New York State Bar Association

Committee on Professional Ethics

OPINION 731 (7/27/00)

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

Digest: Lawyer may not compensate employees for soliciting parties to real estate transaction to engage services of title insurance agency in which lawyer has ownership interest.

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

QUESTION

In connection with representing mortgage lenders and brokers in real estate transactions, may a lawyer compensate the lawyer's employees for soliciting clients or other parties to the transaction to engage the services in that transaction of a title insurance agency in which the lawyer has an ownership interest?

OPINION

A lawyer represents various mortgage lenders and brokers in real estate transactions. When acting as counsel for such clients in these transactions, the lawyer or employees of the law firm review the title insurance report and policy to assure that, upon closing of the transaction, the mortgage lender has a valid mortgage and appropriate lien against the borrower's property. The title company may be selected by either the lender or the borrower (or the agents of either one or the other). The lawyer owns a title company, but the lawyer does not participate in its day-to-day operations, including making decisions about the insurability of a particular transaction. The lawyer proposes to provide monetary incentives to employees of the law firm based upon the employees' success in soliciting lenders or borrowers to engage the services of the lawyer's title company in transactions in which the law firm represents the lender.

In this Committee's view, the proposed compensation arrangement is impermissible under DR 5-101(A). As we recognized in N.Y. State 595 (1988)

and further confirmed in N.Y. State 621 (1991), a lawyer may not ethically represent a client in a real estate transaction if the lawyer also acts as a principal in the title insurance agency engaged for that transaction. It follows from this that the lawyer for a party in a real estate transaction may not permit employees to solicit the lawyer's clients to engage the services of a title company in which the lawyer has an ownership interest. Nor may the lawyer compensate employees for making such referrals.

At the outset, this inquiry may implicate issues of federal and state law -- including the Real Estate Settlement Procedures Act of 1974, 12 U.S.C. § 2601 *et seq,* and the New York State Insurance Law -- which are beyond the jurisdiction of this Committee to address. This Opinion assumes, without deciding, that the arrangements proposed comply with all applicable statutes and regulations and addresses only the consistency of the proposal with the Code of Professional Responsibility.

In Opinion 595, this Committee considered whether the Code permits a law firm to refer clients to a title abstract company in which the law firm held an interest. In the facts posed in that earlier inquiry, the title abstract company not only performed title searches, but also (as in the inquiry you pose) prepared the title report and either issued or acted as agent for the underwriter of the title insurance policy. This question was analyzed primarily under DR 5-101(A), which concerns conflicts of interest involving a lawyer's personal or financial interests and the lawyer's representation of a client. The Committee recognized that the client's interests inherently conflict with those of the title company regarding what risks will be insured:

> Typically this conflict occurs when the lawyer-owned abstract company prepares a title report or serves as an agent for the title underwriter. In either of these situations, the dual roles [of representing a lender and owning the abstract company] are improper because they require a law firm which as a principal in the abstract company prepares a title report showing exceptions in title and recommending whether a title insurance policy will be issued, to negotiate these issues, as counsel for a party in the underlying transaction, with itself.

N.Y. State 595 (1988). The sharpness of this conflict -- and particularly the differing economic interests of the lender or borrower and the insurer -- persuaded us that a lawyer ordinarily could not adequately represent the interests of a party in a real estate transaction in which the lawyer held an ownership interest in a title company preparing the title report and issuing (or acting as an agent for the issuer of) the title insurance policy. *Id.* We concluded that the lawyer could undertake the representation with the informed consent of the parties only in situations in which the title abstract company performed only the ministerial service of conducting a title search.

This Committee's conclusion in Opinion 595, to which we adhere, resolves the question raised by this inquiry. Although the language of DR 5-101(A) has been amended since the issuance of N.Y. State 595, we do not believe that the amendments alter the conclusion reached in that opinion. At the time N.Y. State 595 was issued, DR 5-101(A) contained no explicit limit on the types of conflicts that could be subject to client consent; nevertheless, in that opinion and in prior ones, this Committee imported the explicit limits on consentable conflicts contained at the time in DR 5-105(C) or in EC 5-2. At that time, DR 5-105(C) required a lawyer to determine, in resolving whether client consent could cure a conflict, that it was "obvious" that the lawyer could adequately represent the interests of the client in the matter presenting the conflict; EC 5-2, now as then, counsels a lawyer to decline a proffered engagement if (among other things) a "reasonable probability" exists that the lawyer's personal interests will adversely affect the advice to be given or the services rendered to the client.

Today, as a result of a recent amendment, DR 5-101(A) explicitly limits when client consent may cure a conflict to those circumstances in which "a disinterested lawyer would believe that the representation of the client will not be adversely affected." As explained when the change was proposed, the "disinterested lawyer" standard is more "understandable and objective" than the "obviousness" test. N.Y. State Bar Association, Special Committee to Review the Code of Professional Responsibility, Proposed Amendments to New York Lawyer's Code of Professional Responsibility 61 (Mar. 4, 1997). However, the essential analysis is unchanged.

Accordingly, a lawyer may not ethically refer a client in a real estate transaction to a title company in which the lawyer holds an interest. It follows that a lawyer may not compensate the lawyer's employees for making such referrals.

Nothing in this opinion is intended to detract from this Committee's longstanding view that "it is not improper for a lawyer to engage in a business other than the practice of law provided that the lawyer does not violate any ethical or legal rules." N.Y. State 583 (1987). Nor does this inquiry require consideration of whether a lawyer engaged in some other business may compensate a law firm's employees based on permissible referrals made to that other business. Rather, we note only that, on the facts presented, N.Y. State 595 compels the conclusion that, when a lawyer is representing a lender in a real estate transaction, the lawyer may not compensate the lawyer's employees for referring the borrower or lender to a title insurance company in which the lawyer holds an interest, regardless of whether the lawyer's client (or any other party to the transaction) consents to the lawyer's dual role.

CONCLUSION

For the reasons stated, the question is answered in the negative.

(12-00)