New York State Bar Association

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Committee on Professional Ethics

Opinion 621 – 4/18/91

Clarifies and amplifies
N.Y. State 595 (1988)

TOPIC: Conflict of Interest; referral of real estate clients to attorney-owned abstract company.

DIGEST: Improper for attorney to refer real estate client to abstract company in which he has ownership interest.

CODE: DR 5-101(A), 5-105, 5-105(C); EC 5-2

OPINION

At the request of the Real Property Law Section of the New York State Bar Association (upon whose 1986 Report we relied heavily in fashioning N.Y. State 576 [1986]), our Committee has reconsidered N.Y. State 595 (1983). Our reconsideration dealt principally with the argument that its *per se* result was arguably inconsistent with the result reached in N.Y. State 576. In N.Y. State 576, we concluded that the conflict inherent in the situation in which an attorney procuring title insurance for a principal in a real estate transaction has a financial stake in the premium paid for that insurance is curable by appropriate disclosure, informed consent and a crediting to the client of the fee received from the title insurer. In N.Y. State 595, we reached an opposite conclusion where the attorney seeks to refer the real estate client to an abstract company in which the attorney has an ownership interest. After inviting written views, we held a day long hearing during which we received the testimony of the bar and segments of the title insurance industry concerning the merits of the conclusions reached in N.Y. State 595 and its consistency or lack thereof with N.Y. State 576.

After carefully considering all of the views presented, we adhere to the result reached in N.Y. State 595 and to the reasoning set forth in the introductory portion of that opinion, as well as in Parts A, B and C (i) thereof. Indeed, nothing presented to us takes basic issue with the conclusions reached in those sections of N.Y. State 595. We now clarify and expand upon the reasoning set forth in the balance of N.Y. State 595.

Where a lawyer is compensated by a title insurer for services rendered as its agent and also represents the real estate client to be insured by the title

company, the conflict of interest posed implicates DR 5-105(C) because the lawyer is representing multiple clients. That Disciplinary Rule permits the dual representation only "if it is obvious that the lawyer can adequately represent the interest of each and if each consents to the representation after full disclosure of the possible effect of such representation on the exercise of the lawyer's independent professional judgment on behalf of each" (emphasis added). This much is simply a restatement of N.Y. State 576 (p. 9 ¶ Fourth).

Where a lawyer procures title insurance for a real estate client via an abstract company in which the lawyer is financially interested and which receives a portion of the premium for the policy issued to the real estate client, we are dealing with the different (although closely related) conflict covered by DR 5-101(A), which prohibits a lawyer, except with consent after full disclosure, from representing a client "if the exercise of professional judgment on behalf of the client will be or reasonably may be affected by the lawyer's own financial, business, property, or personal interest." The abstract company, 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 Code.[1] The compensation of the abstract company consists of that portion of the title insurance premium which it either retains in the first instance or receives back from the title company issuing the policy, and the attorney who is a part owner of an abstract company has an obvious business interest in the success and profitability of the company.

Because this Committee has read the "obviousness" test of DR 5-105 (C) into the closely analogous conflict of interest proscribed by DR 5-101(A), *see, e.g.,* discussion at pages 6 and 7 of N.Y. State 595 and N.Y. State 619 (1991), and because the work performed by an abstract company as agent for the title insurer is presumed to be identical to the services rendered by the attorney-agent, the fact that different Disciplinary Rules are implicated does not in and of itself justify either the same or disparate ethical treatment.[2] The difference lies in the fact that the critical caveats preconditioning our sanction of the practice approved in N.Y. State 576, *i.e.*, with respect (1) limiting payment to the attorney-agent for services actually rendered, (2) reducing the real estate client's fee by the remuneration received from the title insurer and (3) prohibiting the practice altogether where the non-curable conflicts to which we alluded in footnote 5 of N.Y. State 576 (see *infra*) are present, cannot be dealt with in the abstract company conflict either at all or, at least, with the same assurance of ethical

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[1] Whether the abstract company is also a "client" of the attorney-owner is irrelevant to the ethical problem and analysis considered in our opinion in N.Y. State 595.

[2] We reject as fallacious the minority's desire to turn its back on the obviousness test in construing DR 5-101(A). In our view, to fail to apply the obviousness test to DR 5-101(A) would be to subject a lawyer's conduct when faced with a conflict between a client's interests and the lawyer's personal interests to a less rigorous standard than applies when the conflict is between the interests of two clients.

propriety as in the attorney-agent conflict. We conclude, therefore, that the "obviousness" barrier cannot safely be surmounted in the abstract company situation.

Payment for Services Rendered

Unlike the attorney-agent, an abstract company, whether solely owned by one or more lawyers or by lawyer and laymen, is a separate legal entity.[3] The "cut" of the insurance premiums retained or received by the abstract company for its services ultimately inures (by way of dividend or otherwise) to the benefit of its owners, including the attorney who represents all or some of its clients. The attorney who receives a financial return from an abstract company renders no title services to his or her client, who is a customer of the abstract company, for that return. Thus, the *quid pro quo* of sharing in the insurance premium in return for services actually rendered – critical to the analysis in N.Y. State 576 – is entirely absent where it is the abstract company, not the attorney, which renders the title services.[4]

Credit Against Legal Fee

In N.Y. State 576, we underlined the requirement of N.Y. State 351 (1974) "that the lawyer credit the client with any amount received from the title company unless the client otherwise consents" and we stressed the "substantial ethical difficulty" incident to "the obtaining of such consent by a trained advocate from any unsophisticated client." In the abstract company situation, there is no plausible arrangement or avenue by which the attorney may reduce his or her fee for handling the real estate transaction by some *pro rata* portion of the dividend or other financial return he ultimately receives from the abstract company.[5] This lack not only eliminates the possibility of a credit to the client that could achieve

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[3] It is simply not feasible to prescribe different ethical rules for the variety of ownership, organizational and operational structures that may characterize abstract companies and the differing clients they serve, and we decline to do so. For this reason, we cannot regard the abstract company as simply the "alter ego" of the attorney representing a real estate client, and we would be loath to do so any more quickly for ethical purposes than a court or regulatory agency might for liability or tax purposes.

[4] It has been suggested that this distinction is false because the attorney-agent uses employees of his law firm to do the same work performed by employees of the abstract company and a portion of the payment to the attorney-agent for title work has the same component of overhead reimbursement as the payment to the abstract company. It is important to bear in mind, however, that we were dealing in N.Y. State 576 with an individual attorney who could easily reduce the legal fee to his client by the payment received from the title company. We did not expressly or impliedly sanction a law firm acting as an in-house agency for a title insurer.

[5] The abstract company has no duty and is presumed to have no desire to reduce its fee to those of its customers who are represented by an attorney-owner and it seems doubtful that it could legally so differentiate or otherwise "kick back" a portion of its fee to its customers.

the "reduction in total cost" contemplated by N.Y. State 576, but also effectively aborts any meaningful inquiry into, or compliance with, the caveat posted in N.Y. State 576 that "even with client consent, the lawyer is not entitled to receive amounts from the transaction that would in the aggregate constitute an excessive fee."

Exceptions to Title

The commentaries received by the Committee critical of N.Y. State 595 paid scant attention to footnote 5 of N.Y. State 576, where the Committee noted:

> Where exceptions to title might be negotiable or where questions otherwise arise as to whether the principal represented by the attorney-agent should accept certain exceptions to title or insist on their omission as a condition to title closing, DR 5-105 and the corollary ethical considerations proscribe multiple representation irrespective of disclosure and client consent.

In the abstract company situation, initial discussion or negotiation with the title company regarding the omission of title exceptions or the issuance of affirmative insurance will often be done by employees of the abstract company and may only reach the attorney for the client later and in a distilled fashion. We cannot be sure that the attorney will react to the apparent result of such discussion or negotiation on behalf of the real estate client in the same manner the attorney would have reacted had she or he not been one step removed, but had participated in the first instance as attorney-agent. Moreover, if the attorney is not happy with the result reached on behalf of his or her real estate client by the employees of the abstract company *vis-à-vis* the omission of exceptions or the issuance of affirmative issuance, the attorney must then negotiate with his or her own abstract company, i.e., with "himself," as to the ultimate resolution, with the attorney's company's participation in the insurance premium hanging in the balance.

In rejecting the ethical propriety of this arrangement, we are mindful of the following comment made by James M. Pedowitz[6] in his June 27, 1989 Memorandum to the Chair of the Real property Section on the Report of the Special Committee to Consider Ethics Opinion No. 595 (which was part of the voluminous materials furnished to the committee):

> Those attorneys who believe that a title insurance policy is a fungible product, and that all title insurance companies are fungible, have a real need to learn more as to what title insurance is really all about.

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[6] Mr. Pedowitz is a highly regarded expert on title insurance and has written extensively in the field.

In short, the danger of the attorney using his or her fiduciary leverage over the real estate client to dictate the choice of title insurer, couples with the ultimate risk that the client may not get the right kind of title insurance, brings the attorney-owned abstract company within the same *per se* ethical constraints as the lawyer-broker involved in N.Y. State 208 (1971)(lawyer for a real estate client may not also act as a broker in the same transaction), the lawyer-life insurance agent involved in N.Y. State 516 (1980)(lawyer employed by life insurance company to prepare estate plans for its customers may not prepare and supervise execution of a will implementing the estate plan the lawyer has devised), or the lawyer-estate planner involved in N.Y. State 619 (1991)(lawyer-estate planner may not recommend to his or her estate planning clients the purchase of life insurance products in the sale of which lawyer has a financial interest.) This is particularly so when all the constraints imposed on the attorney-agent for a title company by N.Y. State 576 cannot plausibly be met by the attorney-owner of a title company.

CONCLUSION

For reasons stated herein, we adhere to the result reached in N.Y. State 595.

DISSENTING OPINION

Four members of the Committee dissent from the majority's reasoning and result, for reasons that include the following:

(1) Whether a lawyer representing a client in a transaction has an ownership interest in an agency for the title insurer or serves as attorney-agent for the insurer, the ethical concerns about the dual interests are fundamentally the same and the guidelines for close scrutiny, disclosure and consent adopted in N.Y. State 576 should apply. *See also* ABA 331 (1972)(allowing a lawyer with a financial interest in the title company to represent a client, if the client consents after full disclosures are made, but applying the obviousness standard when the lawyer is performing legal services for the title company and the client); Alabama 83-64; Virginia 545 (1984), 886 (1987) and 939 (1987); and Wisconsin E-85-5 (1985).

(2) There is no basis in the Code for eliminating the consent provision from DR 5-101(A), and making a client's consent unavailable when the lawyer has an ownership interest in the agency, yet allowing client consent under identical circumstances when the lawyer represents the insurer and acts as its agent.

(3) When the lawyer has only a business interest in the agency, the aspirational Ecs adopt a "reasonable probability" standard for evaluating whether the lawyer's advice to a client will be affected (EC 5-2), in contrast to

the more stringent "obviousness" test mandated by DR 5-105 (C) for evaluating whether a lawyer can ethically represent two clients.

(4) There is no basis in the Code of "importing" an "obviousness" standard from DR 5-105(A) when the Code's drafters themselves did not do so. Indeed, the New York Code recently underwent substantial amendment (and thus an opportunity to add the obviousness test to DR 5-101(A)) and no such change was made.

(5) The distinctions on which the majority relies for its *per se* treatment of the lawyer-owner are not persuasive: the lawyer-owner has no legal or ethical duty to perform the agency's services personally to receive a dividend, the lawyer may reduce the fee to the client to offset an expected dividend (absent client consent), and there is little to recommend the supposition that the lawyer-agent will be significantly more sensitive to ethical concerns or less subject to negotiating with "himself" than the lawyer-owner.

(18-90)