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In Memoriam

The Real Property Law Section notes with sadness the death of a friend and former Chair of the Section, Marvin R. Baum, and extends to his family our deepest condolences.

Marvin R. Baum

On January 28, 1999, my father, Marvin R. Baum, passed away unexpectedly. He was, as I have heard many times, a "lawyer's lawyer," perhaps the highest honor among his peers. A past Chairman of the Real Property Law Section of the New York State Bar, and member of its Executive Committee, he tirelessly gave of his time to both new and experienced attorneys. Anyone could call and ask him a question. They would receive not only an educated response, but possibly one that could not be found in any book.

For many years, he lectured on the subject of mortgage foreclosures, a field in which he was regarded as an expert. My father shared his foreclosure forms with the Bar, hoping they would enhance or enlighten an attorney's knowledge of the law. His sense of humor and intelligence pervaded everything he did.

In addition to authoring many articles on mortgages and foreclosures, he was a member of the American College of Real Estate Lawyers, American and New York Land Title Associations, and New York and Erie County Bar Associations. He was also counsel to the Western N.Y. Mortgage Bankers Association.

I practiced with my father for 11 years. He emphasized that I should not be a "mechanic" but should study and work toward advancing the law. His encouragement to become actively involved in the Bar helped me to become more independent and knowledgeable. His guidance and creativity will be missed by all.

Steven J. Baum

INSIDE

Message from the Section Chair

As I wrote in an article for the *Law Journal* published during the State Bar's Annual Meeting this January, real property is back!! Two clear indicators are that (1) we had standing room only at our Section's meeting and program on recent real estate developments (although I have a feeling that mandatory CLE may have also played a part), and (2) so many of us were busy closing year-end deals.

With respect to the Annual Meeting, Steve Horowitz, Program Chair, put together a terrific panel of speakers, including Dorothy Ferguson, Larry Preble, Jon Santemma, Larry Zimmerman, Les Bliwise, Matt Leeds, Judge Peter Wendt, John Wilson, John Privitera, Brian Lawlor, Jerry Hirschen, Pete Coffey, Sue Mancuso, Karl Holtzschue, Richard Fries, Jason Polevoy and Joshua Stein. Our thanks to each of them for their presentations and the written materials, which are invaluable. For those of you who stayed for lunch, you were treated to a wonderful presentation from Rebecca Robertson, Vice President for The Shubert Organization, who took us down memory lane with pictures of the old Times Square and the history of the theater district. I was particularly interested in the old theaters and the vaudeville era, since my grandparents were both in show business—and my grandmother was a Ziegfeld Follies girl!

The second indicator—how many of us were busy with year-end

deals—also bodes well for our area of practice. A complicated bond deal arrived on my desk the Tuesday before Christmas and the deal had to fund by New Year's Eve. While we are all used to time constraints, this deal presented a new extreme in my experience. I received a voicemail message one day at 11:55 a.m. from the underwriter's counsel in this matter; he told me that a 40-page fax was en route, and that he had to receive all of my comments on that fax by noon—which was, by the time his message finished, four minutes away! The deal closed, and while there was extreme pressure, what made it bearable was that all parties were civil to one another.

In my previous message, I wrote to you about the importance of mentoring. This time I want to stress civility, all the while recognizing that sometimes civility must be taught, and often by a mentor. The State Bar has adopted guidelines on civility and, for the most part, they are a commonsense approach for attorneys dealing with one another in a complicated, time-pressured profession. My father, William H. Power, Jr., is a lawyer and a retired district attorney. He had a reputation as an extremely tough and effective district attorney, yet I know that he dealt with all persons fairly and civilly. My father dispelled the notion, held by some attorneys, that being civil means being weak. Recently, he and other attorneys who had been in practice for many years were recognized by the St. Lawrence County Bar Association at a function which I attended. I was very impressed by the collegiality expressed by those attorneys and the respect they clearly had not only for the honorees but for one another. Collegiality, respect, civility—they do not preclude one from representing one's client most zealously. My father is not the only influence in my life in this regard. My mother, Oske Power, sets an example by her kindness to others and by her reminder to me from time to time that "you get more flies with honey than with vinegar." I continue to learn from my dear parents—as we all should from our lifelong mentors—even on issues such as civility in the profession.

As I write this message, I share one bright note with you—in glancing out my office window at around 5:30 p.m., I see there is still light in the sky. Spring beckons.

Lorraine Power Tharp

Using Voluntary Cleanup Agreements to Increase the Bankruptcy Pie—Not a Half-Baked Idea

By Andrew J. Gershon*

The modern hazardous waste laws were enacted two decades ago to redress the toxic legacy of an unregulated industrial past. *Laissez faire* yielded to "polluter pays," as the government extended a web of strict, joint and several liability back in time to recoup cleanup costs from those who profited at the expense of the environment and the public, or their successors. As this effort has unfolded, even the suspicion of hazardous waste contamination often proved toxic to real property values. Not surprisingly, more than a few owners of contaminated properties have sought refuge from cleanup responsibilities in bankruptcy, in whole or in part to avoid the cost of environmental remediation. From a market perspective, adding the insolvency of the person who (usually) most clearly bears legal responsibility for cleanup to the factual and legal uncertainties that often typify hazardous contamination situations, further impairs value.

While the process of tracking down those responsible for years of pollution and establishing appropriate standards of liability has wended its way through the regulatory agencies and the courts, even properties which can be described (albeit unscientifically) as "slightly" contaminated have lain fallow. Over the last few years, government has begun to pay more attention to such properties, which have come to be known as "brownfields."[1] Regulatory initiatives have emerged at the federal and state levels to reward those who voluntarily commit to remediating brownfields by limiting the potential cleanup liability of the "volunteer." One example is the voluntary cleanup program (VCP) of the New York State Department of Environmental Conservation (DEC), which is implemented through voluntary cleanup agreements (VCAs) between DEC and volunteers.

The VCA is a flexible tool. It has the potential, under appropriate circumstances, to be used in the bankruptcy context to add value to contaminated real property and thus to facilitate reorganization or liquidation of the estate by making more money available to creditors and debtors—at least those who did not actually cause the contamination in question—while providing DEC with the added comfort that, in the end, a contaminated property will be remediated to a level appropriate to the volunteer's intended use. This article will describe the evolution and workings of the New York VCP and then discuss how the program can be—and now has been—used to maximize the value of real property involved in bankruptcy cases.

The Modern Environmental Law Era and the Stigma of Hazardous Waste

The VCP and other brownfield cleanup initiatives are part of a governmental effort to draw private capital and manpower to the government's efforts to remediate and restore our nation's contaminated sites, which began with passage of the modern hazardous waste laws. The most significant hazardous waste statute is the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA),[2] which Congress passed in 1980. Subject only to a few—rarely successful—defenses, CERCLA imposes strict, joint and several liability on any party that may have generated, handled or controlled hazardous substances which are subsequently "released" or threatened to be released into the environment. Each "potentially responsible person" (PRP) is liable for all costs incurred by the federal or state government in preventing or remediating a release of hazardous substances, which is consistent with ground rules established by the United States Environmental Protection Agency (EPA) in its "national contingency plan." (Although a review of the fairly complex law regarding PRP liability to a private party who incurs such costs is beyond the scope of this article, it is safe to say that the PRP is at minimum liable for its proportionate share of such costs.) CERCLA additionally imposes liability for damages to natural resources and certain costs relating to health studies.[3]

CERCLA also established a multi-billion dollar "Superfund" to fund federal cleanups of the highest priority cleanup sites, after which the United States can seek recovery of its costs from the identifiable and still-existent PRPs.[4] However, the billions allocated to the Superfund soon proved far too little to make a dent in the actual projected cleanup costs, so the EPA came to focus its efforts on identifying major polluters and compelling them to take control of the cleanup efforts.

The states may also bring CERCLA actions to recover costs they have incurred in cleanup.[5] Additionally, states have enacted their own hazardous waste laws which supplement the federal

statute. N.Y. Environmental Conservation Law article 27, title 13, empowers DEC to order the owner of, and any person responsible for disposing hazardous wastes at, an "inactive hazardous waste site" which poses a "significant threat to the environment," to develop and implement a remedial plan. If the threat constitutes "an imminent danger of causing irreversible or irreparable damage to the environment," or if no such imminent threat is posed but the owner and any responsible party fail to implement a DEC order within a reasonable time, the agency may itself develop and implement the remedial plan and then obtain recovery of its costs under either the ECL or CERCLA. DEC may also develop and implement remedial plans for sites for which the responsible parties cannot be located.[6] DEC cleanup efforts are funded out of a "state superfund," the Hazardous Waste Remedial Fund, paid for by assessments on hazardous waste generators.[7]

The New York law also contains provisions intended to put prospective purchasers on notice if properties are contaminated. Counties are required to determine and report to DEC all "suspected inactive hazardous waste disposal sites" within their boundaries.[8] DEC must investigate these suspected sites and maintain a publicly available registry of inactive hazardous waste sites (the "Registry"), which includes, among other things, addresses, site boundaries, tax map information and the type and concentration of contaminants present.[9] Although an owner seeking deletion of its site from the Registry can petition the DEC commissioner, this may require a hearing at which the owner bears the burden of proof and costs of the proceeding.[10] The Registry places each site into one of six classifications:

1. Site causes or presents an imminent danger of causing irreparable damage to the public health or environment—immediate action required;
2. Site is significant threat to the public health or environment—action required;

2A. Temporary classification assigned to sites that have inadequate and/or insufficient data for inclusion in any of the other classifications;

3. Site does not present a significant threat to the public health or the environment—action may be deferred;
4. Site is properly closed—requires continued management;
5. Site properly closed, no evidence of present or potential adverse impact—no further action is required.[11]

Thus, under CERCLA and ECL article 27, title 13, a New York owner of property contaminated with hazardous waste is potentially subject to federal lawsuits by the EPA, and lawsuits by New York State and private parties compelled to take remedial action. The owner (and other PRPs) additionally face the prospect of a DEC cleanup order or cost recovery action pursuant to the ECL. From the owners' perspective, the situation was perhaps most vexing in the few years immediately after enactment of these laws. The science of remediation was new, the cost of effectuating cleanups difficult to estimate and federal and state regulators were still wrestling with what cleanup levels should be required. This picture was further complicated by legal uncertainties, including those concerning lenders' exposure to CERCLA liability. In 1990, the Eleventh Circuit alarmed the lending community with its decision in *United States v. Fleet Factors Corp.*,[12] holding that a secured lender could be a PRP if it had the right and capacity to step in and manage a contaminated facility. Although the 1996 CERCLA amendments did clarify that banks and other lenders are not PRPs unless they actually participate in a facility's management,[13] prior to this clarification the prospect of joint and several liability because of an unexercised capacity to affect management impaired lenders' willingness to finance potentially tainted properties, and certainly complicated the role of secured lender as creditor in bankruptcy situations.

The Brownfield Initiative Response

Hazardous substance contamination, although hardly value-enhancing, does not quite have the negative effect it once had. Part of this is the natural result of time and experience. CERCLA is almost 20 years old, and litigation and amendment have settled some of the legal issues which have complicated informed decision making about contaminated properties. Hazardous waste remediation is a more established discipline, cleanup technologies have been tested, and site assessments and remedial plans are based on greater experience. Regulatory agencies share this greater experience, and government generally shows a greater willingness to entertain less-stringent cleanups where the remediation achieved will protect public health—given the intended subsequent use. Reflecting these factors, private funds have formed specifically to invest in contaminated properties.

Political, socioeconomic and policy factors have recently encouraged a hard look at contaminated properties, particularly the paradigmatic brownfields in older urban

core areas, which have the advantage of tending to be near existing infrastructure. New York City and other urban centers have rebounded, placing a premium on urban real estate; at the same time, suburban "sprawl" has aroused concern. Recognizing the aesthetic, environmental and recreational value of open space, policymakers and the public have sought ways to steer development away from "greenfields" in suburban or rural areas. As the *New York Times* reported last November: "On election day, voters from Southern California to New Jersey showed that the sprawl issue may have become a political driving force."[14]

These trends have both encouraged and been encouraged by the various brownfield initiatives promulgated by federal and state government. These can be broadly defined as governmental efforts to encourage the voluntary remediation and redevelopment of brownfield sites by providing funds and/or caps on hazardous contamination liability associated with the brownfield to be remediated.

New York's Brownfield Initiatives

New York has two such brownfield initiatives, one a creature of statute and the second an administrative initiative by DEC: the VCP. The former provides for the funding of "Environmental Restoration Projects" with $200 million from the 1996 Environmental Bond Act; it is codified at ECL article 56, title 5. These funds are available to assist municipalities with up to 75 percent of the costs of remediating contaminated sites to which they hold title. However, the funds are not available for Class 1 or Class 2 sites, and the municipality cannot have actually caused the contamination. Although these eligibility criteria are fairly narrow, as of January 27, 1999, the state had approved 83 investigation grants in the total amount of $6.9 million and 5 remediation grants totaling $7.9 million under this program.[15]

The VCP is far less restricted (but it is not funded), and eligibility to participate is broad. Although the paradigmatic brownfield is a "slightly" contaminated site, *all* sites over which DEC exercises enforcement jurisdiction including, but not limited to, Class 1 and Class 2 sites on the Registry, may be the subject of a VCA under the program. Anyone desiring to remediate such a site is eligible to qualify as a "volunteer." The exception is PRPs responsible for contaminating the subject site, who cannot participate if (1) the site is listed as Class 1 or 2, (2) the PRP is already subject to a DEC or EPA enforcement action or (3) the site is subject to corrective action under the federal Resource Conservation and Recovery Act.[16]

To participate, the volunteer first enters into a legally enforceable agreement or consent order (the VCA) with DEC, which either commits the volunteer to remedial investigation or to investigation and remediation. (If the former, the volunteer can decide to go forward with remediation after the investigation is complete.) The VCA commits the volunteer to reimbursing DEC for reasonable costs of overseeing its implementation and, if the volunteer is a PRP, for such costs prior to the effective date of the VCA.[17]

The type of cleanup required depends first on the intended use of the property post-remediation—that is, the cleanup level must be consistent with safe use of the property for the intended purpose. For example, if the intended use is industrial, DEC will likely require a less-stringent cleanup than if the intended use is for a school. An additional factor is whether the volunteer is a PRP who actually contributed to contamination of the site (as opposed to being a PRP solely through site ownership). If the volunteer is such a PRP, the cleanup must address both on-site and off-site impacts of the contamination. If not, the volunteer is only required to address on-site contamination and on-site conditions that cause off-site impacts.[18]

Once DEC determines that the cleanup level has been met, the DEC issues a qualified release in the form of "a letter declaring that the [DEC] agrees that the volunteer has cleaned the site to the previously agreed-upon cleanup level and that . . . [DEC] does not contemplate further action needing to be taken at the site." The letter also releases the volunteer from "further past contamination remediation liability." These releases are subject to certain reopeners, including where (1) the response action proves not to be sufficiently protective to allow the contemplated use of the site to proceed safely, (2) the volunteer or its successor changes the site's use to one requiring a lower degree of residual contamination, (3) the volunteer is found to have fraudulently obtained the release, (4) environmental conditions are found at the site that were unknown at the time the VCA was signed and (5) a change in scientific standards indicates that the level of cleanup implemented was insufficient to protect human health, given the site's use.[19] As these reopener factors indicate, the thoroughness and quality of the volunteer's remedial investigation is critical. The more that is known prior to cleanup, the less likely new information will later come to light requiring reopening.

Under the VCP, public notice must be given before the VCA is signed. As of January 22, 1999, DEC had entered into 108 VCAs.[20]

Potential Uses of the VCP in Bankruptcy

For the person in charge of a bankruptcy estate, whether a trustee or debtor-in-possession, an

obvious goal is to maximize the estate's value. This is accomplished by good stewardship of the estate's assets and by minimizing liabilities by sale, abandonment or, eventually, discharge through operation of the bankruptcy laws. Hazardous waste contamination presents particular challenges on both sides of this equation.

In a typical New York bankruptcy involving a property known to be contaminated, DEC asserts claims against the estate for any past or future cleanup costs. In addition, DEC continues to pursue as nondischargeable, either within or outside the bankruptcy, the debtor's obligations to remediate contamination for which it is responsible. Because of such agency claims, which reflect the risk factors described above, a contaminated property owned by a bankrupt—particularly one that has not been thoroughly investigated—is difficult, if not impossible, to sell, certainly not at anything above a bargain-basement price.

Legally, the courts have severely restricted the ability of trustees and debtors to use the abandonment power provided under Bankruptcy Code section 554[21] to escape liability by simply walking away from properties contaminated with hazardous waste. Moreover, because responsibility to remediate hazardous waste conditions cannot be avoided through abandonment, New York has successfully argued that all expenses incurred in complying with the applicable laws and removing the hazard are "necessary to preserve an asset of the estate" and therefore entitled to administrative priority, which means that a debtor must satisfy DEC's site remediation claims before distributions can be made to creditors with nonpriority claims.[22]

Since a trustee or debtor cannot simply abandon the contaminated property (and might not want to, in any event, if it represents much of the estate's assets), this leaves the option of trying to maximize whatever value the property has. This is where the VCP has potential to be very useful, provided participation can be structured so as not to undermine DEC's overriding goals of holding the parties who caused the contamination responsible for the environmental consequences and achieving site remediation.

The cost of negotiating a VCA with the DEC is not great. The VCA can commit the volunteer only to perform a remedial investigation of the property, using consultants of its own choosing, without committing to the actual cleanup. Thus, cost can be kept under control while the site is analyzed and a realistic remedial program developed, if remediation is determined to be feasible. The further the VCP process proceeds, the more the uncertainties about the property and future enforcement by the DEC are reduced. In short, by addressing the uncertainties that typically characterize contaminated sites, the VCA offers a potentially great return on a relatively small investment.

The answer to the question of who involved in a particular bankruptcy situation should seek volunteer status—trustee, debtor, creditor, examiner or third party—is necessarily fact-specific. One can certainly eliminate as ineligible the debtor who is a PRP at a site which is Class 1 or 2, or which is already the subject of enforcement. Nor would DEC or the New York Attorney General's Environmental Protection Bureau likely accept a company related to the debtor, of the type often set up for real property ownership purposes, without close scrutiny. These agencies (as well as the bankruptcy courts) would be wary about the VCP being used to benefit a would-be volunteer who either directly caused the site contamination or indirectly profited from that activity.

Otherwise, one can think of situations where a (nonpolluter) debtor, major creditor, creditors' committee and, certainly, a trustee charged with the fiduciary duty to maximize estate value might find it in their interest to seek volunteer status.[23] Indeed, reasonable business judgment may require a trustee to pursue a VCA. It is not difficult to imagine situations where the creditors should, at the very least, not object to the use of estate assets to fund efforts by the trustee or debtor to qualify as a volunteer and perform the required remedial investigation, as this might represent a relatively minor investment relevant to the potential property value enhancement of having a VCA in place. Rather than fighting over the relatively small pool of assets available to pay their claims, creditors might do well to support "investment" of that pool in the hope that this would ultimately make a far larger pool of assets available for distribution.

Two Examples

Parties involved in bankruptcy proceedings have begun to take advantage of the VCP, as the following two examples will illustrate. In *In re Cantor Brothers, Inc.*,[24] a liquidating Chapter 11, the debtor-in-possession had operated a paint-mixing facility, and operations had left the ground at the site contaminated with hazardous substances. Prior to the bankruptcy filing, DEC had listed the site as Class 2 on the Registry, and the debtor had agreed to entry of a DEC administrative order requiring it to develop and implement a plan for remediating the contamination.

In early 1993, the debtor filed for bankruptcy. DEC filed an administrative claim asserting that the costs incurred and to be incurred by the debtor in complying with the administrative cleanup order, including DEC's oversight costs, were entitled to administrative expense status and priority. In 1994, New York State

brought an adversary proceeding within the bankruptcy case to compel the debtor to comply with the administrative order. The other major creditor was the bank that held the mortgage on the building at the site (the building owner was a company related to the debtor, which leased the building to the debtor). The bank had claims for post-petition rent obligations, lease rejection and environmental remediation. Although the bank had commenced foreclosure proceedings, it was extremely reluctant to move them to conclusion for fear of taking possession only to become responsible for cleaning up the property. Debtor filed various objections to the DEC and bank claims.

In June 1996, the bankruptcy court approved an interim settlement in the state's adversarial proceeding which required debtor to retain a consultant to investigate the contamination at the site. This study was completed in early 1997 and led DEC to conclude that there were sufficient assets left in the estate to fund remedial actions sufficient to clean the site. The state was, therefore, willing to settle its claims if a sufficient amount of the remaining assets was placed in escrow solely for purposes of funding the specific remedial actions demanded by DEC.

In order to assure the bank's support for a plan which would essentially require it to give up on its substantial claims (but would, conversely, significantly enhance the value of its collateral), the state agreed that the detailed cleanup provisions in the proposed settlement *would* be accepted by DEC as the work plan component of a VCA. The relevant provision states:

> If [Bank] or any third party who qualifies for "volunteer" status (the "Volunteer") under the NYSDEC's Voluntary Cleanup Program (the "Program") applies for and is accepted as a volunteer to clean up the Site for industrial use under the Program, NYSDEC shall, consistent with its legal authority, accept this Agreement and Order and any approved Work and Design Plans submitted to NYSDEC by the Debtor pursuant to this Agreement and Order as an approved work plan for inclusion in a voluntary third party cleanup agreement for the Site between the Volunteer and the NYSDEC.[25]

This provision was intended to enhance the value of the property and therefore the bank's prospective return at a foreclosure sale. From DEC's perspective, there was little downside to committing to accept a remedial investigation and work plan which the agency was already prepared to accept as part of a bankruptcy settlement. At the same time, by increasing the likelihood that a solvent third party would purchase the site, DEC gained added assurance that if the escrowed money from the estate proved insufficient to complete the required cleanup, another party would be responsible for completing the work.

Debtor, the DEC and the bank entered into the agreement, which the court approved on December 2, 1997, facilitating final liquidation of the estate and conclusion of the case. The bank subsequently foreclosed and sold the property at a surprising profit to a third party, who applied for volunteer status. At the time this article went to press, DEC and this third party were close to signing a VCA. (It is worth noting that neither the bank nor the volunteer had any involvement in the activities which caused contamination of the site.)

A more recent and straightforward use of the VCP in a bankruptcy context occurred in *In re Comm 100 Associates*,[26] a Chapter 11 reorganization. In 1992, the bankruptcy court appointed a trustee (the "Trustee") to administer the estate. Since 1989, the debtor has owned a commercial site in Nassau County, which it has used as a warehouse. The site is listed on the Registry as Class 2A (inadequate and/or insufficient data for inclusion in any of the other classifications). Debtor retained consultants to investigate the site, who found various hazardous substances present in the soil and groundwater, although to date this information has not resulted in a change of the site's classification from 2A.[27]

In furtherance of his fiduciary duty, the Trustee applied for volunteer status, was accepted by DEC and entered into a VCA, which the bankruptcy court approved on November 17, 1998.[28] One of the Trustee's purposes in entering into the VCA was to "maximize the return to the creditors of the Debtor, including the sale of the Site for commercial, industrial, or light industrial use."[29] Another interrelated purpose was

> to resolve [the Trustee's] and the Debtor's potential liability as a responsible party . . . under [CERCLA] or under comparable statutory or common law theories of remedial liability . . . , and upon completion of the Department-approved remedial work plan, to receive, and have the Debtor and the [secured creditor bank] . . . receive . . . a Covenant Not to Sue and release from any claim, costs and liability related to . . . the contamination at or under the Site.[30]

Although not without the usual risks inherent to actually implementing a remedial plan, such as discovery of unforeseen contamination and cost overruns, the signing of this VCA at

least provides a light at the end of the hazardous waste tunnel for Trustee, debtor and creditor. Moreover, its commitment to a DEC-approved remedial plan gives the agency cause *not* to upgrade the property's classification from 2A to 2.

Conclusion

The VCA is no longer new and exotic. It is becoming an established tool in the environmental practitioner's arsenal for limiting exposure to hazardous waste liability and restoring value to contaminated properties. While hazardous waste issues can be complex, and should properly be tackled only by attorneys with an appropriate level of environmental law experience, the VCA is a flexible tool with which all attorneys who practice in bankruptcy, real estate or any other area in which hazardous property contamination issues arise should be familiar.

Endnotes

1. One authority defines brownfields as "slightly contaminated properties that were formerly used for industrial purposes, but that are now unused or underused." Gerrard, *New York State's Brownfields Programs: More and Less Than Meets the Eye*, 28 ELR 10444 (Aug. 1998).
2. 42 U.S.C. §§ 9601-9675.
3. 42 U.S.C. §§ 9605, 9607(a)(4).
4. 26 U.S.C. §§ 9507, 9611(a).
5. *State of New York v. Shore Realty Corp.*, 759 F.2d 1032 (2d Cir. 1985).
6. Environmental Conservation Law § 27-1313(3)-(5) (ECL).
7. *See* ECL § 27-0923; N.Y. State Finance Law § 97-b.
8. ECL § 27-1303.
9. ECL § 27-1305(3).
10. ECL § 27-1305(4)(c).
11. DEC Division of Hazardous Waste Remediation, *Inactive Hazardous Waste Disposal Sites in New York State: Annual Report* 3 (Apr. 1998). The 1998 report contains 849 sites.
12. 901 F.2d 1550 (11th Cir. 1990).
13. 42 U.S.C. § 9601(20)(A).
14. Egan, *The New Politics of Urban Sprawl*, N.Y. Times, Nov. 15, 1998, § 4 (Week in Review), at 1.
15. Telephone interview with Cindy Wabnick, DEC (Jan. 27, 1999).
16. *See* DEC, *Voluntary Cleanup Program Application*, revised April 1997, and the accompanying memorandum describing the program; *see also* Charles E. Sullivan, Jr., *The Department of Environmental Conservation's Voluntary Remedial Program*, 8 Envtl. L. in N.Y. 23 (1997) (*cited in* Gerrard, *New York State's Brownfields Programs: More and Less Than Meets the Eye*, 28 ELR 10444 (Aug. 1998)).
17. *Id.*
18. *Id.*
19. *Id.*
20. Telephone interview with Edward Devine, Esq., DEC (Jan. 27, 1999).
21. 11 U.S.C. § 554. See the seminal cases of *Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection*, 474 U.S. 494, 507 (1986), and *In re Chateaugay Corp.*, 944 F.2d 997, 1010 (2d Cir. 1991), for an introduction to this complex and evolving area of law, a full discussion of which is beyond the scope of this article.
22. *See* 11 U.S.C. § 503(b)(1)(A); *In re Chateaugay Corp.*, 944 F.2d 997, 1010 (2d Cir. 1991).
23. *In re Martin*, 91 F.3d 389, 394 (3d Cir. 1996).
24. Bankruptcy Case No. 893-80853-478 (E.D.N.Y.)
25. *In re Cantor Bros., Inc.*, Final Agreement and Stipulated Order, Dec. 2, 1997, ¶ 30.
26. Case No. 191 B 14097-353 (E.D.N.Y.).
27. Telephone interview with Mark A. Chertok, Esq., Sive, Paget & Riesel, environmental counsel to Trustee (Feb. 1, 1999).
28. *In re Comm 100 Assoc.*, Order Approving Settlement Agreement and Remedial Work Plan with the New York State Department of Environmental Conservation, Nov. 17, 1998.
29. VCA D1-0001-97-04, *In re Implementation of a Response Program for 100 Commercial Street, Plainview, N.Y.*, ¶ 3.B.
30. *Id.* at ¶ 6.A.

***Andrew J. Gershon is an Assistant New York State Attorney General in the Environmental Protection Bureau, which, among other things, represents the New York State Department of Environmental Conservation in bankruptcy matters. Mr. Gershon represented the state and DEC in *In re Cantor Brothers*, which is discussed herein.**

Adventures in the Mortgage Trade

A Case Study in Legal Ethics

By Bruce A. Green & Joshua Stein*

Real estate lawyers can run into ethical issues in any transaction at any time. Some of those issues are easy to identify and handle; others are not as easy. The lawyer who doesn't "spot the issue" as soon as it arises may find himself or herself embarrassed or worse when the ethical issue they didn't spot eventually comes to light.

The following case study shows how a wide range of ethical issues can arise in the practice of real estate law—specifically in a hypothetical loan transaction that, when it started, might have seemed rather unlikely to pose ethical challenges.

This case study was originally prepared for a session on ethics and mistake prevention in the Practising Law Institute's seminar *Commercial Real Estate Financing: What Borrowers and Lenders Need to Know Now*. That seminar, scheduled for New York City on June 14 and 15, 1999, and for three other cities in May 1999, will be chaired by Joshua Stein.

After the "case study" is a series of endnotes where the authors discuss ethical issues and other problems that arise from the case study. Those endnotes are not, however, intended to provide "all the answers" or an exhaustive discussion of every possible ethical issue and all relevant authority. They are intended more to stimulate thought and discussion.

In real life, of course "the issues" are never as stark and "the answers" are never as easy as they may seem here. Among other things, the answers often depend on facts not in evidence and the issues often arise under adverse circumstances, such as extreme time pressure.

The content of this case study is generally fictitious; in a few areas, it is loosely inspired by stories the authors have heard; and, in even fewer areas, by the authors' experiences. All characters are named after the authors' friends, family members or a cosmetics line owned by one of the foregoing; any similarity to real people in real estate is unintended. This case study is not intended to reflect the actual state of legal ethics and sensitivity thereto in the real estate bar.

Many ethical discussions and analyses in the text of the case study are inconsistent with accepted standards (surprise!). Do not rely on them.

Adventures in the Mortgage Trade

A Case Study in Legal Ethics

Clay Johnson's secretary interrupted another call to tell him that Francine Rosetti was on the line. Rosetti wanted to talk to Johnson right away about a new deal. She couldn't wait. And Johnson didn't want to make her wait, so he took the call quickly.

"Clay, do you think you can handle about a half billion dollars worth of new originations for us during the next year?"

The request certainly caught Johnson's attention. Rosetti was a mortgage loan officer at Wildside Commercial Mortgage Investment Company, a leading institutional mortgage lender. Over the last few years, Johnson's firm, Sherman & Hannah, LLP ("S&H"), had received more than its share of Wildside's work.

Rosetti said that the new transaction would collectively involve over 50 properties in about 20 states, and that she had obtained special approval to have S&H handle the entire matter.[1]

Johnson thought about his calendar and the calendar of his group.

It was jammed. And it would stay jammed for the next two months. But regardless of how much work he had, Johnson never turned away work. One way or another, Johnson and S&H had always managed. If need be, he thought, he could hire more part-time law students and paralegals—whatever it took.[2]

"Of course, Fran. We can start right away and we've got the team to do the job,"[3] he said, fervently hoping the transaction wouldn't start for another two months.

Rosetti described the new borrower and its business plan. Helaina Equities, a newly formed real estate company, was made up of a group of real estate lawyers who had invested quite successfully in real estate over the years, but had decided to go into the business full-time after lining up a dozen major investors to back them.

One of Helaina's great selling points, according to Rosetti, was the fact that every principal in its organization was a lawyer—an active member of the bar of at least one

state. Rosetti felt this would, among other things, help keep their investment strategy conservative and assure that they wouldn't play any games.

Rosetti thought one or two of Helaina's principals had once worked at S&H, a fact that seemed to give her a particularly high level of comfort about the whole group.

Rosetti told Johnson that Helaina had hooked up with United Widget ("UW"), a company with light manufacturing and distribution operations around the United States. UW wanted to stop owning real estate, which was a significant drag on earnings, a misallocation of its limited capital resources and a distraction to senior management. So Helaina would, through a staged series of four multiproperty closings, acquire all of UW's real estate, with mortgage financing from Wildside. UW would simply pay rent to Helaina.

Rosetti asked Johnson to prepare a term sheet for the proposed Helaina financing, which he was happy to do.[4] He achieved an unbelievably quick turnaround because the transaction was just like one he had closed the preceding week for another client, National Mortgage Origination Corporation ("National Mortgage"). All he had to do was slightly edit the National Mortgage term sheet.[5] And he could do it right on his computer screen.

Ten minutes later, Johnson printed out the UW term sheet, slapped on a fax cover sheet, and gave the package to his secretary, Richard Marks, to take to the fax room.

After taking two calls from other clients, Johnson started leafing through his copy of the fax to Rosetti. He noticed that the Wildside term sheet contained some information about the National Mortgage transaction, such as the number of sites and total dollars involved and, in the header area of every page except page one, the name of National Mortgage—one of Wildside's main competitors.[6]

Johnson had not noticed this second item, the problem in the header, because he had never actually printed out the term sheet to review it on paper. He had just edited it on the computer screen. But the header had never actually appeared anywhere on his computer screen. It showed up only on the printout, which he hadn't taken the time to read. After all, he had reviewed every word of the text on his computer screen already.[7]

Johnson asked Marks to stop the fax so Johnson could fix it. Marks quickly picked up the phone, called the fax room, left an urgent message on the fax supervisor's voicemail and promptly went back to work on the movie script he was editing for a friend.

On one level, Johnson wasn't all that concerned about the fax, but then he thought better of it. If there was something more he could still do to stop the fax, he should probably try.[8] Even if the National Mortgage information wasn't really confidential (the transaction had now been widely reported in the industry press), it wouldn't look good for Rosetti to see all the references to National Mortgage.[9]

As Johnson starting walking to the fax room, he was paged. Another client had to talk with him—now—about an urgent problem that had arisen on another transaction. Johnson took the call.[10]

Twenty minutes later, Rosetti called. She had received the fax and thought Johnson's term sheet was great.

Rosetti didn't notice the references to the National Mortgage transaction until Johnson mentioned them.[11] She was impressed that Johnson represented National Mortgage,[12] and was quite interested to find out that the National Mortgage transaction had involved 72 sites. "We'll have to do at least 73," she joked. And she was delighted to see her transaction was several times the dollar size of National Mortgage's.

Rosetti had some questions and comments about the term sheet. The whole process helped both Rosetti and Johnson focus on the Helaina transaction and some business and legal issues it raised.[13]

On further thought, Johnson realized the Helaina term sheet should provide for a new "multilateral transmediation" structure. This was a structural feature that Johnson had never seen until his recent work with National Mortgage.

As part of that assignment, he had spent hours with National Mortgage's accountants, who had analyzed historical data about thousands of mortgage loans originated by National Mortgage over three decades. Based on that analysis, the accountants had identified an accounting problem that Johnson had never before heard of, which was neatly solved by the new multilateral transmediation structure.[14]

Rosetti was very impressed when Johnson explained multilateral transmediation and how it worked. "That's why we hire you," she said.

Johnson decided that he should also include in the term sheet some special provisions on ancillary jurisdiction and intercurrency cross-validation—two issues that had arisen in the National Mortgage transaction after the term sheet had been signed. He had identified these two issues himself; so, although he felt a little uncomfortable about sharing multilateral transmediation, he felt no concern at all about ancillary jurisdiction and intercurrency cross-validation.[15]

Multilateral transmediation, ancillary jurisdiction and intercurrency cross-validation—all would clearly help Wildside mitigate some risks in the Helaina transaction, just as they had for National Mortgage. And any mitigation of risk might support some reduction in rate, thereby making Wildside just a bit more competitive. But National Mortgage and Wildside weren't bidding for the same transaction, Johnson assumed; this transaction had already priced, anyway, so it really didn't matter. And new ideas like these travel around in the industry pretty freely, so Johnson's conscience was clear.[16]

After Rosetti and Johnson spoke about the term sheet for half the morning, Rosetti asked Johnson whether Johnson's firm ever did any work for Helaina Equities or UW.

"Well, I've already ordered the conflict check," Johnson said, reassuringly. "It should be routine."

It wasn't.

Julia Equities of Lake Ozark, a subsidiary of Helaina under separate management, was an active development and land sales client in another office of S&H, according to the conflict report. Johnson dismissed that engagement as a nonissue, because it was a different entity—not the same as Wildside's borrower, which would be one or more wholly-owned single-purpose subsidiaries of the Helaina parent.[17]

The conflict report also noted that one of the individual principals of Helaina, Jaclyn Matthews, had previously been an associate at S&H, though for no more than three months. Matthews had left S&H almost a decade before under circumstances that, Johnson recalled, involved expense accounts and airplane tickets.

The excitement about Matthews had arisen before she was even admitted to the bar, and had ended with a mutually satisfactory agreement. Both sides had agreed to keep the whole thing confidential.[18] Johnson thought nothing more of it.[19]

Another S&H partner had noted in the conflict system that he had recently submitted a proposal to represent Helaina's retail development subsidiary in its leasing work. This proposal was marked as "pending—open" in S&H's conflict system. Johnson called the S&H partner in question, who confirmed that S&H had not been engaged by Helaina Retail Corporation, though he was hoping to hear any day now.[20] Johnson asked for a copy of the presentation to Helaina Retail Corporation.[21]

The conflicts system also showed that another S&H partner had previously represented another Helaina affiliate in some litigation against a financial institution. The file had been "closed" the preceding month. A closed file is clearly not a problem, Johnson thought.[22]

Although Johnson did not normally run a conflict check against names of lessees when he represented lenders, he thought it might be a good idea to run one for UW, as UW's credit and rent payments were the basis for the entire deal.[23]

He found that UW had been an active client of another office of S&H for a dozen years, with over 100 open matters. S&H had handled a wide range of matters for UW, including: "M&A," "Publicly Traded UW Stock," "Environmental Concerns," "Superfund Defense Strategy," "Hazardous Substances—Miscellaneous," "Insolvency," "Insolvency Structuring," "Insolvency Planning," "Insolvency 1997," "Insolvency 1998" and "Upstreaming Analysis (Off-Shore)."

Johnson wasn't surprised. S&H often represented lessees that leased real estate from borrowers financed by S&H's lender clients. In these cases Johnson typically went out of his way to avoid any direct negotiations with the lessee, such as nondisturbance agreements. Except for that, he had never regarded these situations as conflicts[24] and had never obtained a conflict waiver, oral or written. He never even raised the subject and only rarely checked for possible conflicts of this type.

Although the titles of some of the UW open matters sounded less than appetizing, Johnson decided he had no business sharing this information with Wildside. Wildside knew how to conduct its own due diligence. If Wildside wanted to find out about S&H there were plenty of ways to do so without relying on the S&H conflict-checking system. Information in that system was confidential.[25]

So he called Rosetti back and confirmed that S&H had no conflict[26] and that he would be happy to proceed.

Rosetti started to give Johnson more details about the engagement: the name of the law firm and individual lawyer who would represent Helaina, the schedule for the first 12-property closings (aggressive, of course), the environmental consultant that Helaina was using (and Wildside would also use, although Helaina would handle all communications and coordinate the process[27]), the appraiser and other useful information.

Johnson thanked Rosetti for thinking of S&H and said good-bye. Then he cleared his desk by throwing away the conflict printout for the new matter[28] and turned his attention to the pile of phone messages that had already accumulated.

The first message was from Jaclyn Matthews, the former S&H associate who was now a principal with Helaina Equities. Johnson returned the call immediately, even

before calling Helaina's lawyer, to say hello and introduce himself.[29]

"Clay, it's great to be able to work with you again," Matthews said. "I learned so much at S&H ten years ago . . . some of it the hard way . . . you're not going to mention anything to Wildside about what happened, are you?"

"It was all very confidential, wasn't it?" Johnson replied, and they laughed.

In Johnson's mind, he had just boarded a train pulling out of the station, but perhaps, he thought for a moment, this train would have been a good one to miss. Although, in Johnson's opinion, S&H didn't technically have a conflict, everyone at the firm could have egg on their face if anything at all ever went wrong with the Helaina financing or United Widget.

Johnson was already on the train, though, he thought and probably too far down the track to turn back. Rosetti was counting on him to help with the transaction, and the first closing was scheduled to occur almost immediately. If he were going to turn down the work, it seemed to him he should have done so a long time ago. Now he had no choice.[30]

The involvement of Jaclyn Matthews, particularly the weight that Rosetti attached to Matthews's tenure at the firm, caused him some particular discomfort.

On the other hand, there almost always seemed to be some conflict or issue, or possible conflict or issue, in every possible engagement. Johnson had always been able to deal with these problems just by knowing they existed and making sure he didn't step in anything. He hadn't stepped in anything yet.

Could Johnson in good conscience decline to represent Wildside? He remembered that he had once seen somewhere that lawyers aren't supposed to turn down any clients. Lawyers have an ethical obligation to represent anyone who walks in the door. That certainly sounded like a good rule to follow here,[31] so he stopped thinking about declining the engagement.

Matthews began to describe to Johnson the structure of the UW transaction. It became clear that Matthews's version of the deal was quite different from Wildside's. Johnson told Matthews about a few of those differences, each of which raised a genuine substantive legal issue of a type that Johnson would typically discuss with borrower's counsel early in the negotiating process.

"Well, we'd never agree to that," Matthews responded to one of Johnson's points. A few more of Johnson's comments seemed okay to Matthews, and she said she would update their internal transaction summary and instruct counsel accordingly. Johnson was glad he wouldn't have to negotiate those issues with Helaina's outside counsel.[32]

Matthews asked Johnson to look into a dozen substantive issues about the loan, then get back to her with Wildside's position on them. Some of these were "business" issues as basic as the interest rate on the note. Others were of a more legal nature.

Johnson was glad to assist. It occurred to him that maybe he could eventually get some assignments from Helaina. Matthews was obviously in a position to refer work and clearly was motivated to maintain a great relationship with the firm.[33]

Johnson's next call was from Helaina's outside counsel, a lawyer Johnson had never met before, David Witty. Witty made it clear that he would be playing a very central role in the closing process, and that any negotiations or discussions with Helaina would take place through Witty.

Johnson told Witty about the call he had just received from Matthews, and the previous connection between S&H and Matthews. Witty made it clear that he would prefer that his client not call Johnson again. If she did call again, Witty said, it would probably be better if Johnson limited the conversation to matters unrelated to the transaction.[34]

The next morning Johnson received the first due diligence package for the Helaina transaction. It contained photocopies of all the environmental reports for the first dozen Helaina sites. Ten minutes later, Matthews called, "just to touch base and see if you got the package."

"Yes, Jacki, it's here," Johnson assured her.

"Well, we've been through all the reports. We chose great environmental consultants in every city. Please don't hesitate to call me if you have any questions at all. We are really under tremendous time pressure to get these first dozen deals closed, and if there's anything I can do to help move things along please let me know."[35]

Johnson mentioned the call from Witty, and Witty's apparent desire to channel all communications and deliveries through his office.

"Oh, don't worry about him," Matthews said. "You and I are old friends. There's nothing wrong with us working together as a team on this one!"

Matthews said she wanted to talk to Johnson about the loan documents, and she was particularly concerned about personal liability and the "nonrecourse" clause.

"I assume you'll use the nonrecourse clause from Marilyn's Mountainside Motel," Matthews said, displaying a remarkable memory of the one transaction where Matthews

and Johnson had worked together during her brief tenure at S&H.

Actually, Wildside's standard documents typically used a more borrower-friendly nonrecourse clause than the one from Marilyn's Mountainside Motel. If left to his own devices, Johnson would never have thought of using the nonrecourse clause from Marilyn's Mountainside Motel. But why not, if that's what Matthews wanted?

The Marilyn's Mountainside Motel loan had defaulted in 1991, Johnson remembered. The lender, a savings and loan, had used the nonrecourse clause and related provisions to obtain a personal judgment that forced Marilyn into personal bankruptcy. Marilyn was now working as a waitress at a diner on Highway 61. Matthews obviously hadn't heard about this subsequent history.

"Sure, we'll be happy to use that nonrecourse clause," Johnson said.[36]

Johnson finished the call and sent Matthews's environmental reports to a paralegal at S&H.[37] The reports were copies, as originals typically were sent to the lender for review by its internal environmental people. Johnson reminded himself to confirm that Wildside was following the same procedure here.

As the Helaina transaction unfolded, it became obvious that Helaina needed more financing than the 80 percent loan-to-value originally contemplated.[38] So Johnson was not at all surprised to get a call from Rosetti telling him that an offshore majority-owned affiliate of Wildside—Kalson Lending, LP—was going to lend another 10 percent of value to bring total financing up to 90 percent.

Rosetti asked Johnson to prepare the documents for the new "mezz piece" of the loan structure. She said the mezz loan would technically be funded by Kalson Lending; but it would be handled completely by Rosetti and her team.

Johnson asked Rosetti if Kalson Lending had its own personnel and its own loan underwriting procedures, and Rosetti said Johnson didn't need to worry about them. But Kalson Lending was a legally separate entity, and not entirely owned by Wildside. As a mezzanine lender, its interests were in many ways inconsistent with those of Wildside. But Johnson was happy to have the extra work and one less set of opposing lawyers to negotiate with.[39]

Johnson felt uneasy about the extra financing, however. In his experience, it was the "stretch" deals—above 80 percent loan-to-value—that were most likely to run into trouble, most likely to "test" the strength of the closing documents. There had been some kind of edict from somewhere about mezzanine financing. Was it the Federal Reserve? Was it some other regulatory agency? He couldn't remember.

Johnson sent an e-mail to the other lawyers in his group, asking if anyone had seen anything that would limit the ability of lenders to provide mezzanine financing.[40] Within three minutes, his computer beeped with a response from Gloria Malkin, one of his partners who also worked on the Wildside account. Here's what it said:

> Clay, I got your e-mail. We just got a notice from legal at Wildside. Their Board made an order saying Wildside will not do mezz loans any more under any circumstances. Outside counsel is supposed to watch out for any form of mezz financing and report it to legal immediately. Top management seems very concerned. They had a subsidiary just for mezz financing, which they are trying to shut down. Have you ever run into Wildside's mezzanine financing operations? Hope this helps. /s/ GM

No, Malkin's e-mail didn't help. In fact it further complicated a client relationship that was already a bit too complicated. Johnson walked to Malkin's office and got a copy of the Wildside legal announcement. It was unambiguous, and totally consistent with Malkin's e-mail.

"Clay, you look concerned," Malkin said. Then, with a smile and a laugh: "What's the problem? Did you just close a mezz loan for Wildside?"

"No. Not at all." Technically, Johnson's response was accurate. He wasn't sure how he wanted to handle the situation. The less he told Malkin, the more flexibility he would have.

Once he brought her into it, he would lose control over how things would turn out. Presumably she wouldn't be too pleased if he just went ahead and closed the mezz financing, but did he have any obligation to her?[41]

It was clear that legal wanted to clamp down hard on all mezzanine lending.

But Johnson's relationship was with Rosetti and her loan origination team. They were the people who chose counsel and made sure counsel were paid.[42] And Johnson was very aware that Rosetti's compensation depended on the dollar volume of loans closed. Rosetti was the top producer in the company. They called her "The Closer," because year after year her dollar volume was consistently twice the next higher loan officer's. And this deal would clinch her position for the current year.

The last thing Johnson needed was to have Rosetti feel that Johnson had not only derailed the

Helaina transaction, the biggest in Rosetti's career, but also gotten Rosetti into trouble within the Wildside organization.[43]

"Mezzanine financing" had been all the rage just a few weeks before. All the lenders were doing it. Now the world had changed again. Quickly, too. Clay remembered other "stretch" deal structures he had seen over the years. Sixth trust deeds in California. Triple wrap-around mortgages in New York. Sale-and-leasebacks in Kansas with back-to-back subleases and an implied valuation of 150 percent of the last real appraisal. He thought about some of the characters involved in these transactions, and how badly many of these transactions had turned out.

The legal department wasn't wrong to care about mezzanine financing. But who was Johnson's client anyway? Johnson didn't even know anyone in the Wildside legal department! He made a mental note to deal with the problem. Then his thoughts turned to the constitutional law of impeachment. He had been thinking more than usual about constitutional law lately. Maybe it would have been a better career option, at least this year.

The phone rang. It was Jaclyn Matthews, calling just to touch base and to tell Johnson that Wildside was having its environmental consultants review the environmental reports so Johnson didn't need to worry about them and he should just file them away or even trash them, but he really didn't need to look at them at all.

Matthews asked Johnson if he had heard about the new "mezz loan," which she said was going to be handled quietly through a special subsidiary of Wildside. "Fly low and avoid the radar, you know," she said with a laugh.

But the real reason she called, she said, was to see if S&H would have any interest in representing Helaina Retail Corporation in its retail development program. "Let's talk about it later. No need to start thinking about it just yet, but it's probably there if you want it, assuming this Widget thing goes well," she said.[44]

She mentioned that another lawyer from another office of S&H had been sent a copy of Helaina's request for proposals for the retail job, but Helaina wasn't impressed with that lawyer's credentials. Johnson would probably have a better shot.[45]

Johnson asked her to send him a copy of Helaina's RFP. She faxed it to him within minutes, with a handwritten cover note: "Looking forward to helping you get this job. Don't worry about the deadline. Call me whenever you want. Best regards. Jacki."[46]

The Helaina transaction inched forward. Johnson assembled a team of lawyers and paralegals, and distributed several sets of draft documents. Witty provided comments on round after round of documents. Matthews called at least once a day just to touch base and to tell Johnson which of Witty's comments were truly important to Helaina, and which were just Witty's "legal minutiae" that Helaina didn't care about.[47]

Two days before the first closing, Johnson convened an "all hands" checklist meeting to go over the status of the closing.

"You checked the environmental reports, didn't you?," Rosetti asked Johnson.

"Well, we were going to review them all tonight, Fran, absolutely."[48]

And Johnson did. He wasn't an environmental lawyer, but he had seen enough environmental reports to be able to tell when a property was clean and when it wasn't.[49]

The 12 reports were all issued by different environmental firms. They had originally been commissioned by UW. Each was addressed to UW, with a handwritten note saying it was also directed to Helaina and Wildside.

In each report, the environmental firm noted that at the client's request, they had prepared a separate Hexadecimal Assay Analysis ("HAA") of the property, and attached it as an exhibit to their report. Johnson knew the HAA was often important, so he looked first at the HAA in each report.

Johnson noticed that although each property report had been prepared by a different environmental firm, all reports had exactly the same HAA exhibit, in exactly the same format. The HAA exhibit simply said: "Hexadecimal Assay Analysis—No Problems Found (Clean)." And each HAA was in exactly the same typeface, which was different from the typeface used in the body of the reports.

The next day, after a long series of inquiries, including long telephone conversations with some of the environmental firms (each prompting an even longer fax transmission), it became apparent to Johnson that someone at Helaina had removed the original HAA from each environmental report, and had replaced it with a one-page exhibit indicating there were no problems.

Jaclyn Matthews was the only person at Helaina who had ever been involved in the environmental work for the sites. She was the one who had received all the environmental reports and had arranged to copy them for Johnson. In fact at one point she had gone out of her way to tell Johnson how reliable the environmental reports were because she maintained complete control of them herself. Her job title included "chief environmental officer." Her cover letter was on every

package; her cover letters all used the typeface that appeared in each of the HAA's.

But Jaclyn Matthews was a lawyer—a former associate at S&H. Would a lawyer deliberately falsify an environmental report submitted to a lender? It was unthinkable.

Didn't Helaina have obligations to its investors? Wasn't every principal in the Helaina organization a lawyer? Weren't they above "playing games"—particularly games as amateurish and transparent as this one?

Johnson's first concern was to let Francine Rosetti know about the problem, and he dashed off a quick memo to her noting how odd it was that the HAA for each environmental report looked exactly the same. He wondered whether maybe he should notify someone else at Wildside—legal, perhaps?—but decided that doing so might violate normal protocol. A memo to Rosetti would probably be enough.[50]

Johnson was relieved. His rear end was completely covered. There was nothing else that anyone could say he should have done. Rosetti could make her own decision about the borrower and the loans.[51]

Rosetti called back and told Johnson to close the first 12 loans immediately. He did.

Then S&H closed another batch of properties, with a totally streamlined closing process that required almost no effort by Johnson. Johnson had negotiated a fixed fee for each closing that was more than seven times what he would have charged at the firm's regular billing rates for the actual lawyer and paralegal time each closing required. This was largely attributable to the firm's multimillion-dollar investment in automation and special loan documentation software.[52]

One night at home Johnson got a panicked call from Witty.

"You won't believe this, Clay," Witty said, "but I just realized that the deals we've closed so far all have the wrong interest rate. Every single property!"

Witty reminded Johnson that the interest rate in the term sheet was tied to a complicated formula that took into account the diversification and size of the portfolio, as well as the average loan size. Johnson had prepared the documents for the first advance assuming zero diversification and minimum portfolio size and loan size.

Actually, even the first advance would have qualified for a lower rate than the rate in the documents, and each subsequent advance would have qualified for a slightly lower rate. But each set of loan documents was prepared under extreme time pressure—cloned from the last set of documents—and no one ever checked the interest rate.[53]

Instead, when Witty had negotiated the loan documents he focused closely on other provisions of special importance to him.

His top priority had been casualty and condemnation—what would happen if the building burned down, how the insurance proceeds would be held and disbursed. He had negotiated an elaborate procedure with several notices back and forth and eight different levels of materiality, carefully tailored to take into account whether the affected building was "single purpose," the type of construction involved, the mechanic's lien procedures of each particular state and a number of other considerations. Every element of Witty's procedure made sense under some circumstance or another if you thought about it long and hard enough.

As a result, Johnson's original two paragraphs on casualty and condemnation had blossomed to twelve pages, including 27 new definitions and four pages of state-by-state optional provisions.

Witty also cared a great deal about notice clauses. He was concerned about things like what would happen if Wildside gave a notice of default to Helaina, but Helaina's entire top management was off-site for a week or the notice was lost in the mail. And Witty created an elaborate procedure to verify notices given by fax.

In negotiating these and several dozen issues of similar magnitude, Witty had overlooked the interest rate.[54] He seemed to give it the same priority as the nonrecourse clause, which had also sailed through without a single comment.

"Of course we'll fix the interest rate,"[55] Johnson said, then quickly thought better of it and said: "I'll speak to my client about this and get back to you first thing in the morning. I'll see if there's anything we can do."[56]

Johnson arrived at work early the next day and pulled out the term sheet. Witty was absolutely correct. Every loan document had the wrong interest rate—a mistake that could cost Helaina (or Witty's malpractice insurance carrier) well over a million dollars a year for the next ten years. And the prepayment provisions gave Helaina no practical ability to prepay.

When Johnson called Rosetti to talk about correcting the error, her reaction surprised him. She had already noticed the higher rate in the documents. She had actually noticed it during loan negotiations. She reminded Johnson that during one of their earliest conversations on the deal they had talked about using "basis points" as a way to address possible concerns about United Widget's "credit quality." She had assumed the higher rate was part of what Johnson had negotiated with Witty. She was glad to see that Johnson had taken the initiative,

but had never thanked him for it. And now she did.

Credit Committee had been very tough on the Helaina loan, Rosetti said. The little "bump" in the rate was the only thing that got Helaina approved. And the loans had already been pledged to a warehouse bank syndicate, so any change at all would require a 95 percent vote by almost three dozen banks. So there was nothing Rosetti could do, or Johnson should do, about the interest rate now.

Johnson dreaded talking to Witty. Witty had called twice, but Johnson told his secretary to say Johnson was in a meeting. He was actually checking his e-mail.[57]

He received 50 or so e-mails a day, of which only a handful were worth reading. The rest were a combination of "get rich quick," bad jokes from his cousin, and firmwide e-mails about lost eyeglasses and missing library books. So today he skimmed through his e-mail "in box" until he found a few messages he wanted to read. Quickly he highlighted all the others for deletion. He pushed the delete button and watched absentmindedly as 47 worthless e-mails were deleted, one after another. As the last e-mail flashed past, Johnson glanced at the heading: "United Widget—Urgent and Confidential."[58]

Perhaps in the short run Johnson's life would have been simpler if he had missed the United Widget e-mail. Luckily or not, Johnson retrieved it from his computer's "trash can" and read it.

The e-mail came from another office of S&H. It said that UW had engaged S&H to help UW prepare its Chapter 11 petition, which would be filed in about 30 days. The lawyers handling the filing needed to know whether anyone in S&H had any investment in UW, or represented or was otherwise involved with UW in any way.

In the meantime, according to the e-mail, the fact that UW contemplated filing was highly sensitive and should not be repeated outside S&H. The e-mail said that UW wanted its creditors to think UW was conducting "business as usual," so it could close some major capital transactions before filing.[59]

Johnson thought it odd for a firmwide e-mail to say so much about UW, and wondered whether it was realistic to think that this information would stay confidential. Thousands of people were on S&H's e-mail system around the world. They would all need to keep their mouths shut for several weeks. Would they? But then he remembered that very bad things happen in bankruptcy to law firms that don't disclose conflicts, so perhaps S&H had no choice but to send the e-mail.[60]

Johnson wondered whether he should give Wildside a discreet "heads-up" that they might want to limit their exposure to UW.

Rumors would inevitably fly in the business world about UW's upcoming filing.

And Johnson certainly intended to tell his wife[61] so she could tell her cousin and her cousin could "sell short" a block of UW stock. That plus dozens of other short sellers[62] would communicate the news about UW more effectively than any words ever could.

Given how quickly bad news travels and how hard it is to trace, what harm could Johnson do by saying something to Wildside?[63] How else would he have any hope of preserving his relationship with Rosetti once the filing and S&H's role became public? Maybe he could just whisper in Rosetti's ear that she should watch the UW share price and draw her own conclusions—not exactly typical advice for him to give.[64]

When Witty called a third time, Johnson took the call. To Johnson's surprise, Witty didn't want to talk about interest rates. Instead, he said that Helaina had identified the next batch of UW properties, and the whole batch had to close within 27 days to meet a crucial reporting deadline for UW.

This batch of properties was clearly the heart of the portfolio. It would support financing of more than three times as much as Wildside had previously loaned to Helaina in total. But Helaina was committed to close this package in time to meet UW's reporting schedule. As an incentive, UW would pay an up-front leasing fee of 11 percent of the value of the new properties[65] if the deal closed on time—"so there's plenty to go around," Witty said.

Helaina had agreed to pay Wildside an "expediting fee" of 3 percent of the loan, which would go right into the bonus pool—90 percent for Rosetti and the rest for her staff. Witty reminded Johnson that no one ever required any of the lawyers to provide backup on any bill for Helaina. Witty said he and his client would understand if the bill for these closings were higher than usual.[66]

Johnson wondered whether UW's accelerated closing deadline had anything to do with its upcoming filing. Of course it did, he thought. But was there anything Johnson could do?

It was Rosetti's job—not Johnson's—to underwrite Wildside's credit risks, and she knew what questions to ask and how to get answers. Moreover, the risk of a lessee bankruptcy was one that mortgage lenders take all the time.[67]

The next day, Jaclyn Matthews called again to touch base, and another large Federal Express box full of environmental reports arrived. Johnson was not surprised to find

the same familiar HAA attached to each of the new environmental reports, even though each report was again prepared by a different environmental firm.[68]

The phone rang. It was someone whose name Johnson didn't recognize, someone from Wildside's legal department. Earlier that very day, Johnson had meant to call Wildside legal, but had gotten distracted again. He took the call. It was a conversation he would never forget for the rest of his career.

Endnotes

1. Does this mean Rosetti expected Johnson to handle the matter without using local counsel? Would doing so run afoul of "unauthorized practice of law" provisions? *See Birbrower, Montalbano, Condon & Frank, P.C. v. Superior Court*, 17 Cal. 4th 119, 949 P.2d 1 (1998) (holding that New York law firm engaged in unauthorized practice of law in representing a California client in connection with a California arbitration, and noting that out-of-state lawyers cannot avoid this restriction even by associating local counsel in the case).

2. Does Johnson have an ethical obligation not to take on work that he knows his group does not have time to handle? What if he has always been able to solve the problem in the past through measures like hiring temporary lawyers? Are temporary lawyers permissible? *See* ABA Model Rules of Professional Conduct ("Model Rules"), Rule 1.2(a) (requiring a lawyer to consult with the client as to the means by which the client's objectives are to be pursued), *id.*, Rule 1.4 (relating to client communication), ABA 88-356 (1988):

> Where the temporary lawyer is performing independent work for a client without the close supervision of a lawyer associated with the law firm, the client must be advised of the fact that the temporary lawyer will work on the client's matter and the consent of the client must be obtained. . . . [W]here the temporary lawyer is working under the direct supervision of a lawyer associated with the firm, the fact that a temporary lawyer will work on the client's matter will not ordinarily have to be disclosed to the client.

   Would a reasonable client expect to be told if the lawyer were staffing the matter with temporary lawyers? What if Wildside would care less (or more) than a hypothetical "reasonable client"?

3. Is there anything wrong with a "white lie" like this one? *See* Model Rules, Rule 7.1 ("A lawyer shall not make a false or misleading communication about the lawyer or the lawyer's services.").

4. Should Johnson have completed his conflict check before getting this far into the substance of the transaction? See New York Lawyer's Code of Professional Responsibility, Disciplinary Rule (DR) 5-105(E), which requires that

> [a] law firm shall keep records of prior engagements, which records shall be made at or near the time of such engagements and shall have a policy of implementing a system by which proposed engagements are checked against current and previous engagements, so as to render effective assistance to lawyers within the firm in complying with [the rule on conflicts of interest].

5. What restrains a lawyer's reuse of work product prepared for other clients? Does it depend on whether: (a) Johnson prepared the National Mortgage term sheet himself, from scratch; or (b) National Mortgage prepared the first draft and transitioned the term sheet to Johnson? Does Johnson have to reinvent the same term sheet independently for each client? If Johnson can re-use prior work prepared for a previous specific transaction, can Johnson charge Wildside a premium for efficiency (the time it would have taken to prepare the term sheet from scratch)? In that case, should he give National Mortgage a credit against its bill to reflect the benefit achieved for another client?

6. Did this amount to a prohibited disclosure of confidential information? *See* Model Rules, Rule 1.6 ("A lawyer shall not reveal information relating to representation of a client unless the client consents after consultation."). What if it wasn't intentional? *See* ABA Code of Professional Responsibility ("Code"), Ethical Consideration (EC) 4-5 ("Care should be exercised by a lawyer to prevent the disclosure of the confidences and secrets of one client to another.").

7. Problem prevention technique for computer users: Read the whole thing on paper, from beginning to end, before sending it out the door.

8. Can Johnson safely delegate to Marks the responsibility for preservation of client confidences? Is it a "non-delegable duty"?

9. Do mere appearances drive ethical obligations?

10. Should Johnson have done whatever he had to do—first—to stop the potentially troublesome fax? Should he have said he would call the other client back?

11. Should he have said nothing and hoped Rosetti wouldn't notice? Perhaps he could have quickly revised the term sheet and sent her an improved version that didn't contain any National Mortgage confidential information.

12. By disclosing the mere fact that he represented National Mortgage, was he disclosing confidential information? *See* Annotated Model Rules of Professional Conduct 87 (3d ed. 1996) ("Annotated Model Rules") ("The scope of [Rule 1.6] is broad enough to support the contention that a client's identity under some circumstances must not be disclosed."). Was this a circumstance where Johnson should not have disclosed his representation of National Mortgage? Can transactional real estate lawyers freely say who their clients are?

13. Johnson still hadn't conducted a conflict check. Was it wrong for him to get this far into the substance of the matter?

14. Did this make "multilateral transmediation" confidential proprietary information owned by National Mortgage? Was it appropriate for Johnson to use the same method for Wildside? National Mortgage had never asked him to keep it confidential. If he had asked them, though, they might very well have said that of course they would expect him to keep this technique confidential. But he hadn't asked them. Should he have done so?

15. Both "ancillary jurisdiction" and "intercurrency cross-validation" were new concepts he had developed "on National Mortgage's nickel." Should he have used them only for National Mortgage?

16. Should his conscience be clear? Should a lawyer be playing the "cross-pollination" role?

17. As a matter of (a) legal ethics and (b) client relations, did Johnson make the right call? *See* ABA Formal Op. 95-390 (1995) (discussing conflicts of interest in the corporate family context).

18. Was S&H right to keep this information quiet? Did S&H have an obligation to report it to the appropriate ethics com-

mittee? *See* Model Rules, Rule 8.3(a) ("A lawyer having knowledge that another lawyer has committed a violation of the Rules of Professional Conduct that raises a substantial question as to the lawyer's honesty, trustworthiness or fitness in other respects, shall inform the appropriate professional authority."). What about the fact that it happened before Matthews was admitted to the bar? *See* Michigan OP. RI-29 (1989) (recognizing lawyer's duty to report law student's disciplinary violation to admissions authorities); Nassau County Bar Op. 94-23 (1994) (lawyer has no affirmative duty to report misconduct by applicant to the bar, but employer or former employer who is asked to provide information may not withhold information concerning misconduct by the applicant).

19. Regardless of what S&H's reporting obligations might be, does Johnson have any obligation to disclose to Rosetti what Johnson knows? *See* Model Rules, Rule 1.4(b) ("A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation."). Should Johnson consider himself bound by S&H's agreement not to tell? Remember that Rosetti is drawing great comfort from the fact that (a) Matthews is a lawyer and (b) Matthews worked for S&H earlier in her career. Does this matter?

20. Can a lawyer ethically take on an engagement where he or she will be negotiating against an affiliate of a possible future client? Is any disclosure or consent required? *See* note 17, *supra*.

21. Was there any legitimate reason to ask for this presentation? Does it create an unreasonable risk that Johnson might obtain confidential information about Helaina? Is there any constraint on his asking for it? *See* Annotated Model Rules, at 74-75 ("When a prospective client consults a lawyer in good faith for the purpose of obtaining legal representation or advice, the duty of confidentiality may arise under Rule 1.6 even though the lawyer performs no legal services for the would-be client and declines the representation."); ABA Formal Op. 90-358 (1990) (same).

22. Is that true? As an ethical matter? As a "client relations" matter? What if Helaina's litigation involved horrible allegations of fraud and lender liability? *See* Model Rules, Rule 1.9(a) ("A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interest of the former client unless the former client consents after consultation.").

23. A multiproperty retail deal may involve hundreds of lessees. Some random subset of those lessees may create trouble regarding estoppels and nondisturbance agreements to a point where lender's counsel needs to get involved in negotiations with them—either directly or through borrower's counsel as an intermediary. To check conflicts on all these lessees would be a major job, and it would probably show that in some random subset of cases, lender's counsel's firm presently represented some of the lessee(s). Should that be a problem? Whose decision should that be? Can the problem be avoided by obtaining prospective waivers of conflicts of interest? *See* ABA Formal Op. 93-372 (1993) (lawyer may obtain advance waiver of conflicts of interest arising out of the representation of future clients with potentially adverse interests, but the client must receive enough information to appreciate the consequences of the prospective waiver).

24. If he thought these situations were not conflicts, why did he go out of his way to avoid direct communications with the lessees? Was that practice an "admission" that the situation created a conflict? Or was it a reasonable and practical way to deal with a potentially sticky situation?

25. When a lawyer finds that he or she represents a party that is adverse to a new or potential client, how much can the lawyer say about the former engagement without breaching confidences to the first client? Should the lawyer say anything at all, or instead find some other reason to decline the engagement?

26. Do you agree with this conclusion?

27. Should Johnson insist on controlling the communications with outside third-party advisers? Can Johnson reasonably assume that the borrower will not use its control of the process to commit fraud? Does the answer depend on Johnson's view of the business reputation and ethics of the borrower? Or is it simply a risk he shouldn't take?

28. Shouldn't he keep the conflict printout as part of his "client intake" folder? Does he have an ethical obligation to do so? Any other obligation?

29. At this point, Johnson knew Helaina was represented by counsel. Was it proper for Johnson to communicate directly with Matthews? Does the fact that Matthews initiated the call change the result? What about the fact that she was a lawyer? *See* Model Rules, Rule 4.2 ("In representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized by law to do so.").

30. What flexibility did Johnson have to resign the engagement at this point? *See* Model Rules, Rule 1.16(b) ("a lawyer may withdraw from representing a client if withdrawal can be accomplished without material adverse effect on the interest of client"), *id.*; Rule 1.16(a)(1) (a lawyer must withdraw from the representation if the representation will result in a disciplinary violation).

31. Is that a correct statement of the principle? *See* Monroe H. Freedman, *Understanding Lawyers' Ethics* 49 (1990) ("In short, a lawyer should indeed have the freedom to choose clients on any standard he or she deems appropriate. . . . [T]he choice of client is an aspect of the lawyer's free will, to be exercised within the realm of the lawyer's moral autonomy."). In transactional real estate work, when does a lawyer lose the ability to "turn down" a prospective client? What if the engagement seems headed for trouble, but the lawyer can't point to any particular ethical proscription that it would violate? And what if a possible client is clearly "high maintenance"—likely to complain about any outcome (regardless of how good) and refuse to pay any bill (regardless of how low)? What if a possible client has already fired four previous firms that handled this matter, and is in litigation with two of them?

32. The Matthews conversation turned out to be highly substantive. Should Johnson have cut off the conversation at some point, and continued it through Helaina's counsel instead? *See* Model Rules, Rule 4.2.

33. In other words, Matthews needed S&H to help preserve the secrecy of her earlier transgressions. If Johnson uses this leverage to obtain Helaina as a client or even as part of the negotiation process for this deal, does that amount to implied blackmail? If so, how can Johnson solve the problem? If his goal is to pursue Helaina as a future client, does he have a conflict of interest? *See* Model Rules, Rule 1.7(b), regarding conflicts arising out of the lawyer's own interest.

34. Was this within Witty's rights? If so, how far does Johnson have to go to comply with the request the next time Matthews calls? *See* Model Rules, Rule 4.2.

35. Should Johnson have cut Matthews off before she started talking about the environmental reports? Matthews is the client and she obviously knows what

she's doing. Does she have the right to overrule Witty's preferences about controlling communications? Can Johnson proceed accordingly? *See* Model Rules, Rule 4.2. Should Johnson tell Witty?

36. Assume Johnson should have cut off all direct communications with Matthews. On that assumption, does the Marilyn's Mountain House nonrecourse clause now amount to "forbidden fruit" because it would never have been part of the transaction but for those direct communications? Should Johnson simply use Wildside's standard nonrecourse clause? Is it his decision? Wildside's decision?

37. Was that the right way to handle the environmental reports? Was the paralegal supposed to do anything with them?

38. Are there any particular concerns that arise when lender's counsel realizes the business structure originally contemplated by the parties is not going to work and they seem to be shifting toward a much riskier structure?

39. Should Kalson Lending have its own counsel? It was not a wholly-owned affiliate of Helaina. Was Johnson supposed to protect the minority investors in Kalson Lending against any possible imprudence or disregard of their interests by Wildside? Just who is Johnson's client?

40. To what extent should a lawyer closing commercial real estate loans know and understand applicable banking (and other) regulatory restrictions? Do clients typically expect their "deal counsel" to advise them on these issues? Should Johnson clarify his responsibility for these issues, one way or the other, with Wildside? Can he agree with Wildside that they will handle, internally, issues relating to legal lending restrictions? Can a lawyer disclaim responsibility for knowing about a whole area of law potentially relevant to the work he or she is doing? And if Wildside does think Johnson is looking out for these issues, what should Johnson do to make sure he handles them competently? Are e-mails enough?

41. Did he?

42. Who was Johnson's client? Rosetti's group? The legal department? Wildside generally?

43. Aside from the concern in the legal department about mezzanine lending, if Johnson was himself growing very concerned about the wisdom of the contemplated transaction, is there anything he should have done? Clearly Rosetti wanted to maximize her current bonus, but what if it was patently obvious to Johnson that the transaction would inevitably come back to haunt Wildside sometime soon after the closing? When that happens, Rosetti will probably be living on an island somewhere, spending her accumulated bonuses, but Johnson and S&H will probably still be representing Wildside and, potentially, blamed for the problem. What, if anything, can or should he do now?

44. Was it proper for Matthews to dangle future work in front of Johnson? Does the answer depend on whether Matthews is a lawyer? Is there anything Johnson should now say or do about this interaction? If Johnson wants to take Matthews's bait, does he now have a conflict of interest?

45. Should Johnson say anything to his partner who he already knows is trying to get this work? Should Johnson chase the same work independently? Remember that Johnson already requested a copy of the materials that his partner prepared for Helaina Retail. Does it matter whether he actually received the materials? Reviewed them? Is this an issue of legal ethics at all? If not, then what?

46. Johnson now knows that either (a) the RFP process is a sham or (b) Matthews is trying even harder to manipulate Johnson. Again, is there anything he should say or do?

47. Did Johnson have an obligation to stop receiving these extracurricular reports?

48. This statement was not true when made, but Johnson had the ability to make it true. Did Johnson do anything wrong? Does the answer depend on whether "were" means "are"?

49. When can a real estate finance lawyer review an environmental report without assistance from an environmental lawyer? ABA Model Rules, Rule 1.1 ("A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.").

50. Is that true? If not, would a memo to legal have discharged Johnson's obligations? *See* ABA Model Rules, Rule 1.13(a), (b) (lawyer retained by organization represents the organization acting through its duly authorized constituents; but if the lawyer knows that an officer or employee is acting in violation of a legal obligation to the organization, the lawyer "shall proceed as is reasonably necessary in the best interest of the organization."). Should Johnson have reported the matter to the applicable ethics committee for investigation? *See* Model Rules, Rule 8.3(a). The district attorney or other prosecutors? Does the answer depend on what type of institution Wildside is?

51. Assume that no reasonable lender would proceed in the face of abject fraud of this type. If Rosetti nevertheless proceeds (and if Johnson reports it to the legal department, and the legal department doesn't seem to care either), does Johnson have an obligation to tell anyone else at Wildside? Outside of Wildside? *See* Model Rules, Rule 1.13.

52. What makes a fee "excessive"? *See* Model Rules, Rule 1.5(a) (listing factors relevant to determining reasonableness of a lawyer's fee). If the lawyer doesn't purport to tie the fee to billable hours—but simply negotiates at arm's length in an open market (is it an open market?) a specified number of dollars for a specified result—does the "time value" of the job matter? What if the lawyer is incredibly efficient? What if the lawyer's efficiency is driven by large investments previously made by the law firm? How far can a bar association or other "ethics" body go in discussing how much a lawyer can or can't charge for a particular result? When does an "ethical issue" become a "restraint of trade"?

53. Problem prevention techniques: (a) Keep it simple. (b) Watch the money. (c) Don't assume this deal is the same as the last one, even if it's "a cookie cutter." (d) Haste makes waste.

54. Problem Prevention Tip: Focus on the important stuff, particularly when under extreme time pressure.

55. Did Johnson have an obligation to (try to) correct something that he believed was a clear mistake by opposing counsel?

56. Is it Johnson's decision or Rosetti's? What if Johnson wants to correct the mistake but Rosetti wants to take advantage of the mistake? Should Johnson resign the engagement? *See* N.Y. City Op. 477 (1939) (when opposing lawyer recognizes inadvertent mistake in settlement agreement, lawyer should urge client to reveal the mistake and, if the client refuses, the lawyer should do so); ABA Informal Op. 86-1518 (1986):

> Where the lawyer for A has received for signature from the lawyer for B the final transcription of a contract from which an important provision previously agreed upon has been inadvertently omitted by the lawyer for B, the lawyer for A, unintentionally advantaged, should contact the lawyer for B to correct the error and need not consult A about the error.

57. Should Johnson's secretary have told the truth? Is a lawyer obligated to tell the truth about why he or she doesn't want to take a telephone call? *See* Model Rules, Rule 4.1 (in the course of representing a client, a lawyer shall not "make a false statement of material fact or law to a third person"). What's "material"?

58. Did Johnson have a professional obligation to be more careful about reading his e-mail? If the missed message was truly important, did the senders have an obligation to send it through a more "serious" medium than e-mail? Should e-mail administrators do what they can to filter out garbage e-mail to increase the likelihood that system users will actually see e-mails that matter?

59. Should the lawyers representing UW have gone into this level of detail, particularly before knowing the answers to their first questions?

60. But how much did the e-mail really need to say? "Less is more" may be a great rule in all kinds of contexts.

61. Can a lawyer share this kind of confidential information with his or her spouse (even if the spouse weren't going to pass the information on to anyone else)?

62. When Johnson sets in motion the short sales by his wife's cousin, Johnson is probably violating the securities laws. Is he also violating any obligations to any client(s)? *See* Model Rules, Rule 1.6.

63. Presumably the information about UW retained its confidential status even though it was e-mailed to thousands of people at S&H. If disclosure by someone else is inevitable, does that make it OK for a lawyer to make the same disclosure?

64. Would it be improper for Johnson to give Rosetti this advice?

65. If this fee is more than five times the highest "leasing fee" Johnson had ever before seen in his career, should this set off special alarm bells for Johnson? And if so, then what should he do? Or is it inappropriate for him to make judgments about the business terms of his clients' deals?

66. Is it appropriate for opposing counsel to discuss the potential amount of each other's bills?

67. Did Johnson have any obligation to Rosetti to disclose what he knew about the magnitude of the risk of UW bankruptcy? If so, how could Johnson harmonize that obligation with his firm's obligations to UW? Could Johnson deliberately "go slow" in closing the next transaction, in the hope that Rosetti would find out about UW's newest problems before Rosetti advanced Wildside's money? Would "going slow" violate any obligation of S&H to UW?

68. Does Johnson himself at some point become an accomplice to Matthews's fraud?

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Ethics and Professionalism

By Karl B. Holtzschue*

A. The General Rules (Description and Sources)

1. A LAWYER SHOULD KNOW THE RULES

A lawyer should be familiar with the Canons of Professional Responsibility, the Ethical Considerations and the Disciplinary Rules and, as a bare minimum, be careful to comply with the Disciplinary Rules. Specific guidance is given in opinions issued by the NYSBA Committee on Professional Ethics and local bar associations.

> A review of published decisions [as to violations of the Disciplinary Rules] shows that public discipline is largely confined to *failure to segregate client funds*, *stealing from clients*, *neglect* so gross as to delay or deny justice, *conflicts of interest* so gross as to cause identifiable client harm, inappropriate courtroom conduct so gross as to warrant criminal contempt, or *conspicuous dishonesty*.[1]

2. A LAWYER SHOULD REPRESENT A CLIENT COMPETENTLY. CANON 6

Attendance at a CLE program is a good start on compliance with EC 6-2: "A lawyer should maintain competence by participating in continuing legal education programs."

A lawyer shall not handle a legal matter which the lawyer knows or should know that he or she is not competent to handle, without associating with a lawyer who is competent to handle it.[2]

3. A LAWYER SHOULD REPRESENT A CLIENT ZEALOUSLY WITHIN THE BOUNDS OF THE LAW. CANON 7

A lawyer should represent the client zealously, but should accede to reasonable requests of opposing counsel, be punctual, avoid offensive tactics and treat with courtesy and consideration all persons involved in the legal process.[3]

A lawyer may exercise professional judgment to waive or fail to assert a right or position of a client.[4]

A lawyer may refuse to aid or participate in conduct that the lawyer believes to be unlawful, even though there is some support for an argument that the conduct is legal.[5]

A lawyer shall not assert a position when the lawyer knows or when it is obvious that such action would serve merely to harass another.[6]

A lawyer must not knowingly make a false statement of law or fact.[7]

A lawyer must not counsel or assist a client in conduct that the lawyer knows to be illegal or fraudulent.[8]

A lawyer who learns that a client has perpetrated a fraud shall promptly call upon the client to rectify the same; and if the client refuses, the lawyer shall reveal the fraud to the affected person, except when the information is protected as a confidence or secret.[9]

A lawyer shall not communicate on the subject of the representation with a party the lawyer knows to be represented by a lawyer, unless the lawyer has the prior consent of the lawyer representing the other party.[10]

4. A LAWYER SHOULD PRESERVE THE CONFIDENCES AND SECRETS OF A CLIENT. CANON 4

Except when permitted by the Disciplinary Rules, a lawyer shall not knowingly reveal a confidence or secret of a client to the disadvantage of the client.[11] A lawyer may reveal the intention of a client to commit a crime and the information necessary to prevent the crime.[12]

5. A LAWYER SHOULD EXERCISE INDEPENDENT PROFESSIONAL JUDGMENT ON BEHALF OF A CLIENT. CANON 5

Except with the consent of the client after full disclosure, a lawyer shall not accept employment if the exercise of professional judgment on behalf of the client will be or reasonably may be affected by the lawyer's own interests.[13]

A lawyer may represent multiple clients 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.[14]

With consent of the client after full disclosure, a lawyer may accept compensation from one other than the client (e.g., parent of client), but the lawyer may not permit the person who pays the lawyer to direct or regulate his or her professional judgment.[15]

6. A LAWYER SHOULD ASSIST THE LEGAL PROFESSION IN FULFILLING ITS DUTY TO MAKE LEGAL COUNSEL AVAILABLE. CANON 2

A lawyer shall not charge an excessive fee.[16]

A lawyer shall not divide a fee for legal services with another lawyer who is not a partner or associate unless the client consents after full disclosure, the division is in proportion to the services performed and the total fee does not exceed reasonable compensation.[17]

B. Referrals of Clients, Advertising and Brokers

1. Can a lawyer accept referrals from a broker? Yes. What about *repeated* referrals? Yes.[18]

2. Can a lawyer accept a referral fee from a *mortgage broker*? Yes, provided the client consents after full disclosure, all proceeds thereof are credited to the client if the client so requests, the aggregate attorney's fees are not excessive, and the attorney exercises independent professional judgment on behalf of the client.[19]

3. Can a lawyer pay for an advertisement in a broker's brochure? No.[20]

4. Can a lawyer also act as a *broker* in the same transaction? No.[21] What if the lawyer or his *spouse* has an interest in the brokerage agency? No.[22] If the lawyer's spouse is a broker, the lawyer may not share an office, accept the spouse's client as a client or permit unsolicited recommendations from the spouse's firm.[23] The lawyer can accept clients from a brokerage agency employing the spouse only if the spouse does not participate or benefit from the transaction.[24]

* * *

Excerpts from *The Lawyer's Code of Professional Responsibility* and selected Ethics Opinions follow.

PROFESSIONAL RESPONSIBILITY

The following excerpts from *The Lawyer's Code of Professional Responsibility* are selected for educational purposes as potentially relevant to purchases and sales of homes. In any particular case, the full text should be consulted.

The Canons embody the general concepts from which the Ethical Considerations and Disciplinary Rules are derived. The Ethical Considerations are aspirational and constitute a body of principles upon which the lawyer can rely for guidance. The Disciplinary Rules are mandatory and state the minimum level of conduct below which no lawyer can fall without being subject to disciplinary action.

The current Code was adopted effective January 1, 1970, with the most recent amendments through May 22, 1996. Another set of amendments was proposed by the NYSBA on January 24, 1997.[25]

CANON 1 A LAWYER SHOULD ASSIST IN MAINTAINING THE INTEGRITY AND COMPETENCE OF THE LEGAL PROFESSION

DR 1-102 Misconduct.

A. A lawyer or law firm shall not:

4. Engage in conduct involving dishonesty, fraud, deceit or misrepresentation.

CANON 2 A LAWYER SHOULD ASSIST THE LEGAL PROFESSION IN FULFILLING ITS DUTY TO MAKE LEGAL COUNSEL AVAILABLE

EC 2-17 The determination of a proper fee requires consideration of the interests of both client and lawyer. A lawyer should not charge more than a reasonable fee.

EC 2-18 The determination of the reasonableness of a fee requires consideration of all relevant circumstances, including those stated in the Disciplinary Rules. The fees of a lawyer will vary according to many factors, including the time required, the lawyer's experience, ability, and reputation, the nature of the employment, the responsibility involved and the results obtained.

EC 2-19 As soon as feasible after a lawyer has been employed, it is desirable that a clear agreement be reached with the client as to the basis of the fee charges to be made.

DR 2-103 Solicitation and Recommendation of Professional Employment.

B. A lawyer shall not compensate or give anything of value to a person or organization to recommend or obtain employment by a client, or as a reward for having made a recommendation resulting in employment by a client, except by any of the organizations listed in DR 2-103 [e.g., bar association referral service].

DR 2-106 Fee for Legal Services.

A. A lawyer shall not enter into an agreement for, charge or collect an illegal or excessive fee.

DR 2-107 Division of Fees Among Lawyers.

A. A lawyer shall not divide a fee for legal services with another lawyer who is not a partner in or associate of the lawyer's law firm or law office, unless:

1. The client consents to employment of the other lawyer after a full disclosure

that a division of fees will be made.

2. The division is in proportion to the services performed by each lawyer or, by a writing given to the client, each lawyer assumes joint responsibility for the representation.

3. The total fee of the lawyers does not exceed reasonable compensation for all services they rendered the client.

CANON 3 A LAWYER SHOULD ASSIST IN PREVENTING THE UNAUTHORIZED PRACTICE OF LAW

EC 3-6 A lawyer often delegates tasks to clerks, secretaries, and other lay persons. Such delegation is proper if the lawyer maintains a direct relationship with the client, supervises the delegated work, and has complete professional responsibility for the work product. This delegation enables a lawyer to render legal service more economically and efficiently.

DR 3-101 Aiding Unauthorized Practice of Law.

A. A lawyer shall not aid a non-lawyer in the unauthorized practice of law.

DR 3-102 Dividing Legal Fees with a Non-Lawyer.

A. A lawyer or law firm shall not share legal fees with a non-lawyer . . .

CANON 4 A LAWYER SHOULD PRESERVE THE CONFIDENCES AND SECRETS OF A CLIENT

DR 4-101 Preservation of Confidences and Secrets of a Client.

B. Except when permitted under DR 4-101(C), a lawyer shall not knowingly:

1. Reveal a confidence or secret of a client.

2. Use a confidence or secret of a client to the disadvantage of a client.

3. Use a confidence or secret of a client for the advantage of the lawyer or of a third person, unless the client consents after full disclosure.

C. A lawyer may reveal:

1. Confidences or secrets with the consent of the client or clients affected, but only after a full disclosure to them.

2. Confidences or secrets when permitted under Disciplinary Rules or required by law or court order.

3. The intention of a client to commit a crime and the information necessary to prevent the crime.

4. Confidences or secrets necessary to establish or collect the lawyer's fee or to defend the lawyer or his or her employees or associates against an accusation of wrongful conduct.

5. Confidences or secrets to the extent implicit in withdrawing a written or oral opinion or representation previously given by the lawyer and believed by the lawyer still to be relied upon by a third person where the lawyer has discovered that the opinion or representation was based on materially inaccurate information or is being used to further a crime or fraud.

CANON 5 A LAWYER SHOULD EXERCISE INDEPENDENT PROFESSIONAL JUDGMENT ON BEHALF OF A CLIENT

EC 5-1 The professional judgment of a lawyer should be exercised, within the bounds of the law, solely for the benefit of the client and free of compromising influences and loyalties. Neither the lawyer's personal interests, the interests of other clients, not the desires of third persons should be permitted to dilute the lawyer's loyalty to the client.

EC 5-2 A lawyer should not accept proffered employment if the lawyer's personal interests or desires will, or there is reasonable probability that they will, affect adversely the advice to be given or services to be rendered the prospective client.

EC 5-14 Maintaining the independence of professional judgment required of a lawyer precludes acceptance or continuation of employment that will adversely affect the lawyer's judgment on behalf of or dilute the lawyer's loyalty to a client. This problem arises whenever a lawyer is asked to represent two or more clients who may have differing interests, whether such interests be conflicting, inconsistent, diverse, or otherwise discordant.

EC 5-15 If a lawyer is requested to undertake or to continue representation of multiple clients having potentially differing interests, the lawyer must weigh carefully the possibility that the lawyer's judgment may be impaired or loyalty divided if the lawyer accepts or continues the employment. The lawyer should resolve all doubts against the propriety of the representation. . .there are many instances in which a lawyer may properly serve multiple clients having potentially differing interests in matters not involving litigation. If the interests vary only slightly, it is generally likely that the lawyer will not be subjected to an adverse influ-

ence and that the lawyer can retain his or her independent judgment on behalf of each client; and if the interests become differing, withdrawal is less likely to have a disruptive effect upon the causes of the clients.

EC 5-21 The obligation of a lawyer to exercise professional judgment solely on behalf of the client requires disregarding the desires of others that might impair the lawyer's free judgment. The desires of a third person will seldom adversely affect a lawyer unless that person is in a position to exert strong economic, political, or social pressures upon the lawyer.

DR 5-101 Refusing Employment When the Interests of the Lawyer May Impair Independent Professional Judgment

A. Except with the consent of the client after full disclosure, a lawyer shall not accept employment 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 interests.

DR 5-104 Limiting Business Relations With a Client.

A. A lawyer shall not enter into a business transaction with a client if they have differing interests therein and if the client expects the lawyer to exercise professional judgment therein for the protection of the client, unless the client has consented after full disclosure.

B. Prior to conclusion of all aspects of the matter giving rise to employment, a lawyer shall not enter into any arrangement or understanding with a client or a prospective client by which the lawyer acquires an interest in literary or media rights with respect to the subject matter of the employment or proposed employment.

DR 5-105 Refusing to Accept or Continue Employment if the Interests of Another Client May Impair the Independent Professional Judgment of the Lawyer.

A. A lawyer shall decline proffered employment if the exercise of independent professional judgment in behalf of a client will be or is likely to be adversely affected by the acceptance of the proffered employment, or if it would be likely to involve the lawyer in representing differing interests, except to the extent permitted under DR 5-105(C).

B. A lawyer shall not continue multiple employment if the exercise of independent professional judgment in behalf of a client will be or is likely to be adversely affected by the lawyer's representation of another client, or if it would be likely to involve the lawyer in representing differing interests, except to the extent permitted under DR 5-105(C).

C. In situations covered by DR 5-105(A) and (B), a lawyer may represent multiple clients if it is obvious[26] 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.

DR 5-107 Avoiding Influence by Others than the Client.

A. Except with the consent of the client after full disclosure a lawyer shall not:

1. Accept compensation for legal services from one other than the client.

2. Accept from one other than the client anything of value related to his or her representation of or employment by the client.

B. A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal service for another to direct or regulate his or her professional judgment in rendering such legal services.

DR 5-108 Conflict of Interest—Former Client.

A. Except with the consent of a former client after full disclosure a lawyer who has represented the former client in a matter shall not:

1. Thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client.

2. Use any confidences or secrets of the former client except as permitted by DR 4-101(C) or when the confidence or secret has become generally known.

CANON 6 A LAWYER SHOULD REPRESENT A CLIENT COMPETENTLY

EC 6-2 A lawyer is aided in attaining and maintaining competence by keeping abreast of current legal literature and developments, participating in continuing legal education programs, concentrating in particular areas of the law, and by utilizing other available means.

DR 6-101 Failing to Act Competently.

A. A lawyer shall not:

1. Handle a legal matter which the lawyer knows or should know that he or she is not competent to handle, without associating with a lawyer who is competent to handle it.

2. Handle a legal matter without preparation adequate in the circumstances.

3. Neglect a legal matter entrusted to the lawyer.

CANON 7 A LAWYER SHOULD REPRESENT A CLIENT ZEALOUSLY WITHIN THE BOUNDS OF THE LAW

DR 7-101 Representing a Client Zealously.

A. A lawyer shall not intentionally:

1. Fail to seek the lawful objectives of the client through reasonably available means permitted by law and the Disciplinary Rules, except as provided by DR 7-101(B). A lawyer does not violate this Disciplinary Rule, however, by acceding to reasonable requests of opposing counsel which do not prejudice the rights of the client, by being punctual in fulfilling all professional commitments, by avoiding offensive tactics, or by treating with courtesy and consideration all persons involved in the legal process.

2. Fail to carry out a contract of employment entered into with a client for professional services, but the lawyer may withdraw as permitted under DR 2-110, DR 5-102 and DR 5-105.

3. Prejudice or damage the client during the course of the professional relationship, except as required under DR 7-102.

B. In the representation of a client, a lawyer may:

1. Where permissible, exercise professional judgment to waive or fail to assert a right or position of the client.

2. Refuse to aid or participate in conduct that the lawyer believes to be unlawful, even though there is some support for an argument that the conduct is legal.

DR 7-102 Representing a Client Within the Bounds of the Law.

A. In the representation of a client, a lawyer shall not;

1. File a suit, assert a position . . . or take other action on behalf of the client when the lawyer knows or when it is obvious that such action would serve merely to harass or maliciously injure another.

3. Conceal or knowingly fail to disclose that which the lawyer is required by law to reveal.

5. Knowingly make a false statement of law or fact.

7. Counsel or assist the client in conduct that the lawyer knows to be illegal or fraudulent.

8. Knowingly engage in other illegal conduct or conduct contrary to a Disciplinary Rule.

B. A lawyer who receives information clearly establishing that:

1. The client has, in the course of the representation, perpetrated a fraud upon a person or tribunal shall promptly call upon the client to rectify the same, and if the client refuses or is unable to do so, the lawyer shall reveal the fraud to the affected person or tribunal, except when the information is protected as a confidence or secret.

DR 7-104 Communicating With One of Adverse Interest.

A. During the course of the representation of a client a lawyer shall not:

1. Communicate or cause another to communicate on the subject of the representation with a party the lawyer knows to be represented by a lawyer in the matter unless the lawyer has the prior consent of the lawyer representing such other party or is authorized by law to do so.

2. Give advice to a person who is not represented by a lawyer, other than the advice to secure counsel, if the interests of such person are or have a reasonable possibility of being in conflict with the interests of the lawyer's client.

DR 7-105 Threatening Criminal Prosecution.

A. A lawyer shall not present, participate in presenting, or threaten to present Criminal charges solely to obtain an advantage in a civil matter.

CANON 9 A LAWYER SHOULD AVOID EVEN THE APPEARANCE OF PROFESSIONAL IMPROPRIETY

EC 9-5 Separation of the funds of a client from those of the lawyer not only serves to protect the client but also avoids even the appearance of impropriety, and therefore

commingling of such funds should be avoided.

DR 9-102 Preserving Identity of Funds and Property of Others; Fiduciary Responsibility; Maintenance of Bank Accounts; Recordkeeping; Examination of Records.

A. Prohibition Against Commingling.

A lawyer in possession of any funds or other property belonging to another person, where such possession is incident to his or her practice of law, is a fiduciary, and must not commingle such property with his or her own.

B. Separate Accounts.

1. A lawyer who is in possession of funds belonging to another person incident to the lawyer's practice of law shall maintain such funds in a banking institution with the State of New York which agrees to provide dishonored check reports in accordance with the provisions of 22 NYCRR Part 1300. . . . Such funds shall be maintained, in the lawyer's own name, or in the name of a firm of lawyers of which he or she is a member, or in the name of the lawyer or firm of lawyers by whom he or she is employed, in a special account or accounts. . . .

2. A lawyer or the lawyer's firm shall identify the special bank account or accounts required by (B)(1) of this section as an "Attorney Special Account," or "Attorney Trust Account," or "Attorney Escrow Account," and shall obtain checks and deposit slips that bear such title.

4. Funds belonging in part to a client or third person and in part presently or potentially to the lawyer or law firm shall be kept in such special account or accounts, but the portion belonging to the lawyer or law firm may be withdrawn when due unless the right of the lawyer or law firm to receive it is disputed by the client or third person, in which event the disputed portion shall not be withdrawn until the dispute is finally resolved.

C. Notification of Receipt of Property; Safekeeping; Rendering Accounts; Payment or Delivery of Property.

A lawyer shall:

1. Promptly notify a client or third person of the receipt of funds, securities or other properties in which the client or third person has an interest.

3. Maintain complete records of all funds, securities, and other properties of a client or third person coming into the possession of the lawyer and render appropriate accounts to the client or third person regarding them.

D. Required Bookkeeping Records.

A lawyer shall maintain for seven years after the events which they record:

1. The records of all deposits in and withdrawals from the accounts specified in DR 9-102(B) and of any other bank account which records the operations of the lawyer's practice of law. These records shall specifically identify the date, source and description of each item deposited, as well as the date, payee and purpose of each withdrawal or disbursement.

2. A record for special accounts. . . .

3. Copies of all retainer and compensation agreements with clients.

4. Copies of all statements to clients or other persons showing the disbursement of funds to them or on their behalf.

5. Copies of all bills rendered to clients.

6. Copies of all records showing payments to lawyers, investigators or other persons, not in the lawyer's regular employ, for services rendered or performed.

7. Copies of all retainer and closing statements filed with the Office of Court Administration.

8. All checkbooks and checkstubs, bank statements, prenumbered canceled checks and duplicate deposit slips with respect to accounts specified in DR 9-102(B) and any other bank account which records the operations of the lawyer's practice of law.

E. Authorized Signatories.

All special account withdrawals shall be made only to a named payee and not to cash. Such withdrawals shall be made by check or, with the prior written approval of the party entitled to the proceeds, by bank transfer.

I. Disciplinary Action.

A lawyer who does not maintain and keep the accounts and records as specified and required by this Disciplinary Rule, or who does not produce any such records pursuant

to this Rule, shall be deemed in violation of these Rules and shall be subject to disciplinary proceedings.

ADVICE ON ETHICAL QUESTIONS

An attorney may obtain ethical guidance regarding questions concerning the attorney's own professional conduct by writing to the New York State Bar Association, Committee on Professional Ethics, One Elk Street, Albany, NY 12207, (phone: (518) 463-3200; fax: (518) 487-5694. Current volumes of ethics opinions issued by the Committee are available for purchase from the NYSBA Publications Department. Opinions since 1986 are also available on LEXIS.

SELECTED ETHICS OPINIONS OF THE NYSBA COMMITTEE ON PROFESSIONAL ETHICS

#38 (1966): A lawyer may not represent both buyer and seller of real estate where there is a clear instance of conflicting interests. Canon 6.

#162 (1970): An attorney may represent both buyer and seller of real property only when there are no actual or potential differing interests and there is complete disclosure to and consent by both clients. Canon 5; DR 5-105, 104; EC 5-1, 5-14 to 19.

#208 (1971): Lawyer-real estate broker should not act as both a lawyer and as a broker for a client or party in the same transaction. Canon 5; EC 4-1, 5-2; DR 2-102(E), 5-101(A).

#244 (1972): Lawyer whose spouse is a real estate broker: (a) should not share office with spouse's firm; (b) should not accept as client a party to a real estate transaction involving spouse's firm; (c) should not permit unsolicited recommendation by spouse's firm to represent a party to a real estate transaction; (d) may act as attorney for spouse's firm to collect commissions earned if attorney did not represent any party to the real estate transaction. Canon 9; EC 5-2; DR 2-103(B).

#291 (1973): Lawyer may not accept legal fee and brokerage commission from same client in connection with same transaction, if he or his spouse has an interest in brokerage agency. Canon 5; EC 5-1, 5-2; DR 5-101(A).

#340 (1974): Lawyer whose spouse is a real estate salesperson working on a commission basis should not accept as client a party to a real estate transaction in which lawyer's spouse has participated as salesperson, but may act as attorney for clients who have used the brokerage agency employing the spouse, provided spouse has not participated in the transaction or benefited therefrom. Canons 5, 9; EC 5-2, 9-6; DR 2-103.

#351 (1974): An attorney may act as title examiner and agent for a title company in a real estate transaction where he also represents a party if there is full disclosure and consent [and credit to the client for any fees, unless the client expressly consents to retention of the fee]. DR 5-107(A), 5-105(C).

#438 (1976): Lawyer representing mortgagee may collect legal fees from mortgagor, so long as fees are not shared with lay corporation; attorney cannot represent mortgagor and mortgagee without express consent after full disclosure. EC 2-19; DR 5-105(C), (D), 5-107(A), 3-102.

#467 (1977): Not per se improper for lawyer to accept repeated referrals from real estate broker. Canon 5; EC 5-1, 5-21; DR 2-103(C), (D), 5-107(B).

#493 (1978): A lawyer may conduct his law practice and a real estate brokerage business from the same office, but he cannot solicit employment as a lawyer in violation of any statute or court rule, and he cannot act as lawyer and broker in the same transaction. DR 2-101, 2-102, 2-103.

#532 (1980): Lawyer escrow agent may not retain interest earned on funds during escrow. Canons 5, 9; EC 2-17, 2-18, 5-3, 9-5, 9-6; DR 2-106(A), 5-104(A), 9-102(A), (B).

#566 (1984): Advertisement improper if paid for endorsement or recommendation by third party to use attorneys' services and misleading if does not appear to be an advertisement but in fact is paid for by the attorney. DR 2-101(A), (B), 2-103(A)-(D).

#575 (1986): A lawyer holding a contract deposit as escrow agent-attorney should request instructions from the contracting parties about placing the funds in an interest-bearing account. DR 9-102.

#576 (1986): It is proper for an attorney representing a seller, buyer or mortgagee to act also as a title insurance agent provided such conduct is legal, no prohibited conflict exists, consent is obtained from all parties after full disclosure, the legal fee is reduced by remuneration for the title company absent express consent to the contrary from the client and the legal fee is not excessive. DR 1-102; DR 2-106(A); DR 5-105; DR 5-105(C); DR 5-107; DR 6-102(A); DR 7-102; EC 2-17. This opinion notes that the federal Real Estate Settlement Procedures Act and N.Y. Ins. Law 6409(d) proscribe unearned fees for referrals.

#595 (1988): Improper for law firm that represents real estate clients, and that has formed and is a principal in an abstract company, to refer clients to the title abstract company except for purely ministerial

title searches. EC 5-2; DR 3-103(A), 5-101(A).

#611 (1990): An attorney should not represent both the seller and lender in the same transaction except under unusual circumstances and unless the conditions of DR 5-105(C) are met. DR 5-105(C). This opinion notes that Op. 38 (1966) states that a lawyer may represent the buyer and seller in carrying out their common desire to close a real estate transaction, but only "in unusual and very limited circumstances, and only after complete disclosure and consent." If an actual conflict of interest arises, the lawyer must withdraw from representing either party.

#621 (1991): It is improper for an attorney to refer a client to an abstract company in which the attorney has an ownership interest (see dissent). DR 5-101(A), 5-105(C).

#626 (1992): A lawyer representing a lender in a transaction where the fee is paid by the borrower must disclose to the borrower that the lawyer also will receive compensation from the title insurer for representing its interests at closing; the lawyer may retain the total fees paid by the borrower and title insurer so long as the lender-client consents and the total amount is not excessive. DR 2-106(A); DR 4-101; DR 5-107(A); EC 2-17. This opinion clarifies and amplifies Op. 595 (1988).

#667 (1994): An attorney may accept a referral fee from a mortgage broker, provided the client consents after full disclosure, all proceeds thereof are credited to the client if the client so requests, the aggregate attorney's fees are not excessive, and the attorney exercises independent professional judgment on behalf of the client. EC 2-21, 5-1; DR 2-106(A), 5-107(A)(2).

#677 (1995): A lawyer may delegate attendance at a real estate closing to a paralegal under certain circumstances (if task is merely ministerial). EC 1-8, 3-1, 3-5, 3-6; DR 1-104(A).

Endnotes

1. Fales, *The Bar Association's Role in Maintaining Professionalism*, 69 N.Y. St. B.J. 49 (May/June 1997) (emphasis supplied).
2. DR 6-101.
3. DR 7-101(A)(1).
4. DR 7-101(B)(1).
5. DR 7-101(B)(2).
6. DR 7-102(A)(1).
7. DR 7-102(A)(5).
8. DR 7-102(A)(7).
9. DR 7-102(B).
10. DR 7-104.
11. DR 4-101(B)(1).
12. DR 4-101(C)(3).
13. DR 5-101.
14. DR 5-105(C).
15. DR 5-107.
16. DR 2-106.
17. DR 2-107.
18. NYSBA Ethics Op. 467 (1977).
19. NYSBA Ethics Op. 667 (1994).
20. NYSBA Ethics Op. 566 (1984).
21. NYSBA Ethics Op. 208 (1971); Op. 493 (1978). Conflict of interest.
22. NYSBA Ethics Op. 291 (1973).
23. NYSBA Ethics Op. 244 (1972).
24. NYSBA Ethics Op. 340 (1974).
25. Krane, *Proposed Amendments to the Code of Professional Responsibility: A Continuing Process of Change*, 69 N.Y. St. B.J. 42 (May/June 1997).
26. Author's Note: A proposed amendment would substitute for "obvious": "unless a disinterested lawyer would believe that the representation of the client will not be adversely affected thereby." 59 N.Y. St. B.J. 44 (May/June 1997).

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Ethics Opinions

Set forth below are pertinent parts of some of the most recent Opinions of the New York State Bar Association Committee on Professional Ethics. In some instances, because of the perceived applicability or general interest to real property practitioners, the complete Opinion has been reproduced.

The complete text of Ethics Opinions may be obtained by calling or writing: New York State Bar Association (518) 463-3200, One Elk Street, Albany, New York 12207. The Ethics Opinions are also available on the Bar Association's Web site: *www.nysba.org/opinions/opinions/html.*

Inquiries may be mailed to: Committee on Professional Ethics at One Elk Street, Albany, New York 12207 or faxed to (518) 487-5694 or e-mailed to Ethics at nysba.org. All inquiries should include the inquirer's name, mailing address, telephone and fax numbers.

Opinion 705—5/26/98 (43-97)

Topic: Aiding unauthorized practice of law; fee splitting with non-attorney; acceptance of cases from non-attorney tax reduction company.

Clarifies N.Y. 371 (1975)

Digest: Whether it is improper for an attorney to accept cases from a non-attorney tax reduction company that has agreed to engage counsel to conduct judicial proceedings in the event the company is unsuccessful in securing a reduction of property taxes in administrative proceedings depends on the specific circumstances; the attorney may agree to work for a percentage of the tax reduction company's fee, which itself is a percentage of the amount by which property taxes are reduced.

Code: DR 2-103, DR 3-101(A), DR 3-102(A); EC 7-7, EC 7-9

Questions

1. May an attorney accept an engagement by non-attorney tax reduction company to represent a property owner in Supreme Court proceedings?
2. If so, may the attorney agree to work for a percentage of the tax reduction company's fee, which is one-third of any amounts by which taxes are reduced?

Conclusion

It is not necessarily improper for an attorney to accept cases from a non-attorney tax reduction company that has agreed to engage counsel to conduct judicial proceedings after the company failed to secure a reduction of property taxes in administrative proceedings, although the attorney may not do so if the business of the tax reduction company constitutes the unauthorized practice of law and the attorney's acceptance of repeated referrals assists that improper conduct. The attorney may agree to work for a flat fee or a percentage of the tax reduction company's fee, which itself is a percentage of the amount by which property taxes are reduced.

Opinion 706—9/15/98 (19-98)

Topic: Entertainment of judges.

Digest: Law firm may not host a holiday party exclusively for judges and their law clerks.

Code: DR 7-110A, DR 9-101(C), EC 9-1

Question

May a lawyer ethically host a holiday party for all judges of the local court and their law clerks where the only other guests in attendance are attorneys in the lawyer's law firm?

Conclusion

Accordingly, hosting a holiday party exclusively for the local judiciary and their law clerks is impermissible under DR 7-110(A) and Canon 9.

Opinion 707—9/15/98 (28-98)

Topic: Sale of portion of law practice.

Digest: A lawyer may not sell a portion of a law practice.

Code: DR 2-111; EC 4-6 (former)

Question

May a lawyer who contemplates limiting the fields of law in which he or she practices sell the part of the practice from which the lawyer is withdrawing?

Conclusion

A lawyer may not sell a portion of the lawyer's practice and continue practicing in other limited or specific fields in the same geographic area.

Opinion 709—9/16/98 (55-97)

Topic: Use of Internet to advertise and to conduct law practice focusing on trademarks; use of Internet e-mail; use of trade names.

Digest: Attorney may operate and advertise a trademark practice over the Internet, as long as attorney complies with (a) the Code's obligations to check client conflicts; (b) court rules requiring the posting of a statement of Client's Rights and Responsibilities; (c) the obligation to preserve client confidences by assuring that use of e-mail is reasonable; and (d) the Code's advertising rules and perhaps those of other jurisdictions. The attorney may not engage in or advertise a more limited form of trademark business under a trade name if the business constitutes the practice of law.

Code: DR 1-102(A), DR 2-101, DR 2-101(B), DR 2-102, DR 2-102(B), DR 2-102(D), DR 2-101(F), DR 2-103(A), DR 2-106, DR 3-101(B), DR 4-101(A), DR 4-101(B), Canon 6, EC 2-10, EC 2-13, EC 3-5, EC 3-9, EC 4-1, EC 8-3

Questions

An attorney plans to create an Internet web site in connection with a business that will conduct trademark searches, render legal opinions on availability of trademarks, and file and prosecute applications to register trademarks. The web site will have the capability to take orders from clients from all over the country on the Internet, and charge their credit cards a pre-determined fee for each applicable service. The attorney will speak to clients by telephone when they request a legal opinion, but will otherwise rely on unencrypted Internet e-mail to communicate with clients.

We address the following questions in connection with this proposed conduct:

1. May an attorney make his or her services available through the Internet, including taking orders for conducting trademark searches, communicating with clients using Internet e-mail, conducting trademark searches, rendering legal opinions on trademark availability, filing trademark applications, and charging clients by credit card?

2. May an attorney advertise on the Internet utilizing a web site accessible throughout the United States where the attorney is licensed to practice law only in New York?

3. May an attorney licensed to practice only in New York render legal opinions to non-residents of New York, and if not, may the attorney limit his or her services to performing trademark searches and filing trademark applications on behalf of clients who reside outside of New York, since such services may be performed by non-lawyers?

4. May the attorney operate his or her practice under a trade name as well as his or her own name (*e.g.*, advertising and operating under the trade name "The Trademark Store") and also state that The Trademark Store is operated by the "Law Offices of _____")? If the attorney only performs the trademark searching and filing services that may be performed by non-lawyers, and does not render legal opinions, may the attorney operate the business under a trade name without using his or her own name?

1. Legal Practice on the Internet

There is no express provision in the Lawyer's Code of Professional Responsibility (the "Code") that addresses practicing law over the Internet. The Committee believes that using the Internet to take orders for trademark searches, conduct trademark searches, render legal opinions and file trademark applications is analogous to conducting a law practice by telephone or facsimile machine and is likewise permissible, subject to the same restrictions applicable to communication by those means. Some issues peculiar to practice on the Internet warrant additional comment, however.

A. Statement of Client's Rights and Responsibilities

New York's court rules require the posting of a Statement of Client's Rights and Responsibilities in a lawyer's office, and apply by their terms to any attorney who has an office in the state. 22 N.Y.C.R.R. § 1210.1. As a result, such rules may apply even where the attorney-client relationship is conducted exclusively through the Internet and the lawyer does not typically meet clients in the lawyer's office. In such

circumstances it would be prudent for the attorney to achieve substantial compliance with the terms of the rule (requiring posting of the Statement in the office "in a manner visible to clients") by including the full text of the Statement on the attorney's web site.

B. Conflicts Check

Next, DR 5-105(E) provides that New York lawyers must maintain a system of keeping records of prior engagements and checking them before undertaking a new matter to assure that the attorney will not violate DR 5-105's and DR 5-108's prohibitions on conflicting engagements. Practicing law for clients by means of the Internet does not give rise to any exemption from this fundamental obligation to avoid conflicts and not to undertake a new representation without checking to assure that it does not create an impermissible conflict. *See generally* N.Y. State 664 (1994) (requiring conflicts check by lawyer providing specific legal advice to clients by means of "900" telephone service). We recognize, however, that a conflicts check is not required where the attorney's interaction is limited to providing general information of an educational nature, no confidential information is obtained from a client and no specific advice tailored to a client's particular circumstances is rendered. *Id.; cf.* N.Y. 625 (1992); N.Y. State 636 (1992). In such circumstance, the recipient of such general advice need not be included in the lawyer's records of past engagements.

C. Reliability of Internet Information

To the extent that the attorney in performing legal research for clients relies on information obtained from searching Internet sites, the attorney's duty under Canon 6 to represent the client competently requires that the attorney take care to assure that the information obtained is reliable.

D. Use of Internet E-Mail

As to the attorney's use of Internet e-mail to communicate with clients, we note that the fiduciary relationship between an attorney and client requires the preservation of confidences and secrets, EC 4-1, and an attorney is prohibited from "knowingly" revealing a client confidence or secret. DR 4-101(B). Significantly, the Code expressly requires attorneys to "exercise reasonable care" to prevent others at his or her firm from disclosing a client's confidences or secrets, DR 4-101(D), and EC 4-4 provides that a "lawyer should endeavor to act in a manner which preserves the evidentiary privilege; for example, the lawyer should avoid professional discussions in the presence of persons to whom the privilege does not extend." It is fair to state that an attorney has a duty to use reasonable care to protect client confidences and secrets; whether the use of Internet e-mail is consistent with that duty depends upon the likelihood of interception.

Other ethics committees that have considered this or analogous issues have reached inconsistent conclusions. *Compare* Az. Op. 97-04 (e-mail may pose a risk to confidentiality); Iowa Op. 96-1 (attorneys must obtain waiver from clients as to e-mail security risk); N.Y. City 94-11 (advising that an attorney should use caution and consider security measures when speaking to a client via cordless or cellular telephone because of the risk that the client's confidences or secrets may be overheard); *with* D.C. Op. 281 (1998) (no *per se* rule barring use of unencrypted Internet e-mail to transmit client confidences); South Carolina Op. 97-08 (examining the privacy of Internet communications in view of current technology and laws prohibiting interception or monitoring of e-mail communications, and concluding that Internet users may have a reasonable expectation of confidentiality); Vt. Op. 97-5 (e-mail may pose no risk to confidentiality).

The Electronic Communications Privacy Act ("ECPA"), 18 U.S.C. §§ 2510 *et seq.*, criminalizes the interception of e-mail transmissions and also appears to mitigate the risk of loss of the evidentiary privilege. 18 U.S.C. § 2517(4) ("[n]o otherwise privileged wire, oral, or electronic communication intercepted in accordance with, or in violation of, the provisions of [the ECPA] shall lose its privileged character"). Similarly, in 1998 New York enacted comparable protection for the evidentiary privilege in an amendment to the CPLR.[1] Although the federal and New York statutes may resolve the question of whether use of Internet e-mail waives the evidentiary privilege (a question of law outside the scope of this Committee's jurisdiction), at least to the extent the privilege at issue is governed by federal or New York law, the statutes do not directly resolve the lawyer's independent ethical duty to avoid disclosure of a client's confidences and secrets. The lawyer's ethical duty is broader than the obligation to preserve the privilege, as the Code extends the duty of non-disclosure to client "secrets," which are explicitly defined by the Code to encompass certain client-related information that is *not* protected by the evidentiary attorney-client privilege. DR 4-101(A), (B). Consequently, the recent additions in federal and state law providing that use of e-mail does not by itself jeopardize the applicability of the attorney-client privilege cannot dispose of the ethical issues.

In considering the ethical issue, we believe that the criminalization of unauthorized interception of e-mail certainly enhances the reasonableness of an expectation that e-mails will be as private as other forms of telecommunication. That prohibition, together with the developing experi-

ence from the increasingly widespread use of Internet e-mail, persuades us that concerns over lack of privacy in the use of Internet e-mail are not currently well founded. So far as we are aware, there is little evidence that the use of unencrypted Internet e-mails has resulted in a greater risk of unauthorized disclosure than is posed by other forms of communication that are commonly used without compromising ethical obligations, such as telephones and facsimile machines. We therefore conclude that lawyers may in ordinary circumstances utilize unencrypted Internet e-mail to transmit confidential information without breaching their duties of confidentiality under Canon 4 to their clients, as the technology is in use today. Despite this general conclusion, lawyers must always act reasonably in choosing to use e-mail for confidential communications, as with any other means of communication. Thus, in circumstances in which a lawyer is on notice for a specific reason that a particular e-mail transmission is at heightened risk of interception, or where the confidential information at issue is of such an extraordinarily sensitive nature that it is reasonable to use only a means of communication that is completely under the lawyer's control, the lawyer must select a more secure means of communication than unencrypted Internet e-mail.

A lawyer who uses Internet e-mail must also stay abreast of this evolving technology to assess any changes in the likelihood of interception as well as the availability of improved technologies that may reduce such risks at reasonable cost.[2] It is also sensible for lawyers to discuss with clients the risks inherent in the use of Internet e-mail, and lawyers should abide by the clients' wishes as to its use.

E. Payment By Credit Card

There is nothing in the Code prohibiting an attorney from accepting payment by credit card as long as the fee charged is not excessive and the fee arrangement does not otherwise violate any Code provision. N.Y. State 399 (1975); N.Y. State 362 (1974); *see* DR 2-106. The lawyer's duty to safeguard client interests and property also requires the lawyer who accepts payment by credit card via the Internet to assure that the privacy of the client's credit card information will be preserved.

2. Advertising on the Internet

The Code's advertising rules are intended to protect the public from false and misleading advertisements. There is no ethical distinction to be drawn among different forms of advertising directed to a general population. *See, e.g., Shapero v. Kentucky Bar Assoc.*, 486 U.S. 466, 473 (1988) ("lawyer advertising cases have never distinguished among various modes of written advertising to the general public"); *In re Koffler*, 432 N.Y.S.2d 872, 875 (Ct. App. 1980) (direct mail solicitation by attorneys of potential clients is constitutionally protected commercial speech), *cert. denied*, 450 U.S. 1026 (1981); *cf* ABA Model Rule 7.2(a) (permitting advertising in "public media," including "a telephone directory, legal directory, newspaper or other periodical, outdoor advertising, radio or television, or through written or recorded communication"). Accordingly, we believe that advertising via the Internet—an electronic form of public media—is permissible as long as the advertising is not false, deceptive or misleading, and otherwise adheres to the requirements set forth in the Code. DR 2-101, DR 2-102, EC 2-10.

In addition to the other guidelines for lawyer advertising set forth in DR 2-101, we note that DR 2-101(F) requires retention and in some circumstances filing of advertisements with a departmental disciplinary committee, depending upon the medium used to distribute the advertisement. Thus, broadcasts must be tape recorded and preserved by the lawyer for one year; a copy of mailed advertisements must be filed as noted, and the address list retained by the attorney for a year. We conclude that an Internet web site advertisement is more analogous to a radio or TV broadcast, in which the attorney has no means of identifying the audience, than it is to a mass mailing in which the address list is within the attorney's control. Therefore, the attorney must keep a copy of any Internet advertisement for a period of not less than one year following its last use, but need not file a copy with a departmental disciplinary committee. The copy may be maintained by the attorney in electronic form.

There is no ethical prohibition in the Code against advertising to solicit clients who reside outside the state of New York with respect to matters as to which the lawyer may competently and lawfully practice. However, any Internet advertisement should inform a potential client of the jurisdiction in which the attorney is licensed, and should not mislead the potential client into believing that the attorney is licensed in a jurisdiction where the attorney is not licensed. *See* DR 2-102(D); ABA/BNA Lawyers Manual on Professional Conduct 81:551 at 57 ("lawyer's Web page should clearly identify those states in which he is licensed to practice"); South Carolina Op. 94-27 (1995) (any advertisement by a lawyer on the Internet that may reach potential clients in jurisdictions where lawyer is not admitted to practice must clearly identify the geographic limitations of lawyer's practice or risk being deemed misleading); *see also Florida Bar v. Kaiser*, 397 So.2d 1132, 1133 (Fl. Sup. Ct. 1981) (lawyer engaged in unauthorized practice where his law firm's advertisements gave the impression that he was authorized to practice in Florida).[3]

3. Services to Clients Outside New York

DR 3-101(B) provides that a lawyer "shall not practice law in a jurisdiction where to do so would be in violation of regulations of the profession in that jurisdiction." Thus, whether a lawyer licensed only in New York may render legal opinions over the Internet to clients who reside outside of New York depends on whether the attorney's conduct constitutes the unauthorized practice of law in the other jurisdiction. That question is beyond the scope of this Committee's jurisdiction, though we note that lawyers licensed in one state may appropriately render legal services to clients resident elsewhere in many circumstances. N.Y. State 375 (1975). *But see Birbrower, Montalbano, Condon & Frank v. Superior Court of Santa Clara County*, 70 Cal. Rptr. 2d 304, 306 (Cal. Sup. Ct. 1998) (New York firm that performed legal services in California engaged in the unauthorized practice of law in violation of California statute). We are similarly unable to opine on whether the limitation of the practice to federal trademark issues affects the applicability of state laws regarding unauthorized practice. *See* Charles W. Wolfram, "Sneaking Around in the Legal Profession: Interjurisdictional Unauthorized Practice by Transactional Lawyers," 36 Tex. L. Rev. 665 (1995).

Finally, if an attorney licensed only in New York limits his or her services to trademark searches and filing trademark applications as non-lawyers are typically permitted to do, whether or not the attorney may provide such limited services to clients who reside outside of New York in matters arising in a non-New York jurisdiction is governed by the laws and rules of the other jurisdiction, and therefore is also beyond the scope of this Committee.

4. Use of a Trade Name for a Law Practice

Operating the proposed law practice under a trade name is prohibited by the Code. DR 2-102(B) provides that "[a] lawyer in private practice shall not practice under a trade name." *See In re von Wiegen*, 481 N.Y.S.2d 40 (Ct. App. 1984) (use of phrase "The Country Lawyer" immediately below lawyer's name is acceptable; *In re Shephard*, 459 N.Y.S.2d 632, 633 (3rd Dep't 1983) (finding "The People's Law Firm" was a prohibited trade name); *In re Shapiro*, 455 N.Y.S.2d 604, 605 (1st Dep't 1982) (finding "People's Legal Clinic, Inc." was a prohibited trade name). Operating the proposed law practice under a trade name, while simultaneously indicating in advertising materials that the company is operated by the attorney's law office, is likely to be confusing and misleading to the public as to whether the company and law office are separate entities.

Given the prohibition against attorneys practicing under a trade name in DR 2-102(B), whether an attorney may operate under a trade name a business limited to providing services that can permissibly be offered by non-lawyers depends on whether the attorney's conduct constitutes the practice of law. Although certain activities may be performed by lawyers and non-lawyers alike, this Committee has previously opined that certain activities that may be performed by non-lawyers constitute the practice of law when done by attorneys. *See, e.g.*, N.Y. State 705 (1998) (handling real estate tax reduction proceedings); N.Y. State 678 (1996) (providing divorce mediation services); N.Y. State 557 (1984) (providing accountant services).

On the other hand, this Committee also has opined that an attorney may maintain a separate business that does not involve the practice of law, and operate that business under a trade name, provided that the attorney does not use the separate business as a means of soliciting legal work in violation of any statute or court rule, does not recommend that clients of the law practice purchase a product of the separate business, does not hold himself or herself out as an attorney in connection with the separate business, and does not otherwise violate any ethical or legal rules. N.Y. State 636 (1992) (finding no *per se* ethical proscription to law firm establishing separate business selling will forms operating under the trade name "The Will Store" provided that the phrase was not used in conjunction with the names of the attorney principals, the business did not constitute the practice of law, and the separate business is not used to solicit legal practice); *cf.* N.Y. State 662 (1994) (refraining from holding oneself out as a lawyer may satisfy the literal language of N.Y. State 557, but would constitute deception in violation of DR 1-102(A)(4) where lawyer refrains in order to avoid an ethical prohibition and solicit legal work); EC 2-13 ("to avoid the possibility of misleading persons with whom a lawyer deals, a lawyer should be scrupulous in the representation of professional status").

The lawyer must closely scrutinize the services provided to make certain that the services do not involve the exercise of an attorney's professional judgment, which would constitute the practice of law. We provided the following guidance in N.Y. State 636:

> [T]o the extent that the wills are individualized and offered as a specific solution to individual problems or other services requiring the professional judgment of a lawyer are rendered, the business becomes the practice of law. EC 3-5. Furthermore, if in selling such forms to individual members of the public, an

employee provides assistance or advice in selecting the appropriate form or forms or in adapting their language to particular circumstances, the business becomes the practice of law.

Therefore, even though trademark searches and application filings may be performed by non-lawyers, to the extent that the attorney invokes his or her professional legal judgment in conducting searches or filing applications, the business becomes the practice of law and practicing under a trade name is prohibited.

Conclusion

The questions are answered in accordance with this Opinion.

Opinion 710—11/6/98 (35-98)

Topic: Lawyer as escrow agent; release of funds in escrow to client.

Clarifies N.Y. 371 (1975)

Digest: Absent authorization by all parties, lawyer who serves as escrow agent may not release funds to client except as provided in the escrow agreement; while lawyer may resign as escrow agent, provision must be made to protect funds in escrow.

Code: DR 9-102

Question

A lawyer has been holding funds in escrow for a number of years pursuant to a written agreement made incident to a real estate transaction in which the lawyer represented the sellers. The purpose of the escrow was to secure the purchasers against loss which they might sustain through "an assessment with regard to [a certain sidewalk] violation" by the local municipality. The inquirer states that a representative of the municipality has recently advised that for various reasons there is no possibility the municipality will issue an assessment. Still, the purchasers have refused to permit the lawyer to return the escrowed funds to the sellers, notwithstanding the purchaser's apparent awareness of the recent communications with the municipality. Further, the escrow agreement failed to authorize the lawyer to release the funds to the seller upon ascertaining that no assessment would be made with respect to the sidewalk violation. Nor did it provide for a procedure to resolve disputes relating to the funds in escrow.

Under such circumstances, may the lawyer return the escrowed funds to the clients upon furnishing the purchasers' attorney with an affidavit recounting the investigation and findings?

Opinion

As a general rule, an escrow agent has contractual and fiduciary duties to all parties to an escrow arrangement which may be discharged only in accordance with the terms of the escrow agreement or with the informed consent of all parties. Although the Code of Professional Responsibility imposes some additional obligations on the lawyer who serves as an escrow agent, *see, e.g.,* N.Y. State 575 (1986); N.Y. State 532 (1981), the lawyer's obligations derive principally from the substantive law of contracts and agency. To the extent that the inquiry in this case encompasses issues of substantive law, we are obliged to decline to provide the inquirer with guidance because the resolution of such matters is beyond the jurisdiction of this Committee.

In the event of a dispute relating to the funds in escrow, the escrow agent is required to follow the procedures set forth in the escrow agreement for its resolution. Unfortunately, the escrow agreement in question is silent with respect to dispute resolution. Without such a provision, it would be inappropriate for the lawyer to assume the power to resolve the dispute by releasing the escrow and returning the funds to the sellers, because the stipulated contingency for release of the funds has not occurred. *See* Brooklyn Op. 1993-1 (1993) (attorney escrowee may urge the parties to resolve the dispute, but, if the parties cannot do so amicably, "the attorney escrowee may not disburse the funds based on his or her own notions of fairness"); *see also* N.Y. City 82-8 (1982); N.Y. County 672 (1989).

The inquirer may resign as escrow agent; however, in such case the mandate of DR 9-102 to protect the property of others entrusted to the lawyer's custody requires that the lawyer take steps to preserve intact the funds in escrow and initiate a process whereby the dispute may be resolved. Unless the parties agree to some other arrangement, one way to do this would be for the lawyer to commence a stakeholder's action and deposit the funds with the court. *See* Brooklyn Op. 1993-1 (1993) (the attorney may commence an interpleader action or "[a]wait a suit by a party claiming entitlement to the funds and defensively interplead the remaining party"); *cf.* N.Y. City 1986-5 (1986).

The inquirer's predicament underscores the importance of anticipating problems which may arise when agreeing to act as an escrow agent and of making certain that the escrow agreement provides a means of dispute resolution. *See* New York City 1986-5 (1986) ("We stress the importance of having a carefully drafted escrow agreement that covers, among other things, possible disputes over the escrowed funds."). Attorneys should avoid the danger that such arrangements will be made casually in the press of a

real estate closing, without much thought being given to the possibility that the event stipulated for release of the funds in escrow may not occur.

Conclusion

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

Endnotes

1. New CPLR § 4547 provides:

   > No communication privileged under this article shall lose its privileged character for the sole reason that it is communicated by electronic means or because persons necessary for the delivery or facilitation of such electronic communication may have access to the content of the communication.

2. We note that recent press reports concerning a lack of security arising from the use of Internet e-mail have not reflected interceptions of the content of e-mails, but instead the possible effect of the use of e-mail programs on the security of the contents of the files stored in a computer that is connected to the Internet. *See, e.g.,* Denise Caruso, "Technology: As long as software code is kept secret, Internet security is at risk," N.Y. Times, Aug. 17, 1998, at D3. The security risk at issue is wholly separate from the use of e-mail to transmit confidential communications, as the content of e-mails is not itself intercepted, and the possible interception of the contents of stored computer files potentially occurs when a person receives an e-mail from the would-be interceptor. Should it become clear that a lawyer's use of Internet e-mail exposes the contents of the lawyer's computer files to a meaningful risk of unauthorized interception, lawyers will, of course, be unable to use Internet e-mail without taking steps to eliminate such risk.

3. We express no view as to whether Internet advertising may also be subject to the rules regulating lawyer advertising of other jurisdictions in which the advertising appears and from which potential clients are solicited. Other states have opined that lawyers may advertise over the Internet as long as they comply with that state's ethics and rules on advertising but have not necessarily asserted that such state's rules apply to lawyers licensed and practicing outside that state. Utah Op. 97-10 (attorney may advertise service on web page provided that attorney complies with the state's advertising rules); Iowa Op. 96-1 (Iowa lawyers advertising on the web page must comply with state's ethics rules including publication of mandatory disclosures); Penn. Op. 96-17 (law firm web site is permitted subject to state's advertising ethics rules, including disclosures of the geographic location of the law office and record-keeping requirements); Tenn. Op. 95-A-57 (Tennessee lawyer posting firm brochure on World Wide Web must comply with ethical rules regarding publicity); Tex. Disc. Rules of Prof. Conduct, Part 7, Comment 17 (lawyer's web sites are public media advertisement subject to state advertising rules); *see also* David Bell, *Internet Use Raises Ethics Questions*, Cal. St. B. J. at 36-37 (April 1996) (California rule and statute on attorney advertising applies to attorneys advertising on Internet); *Ethics Update*, Florida Bar News, Jan. 1, 1996 (lawyers' computer ads and industry web site on home pages are subject to Florida ethics rules on advertisements disseminated in electronic media). In addition, at least one state opinion suggests that lawyers should publish separate, unconnected web sites for in-state and out-of-state offices of the same law firm. Iowa Op. 96-14.

BERGMAN ON MORTGAGE FORECLOSURES . . .

Bruce J. Bergman, Esq.**
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When the Mortgage Assignee Does Not Have to Be Substituted

Slavish adherence to general notions of what is apparently wise and correct is sometimes—maybe most of the time—a safe and recommended course of action. As one old saying goes, surplusage does not vitiate. But, in a mortgage foreclosure case, lack of economy, both in expenditures and time, *can*—and often does—have a deleterious effect upon the result. Indeed, the hackneyed bromide "time is money" finds ready and persuasive application in the mortgage foreclosure arena.

So when a mortgage is assigned (a very common occurrence in modern mortgage commerce), the first thought is to record the assignment, a good idea in any event, and which will be discussed further in a moment. If the mortgage is assigned during the course of a foreclosure action, concomitant reaction is to move to amend the caption to substitute the assignee as plaintiff. Whether *that* is a good (or necessary) approach depends upon when during the action the assignment is given.

Returning to the recording of an assignment, as a matter of New York statute,[1] the recording is not itself notice of the assignment to the mortgagor or the owner of the mortgaged premises (if recorded after the conveyance to the new owner). Accordingly, the usual notice that a mortgage has been assigned still needs to be given—although that would not be necessary during the course of a foreclosure action. But statute[2] does necessitate filing the assignment of mortgage before a referee's deed is executed to the purchaser at the foreclosure sale.

Moreover, there are good, practical reasons why recording the assignment is recommended. In serving as notice to the world of the assignee's position, it offers some protection to that assignee. For example, were there to be a foreclosure of a senior mortgage, the risk of process being served upon the assignor with simultaneous neglect to advise the assignee disappears. A like analysis applies upon a tax lien foreclosure or a judgment creditor's sheriff sale, among others. Thus, while rushing to file an assignment is not mandated, it is suggested.

The second part of the issue is the necessity to amend the caption in a foreclosure action to substitute the assignee as the plaintiff. For the sake of clarity—and to avoid offering an apparent (though groundless[3]) defense to any party bent on delaying the action—amending the caption is a sage strategy. But a separate motion for that purpose is unnecessary and would only contribute to delay of the case. The relief can be requested as an addition to the standard relief at the next stage of the case when either a motion or an *ex parte* order naturally arises, e.g., the order of reference or the judgment stage.

Among the most often asked questions in foreclosure practice is, What happens if the assignment of mortgage is given subsequent to issuance of judgment of foreclosure and sale? And, need a special motion be made to amend the caption because the only event remaining in the case is the sale itself? The answer, as both a practical and legal matter, is "no." On the practical side, advise the referee of the assignment and bring a copy to the sale. An assignee stands in the shoes of the named plaintiff and all the benefits inure to that assignee, such as not being obligated to submit a bid deposit. Referees should, and typically do, readily understand this.

On a more technical basis, CPLR 1018, entitled "Substitution upon transfer of interest," provides that upon such a transfer, the action may be continued by the original parties *unless* the court orders the transferee to be substituted. The

issue has recently been litigated in a case where a defendant argued that a foreclosure should be dismissed because the named plaintiff (the assignor) owned no rights in the matter.[4] Based upon CPLR 1018, and absent a challenge to the substantive validity of the assignment, the First Department affirmed the trial judge in finding the argument without merit.[5]

To the extent that practitioners have always sensed that a post-judgment motion to substitute a plaintiff upon an assignment was not required, an appeals court has now confirmed that the feeling was absolutely correct.

Endnotes

1. N.Y. Real Prop. Law § 324.
2. N.Y. Real Prop. Acts. & Proc. Law § 1353(2).
3. N.Y. Civil Practice Law & Rules 1018 (CPLR); *Central Fed. Sav. v. 405 W. 45th Street*, __ A.D.2d __, 662 N.Y.S.2d 489 (1st Dept. 1997).
4. *Central Fed. Sav.*, __ A.D.2d __, 662 N.Y.S.2d 489.
5. *Id.*

****Mr. Bergman, author of the three-volume treatise, *Bergman on New York Mortgage Foreclosures*, Matthew Bender & Co., Inc. (Rev. 1998), is a partner with Certilman Balin Adler & Hyman in East Meadow, New York, outside counsel to a number of major lenders and servicers, and an Adjunct Associate Professor of Real Estate with New York University's Real Estate Institute where he teaches the mortgage foreclosure course. He is also a member of the USFN, the American College of Real Estate Lawyers and is on the faculty of the Mortgage Bankers Association of America School of Mortgage Banking.**

Report from Real Property Section Committee on Professionalism Concerning Executive Committee's Survey of Real Estate Practices and Interim Responses to the Survey

One concern expressed by many members of the State Bar's Real Property Law Section is the perceived increase in the use of non-lawyers in conducting real estate transactions. The Executive Committee, through its standing Committee on Professionalism, is in the process of conducting a survey on real estate transaction practices throughout the state. A copy of the survey is reproduced here and the Executive Committee encourages all members of the Section to respond to:

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Kreisberg Beebe et al.
6 Chester Avenue
White Plains, NY 10601

Peter V. Coffey, Esq.
Parisi, Englert, Stillman et al.
P.O. Box 1092
Schenectady, NY 12301

Co-chairs,
Committee on Professionalism

Once the survey results are tabulated, your Executive Committee will use this data to ascertain the quality of services being provided to the public and to determine whether we should recommend any further action on this issue.

What follows is an interim report based upon responses from some District Representatives to the Executive Committee. It is an overview of the practices conducted, first in the western part of the state, i.e., generally from Rochester to the western end of the state; second, the counties from Albany north to the Canadian border; and finally, the New York City metropolitan region, including the counties north of the city such as Westchester, Putnam, Orange, Rockland and Dutchess. Since, with minor variations, the practices of these counties are similar to those in the New York City area, these counties will be considered part of the metropolitan area for the purposes of this discussion.

The degree of non-lawyer involvement in real estate transactions varies according to the stage of the transaction and the region of the state. As a general principle, the northern and western parts of the state are more likely to have non-attorneys participate in a property transaction, and this involvement is most likely to occur in the critical early stages. Contracts of sale, typically standardized forms drafted by local bar organizations (in some cases, with input from the local realtor organization), are completed by real estate brokers in the north and west. The brokers prepare individualized riders to accompany the standard form and negotiate the deals for the buyers and sellers. In some instances, these riders will advise the parties of the brokers' potential conflicts of interest. Contracts of sale in these locations typically contain a clause allowing attorney approval after the signing of the agreement. The parties generally do retain counsel after signing the contracts, with a post-signing attorney review period extending from three to five days. The brokers are responsible for forwarding the executed contracts to the buyers' and sellers' respective attorneys.

In the New York City area, the contracts are prepared by the seller's attorney, who also prepares the rider accompanying the standardized contract prepared by the local bar association. This document is negotiated through the parties' attorneys prior to execution. It should be noted that the counties just north of the city have seen a few instances of broker-prepared contracts, which has been characterized as a slowly developing trend.

Once the contracts are signed and approved by counsel, attorneys are involved in most of the steps leading to the closing. In the counties north of Albany, instances have been reported where the buyer is not represented at closing and effectively relies upon the lender's attorney.

The Real Property Law Section is most interested in learning about the experiences of its members and, particularly, any information indicating the satisfaction or dissatisfaction of buyers and sellers with the practices in their respective areas. Accordingly, the Executive Committee encourages all members to complete the accompanying survey.

QUESTIONNAIRE TO DISTRICT REPRESENTATIVES
REAL ESTATE CLOSINGS AND THE UNAUTHORIZED PRACTICE OF LAW

Name _____

Representing District _____

Counties included within this District _____

1.	Is there a standard contract-of-sale form in use for the sale of residential real estate in your district (or portions thereof)?	Yes No	☐ ☐
2.	This form of contract was prepared by: (If form prepared by other than legal organization, please supply a copy of the form.)	Local bar association Other legal organization Realtor organization	☐ ☐ ☐
3.	Who usually fills out the standard form?	Seller's broker Buyer's broker Seller's attorney Buyer's attorney	☐ ☐ ☐ ☐
4.	a. Are riders usually added to the standard form by the person who fills it out?	Yes No	
	b. If so, are they. . .	standard riders? -or- individualized riders drafted by the person who filled out the form?	☐ ☐
5.	Does an attorney review the contract before the parties sign?	Yes No	☐ ☐
6.	Does an attorney participate in the negotiation of the terms of the contract prior to signing?	Yes No	☐ ☐
7.	If attorneys are not involved in the transaction prior to contract execution, who, in addition to the parties, participates in the negotiation of the contract? (Please check all that apply.)	Seller's broker Buyer's broker Other _____	☐ ☐ ☐
8.	If attorneys are not involved in the transaction prior to execution, how are the parties advised, if at all of a. risks associated with the sale/purchase of real estate; and b. possible conflict of interest of those mentioned in paragraph 5, above?	_____ _____ _____ _____ _____ _____	
9.	If attorneys do not prepare the contract please answer the following:	Yes	☐
	a. Do the contracts provide for attorney approval?	No	☐
	b. If yes, do sellers retain an attorney for this purpose?	(i) Mostly (ii) 50/50 (iii) Rarely	☐ ☐ ☐
	c. Do purchasers retain an attorney for this purpose?	Yes No	☐ ☐

d. Regarding the time for attorney approval is it generally:
- (i) Under 3 days ☐
- (ii) 3 days ☐
- (iii) 4-5 days ☐
- (iv) Over 5 days ☐

e. Are "days" defined as business days?
- Yes ☐
- No ☐

f. Who has the responsibility for seeing the party's attorney receives a copy of the contract?

_____

_____

g. If the contract is delivered to the attorney after the time for attorney approval, do attorneys in your area generally accept a late attorney's approval or disapproval, i.e. within a reasonable time after the expiration of the time period?
- Yes ☐
- No ☐

h. Brokers are
- (i) Generally accepting of an attorney approval ☐
- (ii) Generally resistant to attorney approval ☐

i. Please set forth your opinion as to the attorney approval process both regarding the concept and its practical application.

_____

_____

_____

10. Who usually prepares the deed?
- Seller's attorney ☐
- Buyer's attorney ☐
- Lender's attorney ☐
- Title insurance attorney ☐
- Other _____ ☐

_____

11. Who usually orders the title insurance?
- Buyer's Attorney ☐
- Real Estate Broker ☐
- Seller's Attorney ☐
- Lender's Attorney ☐
- Other: ☐

12. Does an attorney for the buyer review the title report?
- Yes ☐
- No ☐

13. Is the buyer represented at closing by an attorney?
- Yes ☐
- No ☐

14. If not, who, if anyone, represents the buyer, or whom does the buyer appear to rely upon? For example, if there are multiple buyers, who advises them on how to take title?

_____

_____

_____

15. Is the seller represented at closing by an attorney?
- Yes ☐
- No ☐

16. If not, who, if anyone represents the seller?

_____

_____

_____

_____

Return to:

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