Ethical Pitfalls of Attorneys in Real Estate Transactions

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The ethical obligations of real estate attorneys were considered in two recent cases. In the first, *Matter of Melvin Pine,* 194 A.D.2d 156, 604 N.Y.S.2d 974 (2nd Dept. 1993), the court held that an attorney who steers a client to a corporate mortgage broker in which the attorney has an undisclosed interest, should be suspended for three years.

In the second case *Chemical Bank v. Bowers,* NYLJ December 29,1994, p. 26, col. 3, Brooklyn Supreme Court Justice Shaw held that an attorney for a mortgagee was under an ethical obligation of "full disclosure and explanation of the content and meaning of documents" to an unrepresented mortgagor. An analysis of the cases follows.

Operating in Dual Capacities Without Disclosure to the Client

In *Matter of Pine,* attorney Melvin M. Pine represented a borrower in a refinancing of a $65,000.00 mortgage and charged the client an attorney's fee of $650.00. The attorney completed a mortgage application on which Mint Resources, Inc. was listed as the submitting mortgage broker. Mint Resources, Inc. was paid $1950.00 pursuant to a "Customer Agency and Fee Agreement." The opinion states that Mr. Pine identified himself as an attorney but it does not state whether or not he disclosed that he was a principal of Mint Resources, Inc. By implication however, it appears that Mr. Pine failed to disclose this vital information. As a result of the transaction, the borrower's mortgage payments increased from $267.00 to $700.00 monthly. In addition to the above fees, the borrower paid approximately $33,565.00 for construction done to her home. It may therefore be inferred that the borrower took cash proceeds out of approximately $27,000.00.The borrower went into default and soon faced foreclosure and bankruptcy. A disciplinary proceeding was commenced against attorney Pine, whom the

Appellate Division proceeded to suspend for three years. In its opinion, the Appellate Division found that:

. . . The respondent violated code of Professional Responsibility DR1-102 (A) (7), 22 NYCRR 1200, 3 (2) (7) and DR5-101-(A), 22 NYCRR 1200.20 (2) . . . . By acting as both mortgage broker and attorney the respondent engaged in a clear conflict of interest and disabled himself from exercising the individual professional judgment to which his client was entitled. *Pine* at 158. Upon reading this portion of the opinion, one might come to the conclusion that an attorney is *per se* prohibited from acting in both capacities. Indeed, that very conclusion was made in the December 1994 issue of *Managing Mortgages* at page 11, where the following statement was made in an article entitled "Courts Will Play a Big RESPA Role":

". . . a state appeals court has ruled it is not permissible for an attorney who also is a registered mortgage broker to undertake both roles in the same transaction, *even if disclosed to the borrower in advance."* (Emphasis added)

Nevertheless, the court's opinion should be read in conjunction with the code provisions cited by the court. In doing so one will determine that the proceedings against Mr. Pine were based on a violation of DR 5-101 (A) of the Code of Professional Responsibility *(Pine* at 158), which provides as follows: "A. *Except with the consent of the client after full disclosure* (emphasis added) a lawyer shall not accept employment if the exercise of professional judgment on behalf of the client will or reasonably may be affected by the lawyer's own financial, business, property, or personal interests."

It appears, therefore, that the opinion of the Appellate Division should be read as follows: By acting as both mortgage broker and attorney **without disclosure to and consent from the client,** the respondent engaged in a clear conflict of interest and disabled himself from exercising the individual professional judgment to which his client was entitled.

Such an interpretation is and would be in accordance with the provisions of § 590 (2) (b) of the Banking Law which provides that ". . . No attorney at law who solicits, processes, places or negotiates a mortgage loan incidental to his legal practice shall be deemed to be engaged in the business of a mortgage broker . . . ."

That statute implicitly recognizes the authority of an attorney to act in the capacity of mortgage broker for his

own clients. Indeed, when an attorney is a member of a program such as the Citibank Power Broker Program and, by virtue of being a member of the program, can achieve a lower point structure for his client than the client could achieve by walking into the bank directly and applying for the loan, one might argue that the attorney is obligated to so participate. Mr. Pine's dilemma is not so different from one faced by attorneys who have hidden interests in corporate title abstract companies and do not disclose that to their clients. See Ethics Opinion 595 and 621 of the New York State Bar Association.

Obligations of a Mortgagee's

Attorney to an Unrepresented Mortgagor

In *Chemical Bank v. Bowers,* Justice Shaw expanded the reach of Disciplinary Rule DR 6-102[1] in regard to a lender's lawyer "To impose a duty upon a lawyer to an unrepresented party to a transaction of full disclosure and explanation of content and meaning of documents she is required to sign." The facts in the case are as follows:

Chemical Bank was an assignee of a mortgage made by Bowers to Avstar Mortgage Corporation. After a default, Chemical was seeking summary judgment in a foreclosure action. The defendant Bowers was an elderly woman of limited education who was unemployed and lived on a subsistence income. She owned her own two-family house and alone occupied the first floor apartment. A representative of Wizard, a home improvement company, visited her and convinced her that the company could convert her basement into a legal apartment so that she would have a legal three-family building. Since she did not have the money, he warranted that he could finance the $20,000 cost through a "senior citizen" home improvement program and roll her existing mortgage into the new loan so that her resulting mortgage payment would be $250.00 per month less than her present mortgage payment. A short time later he brought her to Avstar Mortgage Corporation.

The court described the conduct of the closing as follows:

> “There was a number of people present. She recognized only one person beside her Wizard representative, namely the one who appeared on her original loan. She knew no one else. She was unrepresented by counsel. Despite such fact, no one, not even the attorney for the mortgagee conducting

the closing, attempted to explain the proceedings and documents that she was to sign. Patently a "batch of papers" was put before her to sign. No opportunity was given to her to read what she was signing and as soon as she signed one document she was shown where to sign another. She had no knowledge of a mortgage broker or that there was a mortgage broker present. She never knew of DMD Equities Corp, the mortgage broker, nor its representative. She was not aware that she, at any time, signed a mortgage broker retainer. Looking back, she believes that one of the papers put before her for signature, which she had no opportunity to read, was a retainer of the broker. Significant indeed, the retainer is a typewritten form with blanks that were filled in ink. The date of the retainer inserted therein was April 15, 1992 almost a month prior to the closing. The mortgage broker was given $3087.50 out of the mortgage proceeds. There, thus can be no cavil that Avstar was represented by counsel to conduct the closing of its mortgage, to supervise the closing of the mortgage, to make certain that all requisite documents and papers were properly executed and where necessary duly notarized, [and] view[ed] the course of events occurring at a closing, particularly the signing of the documents by Bowers as they were presented to her."

Upon these facts the court based its decision to deny summary judgment and order the case to trial based on the $550.00 legal fee paid to the lender's counsel. Although the court mentioned that other issues were raised by Bower's counsel, it does not indicate whether other defenses or counterclaims, such as fraud in the inducement which might have been the basis for a denial of the motion, were pleaded. Instead, the court stated:

"If the court were to assume, as may possibly be claimed by Avstar, although, not set forth in the papers before the court, that its counsel represented it alone and obtained a writing to such effect signed by Bowers and in addition thereto obtained a release from all responsibility by reason of her appearing at the closing unrepresented by counsel, do such instruments absolve and exonerate its counsel from informing and explaining to Bowers the entire mortgage transaction and all the documents presented to her for signature?

DR. 6-102 bars a lawyer from seeking "by contract or other means, to limit prospectively the

lawyer's individual liability to a client for malpractice. . . to settle a claim for such liability with an *unrepresented client or former client,* (emphasis added). As interpreted by our courts and by this court, DR 6-102 may be expanded to impose a duty upon a lawyer to an unrepresented party to a transaction of full disclosure and explanation of content and meaning of documents she is required to sign. See Matter of Fallon (sic) 86 A.D.2d 897, 898; Matter of Snow 142 A.D.2d 835, 837."

Section DR 6-102 relied upon by the court in arriving at its unprecedented conclusion refers only to "a client" or a "former client" neither of which Bowers was as to the attorney for the lender. In addition, the cases of *Tallon* and *Snow* cited by the court to expand the scope of Section DR 6102 beyond that of "a client" or "a former client" to apply to an un-represented party to the transaction do not seem to so hold. In both cases the injured parties were the clients or former clients of the attorney and consequently fit within the language of DR 6-102. Thus they do not seem to support the court's conclusion that DR 6-102 applies to an unrepresented **party** not a **client.** Moreover, it should be noted, too, that in advising the unrepresented party the lawyer for the lender might be placed in a conflict position between the party the lawyer represents and the unrepresented party.

A reading of other cases cited by the court such as *Cowee v. Cornell,* 75 N.Y.91 (1878) and *Rothmiller v.* Stern, 143 N.Y. 581, 591 (1894), can be distinguished. *Cowee* in dicta refers to situations where an attorney-client relationship exists. *Rothmiller* deals with situations where a party to a contract conceals a material fact. In the case at bar the attorney was not a party to the contract nor is there any indication of the concealment of a material fact.

The remaining case cited by the Chemical Court, *Koncelik v: Abady,* 179 A. D.2d 942, 944, deals with a situation where the attorney was entering into a contractual arrangement with a non-client which was alleged to be fraudulent. That is not the case at bar.

The court in this case tried to do the right thing and right a wrong. In doing so the court directed that the original mortgagee Avstar and the mortgage broker DMD Equities Corp. be brought into the action. If at trial

fraud could be proved against either one of them, the court has the power to award punitive damages. The attempted expansion of the ethical obligations of the mortgagee's attorney however could be a precedent that could cause more problems than it attempts to solve.

Endnotes

1. DR 6-102 reads as follows:

DR 6-102 Limiting Liability to Client

A. A lawyer shall not seek, by contract or other means, to limit prospectively the lawyer's individual liability to a client for malpractice, or, without first advising that person that independent representation is appropriate in connection therewith, to settle a claim for such liability with an unrepresented client or former client.

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