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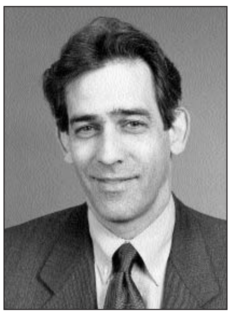
A Message from the Section Chair



It is often not as obvious as one might imagine to determine why lawyers join bar associations, and in particular what New York real estate lawyers expect to receive from the Real Property Section. In a spirit of open inquiry and an attempt to better achieve "customer satisfaction" (surely the mantra of the late 1990s in all lines of endeavor), the State Bar Association has undertaken a survey of our Section's more than 4,000 members. While only about six percent of our membership responded, the survey results nevertheless confirm certain impressions and remind the Section's Executive Committee of how we may better serve our members. We must maintain our historic focus on keeping members informed of current legislative and regulatory developments and on providing practical and practice-specific learning through this *Journal* and the Section's continuing legal education programs. But we must also develop means of making our Section committees more relevant to practitioners and of making their work product more accessible to the members. Our committees provide one of the most valuable means of communication among lawyers in specific practice areas, but relatively few Section members participate actively in committees. The Executive Committee will be considering means of making our Section more useful to its members, and anyone with useful suggestions should forward them to the Chair (by e-mail please, at: shorowitz@cgsh.com).

One recent expansion of the Section's activities is the creation of a committee on computerization and technology, which has as its mandate the exploration of ways in which real estate law is being influenced by a whole host of technological issues. The committee will also work toward improving the Section's website, by posting more useful and current information, especially practice-oriented material. Over time, we hope that work product generated by the substantive law committees will be maintained on the website. The new committee, which will conduct its meetings electronically rather than in person or by phone, is actively recruiting members. Interested volunteers should contact either of the committee co-chairs: Leonard Sienko (of The Sienko Law Office in Hancock; e-mail: lennyesq@hancock.net) and Michael Berey (of First American Title Insurance Company in New York; e-mail: mberey@faticony.com).

On a practice-specific note, the Real Estate Financing Committee has recently established a task force to address a mortgage recording tax problem that arises in the context of securitized financing. While securitized lending (and related forms of loan documentation) is not yet commonplace in all parts of New York State, its reach is growing rapidly, as more and more banks want to maximize their ability to sell mortgage loans to investment banks and other financial intermediaries. In the securitization context, it is increasingly common to find that loan agree-

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ments preclude or significantly limit a borrower's prepayment rights, even when subject to a prepayment premium. Borrowers of course demand some form of exit from their mortgage loans so as to facilitate sales and refinancings. The permitted alternative offered by lenders is that the borrower may "defease" (rather than prepay) the loan by posting Treasury bills as alternative collateral to the mortgaged property, in order to permit release of the mortgage lien on the original mortgaged property. That property is typically refinanced with another mortgage, whether by the original owner or a successor in title. In such a transaction, the end result is that one loan is secured by Treasury bills while the mortgaged property secures the loan made in connection with the contemplated sale or refinancing. The latter security arrangement is usually accomplished by the original mortgage being assigned to the new lender. However, in some circumstances, this defeasance transaction may attract additional mortgage tax to that which was paid in connection with recordation of the original mortgage loan. The task force will explore criteria pursuant to which borrowers may not be subject to additional tax. Members will include lawyers who represent both lenders and borrowers as well as title insurance company representatives. Anyone interested in finding out more about this topic should contact the task force coordinators: Mel Mitzner (of Commonwealth Land Title Insurance Company in New York; e-mail: mmitzner@landam.com) and Joseph Forte (of Thacher Proffitt & Wood in New York; e-mail: jpforte@thacherproffitt.com).

The Section is also undertaking an initiative relating to the Revised Uniform Partnership Act (known as RUPA), a proposal to update various states' partnership statutes and bring them more in line with modern practice in the partnership law area. Some thirty-one states have already adopted a version of RUPA, including California, Delaware and Texas. New York State's statute dates back to the early twentieth century, and many practitioners see the need for substantial revision. Our Section has appointed a representative to the RUPA committee, to work with representatives of the Association of the Bar of the City of New York and the New York County Lawyers Association on this project, which is obviously of great importance to real estate attorneys. If you want to learn more about the RUPA committee, please contact our liaison: Sandy Liebschutz (of Chamberlain D'Amanda Oppenheimer & Greenfield in Rochester; e-mail: sjl@cdog.com).

The State Bar has been active in recent years in developing greater opportunities for lawyers in many practice areas, including real estate, to give back to their communities by undertaking *pro bono* legal work. Public service legal organizations in New York City have long been leaders in affording such opportunities for members of the private bar, but in fact there are many other organizations outside the City which provide similar services to practitioners. The State Bar's Department of Pro Bono Affairs has done us all a great service in publishing a resource directory which describes more than twenty-five *pro bono* programs outside New York City. This directory is a convenient reference guide which may be used by lawyers interested in volunteering their services or by clients in need of free legal assistance. The information is also available on the State Bar's website at (click public assistance). Please find the time to review this valuable resource and to make it available to colleagues and members of your law firm, other organizations and your community. Hard copies of the directory are available from the State Bar's Department of Pro Bono Affairs, and you may e-mail your request to probono@nysba.org. In addition, if you want to learn more about the Section's efforts in connection with *pro bono* matters, you may contact our coordinator, Harold Hanson (of Hinman, Straub, Pigors & Manning in Albany; e-mail: haroldh@hspm.com).

Steven G. Horowitz

What Title Insurance Does Not Cover

By James M. Pedowitz

Title insurance is essential in almost every real estate purchase, mortgage or important leasehold transaction, and its coverages are extremely important, but the protection is limited. Attorneys, owners and lenders must not only understand what is covered, but must also understand what their title insurance policy *does not cover.*

Each of the coverages listed in the title policy is important. Many lawyers and insureds are familiar with them. They also generally understand the Schedule B exceptions, although not always their full effect. Much less is known or understood about the exclusions from coverage. Even less is known or understood about the conditions and stipulations (hereinafter "C & S"), the so-called "boilerplate" provisions that impact on and diminish coverage. None of these factors should be considered alone. The policy coverage depends on the interplay of all of those elements of the policy.

Matters Not Insured

Some appreciation of the foregoing can be gleaned from the following points (without citations and not nearly complete) setting forth what the American Land Title Association (ALTA) policies now in use (absent some special endorsement if available and appropriate), *do not insure:*

1. The value of the property—or that it has any value at all.
2. The manner in which the property can be used, or that the property can be *used* for any economic purpose at all.
3. That a building permit can be obtained to build on or alter the property, not even to make a curb cut.
4. That absent an appropriate zoning endorsement, (which is not available in some states such as New York) that there is no zoning violation, unless notice thereof has been recorded in "Public Records" (as defined in the policy)—and they rarely are.
5. That even if properly zoned, that no special permits are required for the present use of the property, and, if required, that have been obtained or kept in force.
6. That an insured mortgage will be paid or that a mortgage foreclosure will not be delayed, and when finally completed will yield any proceeds to the insured.
7. That the insured premises are not contaminated with hazardous materials, or even that any environmental laws have not been violated, unless the violation is noted in those "public records" as defined in and limited by the policy.
8. That even if an undisclosed defect, lien or encumbrance affecting the property exists, that it will result in a compensable "loss" payable under a loan policy.
9. That damage or loss caused by activities on adjacent properties, such as flooding, lack of adjacent support, or disturbance of the surface by mineral exploration or removal would be compensable under the policy.
10. That any well, cesspool or septic tank servicing the premises lies within the perimeter lines of the premises; or that utility lines servicing the premises will continue to be permitted to do so.
11. That a title problem not excepted by the policy and which causes loss to the insured, but which is timely cured by the title insurer, will be compensable to the insured. It does not matter in most states that the title problem was not excepted because of a negligent title search.
12. That a fee policy may give no protection for monetary loss notwithstanding defects, liens, encumbrances or other matters not excepted if the amount of unpaid insured mortgages equal or exceed the face amount of the fee policy (except for costs incurred under the defense obligation).

All of the foregoing can be gleaned from a careful reading and understanding of the Exclusions from Coverage, and the Conditions and Stipulations.

"Attorneys, owners and lenders must not only understand what is covered, but must also understand what their title insurance policy does not cover.*"*

Survey Coverage

One of the subjects on which there is considerable misunderstanding is the matter of so-called survey coverage in title insurance.

The basic ALTA Title Policy does not insure the accuracy of a land survey used by the title insurer in connection with the transaction. This broad assertion requires some amplification.

The ALTA Title Policy form makes no reference to a survey or any state of facts that a survey would disclose. However, it does insure against loss by reason of title defects, liens, encumbrances or unmarketability of title, among other things. An accurate survey can disclose facts that may evidence a title defect, such as possible adverse possession, prescriptive rights, boundary problems, errors in the record description, etc. and encumbrances such as easements, encroachments, etc., some of which can result in "unmarketability of the title." For that reason, basic title insurance underwriting requires a Schedule B exception such as "any state of facts that an accurate survey would disclose" in the absence of a survey acceptable for use by the title insurer.

A similar exception is frequently also added as to facts that a physical inspection would disclose.

These two basic exceptions are usually deleted by "extended coverage" which may be given by the policy, based upon a survey acceptable to the insurer, in which case new exceptions may be added based upon the survey reading and inspection report.

However, unless poorly phrased, those substitute exceptions do not result in insurance of the accuracy of the entire survey. The survey is merely the basis upon which the title insurer omits the more general survey exception and substitutes the new exceptions, if any, based upon what the survey has disclosed. Of course, if that survey erroneously does not show an encroachment or some other fact that adversely affects marketability of title or some other insuring provision, that omission can result in a loss to the insurer under the policy. So, to the extent that the survey error was incorporated into the policy by reading in the error, it can be argued that the survey was "insured," but that would be wrong. What was insured was what was set forth in the insuring provisions, such as that the title was not unmarketable, or that it was free from defects or encumbrances, except as disclosed by the Schedule B exceptions, which insurance may have been in error because the survey was in error.

Although the title insurer relies on the accuracy of the survey in either deleting, modifying or inserting Schedule B exceptions, it is not normally its intention to act as an insurer or guarantor of the accuracy of the entire survey. That is why the insured should and usually does require that the survey be certified or guaranteed to it as well as to the title insurer. That certification or guaranty creates the contractual privity between the surveyor and the named parties to whom the surveyor recognizes a duty of accuracy as to what is shown on the survey map.

"Every attorney and other user of title insurance should be familiar with [ALTA policies]."

Endorsements to the policy can create insurance coverage that would not exist without them. Some of them deal with the survey. The supplemental materials for the 1989 PLI title insurance program: "Negotiating Additional Coverages" contained various forms of endorsements, including: "butting Direct Endorsement, Location Endorsement - Survey, Encroachment Endorsement, Adjoining land, Encroachment Endorsement, Easement; plus Various California (CLTA) Endorsement Coverages."

Additionally, in some states, various additional custom-crafted endorsements may be available that add many more assurances that are survey related.

In some cases, the normal non-insurance of survey accuracy may be construed judicially as having been transformed into insurance by inappropriate underwriting language in a Schedule B exception dealing with the survey. Starting with the doctrine of "reasonable expectations" in insurance policy litigation, to which we add the principle of construing language against the drafter in a contract of adhesion, such as a title policy, what might a court do with a Schedule B exception that reads:

> Guaranteed survey made by Accurate Surveyors, Inc. dated October 29, 1996 shows a one story brick commercial building set back 26.5 feet from the street; a separate 4 vehicle garage 1.24 feet clear of the easterly line; 12 marked parking spaces; curb cut onto legally opened First Avenue; asphalt driveway leading from street to garage; 6 feet high chain link fence on rear line; no variations?

What might a court hold if it was determined that the building was in fact set back only 23.5 feet from the street, that the chain link fence was actually 18 inches inside the rear line and that an enforceable set-back covenant and restriction (excepted in the policy without affirmative insurance) required a 25 foot set back from the street? What if there were only 10 parking spaces of sufficient width to satisfy the local zoning ordinance?

A knowledgeable title underwriter would either have raised no exception based on that survey or merely have written: "No survey variations, as shown on survey made by Accurate Surveyors, Inc., dated October 29, 1996."

Exclusions From Coverage

The Exclusions from coverage in the ALTA policies are significant. Every attorney and other user of title insurance should be familiar with them. Exclusion No. 1 appears in both the Owner's and Loan policies:

1.(a) Any law, ordinance or governmental regulation (including but not limited to building and zoning laws, ordinances, or regulation) restricting, regulating, prohibiting or relating to (i) the occupancy, use or enjoyment of the land, (ii) the character, dimensions or location of any improvement now or hereafter erected on the land; (iii) a separation in ownership or a change in the dimensions or area of the land or any parcel of which the land is or was a part; or (iv) environmental protection, or the effect of any violation of these laws, ordinances or governmental regulations, except to the extent that a notice of the enforcement thereof or a notice of a defect, lien or encumbrance resulting from a violation or alleged violation affecting the land has been recorded in the public records at Date of Policy.

(b) Any governmental police power not excluded by (a) above, except to the extent that a notice of the exercise thereof of a notice of a defect, lien or encumbrance resulting from a violation or alleged violation affecting the land has been recorded in the public records at Date of Policy.

The effect of Exclusion 1(a) is to eliminate any possible coverage by reason of the existence or violation of practically every type of building or zoning law, ordinance or regulation, environmental protection laws, or the adverse effect or result of any improper or unlawful lot subdivision, whether current or *back in the chain of title*; unless there is some notice (not otherwise excepted) in the "public records" (as defined in the C & S), as of the date of the policy, of the enforcement thereof affecting the insured property, or of some defect, lien or encumbrance affecting the property resulting from the violation or alleged violation.

In many states ALTA Zoning Endorsements or other zoning endorsements may be available to provide some assurances as to applicable zoning and compliance with them by existing structures, but even those endorsements have only limited coverage.

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The effect of the "subdivision" exclusion is also most significant, especially as to those lot subdivisions that occurred back in the chain of title. Inquiry should be made as to the date that any such subdivision law may have become effective as to the insured parcel, and if applicable, some assurance must be obtained as to compliance therewith by the insured parcel.

Although environmental protection laws pretty clearly come within the other broad land use and police power language of Exclusion 1, the specific words "environmental protection" were added in 1987 in order to make it crystal clear that the policy did not cover it unless the public records disclosed a violation.

1(b) excludes from coverage any other exercise of governmental police power not specified in 1(a), with the same exception as to notice in the public records as of the date of the policy with respect to its exercise, or as to violations resulting in a title defect, lien or encumbrance. The breadth of this police power exclusion can be gleaned from a holding that the denial of a curb cut for commercial driveway was an exercise of the police power,[1] notwithstanding that the inability to obtain the curb cut frustrated the known proposed use of the parcel as a "drive in" establishment.

Other examples that have been held to be the exercise of police power are the adoption of a local improvement ordinance for sewer installation (prior to confirmation of the assessment),[2] municipal code violations, including certificate of occupancy violation; and location within a flood plain zone.

Exclusion No. 2 also appears in both the Owner's and Loan policies.

2. Rights of eminent domain unless notice of the exercise thereof has been recorded in the public records at Date of Policy, but not excluding from coverage any taking which has occurred prior to Date Policy which would be binding on the rights of a purchaser for value without knowledge.

This exclusion would have practically no effect in many states (i.e. New York) because of its limiting language and the state's eminent domain taking statutes that provide record notice.

Exclusion No. 3 which also appears in both the Owner's and Loan policies (with only minor variations) is the one most frequently utilized by title insurers in defending against claims made by an insured.

3. Defects, liens, encumbrances, adverse claims or other matters (a) created, suffered, assumed or agreed to by the insured claimant; (b) not known to the Company, not recorded in the pub-

> lic records at Date of Policy, but known to the insured claimant and not disclosed in writing to the Company by the insured claimant became an insured under this policy; (c) resulting in no loss or damage to the insured claimant; (d) attaching or created subsequent to Date of Policy; or (e) resulting in loss or damage which would not have been sustained if the insured claimant had paid value for the estate or interest insured by this policy.

"Each of the words, 'created,' 'suffered,' 'assumed' or 'agreed to' have separate meanings."

A good starting point for research on this subject could be the now 22-year-old Annotation entitled "Title Insurance: Exclusion of Liability for Defects, Liens or Encumbrances Created, Suffered, Assumed or Agreed to by the Insured."[3] More current decisions can be found in Title Insurance Law Handbook by Robert E. Ellis and its Supplements published by Law Text Publishing Company in Chicago. Mr. Ellis was, for many years, Claims Counsel for Chicago Title Insurance Company.

Each of the words "created," "suffered," "assumed" or "agreed to" have separate meanings. Mr. Ellis's book at page 323, in its summary of *First National Bank and Trust Company of Port Chester v. N.Y. Title Insurance Co.*,[4] summarizes these definitions from the decision as follows:

"Created." The word "created" was said to have "reference to some affirmative act on the part of the [insured]." And it was held that the insured had taken the mortgage "but . . . did not create the defect. That was created by operation of law."

"Suffered." As to the term "suffered," the court noted that it "has been variously defined, as to allow, to let, to permit . . . It has been said that every definition of 'suffer' and 'permit' includes knowledge of what is to be done under the sufferance and permission, and intention that what is done is to be done . . . That Federal Court did not adjudge that there was any actual intent on the part of [insured] to obtain a preference . . . The mortgage could constitute a preference without such an actual intent on the part either of the mortgagors or the mortgagee.

"Assumed or agreed to." The words "assumed or agreed to" were held to import some particular defect or encumbrance assumed or agreed to in connection with the conveyance to the insured or "some collateral agreement made . . . with reference to the subject."

Another point that must be emphasized in analyzing the (b) portion of Exclusion 3 dealing with matters not "known" to the Company, but "known" to the insured and not disclosed to the Company in writing before it became an insured under the policy, is the definition in C & S 1(c) as to:

> "Knowledge" or "known": actual knowledge, not constructive knowledge or notice which may be imputed to an insured by reason of the public records as defined in this policy or any other records which impart constructive notice of matter affecting the land.

It should also be noted that there is no requirement for any disclosure to the insurer as to matters recorded in the public records.

Another significant point to an insured claimant who becomes entitled to policy coverage subsequent to the issuance of the policy is that the requirement to disclose adverse matters is still applicable. It even applies to matters that were learned after the date of policy if it was still prior to the date that the claimant becomes an insured. So, a potential assignee of an insured mortgage who will become an insured when it accepts assignment of an insured mortgage will not be covered with respect to off record defects, etc. that it has not disclosed in writing to the title insurer.

It should also be noted that there are several references in the exceptions to the Exclusions from Coverage as to matters disclosed in the "public records," a term that is specifically defined in C & S, #1(f) as:

> "Public records": records established under state statutes at Date of Policy for the purpose of imparting constructive notice of matters relating to real property to purchasers for value and without knowledge. With respect to Section 1(a)(iv) of the Exclusions From Coverage, "public records" hall also include environmental protection liens filed in the records of the clerk of the United States district court for the district in which the land is located.

"[T]here is no requirement for any disclosure to the insurer as to matters recorded in the public records."

Special note should be made of the fact that the term applies only to records established under "state statutes" enacted for the purpose of imparting the constructive notice specifically set forth in the definition. As such, it will most likely not apply to numerous types of other records that one might mistakenly believe are public records, such as federal records, including those involving bankruptcy (unless also provided for by a state's statute), municipal records, tax records, special district records, and various court records.

Exclusion 3(c) suspends the ability to collect under the policy until the insured claimant can establish that it has suffered loss or damage. The net effect of this Exclusion is that even though a defect, lien, encumbrance or adverse interest has surfaced, other than the right to a defense, the insured may not yet be able to claim payment of a loss. This is particularly true under a loan policy prior to completion of a foreclosure.

Under a loan policy, the fact that a loss has occurred, as well as the amount of loss, may be difficult or impossible to establish until after enforcement efforts have been exhausted. For, example, XYZ Bank has a loan policy covering a $300,000 first mortgage made by John and Mary Doe on a substantial one-family residence. The loan goes into default and XYZ Bank orders a mortgage foreclosure search before commencing the action. The foreclosure search discloses a prior mortgage in the principal amount of $200,000 recorded about three (3) years earlier, which the title insurer failed to disclose. XYZ Bank calls its title insurer who may respond by asserting that XYZ Bank has not yet suffered a loss notwithstanding their error. In most states, this is the law.

Exclusion 1(d) protects the title insurer against claims based on matters, including charges, liens, or encumbrances, that may have existed on the date of the policy, but which did not "attach" until after the policy date. This problem arises most frequently with respect to special assessments for improvements. The general rule is that unless the lien has attached by the date of the policy, the title insurer need not pay.

Exclusion i(e) does not affect the normal purchase or loan transaction. If, however, title insurance is being purchased to cover an estate or interest received as a gift, unless some special endorsement can be obtained, which is usually unlikely, any loss suffered because the insured is not a B.F.P. will have to be borne by the insured, and not the title insurer.

Exclusion 4 in the Owner's Policy and Exclusion 7 in the Loan Policy are commonly referred to as the "creditor's rights" exclusion, which as revised on 10-17-92 now reads:

> (Owner's) - "Any claim, which arises out of the transaction vesting in the insured the estate or interest insured by this policy, by reason of the operation of federal bankruptcy, state insolvency, or similar creditor's rights laws that is based on:
>
> (1) the transaction creating the estate or interest insured by this policy being deemed a fraudulent conveyance or fraudulent transfer; or
>
> (2) the transaction creating the estate or interest insured by this policy being deemed a preferential transfer except where the preferential transfer results from the failure to timely record the instrument of transfer or the failure of such recordation to impart notice to a purchaser for a value or a judgment or lien creditor."
>
> (Loan) - "Any claim, which arises out of the transaction creating the interest of the mortgagee insured by this policy, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors, rights laws that is based on:
>
> (1) the transaction creating the interest of the insured mortgagee being deemed a fraudulent conveyance or fraudulent transfer; or
>
> (2) the subordination of the interest of the insured mortgagee as a result of the application of the doctrine of equitable subordination; or
>
> (3) the transaction creating the interest of the mortgagee being deemed a preferential transfer except where the preferential transfer results from the failure to timely record the instrument of transfer or the failure of such recordation to impart notice to a purchaser for value or a judgment or lien creditor."

"Although endorsements should be available to modify or delete this Exclusion in appropriate circumstances, there has been a reluctance to do so on the part of most title insurers, and as of now, New York is still among the states where no such endorsement can be obtained."

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It should be noted though, that the Exclusion applies only to the current transaction creating the insured estate or interest, and not to any prior transfer.

The remaining *two* Exclusions are found only in a Loan Policy and deal exclusively with mortgages.

ALTA Loan Exclusion Number 5 pertains to violations by the insured of usury or consumer protection or truth in lending laws. Lenders generally recognize that these are risks that they and they alone should assume. However, in some states, some form of coverage against loss by reason of a defense of usury are available.

ALTA Loan Exclusion Number 6 (which does not apply in New York because of New York's Lien Law) deals with statutory liens for services, labor or materials (mechanic's liens) and makes it clear that any such lien arising from an improvement which is contracted for and commenced subsequent to the date of the policy is excluded from coverage unless the improvement is financed in whole or in part by the proceeds of the loan and mortgage that is being insured. This Exclusion ties in with insuring Provision 7 in the ALTA Loan Policy which, in New York, is superseded by the broader statutory lien coverage in the New York Endorsement.

The Conditions and Stipulations ("C&S")

As with all "boilerplate" there can be hidden traps for insureds lurking in this technical language and it should be read carefully. Although most of the C&S are the same in both the Owner's and Loan policies, there are variations, some of which can be quite significant.

Some of the highlights in the C&S that have significance as to what is not insured start with the definitions in C&S 1. Unless you come within the definition of "insured," you have no coverage under the policy.

The named "insured" is obviously the beneficiary of the title insurance, but the definition in C&S 1(a) may also include parties other than the named insured. These definitions should be read together with C&S 2 on "Continuation of Insurance" which deals with the continuation of coverage even after a conveyance by an owner, to a limited extent, and which, after assignment of the insured mortgage, provide coverage to the assignee.

With one exception, an Owner's Policy cannot be assigned to or benefit a new owner; not even to a related party such as a corporate affiliate, partnership or trust, etc., without the benefit of a specific endorsement. The exception is found in the language of the Owner's Policy definition in C&S 1(a):

> (a) 'insured': the insured named in Schedule A, and, "*subject to any rights or defenses* the Company would have had against the named insured, those who succeed to the interest of the named insured *by operation of* law as distinguished from purchase including, but not limited to, heirs, distributees, devisees, survivors, personal representatives, next of kin, or corporate or fiduciary successors. (emphasis added)

"Unless you come within the definition of "insured," you have no coverage under the policy."

The definition of "insured" in the Loan Policy is much more inclusive and includes all subsequent owners of the indebtedness, with some minor conditions.

Notwithstanding that a claimant fits within the definition of an insured, the benefits of the insurance can be lost by failure to comply with the provisions for Notice of Claim (C&S 3), Proof of Loss (C&S 5), or the required degree of cooperation and aid (C&S 4(d)) to the insurer.

C&S 6, 7, 8 and 9 contain important limitations on the determination of and the extent of liability of the insurer under the policies, as well as the options available to them to limit or terminate the policy liability. The insurer is given an option to make payment of the amount of the insurance plus other accrued covered expenses and thereby cut off all then existing and future liability including the conduct of pending litigation.

C&S provision No. 8 can also take away from the amount of the insured's recovery under the policy in the event of a covered loss. These provisions permit the insurer to make a pro-rata apportionment of its policy liability among two or more separate and independent parcels contained within the Schedule A description of the premises if not used as a single site. If in fact a policy covers two or more separate parcels that are more valuable in combination than separately, this problem should be addressed by an endorsement.

Under C&S 9(b) of the Loan policy, partial payment of the principal indebtedness can reduce the amount of policy coverage. Careful consideration must be given to the effect of this provision in a case where the policy covers a mortgage on multiple parcels. In some instances, especially in a multistate transaction, it may be well to add a "Last Dollar Endorsement," if it is available.

Other C&S provisions—No. 10 in the Loan Policy and C&S 11 Owner Policy deal with "Liability Non-Cumulative." One effect of these provisions is that unless an owner carries sufficient coverage in excess of all outstanding insured mortgages, the owner *may* land up either with no coverage at all or some very significant lesser amount of coverage in the event of a serious or total loss. The loss paid to an insured mortgagee or mortgagees is deducted from the insurance available to the owner. Whenever a new mortgage is executed the owner should review and, if necessary, increase the Owner's Policy to cover all outstanding mortgages, plus the owner's equity in the property.

C&S 12 in the Loan Policy and C&S 13 in the Owner's Policy deal with the insurer's right of subrogation. Destruction or material interference by the insured with the insurer's subrogation rights can destroy or severely diminish the policy protection.

The subrogation provisions in the ALTA policies are extensive. The rights of subrogation available to an insurer after a payment to an insured under a policy of insurance are well settled in insurance law. The ALTA subrogation provisions recognize that in those cases where the payment under the policy does not fully cover the loss of the insured claimant that the subrogation rights of the insured to the extent of the balance of the insured's actual loss that was not recovered under the policy. The loan policy also specifically permits an insured mortgagee to release the personal liability of the debtor or guarantor, to release a portion of the mortgaged premises, and to engage in certain other activities that are normally engaged in by mortgagees, *but these otherwise normal acts are not permitted after the insured has knowledge of any claim of title or interest adverse to the title of the estate or interest as insured, or as to the priority or enforceability of the lien of the insured mortgage*. The policy also protects the Company's right of subrogation against other insurers who may acquire the insured interest as a result of an indemnity guarantee, or other policy of insurance.

No discussion of what is not insured should fail to mention provisions for mandatory arbitration, which can seriously affect one's rights of recovery under a policy. The ALTA policies contain such provisions, which are new with respect to title insurance.

The arbitration provisions may be triggered either by the Company or by the insured when the amount of insurance is one million dollars or less. If the amount of insurance is in excess of one million dollars, arbitration can only be required when agreed to by both the Company and the insured. Special arbitration rules have been prepared by the American Arbitration Association and arbitration can only be utilized if not prohibited by applicable law in the state in which the dispute is to be resolved.

"The very best title policy is one that accurately reflects the status of the title based upon a complete and competent title examination, a title policy that provides peaceful possession to an owner, and an enforceable lien to the mortgage lender."

Endorsements may be available to eliminate or modify the Arbitration provisions of the ALTA policy forms in most states.

Conclusion

Title insurance provides very significant coverage to almost everyone acquiring an estate or interest in real property. However, it must be understood that there is no form of insurance available anywhere that is all-inclusive. It is important to understand and appreciate what the title insurance covers and what it does not cover. It is equally as important to understand that title insurance must be supplemented by competent legal advice and expertise. A good lawyer is essential to get the best out of the title insurance that is available for the transaction.

Lastly, but very importantly, a title claim rarely fully compensates the claimant for all of the loss that has been suffered, and nothing can fully compensate for the emotional trauma that frequently accompanies a title claim, particularly to an owner. The very best title policy is one that accurately reflects the status of the title based upon a complete and competent title examination, a title policy that provides peaceful possession to an owner, and an enforceable lien to the mortgage lender.

Endnotes

1. *Marriott Financial Services, Inc. v. Capitol Funds, Inc.*, 23 N.C. App. 377, 209 S.E.2d 423 (1974), *aff'd*, 288 N.C. 122, 217 S.E.2d 551 (1975).
2. *BelAir Motel, Corp. v. Title Ins. Corp. of PA.*, 444 A.2d 1119 (N.J. Super 1981).
3. 87 A.L.R.3d 515 (1978).
4. 12 N.Y.S.2d 703 (Sup. Ct. 1939).

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Impending Revision of New York's UCC Article 9 Presents Many Cooperative Apartment Issues

By Joel E. Miller

Years ago, we thought that we had a pretty good idea of what we meant when we said that a person owned a "cooperative apartment." The starting point was a corporation that owned apartments and had allocated shares to some or all of them. It was our understanding that the person to whom we referred as the owner of a "cooperative apartment" owned, not a piece of real estate (as in the case of a condominium), but a two-item package consisting of (1) a block of such allocated shares and (2) a long-term leasehold of the associated apartment.[1] Notwithstanding that the share ownership and the leasehold were expected to travel together, we believed that they remained two separate items. It was like a bird and a cage put together as a package, where no one could doubt that the bird part of the package would be subject to bird rules and the cage part would be subject to cage rules. In the cooperative apartment case, we thought that, regardless of the juxtaposition of the stock and the leasehold, the stock portion of the package remained subject to stock rules and the leasehold portion remained subject to leasehold rules.

But in 1977 the Court of Appeals in the famous *Shor* case told us that we were wrong.[2] In the case of a cooperative apartment, we learned, there were not two items—only one fused item. As soon as the bird was put in the cage, we no longer had a bird and a cage; thereafter we had only a unitary birdandcage.

In the case of a cooperative apartment, the Court of Appeals told us, the stock ownership and the leasehold ownership were "inseparably joined" to form a new species of property. Notwithstanding the absence of any authority for its ruling, the court was very clear on this point:

> The ownership interest of a tenant-shareholder in a co-operative apartment is *sui generis*. It reflects only an ownership of a proprietary lease, . . . conditional however upon his shareholder interest in the co-operative corporation . . . The leasehold and the shareholding are inseparable. *** Neither the stock certificate nor the lease, inseparably joined, can appropriately be viewed . . . in isolation from the other.[3]

> *"Although* Shor *made it clear that we were to apply SALLO rules—not stock rules and leasehold rules—there was a very real problem about that: no one knew what the SALLO rules were."*

In effect, then, the court created a new kind of property. Thus, in a way that was helpful. It was no longer necessary for us to try two disparate sets of rules to apply to a single situation—one governing shares of corporate stock and one governing long-term leaseholds. Now we needed to deal only with one set of rules, namely the rules applying to the new kind of property.

A preliminary question is how one is to refer to the fused package owned by a tenant-shareholder. In conversation the most common reference is undoubtedly to a "cooperative apartment," but that term is also used—and more appropriately—to refer to the physical apartment. In order to avoid confusion, we shall reserve the term for the latter use. We shall instead refer to the intangible ownership package as a "SALLO," which stands for "stock and appurtenant long-term leasehold ownership." Use of the SALLO term also serves to emphasize the unitary nature of the package.

Although *Shor* made it clear that we were to apply SALLO rules—not stock rules and leasehold rules—there was a very real problem about that: no one knew what the SALLO rules were. In fact, except for the one crafted for the occasion by the Court of Appeals in the case before it, they did not yet exist.

How, then, were we supposed to proceed? The answer supplied by the Court of Appeals was this: whenever a SALLO issue arises, the parties will go to court and the court will decide, as a sort of legislative exercise, whether it makes more sense to apply the stock rule or the leasehold rule. And, for the most part, that is what has happened. The courts have held in some contexts that a SALLO is to be treated as if it were solely stock and have held in other contexts that a SALLO is to be treated as if it were solely a long-term leasehold.[4]

However, many issues have not yet been authoritatively resolved. As an example, it remains uncertain whether a SALLO can be involuntarily terminated under the rules that permit a landlord to terminate the leasehold of a defaulting tenant. If it can, the leasehold disappears, but what happens to the stock?

Lest one be tempted to say that in such cases each of the SALLO's original components can be treated separately, let us look at what happened in the *Shor* case itself. There, a judgment debtor owned a SALLO, and the judgment creditor did everything that was necessary to obtain a lien on all of the judgment debtor's long-term leaseholds on real property located in the county where the cooperative apartment was located. But that was ineffective, said the Court of Appeals, the reasoning being that (1) the judgment debtor owned no leasehold, only a SALLO, and (2) as to judgment liens, SALLOs should be treated as if they were purely stock.

The fact is that, ever since *Shor* came down, there has been great uncertainty as to what are the governing rules as to SALLOs. Some of the major unclear areas do—or at least might—involve the Uniform Commercial Code. However, before we look at some of the numerous open questions, let us spend a few minutes reviewing the nature of so-called "uniform laws."

Because our federal government is one of limited powers, each state is free to make its own law on many topics. The result is that the law may vary from state to state on any particular point, which is obviously an impediment to transactions between people in different states. One way to ameliorate the situation would be for all of the states—voluntarily, of course—to enact identical statutes governing a certain area of the law, and that process would be facilitated if a carefully thought out prototype were to be made available by a highly respected nationwide organization. Such an organization does exist. It is the National Conference of Commissioners on Uniform State Laws (hereinafter NCCUSL), which has in fact promulgated a number of prototypes, some of which have been widely adopted.

It must be borne in mind that it is somewhat misleading to refer to a NCCUSL prototype as a "uniform law." First, it is merely a suggested text that can have legal effect only if and when enacted by a state. The prototype is not itself a law at all. Moreover, even if a law based on the prototype were to be enacted by a number of states, it would be a uniform law only if the same text were to be enacted by every jurisdiction in the country. And that has seldom if ever happened. Even as to the most successful "uniform laws"—of which the Uniform Commercial Code is one—there are important variations from state to state.

The New York version of the UCC contains two articles that have particular application to SALLOs—Article 8, which deals with securities, and Article 9, which deals with security interests in most forms of personalty (not including leaseholds in realty).

"[T]he prototype UCC Articles 8 and 9 do not now contain any specific reference to SALLOs, never have contained such a reference, and, judging by past failed attempts, probably never will contain such a reference."

It should be noted that the prototype UCC Articles 8 and 9 do not now contain any specific reference to SALLOs, never have contained such a reference, and, judging by past failed attempts, probably never will contain such a reference.[5]

For many years, the New York version was similarly devoid of any reference to SALLOs. In 1988, however, the Legislature, in order to facilitate secondary borrowing on the security of SALLOs, added some provisions to the New York version of UCC Article 9 that did make specific reference to what was described in one of those provisions as "shares or other ownership interests evidenced by stock certificates or other instruments, and a leasehold evidenced by a proprietary lease or either of the foregoing from a corporation or partnership formed for the purpose of cooperative ownership of real property."[6] For the first time anywhere, a UCC version made specific reference to what we are calling SALLOs. Among other things, New York's UCC Article 9 as amended in 1988 provided that thenceforth a security interest in a SALLO could be perfected only by filing a financing statement in the same office where a mortgage on the corporation's realty would be recorded (which filing, in a departure from the normal five-year rule, could be made effective until terminated). Other SALLO-specific provisions were added to New York's UCC Article 9 in 1997 in connection with the state's then enactment (with modifications) of a revised prototype Article 8 that had been promulgated by the NCCUSL.

The 1997 legislation was of great importance for SALLOs in New York. Before that, it had been far from clear whether in this state a SALLO was governed by the rules set forth in Article 8, which covered stock (including stock in closely held corporations) but not leaseholds. Although some of the lower courts had taken positions on the subject, the Court of Appeals had in a 1995 opinion gone out of its way to point out that it was leaving open "[t]he question whether tenant-shareholders' *sui generis* ownership interests in cooperative apartments are UCC article 8 securities."[7] And, one may add, the court's refraining from addressing the issue seemed entirely appropriate, inasmuch as there is considerable doubt whether it makes sense to apply the "security" rules to SALLOs. However, for better or worse, the question is no longer open, the Legislature having made it clear that a SALLO is indeed a "security" for purposes of New York's UCC Article 8.[8]

That is not to say that all the usual "security" rules apply to SALLOs. The statute itself makes exceptions. For instance, while the prototype UCC § 8-113 eliminates across the board any requirement that a contract for the sale of a "security" must be signed by the person against whom enforcement is sought—and the New York version contains that as a general rule—the New York version adds an exception for any "security" that is a SALLO. Also, while New York's UCC Article 9 provides rules governing the perfection and priority of security interests in "securities" generally, as amended in 1997 it excepts SALLOs from some of those rules. Inasmuch as the above-mentioned special New York rule about perfecting security interests in SALLOs remains in effect, the exception creates no problem about perfection, but there may be questions as to priority in certain limited situations.

There is, however, a much greater problem. The NCCUSL last year promulgated a significantly revised prototype Article 9, which has already been enacted in several states and undoubtedly will soon be enacted—in essentially the prototype form—in New York. If the prototype were to be enacted with no change whatever, New York's special provisions concerning SALLOs would of course disappear. While the alert has already been sounded loudly enough so that we can be sure that the prototype will not be adopted by New York without at least some SALLO provisions, it is not yet clear what those provisions will be. Many issues and sub-issues must be resolved, some of which are discussed below.

A SALLO is in many respects more like a parcel of real estate than like a share of stock or a corporate bond, and there can be no doubt that SALLOs are so perceived by the general public. For instance, a person buying or selling a "cooperative apartment" normally consults a real estate lawyer, not a securities lawyer. It is thus regrettable that the Court of Appeals, having taken it upon itself in *Shor* to authorize the creation of a new body of law for SALLOs, chose to lean toward stock classification rather than toward leasehold classification.[9]

The difficulty is not merely academic. Because lawyers handling cooperative apartment transactions are almost always more familiar with real estate law than with securities law, many are not in the best position to give their clients sound advice.

"Because lawyers handling cooperative apartment transactions are almost always more familiar with real estate law than with securities law, many are not in the best position to give their clients sound advice."

Consider the following hypothetical case. Client wishes to make a loan to Borrower, the repayment obligation to be backed by a security interest in a run-of-the-mill SALLO belonging to Borrower. Lawyer knows that under the present New York version of the Uniform Commercial Code a security interest in such collateral is perfected, not by possession of Borrower's stock certificate and proprietary lease, but by the filing of a financing statement. Lawyer does a lien search and finds that there are no claims against Borrower's ownership interest. Client then makes the loan, entering into a proper security agreement with Borrower and timely filing a proper UCC-1 in the appropriate office. She does not, however, take possession of Borrower's stock certificate and proprietary lease. Borrower then—fraudulently, of course—contracts to sell the same ownership interest to Buyer for its unencumbered market value. Neither Buyer nor Apartment Corporation checks for UCC-1 filings. Borrower surrenders to Apartment Corporation his stock certificate and proprietary lease, along with properly executed instruments of transfer to Buyer, upon receipt of which Apartment Corporation issues to Buyer a new stock certificate and enters into a new proprietary lease with him. Borrower takes Buyer's money and vanishes forever.

Clearly, Buyer now owns the SALLO that formerly belonged to Borrower, but does he own it subject to Client's security interest?

If a condominium apartment had been involved rather than a cooperative apartment (and Client had taken and timely recorded a mortgage), there would be no question. Buyer would have had constructive notice of Client's lien (even though he did not actually know about it) and would therefore hold the property subject to Client's lien.

But SALLOs are different. As noted above, in New York they are now "securities" subject to UCC Article 8. And UCC § 8-105(e) provides in the clearest language that, as to any "financial asset" (which UCC § 8-102(a)(9) defines to include a "security"), "[f]iling of a financing statement . . . is not notice of an adverse claim." Under UCC § 8-303 it follows that, assuming that Buyer otherwise had no notice of any adverse claim, his ownership is free of Client's now-eliminated security interest.[10]

Client seems to be in a bad position. Her borrower is gone and she no longer has any rights in the collateral. It naturally occurs to her to seek redress against Apartment Corporation, which did after all issue "clean" documents to Buyer. But there was no rule of law requiring Apartment Corporation to investigate. To the contrary, UCC § 8-401(a) affirmatively required it to put through the transfer. Accordingly, there would seem to be no basis for holding Apartment Corporation liable for Client's loss.

Could Client have protected herself better? Could she, for instance, have improved her situation by taking possession of Borrower's stock certificate and proprietary lease?[11] If she had done so, what would be the outcome if Borrower had, by means of a perjurious affidavit claiming to have lost those documents, persuaded Apartment Corporation to issue replacements to him? Should Client have refused to make the loan without entering into a recognition agreement with Apartment Corporation?[12]

Perhaps this would be an appropriate time to rethink the advisability of applying essentially all of the "security" rules to SALLOs. Changes in Article 8 might be required to do that, but that should be no impediment. There is very recent precedent; changes were made in 1997 to New York's Article 9 when the state enacted its version of revised Article 8.

> *"Inasmuch as it is well known that virtually every apartment corporation claims such a security interest, a filing requirement would seem to be superfluous."*

Let's look at another problem. Suppose that Nephew, who owns an ordinary SALLO and has borrowed $100,000 from Bank against it, asks Aunt to lend him $25,000 secured by a junior security interest in the same collateral. Aunt does so, but only after satisfying herself (a) that Nephew's ownership interest is worth considerably more than $125,000 and (b) that Nephew has no right to draw down more money from Bank. Aunt and Nephew enter into a proper security agreement, and Aunt timely files a proper UCC-1 in the appropriate office. Nephew and Bank thereafter modify their security agreement, and pursuant thereto Bank lends Nephew an additional $60,000 (his ownership interest then being worth $200,000). As between Aunt's $25,000 security interest and the $60,000 portion of Bank's $160,000 security interest, it may be that UCC § 9-312 gives priority to Bank's interest. If that is the answer, will well-advised people make secondary loans on the security of SALLOs?[13]

There are also procedural matters to consider. Under present New York law, a security interest in a SALLO can be perfected only by filing,[14] that filing must be done "in the office of the recording officer in the county where the real estate or house or building owned by such corporation or partnership is located,"[15] and the financing statement "must identify the real estate or house or building owned by such corporation or partnership."[16] However, if the prototype new Article 9 were to be adopted without modification, all that would change. First, even though prototype new § 9-312(a) provides that "[a] security interest in . . . investment property[17] may be perfected by filing," prototype new § 9-313(a) provides that "[a] secured party may perfect a security interest in certificated securities by taking delivery of the certificated securities under Section 8-301," subsection (a)(1) of which in turn provides that delivery of a certificated security to a lender occurs when the lender "acquires possession of the security certificate." Thus, if perfection by filing is to continue to be required for SALLOs, a modification of the prototype provision would be necessary.

Whether filing is mandatory or optional, other issues will have to be addressed. For instance, prototype new § 9-501(a)(2) establishes as the general rule that all filings must be done in a single statewide office, but substitution of county-by-county filing for SALLOs would seem desirable, as would requiring a specific designation of the cooperative apartment or at least of the cooperative organization's real property. Also, under present New York law a financing statement covering a SALLO can be made effective until affirmatively terminated,[18] but, under prototype new § 9-515, such a filing would (unless extended at the proper time) have a maximum life of five years. Prototype new § 9-515(b) does provide for an initial effective period of 30 years in some instances, and it might be appropriate to make a SALLO filing one of those instances.

Other filing-related problems arise from the fact that the documents of the overwhelming majority of New York apartment corporations say that the corporation has a security interest in each of its tenant-shareholders' ownership interests for amounts owing to it. Under present law, there would appear to be no reason to believe that such a security interest need not be perfected in order to have priority over a conflicting perfected security interest. However, counsel to many apartment corporations seem to be unaware of the perfection requirement, with the result that their clients might not be protected as much as they could be. That is one problem, but, ironically, not the only one. The fact is that awareness of the necessity (or at least advisability) of filing is spreading, and more and more apartment corporations are filing a UCC-1 financing statement (and, it will follow in many cases, a UCC-3 termination statement as well) every time a SALLO changes hands. Unfortunately, that clogs the public records and makes searches much more tedious and expensive. Inasmuch as it is well known that virtually every apartment corporation claims such a security interest, a filing requirement would seem to be superfluous. However, if automatic perfection of such security interests is legislated, a number of issues must be dealt with. Three sets of questions come immediately to mind:

(1) Liens created by which documents should be taken into account? The certificate of incorporation? The by-laws?

The proprietary lease? The offering plan? Any document whatever?

(2) Should there be limits on the kinds of obligations that can be covered without filing? If so, should only obligations arising out of the basic relationship between the corporation and the tenant-shareholder as to the subject SALLO be covered? What about other SALLOs owned by the same person? Should all obligations of that tenant-stockholder, even if having nothing to do with SALLO ownership, be covered?

(3) Should it be provided that the existence of such a security interest shall not be taken into account for purposes of rules requiring certain lenders to have a senior position?[19]

"Many other issues—including, for instance, a number of thorny questions about what ought to be the conflict-of-laws and transition rules—also remain to be resolved."

UCC § 8-209 provides that, where a corporation has a lien on a certificated security that it issued, that lien "is valid against a purchaser [which term includes a buyer or a lender but not a bankruptcy trustee or other "lien creditor"] only if the right of the issuer to the lien is noted conspicuously on the security certificate," even if the purchaser actually knows about the lien. UCC § 8-204 provides that, where the corporation imposes a restriction on transfer of a certificated security that it issued, that restriction "is ineffective against a person without knowledge of the restriction unless . . . the restriction is noted conspicuously on the security certificate." Should these rules apply where the security is a SALLO? If so, should an incorrect description of the lien or transfer restriction narrow the effect thereof? Should the effect of actual knowledge be the same in both situations? If so, what should be the effect of such knowledge?

Other opportunities for improvement exist and ought not be wasted. For instance, some judges have mistakenly stated that a proprietary lease cannot create a security interest.[20] That should be corrected. Also, in the case of a secured party who is being paid in full, provision should be made for delivery (against payment) of a termination statement, so as to facilitate any necessary borrowing by the debtor.[21] It would also be desirable to coordinate the statutes of frauds applicable to both cooperative apartment and condominium apartment sales.

There are also issues about the extent of the statute's coverage of ownership packages that vary from the usual SALLO or SALLO-like package. If partnership realty cooperatives are to remain in the statute, there would seem to be no reason that realty-owning limited liability companies and other forms of organization owning realty should not be included as well. In any event, it ought to be made clear that cooperatives holding long-term realty leaseholds are covered. It has on occasion been suggested that nonresidential ownership packages should be excluded, and perhaps that should be considered. What of out-of-state ownership interests resembling SALLOs? And it would seem to be a good idea to remove from the statute the notion that a person can be a party to a "proprietary" lease without any ownership interest in the organization owning the real estate that is the subject of that lease. Notwithstanding that phrases like "cooperative apartment,"[22] "cooperative housing corporation"[23] and "ownership interest in, and proprietary lease from, an organization formed for the purpose of the cooperative ownership of real property"[24]—and many variations thereof—appear in scores of New York statutes, none of those terms are defined.[25] This might be a good opportunity to rectify that situation.[26]

Many other issues—including, for instance, a number of thorny questions about what ought to be the conflict-of-laws and transition rules—also remain to be resolved.

Finally, some acceptable label for the covered ownership interest—whatever it turns out to be—must be chosen. Obviously, that can best be done after all the substantive issues have been resolved.

Endnotes

1. For an extensive discussion of the legal concepts involved, see "Liens on Individual Cooperative Apartments (Second Revision)," 27 N.Y. Real Prop. L.J. Special Supplement (June 23, 1999), a report of the Liens Subcommittee of the Condominiums and Cooperatives Committee of the Real Property Section (hereinafter referred to as "the Liens Subcommittee Report").
2. *State Tax Comm'n v. Shor*, 43 N.Y.2d 151 (1977). The *Shor* case is discussed at some length in the Liens Subcommittee Report, n. 1.
3. 43 N.Y.2d at 154-57. The court's reference in the last sentence to documents — the "certificate" and the "lease" — cannot be taken literally; obviously, it is the tenant-shareholder's share ownership and the leasehold ownership that it meant to say were "inseparably joined," not the pieces of paper. Also, the two ownerships are not in fact inseparable. As an easy example, all the participants can agree to terminate the leaseholds and remain shareholders of the corporation.
4. Many of the cases are noted in the Liens Subcommittee Report, n. 1. Some commentators read *Shor* somewhat differently, believing that under that opinion a court faced with a new issue need not choose between the stock rule and the leasehold rule but is free to make up a wholly new rule that applies to no other species of property.
5. It has been reported that the Commissioners view treatment of SALLO problems in a uniform law as being inappro-

priate because SALLOs exist only in New York and a few other states. Moreover, it is not yet known whether the courts in other states will follow *Shor* on the new-species-of-property-subject-to-its-own-rules point.

6. UCC § 9-104(j).
7. *ALH Properties Ten, Inc. v. 306-100th St. Owners Corp*., 86 N.Y.2d 643, 648 n.*.
8. Laws 1997, Ch. 566, § 1.
9. Its decision itself shows that bias, as does its statement that "the real property aspect may predominate" only "[f]or some special purposes." 43 N.Y.2d at 154.
10. In a sense, then, Buyer benefited from his failure to check the record. That in itself suggests that something is wrong here.
11. Although, as the only lender, Client had that option, it may be noted that such an option is normally not available to a junior lender.
12. In the widely misunderstood case of *Collins v. Douglas Elliman-Gibbons & Ives, Inc.*, N.Y.L.J., May 7, 1997, p. 29, col. 4 (Sup. Ct., N.Y. Co.), which arose at a time when co-op apartment ownership interests may or may not have been UCC Article 8 "securities," the court (a) assumed that an innocent purchaser took free of a lender's perfected security interest and (b) held the apartment corporation liable on the sole ground that it had breached a recognition agreement that it had entered into with the lender. The court did not find that the corporation had a duty to investigate.
13. If the answer is no, perhaps the old perfection-by-possession rule would be superior to the current perfection-by-filing rule (which, as noted above, was adopted to facilitate secondary financing).
14. UCC § 9-304(7).
15. UCC § 9-401(1)(b).
16. UCC § 9-304(7).
17. Prototype new § 9-102(49) provides that "investment property" includes "a security, whether certificated or uncertificated."
18. UCC § 9-403(9).
19. It has been reported that, even with a recognition agreement, some lenders are troubled about taking a 'junior' position once the apartment corporation has filed a financing statement as to its own security interest.
20. *See, e.g., Saada v. Master Apts. Inc.,* 152 Misc. 2d 861, 579 N.Y.S.2d 536 (Sup. Ct., N.Y. Co. 1991). The same opinion stated, erroneously of course, that a security agreement is ineffective even as between the parties unless it has been filed.
21. If that is done, should the secured party be allowed to charge a fee? If so, should the statute set forth a maximum? Alternatively, should the statute provide that a "reasonable" amount may be charged? How much advance notice to the secured party should be required? Should the charging of a fee be permitted if the debtor is willing to wait for delivery until after payment? How long should the lender be allowed to make delivery? Should there be liability on the part of a secured party who fails to comply? Should there be a minimum amount (because of the difficulty of proving actual damages)? If so, should that minimum be a fixed amount or related to the amount of the loan? Should delivery of any documents being held also be required? Should there be a relief provision for a secured party who cannot locate a stock certificate and/or proprietary lease? If so, what conditions should be imposed in order to protect innocent parties if a missing document appears and is relied upon?
22. *E.g.*, Real Prop. Law § 443.
23. *E.g.*, Tax Law § 1455.
24. *E.g.*, Unconsolidated Laws Ch. 214, § 3.
25. A definition of "cooperative housing corporation" does appear in Internal Revenue Code § 216, but that definition contains elements that might be too restrictive for other purposes.
26. It would seem desirable to define at least the following two things: (1) the organization that owns the underlying realty or other property, and (2) the physical space in which the individual participant has possessory rights.

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Adventures in Home Sales: A Case Study in Legal Ethics[1]

By Karl B. Holtzschue

Ethical issues can come up at nearly every stage of a real estate transaction, even a relatively uncomplicated sale or purchase of a home. This article begins with an overview of the New York ethics rules and an example of their structure and then explores the application of the rules in an annotated case study of a home sale.

> *"Ethical issues can come up at nearly every stage of a real estate transaction, even a relatively uncomplicated sale or purchase of a home."*

Get to Know the Rules

To be able to recognize and cope with ethical isses, a New York lawyer should be familiar with The Lawyer's Code of Professional Responsibility of the New York State Bar Association (NYSBA), consisting of 9 Canons of Professional Responsibility, 132 Ethical Considerations and 48 Disciplinary Rules. At a bare minimum, every lawyer must comply with the Disciplinary Rules to avoid being subject to disciplinary action. Extensive changes were made to some Ethical Considerations and many Disciplinary Rules as of June 30, 1999, as a result of the first comprehensive examination of the Code in over a decade.[2] Rulings on specific cases are given in opinions issued by the NYSBA Committee on Professional Ethics and and comparable committees of local bar associations.[3]

> 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*.[4]

Conflicts of Interest: An Example of the Canons, Ethical Considerations and Disciplinary Rules

Most of the NYSBA ethics opinions on real estate matters have dealt with conflicts of interest, either between the lawyer and the client or among different clients. Canon 5 states the basic commandment: "A lawyer should exercise independent professional judgment on behalf of a client." This is amplified in twenty-four aspirational Ethical Considerations. EC 5-1 states the overall principle:

> 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 interest, the interests of other clients, nor the desires of third persons should be permitted to dilute the lawyer's loyalty to the client.

EC 5-2 through 5-13 deal with interests of the lawyer that may affect the lawyer's judgment. EC 5-14 through 5-20 deal with the interests of multiple clients. EC 5-21 through EC 5-24 deal with the desires of third persons.

As to interests of the lawyer, EC 5-2 states:

> A lawyer should not accept proffered employment if the lawyers' 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.

This is codified as a Disciplinary Rule in DR 5-101(A):

> A lawyer shall not accept or continue 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, *unless a disinterested lawyer would believe that the representation of the client will not be adversely affected thereby*[5] and the client consents to the representation after full disclosure *of the implications of the lawyer's interest* [changes effective 6/30/99 italicized].[6]

A further complication is that some conflict situations have been held to be so obvious that they are *per se* impermissible and cannot be cured by informed consent of the client.[7]

As to interests of multiple clients, EC 5-15 states:

> 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.

This is codified as a Disciplinary Rule in DR 5-105:

> (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 . . .
>
> (C) In situations covered by DR 5-105(A) or (B), a lawyer may represent multiple clients if *a disinterested lawyer would believe that* the lawyer can *competently* represent the interest of each and if each consents to the representation after full disclosure of the *implications of the simultaneous* representation *and the advantages and risks involved* [changes effective 6/30/99 italicized].

Note that DR 5-105(C) is stated positively, unlike DR 5-101(A) and 5-105(A). If, after full disclosure and consent, the interests of the clients become conflicting, the lawyer must withdraw from representing any of them.[8]

Case Study for Home Sales

Purpose of the Case Study

Ethical issues can come up at nearly every stage of any real estate transaction, even a relatively uncomplicated sale or purchase of a home. The following case study is intended to illustrate relevant ethics rules and opinions. The endnotes include citations to the rules and opinions and some commentary on the issues raised.

The actions of the characters in the case study are meant to raise the issues, not to illustrate proper conduct. Describing wrong turns is usually a better teaching tool than describing model behavior. It should go without saying that *most of the conduct described in the case study should not be emulated*.

> *"Describing wrong turns is usually a better teaching tool than describing model behavior."*

Advertising

Laura Lawyer, having spent two years as an associate in a medium-sized general practice law firm in Manhattan, eagerly opened an office as a solo practitioner in Southampton. At the firm she had been involved in litigation and corporate matters and a couple of commercial mortgages for a bank. Between college and law school, she had been a licensed salesperson in a real estate brokerage in Suffolk County, where she met her husband, Bob Broker, a licensed broker in a rival firm. To help her get herself known, Bob suggested that Laura take out an ad in his firm's brochure aimed at buyers and sellers of homes. Laura thought that was a great idea.[9]

Referrals

A few days later, Laura got a call from Randy Realtor, another broker, who had brought about a sale for a seller. He asked Laura if she could represent the seller and prepare a contract, suggesting that there could be similar referrals in the future.[10] Laura said she'd be happy to do so.[11] The broker called back, suggesting that if Laura would represent both parties everything would go more smoothly and the parties could benefit from a lower combined fee. Laura said she didn't think she could do that.[12]

But Laura's luck continued. The next day she received a call from a mortgage broker who offered to pay Laura a fee if Laura would refer to the broker purchasers who were looking for loans. Laura wondered if she could still charge the same legal fee to purchasers and just pocket the referral fee from the mortgage broker.[13] The same day, she got a call from a real estate lawyer at her former law firm who offered to answer her questions and refer home sales to her if she would give him a third of her fee.[14] Laura happily agreed.

Laura was approached some time later by Randy Realtor and Marty Mortgage-Broker to participate in a "Home Buyers Program,' under which Marty would prequalify the buyer for a mortgage loan, Randy would find the home and Laura would represent both the buyer and the lender for a fixed fee that would be substantially less than the aggregate amount the buyer would customarily pay for those services.[15] Since she had no relationship to Randy or Marty, Laura thought that it sounded like a great idea.

Brokers

Knowing that brokers charge much higher fees (sometimes 6%) than lawyers usually charge for home sales (up to 1%), Laura wondered if she couldn't wear both hats and increase her income. Thinking that must somehow be improper,[16] Laura discussed the problem with her husband Bob, a broker. Bob said that was easy, she could just refer her clients to him and he would refer his clients to her.[17]

Contract Drafting and Negotiation

Randy Realtor called Laura the next day. He said he had found a buyer, Burt Buyer, to buy Sam Seller's house in Smithtown for $350,000. Randy said Sam wanted to close by December 1st because he was trying to buy a house in Boca Raton, Florida for the winter season. Randy told Laura to make sure she used the Smithtown mail address so the purchasers would think that the house was in the Smithtown school district.[18] Using the checklist she got from a book,[19] Laura asked Sam about the deal and his house. Sam said that it was in pretty good shape and that the basement hadn't leaked all summer. Somewhat puzzled, Laura asked what the basement looked like. Sam said it looked fine, especially since he had put up the wall paneling last year.[20] Laura prepared a contract on the Multibar Residential Contract of Sale form,[21] using the Smithtown address, stating that title was subject to "covenants, restrictions and easements of record' and containing the usual 'as is' clause, and sent it to Alan Attorney, the lawyer for the buyer. Sam then called and asked Laura to call Burt Buyer and find out if he wanted to buy the dining room chandelier, which Sam just might decide to leave. She did,[22] but Burt said no, he thought it was included in the sale.[23]

Alan Attorney called back with several comments on the contract. Among other things, he asked that the closing be December 15, not December 1, and Laura agreed.[24] After a lengthy exchange, he concluded by asking for copies of the seller's deed, title policy, survey, certificate of occupancy and any covenants, restrictions and easements. Laura said: "Get them yourself. I've spent too much time on this with you already," and hung up.[25]

Escrow of Downpayment

Somehow the contract was later signed by the parties and Laura received a check for $35,000 made out to her as escrow agent. Linda went to her bank and asked for the forms to open an attorney's escrow account. The bank officer asked Laura whether the account was to be interest-bearing and, if so, for the social security number of the client. Laura didn't know the answer, having failed to get that information or fill in the blank in the Multibar Residential Contract, so she said she guessed it should be in a non-interest bearing account. When she got back to the office, Laura looked at Paragraph 6 of the contract and saw that it said that the seller's attorney (Laura) shall be the Escrowee and that the Escrowee "shall (*not*) (*delete if inapplicable*) hold the Downpayment in an interest-bearing account for the benefit of the parties." Since she failed to make the deletion, she was not required by the contract to put the downpayment in an interest-bearing account, and she breathed a sigh of relief.[26] Having seen the paperwork and time consumed in opening the account, Laura wondered if she could have asked to keep the interest herself to help pay for her trouble.[27]

Between Contract and Closing

Two weeks after the contract was signed by the parties, Alan Attorney called to say that his client wanted to inspect the house after the recent heavy rains and that there was a question about the school district. His client wanted to make sure that the house was in the Smithtown school district. Laura said she didn't know anything about that.[28] When Laura asked Sam Seller about it, he said that the house was on the border line, but actually in the Kings Park school district, even though the post office address was Smithtown. Laura said she thought she ought to give Alan that information, but Sam asked her to "fudge' it, refuse the inspection request and insist that the contract be honored as written, since he needed the money to buy a new house in Florida.[29] Laura decided to tell Alan about the school district but refused to agree to the inspection.[30] Alan responded that his client had been defrauded about the school district and the basement condition, was canceling the contract and was demanding a refund of the downpayment. When Laura told Sam Seller, he said the buyer was just trying to get out of the deal and was in default. Sam demanded that Laura turn over the downpayment to him. Laura was sympathetic, but was not sure she could do so.[31]

If Sam Seller had told Laura that he was glad to be selling because he thought that his underground storage tank was leaking fuel oil and was worried that it may be about to contaminate a neighbor's well or public waterway, would Laura be obligated (or even permitted) to do anything about that?[32]

Closing

Fortunately for Laura, the parties decided to proceed, after agreeing to a reduction in the purchase price. Just prior to the closing, Alan learned that Sam Seller had convinced Burt Buyer to take some cash under the table to reduce the purchase price and reduce the transfer taxes payable by the seller, offering to split the savings with Burt. Alan called Burt and strongly advised against this. When Burt hesitated, Alan threatened to resign.[33] Burt relented.

Assuming that the transaction takes place in a county where attorneys act as title insurance agents (primarily upstate), Alan Attorney might tell his client, Burt Buyer, that he would be happy to act as the title insurance agent to search the title[34] or to refer Mr. Buyer to Alan's title abstract company.[35]

The lender submitted a bill for its attorney's fee for preparation of the mortgage to the buyer for payment at the closing. Burt Buyer wondered if it was proper for him to pay the fee of an attorney who didn't represent him.[36] That lead Mr. Buyer to the idea that he might have avoided having to pay for his own lawyer by just having the lender's lawyer represent him at the closing.[37] The lender's attorney could also be paid by the title insurer for representing it on the mortgage title insurance at the closing.[38]

At the closing, the lender was represented only by a paralegal. Burt Buyer asked the paralegal several questions about the loan, including how the escrow for taxes and insurance was calculated and what he could do if the bank made an error.[39] At the closing the paralegal delivered checks on the lender's lawyer's client escrow account that were signed by the paralegal using a signature stamp of the lender's lawyer.[40] Representation of the lender by a settlement corporation would appear to violate the prohibition against corporations practicing law.[41]

Eventually, the sale was closed.

Fee

Laura decided that the transaction was such a pain that she should charge double for her trouble.[42] Surprisingly, Sam refused to pay.

Post-Closing

After the closing, Alan Attorney got a call from a tax reduction company interested in hiring him to conduct judicial proceedings after they failed to secure a reduction in Mr. Buyer's real property taxes in administrative proceedings. They offered him a percentage of the tax reduction company's fee, which itself was based on a percentage of the amount by which the taxes are reduced.[43] Alan accepted.

The Bad News

About a month after the closing, Laura got a copy of a letter from Burt Buyer to the Grievance Committee complaining of her conduct in the matter. Too bad she didn't know the rules or when, where or from whom to seek guidance.[44]

Homethic

Ethics In Home Sales

Issues:

1. Not handle if not competent w/o associating DR 6-101
2. Accede to reasonable requests, be courteous DR 7-101(A)(1)
3. May fail to assert a position of client DR 7-101(B)(1)
4. Not assert position that would merely harass DR 7-102(A)(1)
5. Not knowingly make false statement of law or fact DR 7-102(A)(5)
6. Not counsel or assist in fraud DR 7-102(A)(7)
7. If learn of fraud, call on client to rectify DR 7-102(B)
8. Not communicate with party who is represented DR 7-104
9. Not permit non-client who pays to direct DR 5-107
10. Not charge excessive fee DR 2-106
11. Not divide fee with another lawyer unless in proportion DR 2-107
12. Referral (repeated) from broker Op 467
13. Fee for referral from mortgage broker? Op 667
14. Not pay for ad in broker's brochure Op 566
15. Lawyer and broker Op 208, 493
16. Lawyer and broker-spouse Op 244, 291, 340
17. Rep seller and buyer Op 38, 162
18. Title examiner and rep party Op 576, 626
    Own title abstract co Op 595, 621, 626
19. Rep mee, paid by mor Op 438
    Rep seller and lender Op 611
20. Escrowed funds DR 9-102
    Not retain interest Op 532
    Get instructions as to interest Op 575
21. Delegate attendance at closing to paralegal Op 677
22. Release of escrow Op 710
23. Referral from tax reduction company Op 705
24. Participate in CLE EC 6-2

Transaction

Advertising; referrals 14, 12, 13

Broker 15, 16

Initial hiring 1, 17, 24

Negotiation 2, 3, 4, 5, 6, 7, 8, 9

Escrow funds 20

Title exam 18

Loan 19

Closing 22, 21

Fee 10, 11

Tax reduction 23

Endnotes

1. This article was inspired by Green & Stein, "Adventures in the Mortgage Trade: "A Case Study in Legal Ethics," 27 N.Y. Real Prop. L.J. 49 (Spring 1999),

which provided a generic overview of ethical issues that can arise in commercial real estate transactions. This article focuses on New York ethical rules and opinions. *See also* Holtzschue, "Ethics and Professionalism," 27 N.Y. Real Prop. L.J. 61 (Spring 1999). The persons in the case study are fictitious. Any resemblance to persons living or dead is unintentional. The author thanks Joshua Stein, Esq. and Prof. Bruce Green for their thoughtful comments on this article.

2. The changes affected jurisdiction and choice of law, lawyer advertising and solicitation, conflicts of interest, business transactions with clients, media rights, sexual relations with clients and other matters. The changes in the Disciplinary Rules are available on the NYSBA website: www.nysba.org under "Ethics" where deletions and additions are indicated. For a discussion of the amendments as proposed, *see* Krane, "Proposed Amendments to the Code of Professional Responsibility: A Continuing Process of Change," 69 N.Y. St. Bar J. 42 (May/June 1997). For annotations and opinions, *see The New York Code of Professional Responsibility: Opinions, Commentary and Caselaw* (Daly, ed. Oceana) and Simon, *New York Code of Professional Responsibility Annotated* (West).

3. Copies of recent NYSBA opinions are posted on the NYSBA website: www.nysba.org under "Ethics." Recent NYSBA and Association of the Bar of the City of New York ("ABCNY") opinions are also available on LEXIS. As noted below, N.Y. State Opinions 621 and 693 have been criticized. The Oceana book cited in the previous note has full text ethics opinions after 1989 from the NYSBA, the ABCNY, the New York County Lawyers' Association and the Bar Association of Nassau County.

4. Fales, "The Bar Association's Role in Maintaining Professionalism," 69 N.Y.S. Bar J. 49 (May/June 1997) [emphasis supplied].

5. The disinterested lawyer test was added. It now conforms to a similar change made in DR 5-105(C) (conflicts among clients). Prior opinions read into DR 5-101(A) the prior "obvious" test of DR 5-105(C) ("obvious that the lawyer can adequately represent the interest of each"). N.Y. State 694 (1997).

6. Thus, to be permissible, a conflict between the lawyer and her client must both (1) pass the "disinterested lawyer"/"obvious" test and (2) have consent after full disclosure. How does the lawyer prove full disclosure and consent? Disclosure and consent are not required to be written, though new EC 5-3 states a preference for written consent. *Compare* new DR 5-104(A)(3), which expressly requires for the first time that consent be in writing as to transactions between a lawyer and clients. Is the client capable of making a decision about the exercise of professional judgment that properly should be made by an attorney? Comment, "Full Consent: An Invitation to Conflicts of Interest in the Attorney-Client Relationship," 1972 Law & Soc. Ord. 435, 441, 445 (1972). Is "informed consent" by a client to a conflict with its attorney based on the advice of that attorney an oxymoron? New EC 5-4 advises review by independent counsel. But if the client truly consents after full disclosure, shouldn't the client be entitled to choose its attorney?

7. *E.g.*, NYSBA Opinions 694 (1997) (home buyer program), 208 (1971) (lawyer/broker) and 595 (1988) and 621 (1991) (lawyer owning title abstract company; *but see* strong dissent in Opinion 621: "There is no basis in the Code for eliminating the consent provision from DR 5-101(A), and making a client's consent unavailable when the lawyer has an ownership interest in the agency, yet allowing client consent under identical circumstances when the lawyer represents the insurer and acts as its agent [under NYSBA Opinion 576 (1986)]."

8. EC 5-15; N.Y. State 611 (1990).

9. It may appear to be an attractive marketing tool, but an ethics opinion of the NYSBA Professional Ethics Committee found such an ad to be improper if the attorney paid for an endorsement or recommendation and misleading if it does not appear to be an advertisement paid for by the attorney. N.Y. State 566 (1984).

10. NYSBA Opinion 467 says that it is not *per se* improper for a lawyer to accept repeated referrals from a real estate broker. The concern, of course, is that the lawyer may have a conflict between the interests of a particular client and the longer term interest of the broker in closing sales to earn a commissions. DR 5-107(B) says that a lawyer shall not permit a person who recommends him for legal services to direct or regulate the lawyer's professional judgment. The Opinion concludes that a lawyer receiving repeated referrals should be "especially wary" of any influences that may dilute his professional loyalty to his client. N.Y. State 467 (1977).

11. Based on the facts, Laura has no experience in representing sellers or purchasers of real estate. Is it ethical for her to take on such a matter without experience? If not, how can solo practitioners ever take on a matter that varies from the work they have actually done in the past? DR 6-101 says that a lawyer should not handle a matter that the lawyer knows or should know he or she is not competent to handle, without associating with a lawyer who is competent. Does that mean that Laura can take on the matter if she consults with an experienced lawyer? What if she bought a book, such as *Holtzschue on Real Estate Contracts*? Would it matter whether she actually consulted the book? Would taking a CLE course on home sales make her competent? EC 6-2 says that a lawyer should "maintain" competence by participating in CLE. Must she reveal to her client her inexperience (and consultation)?

12. Even Laura knows that the potential conflict of interest is too great for a lawyer to represent the seller and the buyer in the same deal. Curiously, NYSBA Opinion 162 (1970) states that an attorney may do so, but only when there are no actual or potential differing interests and there is complete disclosure to and consent by both clients. The opinion makes clear that this is unlikely ever to be the case, but the positive statement seems disingenuous and unlikely to be followed today.

13. She can do so only if (1) the client consents after full disclosure, (2) the referral fee is credited to the client if the client so requests (what client wouldn't?), (3) the aggregate attorney's fee is not excessive and (4) the attorney exercises independent professional judgment on behalf of the client. N.Y. State 667 (1994). Could the mortgage broker get around this by treating Laura and Bob to dinners and theater tickets? Would that be circumventing a Disciplinary Rule through acts of another in violation of DR 1-102(A)(2)? An attorney who steered a client to a corporate mortgage broker in which the lawyer had an undisclosed interest was suspended for three years. *In re Pine*, 194 A.D.156, 604 N.Y.S.2d (2d Dep't 1993).

14. An attorney may not split a fee with another attorney unless the client consents after full disclosure, the division is in proportion to the services performed by each lawyer, and the total fee does not exceed reasonable compensation. DR 2-107(A).

15. NYSBA Opinion 694 (1997) found such an arrangement unethical as an impermissible third party solicitation under DR 2-103 and conflicts of interest under DR 5-105(C) with respect to the mortgagor and mortgagee and under DR 5-101(A) as to the attorney and broker (not at all obvious that the lawyer could adequately represent the differing interests, so the conflict could not be cured by consent).

16. A lawyer may conduct a law practice and real estate brokerage business from the same office, but she cannot act as lawyer and broker in the same transaction. N.Y. State 493 (1978). The conflict is

too great between the broker who gets paid only if the deal closes and the lawyer who must be free to advise her client not to close.

17. The conflict of interest is not cured by using a spouse. N.Y. State 340 (1974). Laura can act as attorney for clients of her spouse's office only if the spouse has not participated in the transaction or benefitted therefrom. *Id*.

18. Would Laura then be engaging in conduct involving a fraud, in violation of DR 1-102(A)(4)?

19. *See*, *e.g.*, *Holtzschue on Real Estate Contracts* (Practising Law Institute), App. A or 1 *New York Practice Guide: Real Estate* (Matthew Bender) § 2.29[1][a][viii].

20. Should Laura have asked why he put up the wall paneling? If he put it up to conceal leaks, that would be actionable fraudulent concealment. *Stephens v. Sponholz*, 251 A.D.2d 1060, 674 N.Y.S.2d 244 (4th Dep't 1998). Is it Laura's job to unearth these problems?

21. Jointly prepared by the Real Property Section of the New York State Bar Association, the New York State Land Title Association, the Committee on Real Property Law of the Association of the Bar of the City of New York and the Committee on Real Property Law of the New York County Lawyers' Association and printed by Blumberg Law Products as form A 125 ("Multibar Residential Contract"). This is the most commonly used form downstate, though (regrettably) still somewhat less so in Suffolk County.

22. Laura should have called Alan first. An attorney may not communicate with a party who is represented, without the prior consent of the party's attorney, regarding any matter within the scope of the representation. DR 7-104(A). A new amendment permits a lawyer to cause his client to communicate with a represented person provided the lawyer gives reasonable advance notice of the communication to the represented person's counsel. DR 704(B). New EC 7-18 defines "reasonable advance notice" as notice sufficiently in advance and of sufficient content as to give the lawyer an opportunity to advise the client.

23. Burt's right, if Paragraph 2 of the Multibar Residential Contract was not modified to exclude lighting fixtures. Laura (and the broker) should have made sure that Sam had agreed to the list of personal property specified in the contract as included in the sale. The failure to do so is one of the most common areas of unnecessary dispute in home sales.

24. An attorney may exercise professional judgment to waive or fail to assert a position of a client. DR 7-101(B)(1). Here, Laura knew that December 1 was a preferred date, but probably not a drop-dead date. Still, she should have checked it out with the client first, if only as a courtesy.

25. The Disciplinary Rules require that an attorney accede to reasonable requests, avoid offensive tactics and treat all persons [even opposing attorneys, who are in fact persons] with courtesy and consideration. DR 7-101(A)(1). Was the request reasonable? Does that depend on whether those documents are reasonably available from other sources and on whether Laura already had copies of them?

26. Not so fast, Laura. An attorney is obligated to get instructions from the contracting parties as to whether the escrowed funds should be held in an interest-bearing account. N.Y. State 575 (1986). DR 9-102 provides detailed requirements as to escrowed client funds: they may not be commingled, must be deposited in a banking institution, and must be kept in separate accounts that are specially identified, and records must be maintained for seven years.

27. Wrong again. N.Y. State 532 (1980).

28. Was that a "white lie" or did Laura violate the Disciplinary Rule prohibiting a lawyer from knowingly making a false statement of law or fact? DR 7-102(A)(5).

29. Is Laura being asked to assist in a fraud by the client in violation of DR 7-102(A)(7)? If an attorney learns of a fraud, the attorney must call on the client to rectify it. If the client refuses to do so, the lawyer *must* reveal the fraud to the affected person, except when the information is protected as a confidence or secret. DR 7-102(B)(1). Is the school district a client secret? If it is a secret, isn't Laura prohibited from revealing it under the client confidence rule of DR 4-101(B)(1)?

30. An attorney must accede to reasonable requests. DR 7-101(A)(1). Paragraph 12 of the Multibar Residential Contract gives the purchaser the right to inspect before the closing. Laura should get to know the contract.

31. Laura should read the contract. Paragraph 6 of the Multibar Residential Contract says that the Escrowee must give prompt notice to the other party of a demand for the downpayment and pay it to the demanding party only if the Escrowee does not receive written notice of objection from the other party within 10 business days. A lawyer who released escrowed funds to his client where it appeared that the purpose of the escrow had been fulfilled (to secure against loss due to a sidewalk violation) was held not to have the power to resolve the dispute if the escrow agreement did not so provide. N.Y. State 710 (1998). On the merits, Sam's position seems weak.

32. Not under the client confidence rule of DR 4-101(B)(1) or Model Rule 1.6 of the American Bar Association, one of the most controversial of the Model Rules. Russell, "Unreasonable Risk: Model Rule 1.6, Environmental Hazards, and Positive Law," 55 Wash. & Lee L.Rev. 117 (1998) (criticizing the American Bar Association's Model Rule as favoring attorney-client confidentiality too much over positive environmental law protection of third parties). In New York, Laura is *permitted* to disclose a client secret only if the client intends to commit a crime. DR 4-101(C)(3). Is owning a leaking residential fuel oil tank a crime? What if it was a leak in a commercial tank that was required by law to be reported? Is the seller obligated to reveal a leaking underground tank under New York's version of *caveat emptor*? For an analysis of the evolving rule, *see* Holtzschue, "*Caveat Emptor* Ain't What It Used to Be: New Developments, Trends and Practice Tips," 25 N.Y. Real Prop. L.J. 3 (Winter 1997).

33. Good for Alan. If his client insists on going forward, he must withdraw from further representation. N.Y. City 1994-8 (1994), citing N.Y. State 454 (1976), DR 7-102(A)(7) and DR 2-110(B)(2). Having properly withdrawn, the attorney was not *required* to disclose the fraudulent scheme to anyone because it was a protected confidence or secret of a client. The exception in DR 4-101(C)(3) *permitting* disclosure of a client's intention to commit a crime is strictly construed and would apply only if the attorney concludes that the client intends to commit a future crime. *Id*. A willful attempt to evade the New York State Real Estate Transfer Tax is a misdemeanor. Tax Law § 1818.

34. A lawyer representing a seller, purchaser or purchaser's lender may also act 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 to the lawyer from the title company (absent express consent to the contrary from the client), and the legal fee is not excessive. NYSBA Opinions 576 and 626.

    Opinion 576 analyzes services and fees for arrangements such as attorney closer, approved attorney, examining counsel, and agent. *See also* Glasser and Sachs, "Dual Compensation to Attorneys in Real Estate Transactions," 23 N.Y. Real Prop. L.J. 80 (Spring 1995); Lee, "Dual Roles in Real Estate Transactions: Disclosure & Consent," 24 Real Prop. L.J. 16 (Spring 1996) (recommending specific disclosure of the fees and services rendered).

35. NYSBA Opinions 595 and 621 state that it is improper for an attorney to refer a client to an abstract company in which the attorney has an ownership interest. N.Y. State 595 (1988) and 621 (1991). Opinion 621 contains a vigorous dissent and many commentators believe that the courts would not reach the majority's result, but rather the affirmative result in Opinions 576 and 626. *See* Lee article in the previous note.

36. NYSBA Opinion 438 (1976) expressly permitted the mortgagee's lawyer to be paid by the mortgagor. A similar concept appears in paragraph 5(a) of the Multibar Residential Contract, which requires the purchaser to pay a fee (in an amount to be filled in) to the seller's attorney for preparation of a purchase money note and mortgage. Attorneys in some of the larger firms have been uncomfortable collecting such a fee, however. *Holtzschue on Real Estate Contracts* § 2.2.5.

37. Unwise, but not necessarily unethical. A 1964 NYSBA ethics opinion permitted a bank's attorney to represent the bank and the borrower, a not uncommon occurrence upstate, assuming that the representation was not required, the fee not excessive, the fee was set by the attorney, not the bank, the conflict was fully disclosed, and in fact the interests of the bank and the borrower were not adverse, citing then Canon 6. N.Y. State 8 (1964). *Accord*, assuming full disclosure and express consent. N.Y. State 438 (1976), 694 (1997). Representing both the borrower and the lender where their interests were adverse has been found unethical. *In re Gold*, 240 A.D.2d 74, 668 N.Y.S.2d 605 (1st Dep't 1998). Representing both the seller and the lender is frowned upon, and if an actual conflict arises, the lawyer must withdraw from representing either party. N.Y. State 611 (1990).

38. NYSBA Opinion 626 permits the lawyer to be paid both by the borrower and the title insurer if the conditions laid down in Opinion 576 are met. *See* note 34 *supra*.

39. Delegation of attendance at the closing to a paralegal by the lender's attorney is permissible if the paralegal's work is merely ministerial (not requiring the exercise of professional legal judgment) and under the supervision of a lawyer (who may be available by telephone). N.Y. State 677 (1995). The opinion notes that mortgage closings often do not require independent discretion or judgment from a paralegal assigned to monitor the ceremony. Can the paralegal answer questions of the borrower without referring them to the supervising attorney? Does that depend on the nature of the questions?

40. This is permitted by NYSBA Opinion 693 (1997), but that opinion has been strongly criticized. Coffey, "Authorized Signatories on Escrow Accounts: Ethics Opinion 693 is Misplaced," 26 N.Y. Real Prop. L.J. 19 (Winter 1998).

41. Jud. Law § 495.

42. A lawyer shall not charge an excessive fee. A fee is excessive when, after a review of the facts, a lawyer of ordinary prudence would be left with a definite and firm conviction that the fee was in excess of a reasonable fee (listing eight factors to be considered). DR 2-106. Can Laura change her fee if she had quoted a number to the client in advance?

43. Whether this is permissible depends on the circumstances. It is not permissible 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. N.Y. State 705 (1997).

44. *See e.g.*, reference materials cited in notes 2 and 3 *supra*.

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The Ethical Real Property Lawyer

By Peter V. Coffey

Introduction

Several years ago, the New York State Bar Association formed a special committee (the "Committee") to review the Code of Professional Responsibility. On February 29, 1996, the Committee issued its report and proposed several amendments to the New York Lawyer's Code of Professional Responsibility (the "Code"). The report generated comments from many of the Bar Associations across the state, from the State Bar Association's Committee on Professional Discipline and from Official Committees on Professional Discipline, particularly that of the Third Department.

Thereafter at several consecutive meetings of the New York State Bar House of Delegates the issues were presented and debated. The debate was moderated by Steven Krane, Committee Chair. He presented a detailed knowledge and analysis of the Code, setting forth the rationale of the proposed changes and calmly and professionally explained where disagreements on the Committee existed, the position of the Committee and respectfully listening and responding to all the challenges from the floor.

On July 14, 1999, the presiding Justices of the four Appellate Divisions amended the Disciplinary Rules in response to the proposals by the State Bar Association and so the Code has been extensively revised as a result of the State Bar's undertaking.

Each Disciplinary Rule is preceded by Ethical Considerations which are formulated by the State Bar Association and give a fuller meaning to the Disciplinary Rules themselves. Although they do not have the force of a Disciplinary Rule, the Ethical Considerations are of great value. Pursuant to the suggestions of the Committee, the Ethical Considerations were amended effective June 30, 1999. All these changes are found at the State Bar's Web site.

Your Real Property Section Executive Committee felt that it would be useful for our *Journal* to regularly address ethical issues.

Accordingly, set forth on the following pages 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
One Elk Street
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It should be noted that Opinion 712 deals extensively with the issue of conflicts of interests and although not in the context of a real estate question offers valuable guidance in making decisions where conflicts of interest are involved. The Opinion notes in endnote 3 that it supports the State Bar's proposed amendment to DR5-105(D). The State Bar Association's proposed amendment to DR5-105(D) was, fortunately or unfortunately depending upon your opinion, not adopted by the Presiding Justices and accordingly the rule remains the same. Notwithstanding that, Article 5 was substantially revised. Both Opinions 711 and 712 give substantial guidance.

Peter V. Coffey is Co-chair, Committee on Professionalism for the Real Property Law Section and Vice President for the Fourth District of State Bar Executive Committee.

NYSBA Ethics Opinions

Committee on Professional Ethics

Opinion 711 1/7/99 (41-98)

Topic: Conflict of interest; dual practice as lawyer and insurance agent.

Digest: Lawyer representing clients in estate planning may not sell long-term care insurance to clients.

Code: DR 5-101(A); DR 5-104(A).

QUESTION

May a lawyer who is licensed as an insurance broker sell long-term care insurance to clients whom the lawyer represents in estate planning?

OPINION

In N.Y. State 619 (1991), this Committee opined that it was an impermissible conflict of interest under both DR 5101(A) and DR 5104(A) for a lawyer engaged in estate planning to recommend the purchase of life insurance products to the lawyer's clients if the lawyer has a financial interest in the planning service that sells the recommended products. We also held that because the opportunity for overreaching by the lawyer [was] too great to be tolerated, the conflict could not be cured by disclosure and client consent. A lawyer representing clients in estate planning now inquires whether the same restrictions apply to the sale of a different insurance product namely, long-term care insurance. We conclude that the same restrictions do apply. Therefore, a lawyer who is licensed as an insurance broker may not sell long-term care insurance to clients whom the lawyer represents with respect to estate planning.

As we discussed in N.Y. State 687 (1997), the general question of whether a practicing attorney licensed as an insurance broker may sell insurance products to his or her clients is governed by two disciplinary rules. The first, DR 5101(A), addresses the danger that the lawyer's exercise of professional judgment in rendering legal services will be influenced by the lawyer's financial interest as an insurance broker. It provides:

> 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.

As discussed in Opinion 687, DR 5101(A) applies to the sale of insurance to a client if the lawyer's exercise of professional judgment on behalf of the client will be or reasonably may be affected by the lawyer's interest, as an insurance broker, in selling insurance products to that client. If DR 5101(A) applies, the lawyer must consider whether it is obvious that the lawyer can adequately represent the client in this matter notwithstanding the lawyer's own interest. *See* N.Y. State 635 (1992); N.Y. State 619, *supra*; N.Y. State 595 (1988). If it is obvious that the lawyer can adequately represent the client, then the lawyer may continue the representation and offer the insurance products for sale to the client with the clients consent, after full disclosure of the risks that the lawyer's professional judgment could be affected by the lawyer's self interest.

We recognized in Opinion 687 that DR 5101(A) will generally permit the lawyer-broker to sell insurance to a client, with the client's consent after full disclosure, when advice about the purchase of insurance products is merely tangential to the representation, because the client is not seeking legal advice about which insurance product to purchase or because there is no room for judgment about which insurance product to purchase. On the other hand, if there is a reasonable probability (viewed objectively) that the lawyer's professional judgment will be adversely affected by the lawyer's business interests, then the lawyer must not offer to sell insurance to client. This bar is likely to exist when advising the client about the purchase of insurance is central to the representation, or the client would benefit from the lawyer's professional judgment about which product to choose.

The second rule, DR 5104(A), addresses the danger that, in purchasing insurance products, the purchaser will be misled to believe that the lawyer selling these products will be exercising professional judgment as a lawyer for the benefit of the purchaser. It provides:

> 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.

In the context of selling insurance products, the lawyer would have to be clear that he or she is acting exclusively as an insurance broker and not as a lawyer; and the lawyer, before entering into the business transaction with the client, must obtain client consent after making clear to the client that in the context of the particular transaction, the lawyer is not exercising professional judgment as a lawyer on behalf of the client. Further, the lawyer must not engage in overreaching, but must deal fairly with the client.

Based on these provisions, we conclude that a lawyer is categorically forbidden from selling long-term care insurance to clients whom the lawyer represents in estate planning. For purposes of our analysis, long-term care insurance has many of the same characteristics as life insurance (e.g., a wide array of insurance products sold by various companies at different prices, and threshold questions of whether long-term care insurance products are the most appropriate or economical way to satisfy the clients needs). Furthermore, when a lawyer advises a client in estate planning matters, central objects of the representation include how best to satisfy the financial needs of the client and of those for whom the client wishes to or is obliged to provide; how to conserve the client's assets in the event of various contingencies; and how to provide for various health-related contingencies (such as by means of a health care proxy or living will). Thus, advice about the purchase of long-term care insurance is not likely to be merely tangential to the representation, but central to it. This conflict cannot be cured by disclosure and client consent.

CONCLUSION

A lawyer may not sell long-term care insurance to the lawyer's own clients if the representation relates to estate planning or other matters or areas of practice that might reasonably cause the lawyer's professional judgment on behalf of the client to be affected by the lawyer's own financial or business interests.

* * *

Opinion 712 1/7/99 (38-98)

Topic: Conflict of interest; financial interest.

Digest: Where lawyer is beneficiary of trust holding stock in corporations which may become clients or opponents of clients, lawyer has no conflict of interest or disclosure obligation except on rare occasion when lawyer's exercise of independent professional judgment reasonably may be affected by lawyer's financial interest.

Code: DR 5101, 5105(D); EC 51, 52, 53.

QUESTION

A lawyer engaged in securities work at a firm is one of a number of co-beneficiaries and therewith beneficial owners of a securities trust invested in "blue chip" corporations, paying small annual dividends, and valued at under a million dollars. The lawyer has no influence in the trust's transactions, and it will be twenty years or more before any other significant benefit flows to the lawyer from the trust. In a number of matters, corporations in which the trust has invested are either clients or opponents of the firm's clientele. Does the lawyer's financial interest give rise to a conflict of interest when the lawyer or the law firm undertakes representation in these matters?[1]

OPINION

The inquiry implicates DR 5101(A), which provides:

> 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.

This disciplinary rule is designed to protect against the risk that the lawyer's financial interests (or other interests) would tend to dilute the lawyer's loyalty to the client, EC 51, or make his or her judgment less protective of the interests of the client. EC 52.

Although lawyers are expected to avoid acquiring particular interests that might interfere with their professional judgment in an ongoing representation, ECs 52 and 53, lawyers cannot avoid all interests that might potentially bear on their future representation of clients. Thus, before undertaking a new representation, DR 5101(A) requires the lawyer to consider whether the lawyer's interests may affect the lawyer's exercise of professional judgment in the representation. At one extreme, when there is no more than a fanciful, theoretical or de minimus risk that the lawyer's judgment will be affected adversely by a potentially relevant set of interests, DR 5101(A) imposes no restriction. *Cf.* N.Y. State 655 (1993); N.Y. State 643 (1993). At the other extreme, DR 5101(A) has long been understood to foreclose the lawyer from undertaking a representation, even with the client's consent after full disclosure, if there is a reasonable probability (viewed objectively) that the lawyer's interests will affect adversely the advice to be given or the services to be rendered to the client. N.Y. State 595 (1988); *see* N.Y. State 688 (1997) at 3 n.2 (citing authority).[2] Under DR 5105(D), a lawyer's personal conflict under DR 5101(A) is automatically imputed to the lawyer's firm, so that if the lawyer may undertake a representation only with the client's consent after full disclosure or is foreclosed from doing so altogether, the same restriction would apply to all other lawyers in the firm.[3]

Thus, the question raised by this inquiry is whether, in any given matter in which the lawyer or the lawyer's firm would engage in the representation, the lawyer's professional judgment will be or reasonably may be affected because the lawyer has a financial interest in a trust which holds stock in a company that is either a client or an opposing party in the matter. If it would be, then, under DR 5105(D), the conflict would be imputed to the law firm, and the lawyer or the firm could undertake the representation, if at all, only with the clients consent after full disclosure.

The question whether the lawyer's exercise of professional judgment . . . will be . . . affected by the lawyer's financial interest is a subjective one, which the lawyer in this situation must resolve personally. The question whether the lawyer's judgment "reasonably may be affected" by the lawyer's financial interest is an objective one which invariably will depend on many factors. N.Y. State 688 (1997). In this situation, relevant factors include: (1) the nature of the law firms representation of, or adverse to, the corporation whose stock is held by the securities trust; (2) the likelihood that the value of the securities trust or the amount of income it produces will be significantly affected by the outcome of the representation; and (3) the extent to which a lawyer's judgment might be affected as a consequence.

We believe it would be the rare case in which, objectively speaking, a lawyer's judgment reasonably may be affected by the abovedescribed financial interest. In most cases, the representation by the lawyer or law firm can be expected to have minimal or no impact on the value of the company's stock or the dividends it produces. Because it cannot be said that the lawyer's financial interest reasonably may affect the lawyer's exercise of professional judgment in such circumstances, disclosure and client consent would not be required.

The determination under DR 5101(A) is not susceptible to a per se rule, however, because one can imagine the rare situation where the lawyer's judgment reasonably may be affected by the abovedescribed financial interest. This may occur, for example, where the particular company's stock represents a significant part of the value of the securities trust and the value of the company's stock will be significantly affected by the transaction or litigation in which the lawyer would be involved. In such rare circumstances, it would be permissible to undertake the representation, if at all, only with the client's consent after full disclosure.

CONCLUSION

Subject to the limitation described above, the lawyer generally would have no obligation to disclose to a client that the lawyer has an interest in a securities trust holding stock in the client corporation or in a corporation that is adverse to the client.

Endnotes

1. The inquirer also raised a question concerning the possible role of federal regulations governing "insider trading." Although the question of when securities regulations apply is a matter of law beyond the Committee's jurisdiction, we note that any violation of law is apt to violate the Code. DR 7102(A)(8).
2. A proposed amendment to DR 5101 would appear to codify this Committee's long-standing analysis.
3. This would not be true if amendments to DR 5105(D) proposed by the New York State Bar Association are adopted.

* * *

Opinion 713 2/5/99 (56-98)

Topic: Circumstances justifying non-compliance with client's instructions.

Digest: Lawyer should comply with client's direction to forego title searches.

Code: DR 2-110(C)(1)(e), 7-101(B), 7-102(A)(7); EC 7-1,7-8.

QUESTION

A lawyer has drafted a deed for a client who, contrary to the lawyer's advice, has instructed the lawyer to forego title searches of certain parcels of real property to be taken by the client in satisfaction of a preexisting debt. Should the lawyer comply with the client's instruction, notwithstanding the lawyer's professional judgment that it would be contrary to the client's interest to do so?

OPINION [SUMMARY]

A client's instruction to forego any title searches of the real property to be transferred in satisfaction of a pre-existing debt owed to the client should be followed by the lawyer. The client may limit the scope of the lawyer's representation to drafting a deed as long as the lawyer is able to otherwise competently represent the client and the client fully understands the consequences of the limitation. N.Y. State 604 (1989). The lawyer's duty is to exert his best effort to insure that decisions of the client are made after the client has been informed of relevant considerations. EC 78. The lawyer may continue to represent a client even though the client has elected to pursue a course of conduct contrary to the advice of the lawyer so long as he does not thereby knowingly assist the client to engage in illegal conduct or to take a frivolous legal position. EC 75.

* * *

Opinion 714 2/5/99 (49-98)

Topic: Compensation of lawyer as witness.

Digest: Lawyer as witness may accept reasonable compensation for lost time.

Code: DR 2-106; 5-101(B); 7-109(C)(2).

QUESTION

When a client (or former client) seeks to call a lawyer to testify concerning the prior representation, may the lawyer agree to receive compensation for the lawyer's time spent in preparing to testify and testifying as a witness in the case?

CONCLUSION

Assuming that the compensation to be paid to a lawyer as a witness is not illegal, a fully informed client (or former client) may agree to pay the lawyer reasonable compensation in the amount of the lawyer's customary hourly rate.

* * *

Opinion 715 2/26/99 (3-98)

Topic: Conflict of interest; subcontractor to multiple law firms

Digest: A lawyer may be employed as a contract lawyer by one or more firms. The provisions of DR 5-105 and DR 5-108 apply to the lawyer personally representing clients with differing interests at different law firms. Whether the vicarious disqualification provision of DR 5-105(D) applies depends upon whether the relationship of the contract lawyer to each employing law firm rises to the level of an association with the firm, which depends on the facts and circumstances of the employment.

Code: DR 2-101(A), DR 2-103(A), DR 2-107(A), EC 2-22, DR 4-101(C), DR 5-105(A),(C),(D), DR 5-108(A),(B).

QUESTION

May a solo practitioner supplement the income from his or her own law practice by soliciting and taking on legal work on a temporary project basis from multiple law firms? Must the clients of the sponsoring firm on whose matters the lawyer works be informed that work is being performed by the lawyer?

CONCLUSION

A lawyer may be employed as a Contract Lawyer by one or more firms. The provisions of DR 5-105 and DR 5-108 apply to the lawyer personally representing clients with differing interests at different law firms. Whether the vicarious disqualification provision of DR5-105(D) applies depends upon whether the relationship of the contract lawyer to each employing law firm rises to the level of an association with the firm, which depends on the facts and circumstances of the employment.

* * *

Opinion 716 - 3/3/99 (12/12a-98)

Topic: Lawyer's submission of client billing records to outside auditor employed by insurance company.

Digest: A lawyer representing an insured may not submit legal bills to an independent audit company employed by the insurance carrier without the consent of the insured after full disclosure.

Code: DR 4101, 5107; EC 44, 51, 521.

QUESTION

When an insurance company compensates a lawyer for defending its policyholder in civil litigation pursuant to an insurance contract that requires the insurer to pay for the policyholders defense, must the lawyer obtain the client's informed consent before submitting legal bills to an auditor employed by the insurance company?

OPINION [SUMMARY]

DR 4101 of the Code of Professional Responsibility establishes the lawyer's duty of confidentiality. It generally provides that a lawyer shall not knowingly . . . [r]eveal a confidence or secret of a client except with the consent of the client or clients affected, but only after a full disclosure to them. DR 4101(B)(1) and (C)(1). For purposes of the confidentiality rule, "confidences" include information protected by the attorney-client privilege and "secrets" include "other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client. DR 4101(A). Thus, a lawyer generally must preserve the confidentiality of information learned in the course of representing a client, unless the client provides informed consent to the lawyer's use or disclosure of the information. This rule governs the question of whether a defense lawyer may submit the client's legal bills and supporting documentation to outside auditors who are retained by an insurance company that has contracted to pay the client's legal fees.

Bergman on Mortgage Foreclosures:

When They Finally Render Low the Bad Guys

By Bruce J. Bergman

"The system is made to be abused" could be the mantra for attorneys who prosecute foreclosures and are all too familiar with the plethora of delaying tactics and dissembling which crafty borrowers seem to create from the ether. Legitimate or even marginally colorable defenses can, of course, be accepted with equanimity and a borrower's attorney should certainly represent the client with all due vigor and expertise.

Irksome, though, are the discursive thrusts designed solely to impede conclusion of the case, e.g., perhaps the baseless 3211(a) motion arguing lack of jurisdiction (assuming the borrower manufactured the claim); the transparent answer alleging illusory defenses; the motion to reargue the resultant defeat; the multiple bankruptcy filings with plans never fulfilled, first by one borrower followed by the whipsaw of the next borrower's filing; the eve of sale order to show cause—all a delineation which hardly exhausts the creativity of the dedicated.

Assuming for discussion purposes that the noted roadblocks were indeed meritless (we respect the real defenses and acknowledge their existence), foreclosing plaintiffs' dismay is exacerbated by courts which are constrained to consume time evaluating such defendants' entreaties and, in an effort to give everyone their day in court, are sometimes overly solicitous of the specious. War stories in this regard are legion but uneasily explained to perplexed mortgagees not as conversant as counsel with the vicissitudes of trench warfare litigation.

So, when the courts *do* see through the bogus, and react forcefully, it is especially gratifying, worthy of huzzahs and deserving of mention here.[1] Here are the facts and the result, with the latter recommended as a guiding standard.

Foreclosure is commenced against H and W, with a notice of pendency wisely filed. Judgment of foreclosure and sale issues. During that period (and thereafter), H and W alternatively file no less than three bankruptcy petitions. The stay is lifted each time and after the third occasion, the order vacating the stay prohibited further filings by H or W for 180 days. "Undaunted," as the court phased it, and notwithstanding the lis pendens and the judgment of foreclosure and sale, H and W conveyed the mortgaged premises to a corporation of which H was president and apparent sole shareholder (H's counsel assisted in preparation of the deed.) The grantee corporation (surprise) then filed a bankruptcy petition and after a foreclosure sale was conducted, moved in Supreme Court to vacate the sale. When that motion was denied, an appeal ensued and that really caught the attention of the court.

The denial to vacate was affirmed *and* both H and his counsel were sanctioned $2,500 each. The Second Department recognized H's tactics for precisely what they were. Whether this sage exercise of judicial authority will diminish the zeal of purveyors of sham is doubtful, but it certainly is welcome and refreshing.

Endnote

1. *SRF Builders Capital Corp. v. Ventura*, 229 A.D.2d 431, 644 N.Y.S.2d 813 (2d Dep't. 1996).

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.

Real Property Law Section Historic Preservation Trip to Chicago an Unqualified Success

By Joel H. Sachs

Neither a cold blast of arctic air coming off Lake Michigan nor the street detours created by the Chicago Marathon were able to impede the members of the Real Property Law Section who ventured to Chicago on the weekend of October 21 to 24, 1999 for a program entitled "An Architectural and Historic Heritage Tour of Chicago."

This Section-sponsored trip to America's heartland was the first sojourn of our Section and provided an opportunity for Section Members to both learn and socialize in an informal atmosphere over a long weekend. The trip proved a nice compliment to our Section's Summer Meeting and the Bar Association's Annual Meeting each January.

The educational highlight of the weekend was a half-day program entitled "Current Legal Issues Involving Historic Preservation" co-sponsored by our Section and the Real Property Law Committee of the Chicago Bar Association. The program which was held in the historic headquarters of the Chicago Bar Association in "The Loop" brought together attorneys with expertise on historic preservation from both New York State and Illinois. Two members of our Section, Michael Sillerman, Esq., and Stuart Beckerman, Esq., gave excellent presentations to the assemblage of Chicago and New York attorneys attending the program.

After our morning MCLE program, we then headed to the Chicago Board of Trade where we learned about commodities, options and the like and observed first hand what a wild place the commodities trading floor is. Although the Chicago Stock Yards are long gone, the bulls were present on the trading floor. The afternoon continued with a visit to the John Hancock Tower, where we observed Chicago from 95 stories up. From there, it was down to the world headquarters of Chicago Title Insurance Company for a welcome cocktail party, sponsored by Chicago.

The highlight of Saturday was a four-hour architectural tour of Chicago, sponsored by the Chicago Architectural Foundation. This was no ordinary sightseeing tour in that it gave members of our Section a first-hand look at many of the historic preservation and architectural issues which have guided Chicago's growth in the days since Mrs. O'Leary's cow kicked over the lamp which started the Chicago Fire in 1871. Saturday afternoon gave members of the Section time to visit famous Chicago attractions such as the Chicago Art Institute, the Museum of Science and Industry or spend their hard-earned money at the world-class shops on North Michigan Avenue. The day ended with a gala dinner at one of Chicago's finest steak houses.

The last day of our trip was spent in Oak Park, Illinois visiting the Frank Lloyd Wright home and studio. This proved to be a fascinating experience. We also went of a walking tour of the Oak Park neighborhood near Wright's house and observed several other Frank Lloyd Wright homes. It was then off to O'Hare Airport and back to the Empire State.

Those Section members who attended the trip expressed positive views about the experience and expressed interest in the Section sponsoring other trips in the future. Possible locations such as Savannah, Charleston, South Beach and San Antonio were discussed. If Section members have interest in trips such as this in the future, kindly contact your Section officers or myself.

Joel H. Sachs is Co-chair of NYSBA's Environmental Law Committee of the Real Property Law Section and a past Chair of NYSBA's Environmental Law Section.

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