clients if the contemplated resolution is unsuccessful; and
 - (3) the lawyer reasonably believes that the common representation can be undertaken impartially and without improper effect on other responsibilities the lawyer has to any of the clients.
- (b) While acting as intermediary, the lawyer shall consult with each client concerning the decisions to be made and the considerations relevant in making them, so that each client can make adequately informed decisions.

Rule 2.2, has no counter-part in the former Code of Professional Responsibility. This Rule permits a lawyer to act as intermediary between clients under certain conditions, such as consent after consultation, if the lawyer reasonably believes the matter can be resolved on terms compatible with the client's best interests, and the lawyer reasonably believes that common representation can be undertaken impartially. The comment gives the following examples of situations amenable to the lawyer acting as an intermediary: Helping to organize a business in which two or more clients are entrepreneurs, working out the financial organization of an enterprise in which two or more clients have an interest, arranging a property distributions and settlement of an estate, or mediating a dispute between clients. Although not enumerated, real estate transactions may sometimes be appropriate for the use of the lawyer as intermediary.

Rule 2.3 states:

- (a) A lawyer may undertake an evaluation of a matter affecting a client for the use of someone other than the client if:
 - (1) the lawyer reasonably believes that making the evaluation is compatible with other aspects of the lawyer's relationship with the client; and
 - (2) the client consents after consultation.
- (b) Except as disclosure is required in connection with a report of an evaluation, information relating to the evaluation is otherwise protected by Rule 1.6.
- (c) In reporting an evaluation the lawyer shall indicate any material limitations that were imposed on the scope of the inquiry or on the disclosure of information.

Rule 2.3 permits a lawyer to undertake and evaluate a matter affecting a client for the use of someone other than the client if the client consents after consultation; and a lawyer reasonably believes that making the evaluation is compatible with other aspects of the lawyer's relationship with the client. The confidentiality rules protect the information relating to the evaluation, except its disclosure is required in making the report. The Comment gives an example of a lawyer giving an opinion concerning the title of property at the request of the seller (client), for the prospective buyers information (third party), or at the request of the buyer (client), for the lender's information (third party).

III. MULTIPLE REPRESENTATION

A. Buyer and Lender

(1) Preliminary Considerations

When an attorney performs title work and prepares other documents to enable a buyer to obtain financing from a lending institution, there is a great potential for confusion concerning whom the attorney represents. Banks formerly required a buyer to obtain a title examination from its lawyer, or from a lawyer whose name was on a list of approved attorneys. The buyer paid the attorney's fee, however, as part of the closing costs. L.E.I. 78-9 indirectly touched on the question of whom the attorney represents. That Opinion held a bank has the right to chose its own attorney and require the buyer to pay his fee, as part of the closing costs, as long as the buyer has the right to hire his own attorney as well. It appears that the practice of using the bank's attorney versus the buyer hiring his own attorney varies widely across West Virginia.

The interests of the buyer and lender are not always congruent. It is imperative that an attorney clarify for the buyer and lender whom he is representing.

It is important that the attorney clarify in his own mind whether he can simultaneously represent the interests of the buyer and the lender. Courts in other jurisdictions have held that, if the attorney is representing the lender, he must explain to the buyer the limits of his representation. Florida Bar vs. Teitelman, 261 So.2d 140 (Fl. 1972). The majority of jurisdictions permit joint representation of buyer and lender under certain conditions. Most of those jurisdictions, however, require that the attorney determine that he can adequately represent both buyer and lender, provide full disclosure, and obtain informed consent.

2. Conditions Precedent to Dual Representation

Because of the nature of the real estate market in West Virginia, the Committee finds that it is appropriate for an attorney to represent both buyer and lender, if the following conditions are met:

- (a) The attorney first determines there is no actual conflict between the parties and that he can adequately serve both parties, taking into account the degree to which the parties' interests are adverse or differing, the nature of any adversity, and the kind of disclosures that are appropriate in the situation;
- (b) The attorney makes full disclosure in writing to both parties at the beginning of the dual representation;
- (c) The attorney obtains the written consent of both parties. This may be done by mail, although personal contact with the clients is advised.

3. Subsequent Litigation Between Buyer and Lender

The Committee considered, but rejected, a requirement that an attorney for a real estate transaction be prohibited from placing his name, or the name of his partner, associate, or trustee, on the Deed of Trust which he prepares.

The Committee does find that, in the event of foreclosure, if the attorney/trustee is faced with a conflict or becomes a potential witness in foreclosure litigation, that the attorney must resign as trustee.

The Committee finds that the attorney who represents buyer and lender may not represent either party in any related subsequent litigation. However, the Committee does find that an attorney can represent one or both parties in subsequent negotiation, pursuant to Rule 2.2.

B. Buyer and Seller

1. Preliminary Considerations

The Committee finds that it is less likely for an attorney to represent buyer and seller. However, this does sometimes occur. While the Committee does not place an absolute ban upon an attorney representing both buyer and seller, it finds that the attorney must be very cautious in undertaking such representation. The Committee requires the following:

1. A written disclosure sheet be provided the clients, specifying, among other things, that the attorney/client privilege can not exist as between these clients;
2. Both clients be required to sign written consent agreements;
3. The attorney withdraw should a conflict develop.

Again, the attorney should consult Rule 2.2 for further guidance and must satisfy the conditions set forth in Subsection III (A)(2).

2. Subsequent Litigation

Should subsequent litigation arise between buyer and seller, the attorney is precluded from representing either side. Further, the attorney should bear in mind that it is the subjective belief of the client which controls the formation of the attorney/client relationship. If the attorney represented only one party in the transaction, but took actions which led the other party to believe that the lawyer represented his interests, too, the attorney may not represent the client in litigation against the other party arising out of the transaction. ABA Informal Opinion 1322. (3/31/75)

C. Representation of Buyer, Seller, and Lender

Again, it is noted by the Committee that often only one attorney handles residential real estate transactions. However, an attorney does not usually represent all parties to a transaction. The attorney should make it clear at the outset of the transaction whose interests he is representing, consider the same preliminary issues, and satisfy the same conditions precedent outlined above.

If he prepares documents for the signature of another party (such as the attorney for the buyer and lender preparing documents for the signature of the seller), the attorney should advise the other party that he may wish to obtain the counsel of his own attorney.

While it is permissible for an attorney to act as intermediary, he must withdraw from multiple representation, should a conflict arise. Rules of Professional Conduct, Rule 2.2.

D. Lawyer as Real Estate Broker

The West Virginia State Bar touched upon this subject in 1976, in LEI No. 76-1. That Formal Opinion holds that an attorney shall not conduct his real estate business from the same office as his law practice, or use the business as a feeder for law practice.

The Committee further specifically holds, by way of the Opinion, that an attorney shall not serve as real estate broker and attorney on the same transactions. This holding is consistent with the prohibition on attorneys acquiring a personal interest in the representation of clients.

E. Lawyer as Party to the Transaction

The Committee believes it bears repeating that Rule 1.7 and its predecessor clearly prohibit an attorney from entering into business transactions (such as the sale or purchase of real estate), without the attorney fully informing the client or former client with whom he's transacting business, in writing, that the attorney is representing his own interests and that the client should consult another attorney.

CONCLUSIONS

In summary, the Committee on Legal Ethics finds that it is permissible to represent more than one party in a real estate transaction, provided certain conditions precedent are met. The Committee finds that an attorney who represents multiple clients in a real estate transaction may not represent any such clients in subsequent litigation. However, an attorney may serve as a mediator, if no litigation arises. The Committee finds that an attorney may not serve as real estate broker and attorney in the same real estate transaction and may not be a party to a real estate transaction with a client without the written informed consent of the client.

Did You Know?

L.E.I. 89-01 requires you to give written disclosure to the parties to a real estate closing concerning whom you represent and the limits of your representation. For such disclosure to be meaningful, you **must give it before the closing**. Below are sample disclosure for use when you are solely representing the lender (Form A) and

when you are representing all parties. Please remember that each real estate transaction must be reviewed for potential conflicts on its individual facts. There may be times when it is impossible to represent all parties, and the sample Form B cannot be used.

Please review L.E.I. 89-01 if the

Committee on Legal Ethics receives conflicts of interest complaints in the future from parties to a real estate transaction and you have not complied with 89-01, any disputed issues of fact will be resolved in favor of the complainant.

Sample Form A: Representing Lender Only

INFORMED CONSENT TO REPRESENTATION OF LENDER

RE: Loan application of _____ :

Proposed collateral _____ :

The law firm of _____ has been notified that you have made an application with [name of lending institution] for a loan. We have been retained by [name of institution] to perform the title work on your loan and submit a written title report as required by [name of institution]. The report will contain our opinion as to the status of the title for purposes of determining whether it can be used as collateral for your loan.

We represent [name of institution] in this matter, and do not represent you. Our fees for this work will be charged to you as part of your loan costs. The title work will only determine defects in the title which could affect the [name of institution]'s loan. Should you seek legal advice beyond this scope, you are encouraged to consult your own attorney.

If you have any questions, please contact us. If you consent to our representation of [name of institution] in this matter as outlined above, please sign the enclosed duplicate and return to [name of institution].

We appreciate doing this business for [name of institution].

Sincerely,

[name of firm]

By:

I have read this letter and consent to the law firm of _____ representing [name of institution] with respect to our loan.

Borrower

Sample Form B: Representing All Parties

**INFORMED CONSENT TO REPRESENTATION OF ALL PARTIES
REAL ESTATE TRANSACTION/LOAN**

PARTIES: _____

DESCRIPTION OF REAL ESTATE _____

With regard to the above referenced transaction, please be advised that [name of law firm/attorney] has been requested by [name of lending institution] to examine the title to the above referenced real estate and perform certain other legal services, including the preparation of documents, such as deeds and deeds of trust, which will be necessary to make the loan for which application has been made.

Name of law firm may represent all of the parties named above if there is no actual conflict of interest among the parties and the firm may adequately serve all parties. However, every person or entity has the right to be represented by, or to seek the advice of, a lawyer of his/her own choosing. The firm's multiple representation has the following limitations:

1. In the event a dispute should arise among the parties to this transaction, the firm will not be permitted to represent any of the parties to this transaction in court; but the firm may negotiate on behalf of one or more parties.

2. Among the parties, no communications to the firm will be considered confidential. However, all such communications will be kept confidential with respect to anyone not a party to the transaction. Should a dispute arise, a member of the firm may be called as a witness by any of the parties to testify about any conversation or actions which took place concerning this real estate transaction.

3. [to be used if attorney is named trustee] [name of attorney] will be named as the trustee on the deed of trust. Should it be necessary under the terms of the deed of trust to institute foreclosure proceedings against the borrower, [name of attorney] will do so, not as attorney for the lender, but as the trustee.

4. [if attorney intends to limit scope of title work] The title work performed in the transaction will only determine defects in the title which could affect [name of lending institution]'s loan. The fee for this work will be charged to the borrower as part of his/her loan costs. Should the borrower seek additional legal advice beyond this scope, he/she should notify [name of firm/attorney]. Separate fee arrangements for such representation will be reached.

The parties to this consent may discuss this matter personally with [name of firm/attorney] by contacting him/her directly. Additionally, the parties to this consent have a right to consult with a lawyer of their own choosing about the legal effect of this document, before signing.

By signing at the space provided below, the parties hereby acknowledge the following:

1. That they each have read and understand the contents of this document.
2. That they each have had ample opportunity to consult with a lawyer of their own choosing regarding the contents of this document.
3. That they each know of no conflict among the parties which would prevent [name of firm/attorney] from representing them.
4. That they each consent to [name of firm/attorney] representing them to the extent necessary to complete said real estate transaction, including, but not limited to, examination of real estate title, preparation of all necessary documents and service as trustee for [name of lending institution] in the deed of trust.
5. That they each have received a copy of this document.

Seller

Buyer

[NAME OF LENDING INSTITUTION]

By: _____