Residential Mortgage Lending in North Carolina:

Ethical Issues

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Introduction

Real estate law is not the simple, simplistic set of black letter rules some non-property lawyers sometimes believe. I suppose that anyone reading this manuscript or attending this seminar is more than fully aware of that!

The focus of this manuscript is on some of the critical "relationship" issues that underlie the ethical rules applicable to real estate closings. Remember that the practical side of a failure to honor that relationship at closing is a *real dollar cost* to everyone involved. Each reported case reference in a legal brief represents tens of thousands of dollars in attorney fees and court costs for both sides to litigate the issue, as well as the time, aggravation and actual loss incurred. Therefore, the attorney should probably consider each of these issues as *very* important to the law firm's real estate, domestic law, business law and general practice.

Many items are based on calls I receive daily from attorneys and others around the state and elsewhere. I am *not* trying to impose a standard of practice, but to communicate my perception and a few references to what others of the attorney's peers consider important. This manuscript is about areas of potential risk, made higher by the fact that actual statutes and cases have now set the legal standard. (Therefore, I apologize if it sounds "preachy" but that is unavoidable.)

In some cases, the opinions of attorney about how to address a particular issue differ. Therefore, the attorney's best protection is to take the most conservative position whenever possible.

EXAMPLE: Some attorneys believe that a conveyance of title held under a "blind trust" (in the name of "X, trustee" without identifying the beneficial interest of the trust) pursuant to N.C.G.S. 43-63, does not require joinder of X's spouse. However, many, if not more, believe that since the trust and the beneficial interest may not exist, the title is actually only in the name of X, requiring joinder of X's spouse in any conveyance to waive the spouse's contingent statutory marital interest. Therefore, best practice would be to join the spouse, to prevent a later claim of lack of marketability.

The key to malpractice prevention is *communication* – about the risks the attorneyr client is assuming, the limits of the representation the attorney are providing, the type and extent of coverage they should obtain and any other matter related to the closing. These may include matters which are not of record, but for which the attorney has actual knowledge, or for which the attorney should exercise professional judgment.

EXAMPLE: An attorney aware of a highly publicized trial of husband murdering his wife should advise his purchaser-client that property originally held as tenants by the entireties is not inherited by the husband! N.C.G.S. 31A.

EXAMPLE: An attorney aware that a client is in the business of developing business property or plans to do so with property being

purchased should specifically advise the client about zoning or restriction or private access easement limitations that may affect this anticipated use.

IMPORTANT NOTE REGARDING ETHICS OPINIONS:

Rules of Professional Conduct opinions (RPC) reference and are based upon the Rules of Professional Conduct (effective from January 1, 1986, until July 24, 1997) herein referenced as "Rules". Formal Ethics Opinions (FEO) reference and are based upon the Revised Rules of Professional Conduct (effective on and after July 24, 1997), herein referenced as the "Revised Rules". All are available on-line at the web site of the North Carolina State Bar: www.ncbar.com. The earlier Code of Professional Conduct and opinions (CPR) are often still relevant and referenced, but are not on-line at the above site. Many are reproduced on the web site of Chicago Title at www.northcarolina.ctt.com under "Legal – Bulls, Bulletins and Articles – Ethics Opinions." All Opinions are Reprinted with the Permission of the North Carolina State Bar.

Below is the entire opinion, recited directly from the North Carolina State Bar records, regarding the duty of an attorney (whether in-house or in private practice) to report violations of ethical duties by other attorneys. This opinion is in the real estate area, rendering it more relevant to this presentation, but is based upon the earlier Rules of Professional Conduct.

RPC 17 (October 24, 1986), Reporting Unethical Conduct

Opinion rules that a lawyer who acquires knowledge of apparent misconduct must report this matter to the State Bar.

Inquiry #1: Attorney A conducted a title search on a tract of property for a client, the vendee. Attorney A discovered an outstanding lien of $5000 on the land in question. The client's payments to the vendor covered most of the lien. However, the attorney still needed $1000 from the vendor to clear up the title. The vendor asked if he could bring the remaining $1000 to Attorney A within a week. The vendor had been a good client of Attorney A in other matters, and Attorney A agreed to the vendor's request. In the meantime, Attorney A closed the deal, writing up a general warranty deed, with the $1000 outstanding. In addition, because the vendee purchased the land through a bank loan and used the land as security on that loan, the vendee had to sign an affidavit stating that there were no prior encumbrances. This he did presumably relying on his lawyer's advice. If Lawyer L becomes aware of the situation described above, is he under any duty to report Attorney A's conduct to the North Carolina State Bar? Does it affect the response if Attorney A agrees to put the $1000 into an interest-bearing escrow account in the vendee's name?

Opinion #1: On the basis of the facts stated, there appears to be reason to believe that Attorney A may have violated Rule 1.2(b), Rule 7.1(a)(3) and possibly Rule 5.1. If Lawyer L has knowledge that Attorney A has committed these violations, Lawyer L must report the apparent misconduct to the State Bar under Rule 1.3(a). Whether Attorney A agrees to deposit the $1000 into an escrow account in the vendee's name does not affect whether the violation has occurred and whether Lawyer L has

knowledge that it occurred, but would be more relevant to any legal claims the vendee would have against Attorney A and possibly in consideration as to actual discipline to be imposed by the State Bar if it found the facts as believed by Lawyer L and found them to establish unethical conduct by Attorney A.

Inquiry #2: The same vendor, as in the circumstances above, has been accused of working privately in partnership with a loan officer at the bank involved in the transaction described above and of obtaining a large loan from that bank for the stated purpose of construction work on the property. According to third parties, the vendor, who is the construction company president, drew on the loans when there was no construction actually going on. Additionally, the vendor allowed additional liens to build up on the property to pay for construction work which did actually occur. Although the company is contractually obligated to clear up the subsequent liens, the company in fact no longer exists. The former owner-president has indicated that he will not honor the contract and pay off the liens. He has also refused to pay liquidated damages for which the contract provides even though he was over a year late finishing up the project.

At the time the vendor sold the property and signed the construction contract, his company had been officially suspended by the Secretary of State of North Carolina for failure to pay license fees. The loan officer mentioned above has left the bank and cannot be located.

At what point, if any, must the investigating attorney, Lawyer L, report the activities of the vendor to the State Attorney General? What degree of certainty regarding the truth of the allegations is necessary before any steps are taken to report this case to the Attorney General?

Opinion #2: The Rules of Professional Conduct do not speak to whether an attorney must report possible illegal conduct to law enforcement officers and public officials. These matters are left to the judgment of the attorney in question with due regard to any laws which may be relevant and to his professional judgment and conscience.

The current Rule 8.3 of the Revised Rules of Professional Conduct (similar to the earlier Rule 1.3(a) which provided for "appropriate authority" rather than "court having jurisdiction") provides as follows:

Rule 8.3 Reporting Professional Misconduct: (a) A lawyer having knowledge that another lawyer has committed a violation of the Rules of Professional Conduct that raises a substantial question as to that lawyer's honesty, trustworthiness, or fitness as a lawyer in other respects shall inform the North Carolina State Bar or the court having jurisdiction over the matter.

A. WORKING WITH OTHERS

1. Who is Involved in a Closing?

Questions that must be answered through communication with and disclosures to various entities before, during and after closing, include:

- Who does the attorney represent?
- To whom is the attorney making representations? Who will rely upon the attorney's "word" in the closing process?
- Who is the attorney clearly not representing?
- Who might think the attorney is representing them unless the attorney clarifies otherwise?

Some (but not all) of the potential parties who might be involved in any particular closing include:

- Buyer / Borrower –
  - spouses or estranged spouses
  - officers, directors, managing members
- Seller
- Lender
- Mortgage Broker
- Realtor(s)
  - Listing or seller agents
- Contractor
- Developer
- Title insurer
- Surveyor
- Prior lender(s)
- Casualty insurer
- Division of Motor Vehicles (if mobile home)
- Appraiser
- Register of Deeds

- Clerk of Superior Court
- Tax Dept
- Water-sewer Dept
- Planning Dept
- Creditors - incl. IRS
- Other attorneys – for estranged spouse, bankruptcy, homeowners' association or others
- Courts – bankruptcy, federal, civil or criminal

The failure to communicate with any entity or person, whether or not a client, will ultimately affect the professionalism, quality and completeness of representation of the client. And the legal sources of liability of the closing attorney include:

- Ethical Obligations
- Malpractice vis-à-vis client
- Contractual rights
- Tort (misrepresentation)
- RESPA
- Fraudulent & Deceptive Trade Practices
  - double (G.S. 84-13) damages
  - treble (G.S. 75-1.1) damages

2. Representing Multiple Parties at a Residential Real Estate Closing

The leading opinion in the area of conflicts of interest and representation of multiple parties at closing is RPC 210 (April 4, 1997), entitled "Representation of Multiple Parties to the Closing of a Residential Real Estate Transaction, *Opinion examines the circumstances in which it is acceptable for a lawyer to represent the*

buyer, the seller, and the lender in the closing of a residential real estate transaction." Though the opinion is being re-written, as of the writing of this manuscript, it still stands as the leading opinion on multiple representation at closing. The State Bar found that

> "after the terms of the sale are resolved, the buyer and the seller of residential real estate have a common objective: the transfer of the ownership of the property in conformity with the terms of the contract or agreement. In paragraph [10] of the comment to Rule 5.1 [now Revised Rule 1.7], 'Conflicts of Interest,' it is observed that 'a lawyer may not represent multiple parties to a negotiation whose interests are fundamentally antagonistic to each other, but common representation is permissible where the clients are generally aligned in interests even though there is some difference of interests among them.' If the interests of the buyer and seller of residential property are generally aligned and the lawyer determines that he or she can manage the potential conflict of interest between the parties, a lawyer may represent both the buyer and the seller in closing a residential real estate transaction with the consent of the parties. Rule 5.1(a).
>
> A lawyer may reasonably believe that the common representation of multiple parties to a residential real estate closing will not be adverse to the interests of any one client if the parties have already agreed to the basic terms of the transaction and the lawyer's role is limited to rendering an opinion on title, memorializing the transaction, and disbursing the

> proceeds. Before reaching this conclusion, however, the lawyer must determine whether there is any obstacle to the loyal representation of both parties. The lawyer should proceed with the common representation only if the lawyer is able to reach the following conclusions: he or she will be able to act impartially; there is little likelihood that an actual conflict will arise out of the common representation; and, should a conflict arise, the potential prejudice to the parties will be minimal. *See*, *e.g.*, ABA Model Rule of Professional Conduct 2.2, "Intermediary."
>
> If the closing lawyer reasonably believes that the common representation can be managed in the best interests of both the buyer and the seller, he must obtain the consent of each of the parties after full disclosure of the risks of common representation. Rule 5.1(a). Full disclosure should include an explanation of the scope of the lawyer's representation. The lawyer should advise each party of the right to separate counsel. The disclosure should also include an explanation that if a conflict develops, the lawyer must withdraw from the representation of all parties and may not continue to represent any of the clients in the transaction. Rule 2.8(b). Although it is a better practice to put such disclosures in writing, the Rules of Professional Conduct do not require written disclosures.

This representation can include preparation of deed for the seller. In addition, the attorney may represent the lender’s interest in the closing, subject to the above conflict analysis, provided:

Although full disclosure to the lender of the risks of common representation is recommended, if the lawyer reasonably believes that the lender understands the closing lawyer's role because the lender is a knowledgeable and experienced participant in residential real estate transactions, the lawyer does not have to make a full disclosure to the lender regarding the common representation as required in opinion #1 above.

. . .

By custom, the lender and the buyer are usually represented by the same lawyer. Therefore, if the lawyer does not intend to represent both the buyer and the lender, the lawyer must give timely notice to the party that the lawyer does not intend to represent, so that this party may secure separate representation. CPR 100. If the lawyer does not give such notice, the lawyer will be deemed to represent both the buyer and the lender. CPR 100. If the lawyer represents only the buyer, the lawyer may nevertheless ethically provide title and lien priority assurances required by the lender as a condition of the loan. CPR 100. If the party that the lawyer is not representing obtains separate counsel, both lawyers should fully cooperate with each other in serving the interests of their respective clients and in closing the transaction promptly.

It is not generally assumed that the buyer's lawyer will represent the seller. Therefore, if the closing lawyer does not intend to prepare the deed or perform other legal services for the seller, the lawyer does not have to give

notice to the seller. *But see Cornelius v. Helms*, 120 N.C. App. 172,461 S.E.2d 338 (1995), *disc. rev. denied*, 342 N.C. 653,467 S.E.2d 709 (1996), for related negligence issues.

Of course, the attorney can also provide the title certifications necessary for issuance of all policies. And, the opinion continues:

> If a conflict or controversy relating to the transaction arises between any of the parties being represented by the closing lawyer, the lawyer must withdraw from the representation of all of the clients and is ethically barred from representing any of the clients in the transaction or any dispute arising out of the transaction. Rule 5.1(a).

3. Representing the Developer-Seller *and* the New Purchaser

The leading opinion regarding representation of a developer, and representing the purchasers from the developer at their closing, is 97 Formal Ethics Opinion 8 (January 16, 1998), entitled "Representation of Developer and Buyer in Closing of a Residential Real Estate Transaction,

Opinion examines the circumstances in which it is acceptable for the lawyer who regularly represents a real estate developer to represent the buyer and the developer in the closing of a residential real estate transaction." First the attorney must comply with the ethical analysis of RPC 210 and Revised Rule 2.2. But 97 FEO 8 continues, providing that:

> Where a lawyer has a long-standing professional relationship with a seller and a financial interest in continuing to represent the seller, the lawyer must carefully and thoughtfully evaluate whether he or she will be able to

act impartially in closing the transaction. The lawyer may proceed with the common representation only if the lawyer reasonably believes that his or her loyalty to the seller will not interfere with the lawyer's responsibilities to the buyer. Rule 2.2(a)(3). Also, the lawyer may not proceed with the common representation unless he or she reasonably believes that there is little likelihood that an actual conflict will arise out of the common representation and, should a conflict arise, the potential prejudice to the parties will be minimal. RPC 210 and Rule 2.2(a)(2).

If the lawyer reasonably believes the common representation can be managed, the lawyer must *make full disclosure of the advantages and risks* [emphasis added] of common representation and obtain the consent of both parties before proceeding with the representation. Revised Rule 2.2(a)(1). This disclosure should include informing the seller that, in closing the transaction, the lawyer has equal responsibility to the buyer and, regardless of the prior representation of the seller, the lawyer cannot prefer the interests of the seller over the interests of the buyer. With regard to the buyer, the lawyer must fully disclose the lawyer's prior and existing professional relationship with the seller. This disclosure should include a general explanation of the extent of the lawyer's prior and current representation of the seller and a specific explanation of the lawyer's legal work, if any, on the property that is the subject of the transaction. The latter should include the disclosure of all legal work relating to the development of a subdivision if relevant.

Full disclosure to the seller and to the buyer must also include an explanation of the scope of the lawyer's representation. *See* RPC 210. In addition, the lawyer should explain that if a conflict develops between the seller and the buyer, the lawyer must withdraw from the representation of all parties and may not continue to represent any of the clients in the transaction. RPC 210 and Rule 2.2(c). For example, the lawyer may not take a position of advocacy for one party or the other with regard to the completion of the construction of the house, the escrow of funds for the completion of the construction, problems with title to the property, and enforcement of the warranty on new construction. Areas of potential conflict should be outlined for both parties prior to obtaining their separate consents to the common representation.

The disclosure required must be made prior to the closing of the transaction. The Revised Rules of Professional Conduct do not require the consents to be in writing. However, obtaining written consents is the better practice.

. . .

Inquiry #4: The house and lot that Buyer has contracted to purchase from Seller are located in a subdivision that is being developed by Seller. As a result of his representation of Seller on matters relating to the development of the subdivision, Attorney is aware that Seller is having financial difficulties and may be unable to complete the promised amenities in the

subdivision, including a swimming pool and tennis courts. Seller has instructed Attorney not to disclose this information. May Attorney represent both Seller and Buyer to close the transaction?

Opinion #4: No. Rule 1.7(c) provides that:

[a] lawyer shall have a continuing obligation to evaluate all situations involving potentially conflicting interests and shall withdraw from representation of any party he or she cannot adequately represent or represent without using the confidential information or secrets of another client or former client except as Rule 1.6 allows.

Rule 1.6(a) defines confidential client information as information learned during the course of representation of a client the disclosure of which would be detrimental to the interests of the client. The information regarding Seller's potential inability to complete the amenities in the subdivision is confidential information of Seller that Attorney may not disclose unless Seller consents. *See* Rule 1.6(c). However, to represent Buyer adequately, Attorney should disclose this information. In this situation, Attorney cannot reasonably conclude that his responsibilities to Seller will not interfere with his responsibilities to Buyer. *See* opinion #1 above. Attorney may not, therefore, accept the common representation.

Inquiry #5: Completion of the amenities for the subdivision are not in question. However, Attorney prepared the base title for the subdivision and he is aware that there are some close questions on title to the lot under contract to Buyer. Although these matters may be insignificant, Attorney

would normally disclose this information to Buyer. Seller has instructed Attorney not to disclose the information to Buyer. May Attorney represent Buyer and Seller to close the transaction?

Opinion #5: No, unless Seller consents to the disclosure of the information. *See* opinion #2 above and Rule 1.6(c).

Inquiry #7: Seller believes that it will result in savings of time and money if Attorney closes all of the sales in the subdivision. Seller would like to offer financial incentives to potential buyers to encourage them to use the closing services of Attorney. In particular, Seller would like to offer to pay all legal fees to close the transaction if the buyer agrees that Attorney will handle the closing. Seller asks Attorney if Attorney will close all sales for a pre-agreed fee. Seller also asks Attorney if Seller may include a provision in the contract to purchase in which Seller agrees to pay the legal fees if the buyer agrees that Attorney will close the transaction. May Attorney agree to participate in this arrangement?

Opinion #7: Yes, if Attorney reasonably believes that the common representation can be handled impartially and the proper disclosure of the professional relationship between Seller and Attorney is made prior to the execution of the contract by the buyer. *See* Opinion #1 above.

Developer's counsel should also continually bear in mind the circumstances for conflict underlying RPC 17 and the requirement that other attorneys report ethical violations (discussed earlier).

4. Requiring an Attorney or Other Service Provider – Kickbacks, Referral Fees, Etc.

In RPC 9, "It is noted that in no event may a lender *require* [emphasis added] a borrower to employ a particular attorney. CPRs 108 and 240."

However, pursuant to RPC 57 (October 20, 1989), entitled "Participation as an Approved Attorney, *Opinion rules that a lawyer may agree to be on a list of attorneys approved to handle all of a lender's title work.*"

The Real Estate Settlement Procedures Act ("RESPA"), Regulation X, Section 3500.15 allows affiliated business arrangements ("AfBA's") so long as:

- Disclosure of the relationship between the affiliated businesses at the time the firm is engaged by the client.
- The firm cannot require use of the related agency.
- Any returns on profit from the agency must be a bona fide return on ownership interest, not for business sent.

See HUD's June 7, 1996 Policy Statement, http://www.hud.gov/offices/hsg/sfh/res/res0607c.cfm, and HUD's September 19, 1996 Enforcement Standards for Title Insurance Practices in Florida, http://www.hud.gov/offices/hsg/sfh/res/resp0919.cfm

Pursuant to N.C.G.S. § 58-27-5. Prohibition against payment or receipt of title insurance kickbacks, rebates, commissions and other payments

> (a) No person or entity selling real property, or performing services as a real estate agent, attorney or lender, which services are incident to or a part of any real estate settlement or sale, shall pay or receive, *directly or*

indirectly, any kickback, rebate, commission or other payment in connection with the issuance of title insurance for any real property which is a part of such sale or settlement; nor shall any title insurance company, agency or agent make any such payment.

(b) Any person or entity violating the provisions of this section shall be guilty of a Class 2 misdemeanor which may include a fine of not more than five thousand dollars ($5,000).

(c) No persons or entity shall be in violation of this section solely by reason of *ownership of stock in a bona fide title insurance company, agency, or agent*. For purposes of this section, and in addition to any other statutory or regulatory requirements, a bona fide title insurance company, agency or agent is defined to be a company, agency or agent that passes upon and makes title insurance underwriting decisions on title risks, including the issuance of title insurance policies, binders and endorsements, and that maintains a separate and distinct staff and office or offices for such purposes.

5. Personal Interests of the Attorney

With regard to personal interests of the attorney, *see* Revised Rule 1.7 Conflict of Interest: General Rule (formerly Rule 5.1(b)), especially Comment #6:

Lawyer's Interests: The lawyer's own interests should not be permitted to have an adverse effect on representation of a client. For example, a lawyer's need for income should not lead the lawyer to undertake matters that cannot be handled competently and at a reasonable fee. *See* Rules 1.1

and 1.5. If the probity of a lawyer's own conduct in a transaction is in serious question, it may be difficult or impossible for the lawyer to give a client detached advice. A lawyer may not allow related business interests to affect representation; for example, by referring clients to an enterprise in which the lawyer has an undisclosed interest.

See also Revised Rule 1.8 Conflict Of Interest: Prohibited Transactions And Other Specific Applications

(a) A lawyer shall not enter into a business transaction with a client under any circumstances unless it is fair to the client. A lawyer shall not enter into a business transaction with a client in which the lawyer and the client have differing interests and wherein the client expects the lawyer to exercise his or her independent professional judgment for the protection of the client, unless:

(1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are disclosed and transmitted in writing to the client in a manner which can be reasonably understood by the client;

(2) the client is given a reasonable opportunity to seek the advice of independent counsel in the transaction; and

(3) the client consents in writing.

(b) During or subsequent to legal representation of a client, a lawyer shall not enter into a business transaction with a client for which a fee or commission will be charged in lieu of, or in addition to, a legal fee if the

> business transaction is related to the subject matter of the legal representation, any financial proceeds from the representation, or any information, confidential or otherwise, acquired by the lawyer during the course of the representation.
>
> . . .
>
> Comment #[2] Because of the actual and potential conflicts of interests, paragraph (b) prohibits the sale of business services to a client or former client if the proposed transaction relates to the subject matter or the proceeds of representation. For example, a lawyer who is also a securities broker or insurance agent should not endeavor to sell securities or insurance to a client when the lawyer knows by virtue of the representation that such client has received funds suitable for investment.

RPC 83 (January 12, 1990), entitled "Rendering a Title Opinion Upon Property In Which the Lawyer Has a Beneficial Interest, *Opinion rules that the significance of an attorney's personal interest in property determines whether he or she has a conflict of interest sufficient to disqualify him or her from rendering a title opinion concerning that property*," provides an overview of the situations where an attorney may or may not provide an opinion on title, in relevant part as follows:

> CPR 254 held that an attorney who owns a "beneficial interest" in an entity which was selling property could not certify title to the property sold. The opinion extended the disqualification to the attorney's partners and associates as well. The opinion went on to hold, however, that

ownership of shares of a publicly held corporation did not constitute a beneficial interest for purposes of the disqualification rule. [See Disciplinary Rule 5-101(s) of the Code of Professional Responsibility, replaced by Rule 5.1() of the Rules of Professional Conduct, now Rule 1.7(b) of the Revised Rules above.] . . .

Although CPR 254 appears to disqualify a lawyer with any beneficial interest in the selling entity, the exception for stockholders of publicly held corporations implies that disqualification is really a function of the significance to the attorney of his or her personal interest and the affect of the transaction on that interest. If the attorney or a close relative would realize considerable personal gain from the transaction, it is likely that his judgment would, in the words of Rule 5.1(b), be materially limited. Under such circumstances, a reasonable lawyer probably would be unable to conclude that the conflict could be successfully managed and would be disqualified, regardless of whether the entity requesting the title opinion would consent. By the same token, the judgment of a lawyer whose personal interest is insignificant would probably not be materially limited. In such a case, the lawyer could reasonably believe that the conflict would not adversely affect the representation and could proceed if the client (the entity to whom the opinion is being rendered) consents.

In the facts stated, . . . it appears that there is little likelihood that the investment of Attorney A's wife would sway the judgment of Attorney A. Consequently, Attorney A could reasonably believe that his representation

of the selling partner would not be adversely affected by his wife's interests. If in addition, he or she actually believes that to be the case and the client consents after full disclosure, there would need be no disqualification of the lawyer or other members of the lawyer's firm. To the extent that it differs from this opinion, CPR 254 is superseded.

6. Imputed Disqualification from one Attorney to the Law Firm

Pursuant to Revised Rule 1.10 Imputed Disqualification: General Rule

(a) While lawyers are associated in a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by Rules 1.7, 1.8(c), 1.9, or 2.2.

7. Malpractice and The Attorney's Malpractice Insurance Carrier

"Malpractice" claims against an attorney or law firm may encompass claims based on negligence, breach of contract, breach of fiduciary duty, fraud or constructive fraud. Damages claimed may include:

- Actual damages,
- Punitive damages,
- Double (G.S. 84-13, mandatory for "fraudulent practice" and giving rise to a *presumption* of fraud if attorney takes advantage, under Egerton v. Logan, 81 N.C. 172 (1879).")
- Treble damages (G.S. 75-1.1, for non-professional responsibilities such as a personal interest)
- Consequential damages.

For a more complete discussion of the case law and legal definitions involved, refer to Burnham, "Malpractice Avoidance Tips," North Carolina Bar Foundation Real Property Practical Skills Symposium, November 5-6, 1998.

The negligence standard was articulated by the North Carolina Supreme Court in the case of Hodges v. Carter, 239 N.C. 517, 519, 80 S.E.2d 144, 145-146 (1954), as follows:

> When an attorney engages in the practice of the law and contracts to prosecute an action in behalf of his client, he impliedly represents that:
>
> (1) he/she possesses the requisite degree of learning, skill, and ability necessary to the practice of his profession and which others similarly situated ordinarily possess;
>
> (2) he/she will exert his best judgment in the prosecution of the litigation entrusted to him; and
>
> (3) he/she will exercise reasonable and ordinary care and diligence in the use of his skill and in the application of his knowledge to his client's cause.

In practice, the definition of "malpractice" is a based on a determination of the standard of practice applicable to an attorney in the position of this attorney (vis-à-vis his or her client and known third parties to the transaction). There are few black-letter rules on what is or is not malpractice. This determination is often the subject of negotiation, hearings and even trials involving the malpractice insurer, the State Bar Grievance Committee, the title insurer, the client, or even a court of

law based on testimony of competing expert witnesses. Therefore, the attorney's best offense is a good defense (as always):

- Be on good terms with other attorneys – practicing in the legal area and otherwise.
- Discuss practice issues with them and listen when they do the same.
- Be on good terms with all of the title insurers.
- Establish and maintain a good reputation for quality legal work within the legal community.
- Regularly read legal journals, title company newsletters, North Carolina State Bar Journal, "Real Property" newsletters, and any other legal materials to maintain sharp current professional skills.
- Be an active member of the Real Property Section of the North Carolina Bar Association
- Participate in CLE, such as this one.
- Consult the above materials, or even create internal legal reference files, for easy access.
- *Communicate, Communicate, Communicate*: At a recent Ethics seminar, the speaker noted that the next person walking into the attorney's office may be the attorney's best friend or the attorney's worst enemy. So protect the client (by good counsel) and protect the attorney (by good counsel)!
- *Disclose, Disclose, Disclose!!!*

In the event of a problem or potential claim, *contact the attorney's malpractice carrier first!* Often the attorney's malpractice insurer and the attorney's title insurer may have different "definitions" of what is malpractice versus what should be covered by a title insurance policy. *Be cautious whenever a problem arises to discuss the coverage with the malpractice insurer <u>first</u> to assure that the coverage will not be jeopardized*. In some cases, the attorney may need to seriously negotiate with them to assure the coverage while serving the client as well. Consider consulting with a friend, colleague or partner who may have more independent judgment. By definition, if the claim is that the attorney erred, the attorney is in a clear conflict of interest and may not be able to address the situation coolly and rationally – as the attorney would advise any client to do! Otherwise, the attorney's cure may be worse than the illness!

NOTE: A malpractice policy insures the attorney, not the client or third party relying upon the attorney's representation. Thus, the policy will not insure the attorney against intentional acts, such as fraud or misappropriation.

Professional obligation versus legal liability: The statute of limitations protecting the attorney and law firm from liability for malpractice is N.C.G.S. 1-15. However, the "social" limitations period does not really exist. The attorney's clients will hold the attorney morally responsible – and tell everyone they know about it – for the indefinite future if they are unable to have their problems resolved, whether fair or not. In addition, the attorney's information may be needed to clear up a problem (or verify that the attorney's client is in the right and

the third party's claim is invalid), even if the attorney does not have a legal liability for the loss.

8. Confidentiality and Mandatory Disclosures to Third Parties

See RPC 23 (April 17, 1987), entitled "Disclosure of Information Concerning Real Estate Transactions to the IRS, *Opinion rules that a lawyer may disclose information to the IRS concerning a real estate transaction which would otherwise be protected if required to do so by law, and further that notice of such required disclosure, should be given to the client and other affected parties.*"

9. Obligations to Client Regarding Copies of Files, Title Notes and Documentation

See:

RPC 169 (January 14, 1994), entitled "Providing Client with Copies of Documents from the File, *Opinion rules that a lawyer is not required to provide a former client with copies of title notes and may charge a former client for copies of documents from the client's file under certain circumstances.*"

RPC 227 (July 18, 1997), entitled "Release of Title Notes to Former Client, *Opinion rules that a former residential real estate client is not entitled to the lawyer's title notes or abstracts regardless of whether such information is stored in the client's file. However, a lawyer formerly associated with a firm may be entitled to examine the title notes made by the lawyer to provide further representation to the same client.*" RPC 227 provides in relevant part, as follows:

> Rule 2.8(a)(2) requires a lawyer who has withdrawn from the representation of a client to deliver to the client "all papers and property to which the client is entitled." RPC 178 cites CPR 3 for the proposition that a lawyer must provide a former client with originals or copies of anything in the file which would be helpful to the new lawyer except "the discharged lawyer's notes made for his own future reference and study and similar things not representing a completed work product." *See also* CPR 3, CPR 315, CPR 322, CPR 328 and Rule 2.8(a)(2).
>
> After a residential real estate transaction is completed, the client is entitled to originals or copies of the documents which were generated solely in connection with the client's closing, including the following: the deed to the property, plats, title opinion, title insurance policy, all closing documents, all documents prepared for the lender and other third parties, correspondence, memoranda regarding the client's transaction only, and documents referenced in the client's deed or title opinion. The client is not entitled to the lawyer's title notes, abstracts, or copies of documents not prepared solely for the client's transaction regardless of whether such information is stored in the client's file.

RPC 178 (October 21, 1994), entitled "Release of Client's File, *Opinion examines a lawyer's obligation to deliver the file to the client upon the termination of the representation when the lawyer represents multiple clients in a single matter*," and provides in relevant part as follows:

Rule 2.8(a)(2) of the Rules of Professional Conduct requires a lawyer who is withdrawing from a case to deliver to the client all papers and property to which the client is entitled. By requiring a withdrawing or dismissed lawyer to provide the client with all of his or her papers and property, Rule 2.8(a)(2) recognizes that the file belongs to the client. *See* CPR 3, CPR 315, CPR 322 and CPR 328.

CPR 3 explains that a lawyer must provide a former client with originals or copies of anything in the file which would be helpful to the new lawyer but that "[t]he discharged lawyer's notes made for his own future reference and study and similar things not representing a completed work product need not be turned over."

B. COORDINATION OF THE PROCESS

The Closing process can be basically divided into the following segments:

- Pre-Closing
- At the Closing
- Post-closing

1. Pre-Closing

a. Disclosures

The attorney should consider, prepare and determine when to deliver the various disclosures appropriate or required. These include:

- Existing representation of some parties in a transaction where the attorney will represent multiple parties must be fully disclosed to and discussed with all concerned, as discussed above.
- "Tacking" to a prior policy (RPC 99) must be disclosed to the purchaser.
- The attorney's responsibility (or not) for obtaining recording cancellation of prior liens (99 FEO 5) must be disclosed and explained.
- Title issues affecting the title or marketability of the property should be disclosed.
- Need for title insurance for owner's protection, including amount, type of policy & viable company should be disclosed and explained.
- Need for survey for owner's protection should be disclosed and explained

A Note about Disclosure: Disclosure to the title company is *not* the equivalent of disclosure to the client and vice versa. A disclosure of a title issue to the client but not the title company may result in the title company's ability to deny liability for matters "suffered, assumed or agreed to" or "known but not disclosed" by the insured. Conversely, a tacked or 10-year search may be sufficient for title insurance coverage, but may not be protection against malpractice should the client suffer a loss without having been warned of the limited nature of the representation.

b. Title Search and "Tacking"

Tacking to prior owner's title insurance policies is a frequent practice in the residential and, sometimes, the commercial closing practice. Some title insurance companies will also issue policies based on shorter and shorter title searches.

Shortcuts are necessary, if handled responsibly, but can damage clients and attorney reputations (and pocketbooks) if handled without serious attention! The attorney should consider the following factors in making a determination whether to tack or not:

- Client needs are the most important considerations in the representation. The need for reliable comprehensive title information for a commercial client purchasing a tract of land for development are significantly different than those of the purchaser of an existing home in a uniformly residential neighborhood.
- Client expectations underlie the obligation of disclosure and informed consent under RPC 99 requires disclosure to the client. Are they expecting this limited representation? Do they understand the risk (errors in prior policies) and reward (less expensive closing fees)? The commercial client above may be expecting and willing to pay the full search cost in order to identify all possible title issues. As stated in the opinion:

  "The Rules of Professional Conduct do not require personal inspection of all documents in the chain of title so long as the lawyer rendering the opinion fully discloses to his or her client the precise nature of the service being rendered and the full extent thereof. The client should be advised that he or she should rely on the title insurance policy as to matters of title and not upon the attorney's examination of the public records."

- Is the prior policy from a financially strong company with a history of responsible claims administration? The attorney is inadvertently becoming a financial adviser to the client in choosing the title insurance company whose premium the client will pay.
- The attorney's search should at least extend back to a general warranty deed for fair market consideration (excise tax / transfer stamps), no matter that a later loan policy may have been issued.
- Judgments of all owners within the past 10 years, for the period back at least 10 years and through the date of conveyance to a third party, should still be checked. Some attorneys still do not check "buyer" judgments at their own closings, leading to missed judgments when a subsequent attorney "tacks" without a full 10-year search.
- Was the prior certifying attorney one on whom the current attorney wants to base his client's protectiobn?
- RPC 99, for good reason, does <u>not</u> approve tacking to a loan policy or a "letter" about the prior title, only to an owner's policy, RPC 99, specifically provides: "Since title insurers frequently omit exceptions in mortgagees' policies that would appear in owners' policies, tacking should be limited to tacking onto owners' policies." Many things may be "insured over" in a loan policy which must be reflected appropriately in an owner's policy, including subordinate matters, marital interests, unfiled mechanics' liens or matters for which the title company accepted indemnities or other assurances. Many of the "letters" now being provided do not even provide

assurance to the closing attorney whether the property has ever been insured at all!

NOTE: Tacking to the prior title policy is not synonymous with obtaining a reissue rate. The policy may allow for reissue credit, and/or the attorney may limit their liability to the current title insurer by "tacking" to the prior policy, while still performing and providing to the client a certification based on a full search. This is quite common in commercial transactions.

c. Title Insurance

The relationship of the attorney with a title insurance company is based on both the contract (the application to become an approved attorney with the company) and the individual title certifications regarding particular properties. The relationships have two primary parts: the title insurance and the insured closing coverage for lenders and residential purchasers, pursuant to the enabling statute which provides as follows:

> N.C.G.S. § 58-26-1. Purpose of organization; formation; insuring closing services; premium rates; combined premiums for lenders' coverages
>
> (a) Companies may be formed in the manner provided in this Article for the purpose of furnishing information in relation to titles to real estate and of insuring owners and others interested therein against loss by reason of encumbrances and defective title; provided, however, that no such information shall be so furnished nor shall such insurance be so issued as to North Carolina real property unless and until the title insurance company has obtained the *opinion of an attorney, licensed to practice law*

in North Carolina and not an employee or agent of the company, who has conducted or caused to be conducted under the attorney's direct supervision a reasonable examination of the title. The company shall cause to be made a determination of insurability of title in accordance with sound underwriting practices for title insurance companies. A company may also *insure the proper performance of services necessary to conduct a real estate closing performed by an approved attorney licensed to practice in North Carolina*. Provided, however, nothing in this section shall be construed to prohibit or preclude a title insurance company from insuring *proper performance by its issuing agents*.

An attorney should not rely upon the title insurance policy as a substitute for quality legal representation of and advice to their client.

The title insurance policy is intended to provide assurance to insureds (owner or lender, depending on the policy chosen) for two types of matters: (1) "Hidden Risks" which could not be determined from the search of the public records, and, in special cases, (2) risks which cannot reasonably be cured or which represent a technical but hopefully not a practical risk. The "Hidden Risks" are undeterminable and unavoidable, and are not within the purview of the attorney, including:

- Fraud, undue influence, forgeries
- Indian claims, such as the Catawba Indian litigation and ultimately Treaty in South Carolina

- New interpretations of law. See, for example, the Richardson Corp. v. BarclaysAmerican Mortgage Corp., 111 N.C.App. 432, 432 S.E.2d 409 (1993), *discretionary review denied,* 335 N.C. 177, 438 S.E.2d 201 (1993), commonly called the "Adams Farm" case
- Unexpected interpretations of ambiguous areas of law (mechanics' lien cases)
- Missing heirs
- Missing spouses (whether undisclosed marriage, bigamy, false impersonation)
- Incompetent or minor grantors (including where record fails to disclose tolling of statutes of limitations, their incompetency to join in the conveyance or the lack of authority of their purported fiduciaries to join on their behalf)
- Improper delivery of prior conveyances
- Matters outside the period of the title search
- Estates not fully administered, including later wills, discovered heirs or beneficiaries, claims of creditors
- Improper authority of officers, partners, trustees of grantors in prior transactions
- Mistakes of public officers in recording and indexing documents recorded by others affecting title
- Tax record inaccuracies

- Service or joinder problems in civil actions or foreclosures not disclosed by the record
- Lack of consideration stated on face of deed (rendering it a gift deed) which was recorded more than 2 years after its date (rendering it void) in prior transactions
- Inadequate or incorrect survey matters (if survey coverage is provided)

Regarding the second category, risks which cannot reasonably be cured or which represent a technical but hopefully not a practical risk, leaving outstanding uncured title issues, title insurance policies often appear to provide "affirmative coverage" or to "insure without exception" in two types of situations:

(1) The attorney fully discloses the matter and discusses it with the title company prior to closing. However, if the client is either not informed or is not advised on the ramifications of the uncured title issue, the attorney may remain liable to the client for their losses, including consequential or even punitive damages. NOTE: The attorney should communicate their preferred result and legal analysis with the title insurer, rather than simply "throwing the spaghetti against the wall to see if it sticks."

(2) The attorney fails to even disclose the problem. This is classic malpractice (negligence), possibly fraud, justifying liability to client and title insurer.

Since these are *title* matters, the title insurer may be liable under the terms of its policy for a claim by an insured lender or owner. However, the attorney must be cautious not to assume that the title company chosen will not seek recourse

against them. From experience, we know that most responsible attorneys cover minor errors in their closing and title work before it even reaches the title company's attention. Often these include balances on short or late payoffs, missed assessments or taxes, or even purchasing missed deeds of trust in hopes to collect at some time in the future.

Marketable versus Insurable versus "Perfect" Title: Just because the attorney convinces a title insurance company to insure a title without exception to a title defect does not assure that the attorney is providing the client the protection they want and need. Insurability may be based on the *risk* of a financial loss, rather than the purity of the client's purchased interest. For the title insurer, it is a financial issue. For the owner, it may be an emotional, long-term investment issue.

Title insurance is *not* an assurance that the client may not suffer serious inconvenience and a consequential loss because of the defect.

> EXAMPLE: Title insurers often issue policies without exception for deeds of trust that have been paid but not yet canceled of record. Until the cancellation is complete, the title is technically unmarketable. If the attorney does not follow up to assure the cancellation of record, the attorney may be liable for *consequential* damages to the client outside the coverage of the policy itself should a later purchaser refuse to purchase because of the title defect.

Recall that every claim creates costs, losses, inconvenience, aggravation of the client-insured. A few examples of this include:

- The insurer may choose to litigate or settle with third parties rather than simply pay a claim, and the client has a duty to cooperate even if they prefer a lump sum settlement.
- If the insured's title is judged to be as insured, no loss is paid, even though the insured may have significant consequential and delay damages from the litigation.
- A voluntary payment by the insured of a claim which is not yet finalized, or purchase of a "replacement" parcel at an inflated price, as two examples, could be subject to claim denial as "voluntary" payments by the insured.
- The title insurer can at any point determine that litigation is too expensive, pay to the insured the coverage amount of the policy plus attorneys' fees and costs to date and terminate the coverage (*i.e.*, "pay policy limits and walk away"). This is an unusual provision not contained in most other types of insurance.
- If the loss is less than policy limits, the determination of loss value is based on "diminution in the value of the property caused by the defect," a result often surprising the insured.
- Many consequential damages or collateral losses, are *not* covered, so long as the insurer pursues the remedy diligently and within a reasonable time.

    Example: A developer purchased a tract of land based on a survey showing a pepper patch in a corner. As construction began, the pepper farmer claimed ownership of several acres which had been

a critical part of the development. Over three years of litigation, the developer decided to build one less building so that the rest of the project could continue. The title insurer defended the lawsuit vigorously and ultimately title was finally determined to be in the developer. The title insurer paid the legal defense expenses and court costs all along. However, the title insurer was not liable for the delays, the time and expense of the developer's staff in participating in the lawsuit, the loss in profits from revamping the project or the other consequential damages. Lawyers Title Insurance Corporation v. Synergism One Corp. et al, 572 So.2d 517 (Florida, 1990).

- *A title insurer is not obligated to issue a new policy to a new purchaser or to provide "affirmative coverage" to the new purchaser once a claim issue has arisen! The borrower and the lender must be notified, even if affirmative coverage is to be provided, especially if any federally insured loan is involved.*
- On a Loan Policy, the lender may not suffer a loss until foreclosure and seeking deficiency against the borrower.

Nor is the client covered for Exclusions from Coverage under the ALTA Loan Policy (10-17-92), including:

- Matters "suffered, assumed or agreed to by the insured"
- Matters "known to the insured, but not disclosed to" the title insurer.

- Governmental regulation, policy power, zoning (without endorsement), usury or predatory lending, environmental matters
- Matters resulting in no title loss to the insured
- Post policy matters, attaching subsequent to the effective date of the policy
- Losses which would not have been sustained had the insured paid full value for the property (been a bona fide purchaser for value protected by the recording act)
- Creditors' rights which might be affected such that the current transaction creates insolvency of the borrower

d. The Closing Protection Letter

Lenders will typically require a **Closing Protection Letter (Exhibit A),** often referred to as an **Insured Closing Letter** from a recognized title insurance underwriter. Under G.S. 58-26-1(a), this service is available only for "issuing agents" or "approved attorneys" for title insurance companies. This agreement insures the lender (and its residential borrower) against loss or damage from variations from requirements regarding the Approved Attorney's failure to comply with written closing instructions (unless those instructions are inconsistent with the title insurance commitment issued for the closing)

- Requisite title / lien status
- Proper execution and recordation of documents required
- Proper collection and disbursement of funds (absent lender's failure to fund appropriately)

Some non-title matters (such as a failure to follow written closing instructions) may initially result in a title insurance claim under a Closing Protection Letter of the title insurer with a particular lender or their borrower-insured. However, they are ultimately in the domain of the closing attorney and the title insurer may have recourse back to the closing attorney. NOTE: Malpractice carriers do not insure against fraud or dishonesty by the attorney.

Frequently, at the time of a claim, a lender cannot produce a relevant Closing Protection Letter. Therefore, in order to protect the lender appropriately, in each transaction file: most lenders require a specific letter which should:

- Have a current date,
- Specify the particular named Approved Attorney (not the firm since law firms do not have State Bar licenses, only individual lawyers do) and
- Reference the particular borrower's transaction to be insured.

Liability can be significant for <u>not</u> obtaining amendments from the lender (usually a broker) in writing. Most loans are sold even as they are being closed and the third party investor will usually not be bound by verbal "instructions" from the anxious broker. *See, for example*, <u>Title Insurance Company of Minnesota v. Smith, Debnam, Hibbert and Pahl, et al</u>, 119 N.C. App. 608, 459 S.E.2d 801 (1995), *aff'd in part & rev'd in part* 342 N.C. 887; 467 S.E.2d 241 (1996) in which the lender decided during the transaction to keep 2 prior deeds of trust on record, but the title company did not take exceptions as they did not know. The RTC, as ultimate holder of the note, was not bound by the nonstandard, amended negotiations of the now-defunct original lender.

e. The Survey

The attorney will not be responsible for surveyor error unless it was a clear inaccuracy based on comparison with the title work done. However, the attorney may be at risk for failing to clearly advise the client of the risks of *not* obtaining a survey, just because the lender can get coverage anyway.

> EXAMPLE: If the property lies near a county line (most of which have not truly been surveyed), the risk of loss will lie on the purchaser-client if the documents are not recorded (and title not searched and corrected) in all applicable counties, leading to potential malpractice liability of the closing attorney. Guilford County Planning & Development Department v. Simmons, 115 N.C.App. 87, 443 S.E.2d 765 (1994).

In choosing a surveyor, as in choosing a title insurer, the attorney effectively becomes an advisor on the reputation and services of others. So the choice should be made responsibly, not just on the basis of the "cheapest" unless fully disclosed to the client. "Owners Need Surveys – *Still,*" attached as **Exhibit B**, outlines many specific issues that are not covered by an attorney's opinion and which the client should consider in making an *informed* decision about whether or not to obtain a survey. The brochure is available on-line at http://www.northcarolina.ctt.com/bulletins/bull_owners_survey_print.html and is intended to be shared with clients or others, in the attorney's discretion. A sample form for disclosure to and waiver by the client is also available on-line at http://www.northcarolina.ctt.com/docs/waiver_of_survey.doc

2. At the Closing

a. Generally

Since the attorney controls the closing, many things must be addressed as they arise and communicated to those with an interest – from lender to title insurer. The closing attorney must be alert to recognize and address the issues immediately and should not make assumptions that other parties will know or understand the effects of various issues.

> EXAMPLE: In RPC 17, the attorney did not fully disclose the ramifications of representation of developer and buyer, failed to fully disclose the ramifications of an unpaid lien and had the buyer sign an untrue affidavit that the new lender was a first lien.
>
> EXAMPLE: In RPC 113, the attorney did not fully disclose the ramifications of the buyer signing a lien affidavit.
>
> EXAMPLE: Providing owner's coverage only of the lender in a temporary construction situation or only for the loan amount in an existing home transaction renders the owner uninsured or underinsured. This should be explained clearly.

Practice Tip: Establish checklists and "standard operating procedures" which the attorney and staff *always* follow, without exception. The typical residential real estate attorney has far too many transactions going on daily, weekly, monthly and yearly for them to be able to remember absolutely everything they did! If the attorney and staff *always* follow these procedures – without exception – that is

valid evidence that they did so in any individual case. It is much more credible than trying to assure the claimant that they specifically remember doing so in this particular case among so many others!

EXAMPLE: If the attorney *always* requests photographic evidence of the person signing and *always* requires them to acknowledge their signature to the attorney directly, the attorney has assurance that they did so in any particular case. This is so even if the copy of the photo identification in the attorney's file is a blur or the file has been purged and filed away.

b. Authority of Parties

At or before closing, the attorney must make the determination of who parties are and the authority of the actual individuals signing. This can be particularly tricky in the cases of entities such as limited liability companies, churches, attorneys-in-fact and trustees. Some examples, many of which have been the sources of litigation, title insurance claims, malpractice claims, or underwriting concerns to later attorneys reviewing title, and recommended actions include the following:

- In some open estates, title insurers regularly provide coverage based on conveyances by the devisees, heirs and fiduciaries without requirement of a court order despite the clear requirement of statute, in many cases, that same be obtained for protection against creditors and potential caveators. N.C.G.S. 28A-115-1(c), N.C.G.S. 28A-17-1 *et seq.*; Montgomery v. Hinton, 45 N.C.App. 271, 262 S.E.2d 697 (1980).
- The Annual Report of a limited liability company names the managers and their identities can be relied on as prima facie evidence that they are such.

Relying on another signer on behalf of the LLC will require further inquiry by the attorney to protect their grantee-client.

- Examine the underlying trust agreement, partnership agreement, limited liability company operating agreement, corporate resolution, church congregation resolution, to assure as best the attorney can that the persons signing are the proper officers and that their actions in the attorney's particular closing have been authorized.
- Assure that entities required to be registered with the Secretary of State are in existence, hopefully in good standing, and have not been dissolved. If they have been, contact the title insurer immediately to discuss a cure, a timetable, if it is even reasonably possible!
- Determine if the transaction is in the "ordinary course" of the business of the entity, or if it will require extraordinary consents or votes.
- Obtain verification of consents or votes from all requisite members, partners, shareholders, etc., as required by the organizational documents for the particular type of transaction.
- Make sure the people signing hold the capacity necessary for the particular entity, for example, trustee of a trust, manager of a limited liability company, (Vice) president and (Ass't) secretary of a corporation.
- Assure the *official* corporate seal is affixed to obtain legal presumption of validity and authority. Catawba County Horsemen's Association v. Deal, 107 N.C.App. 213, 419 S.E.2d 185 (1992).

- Assure that the proper notary acknowledgment is completed for each person or entity signing.
- Assure that the proper name of the conveying / signing entity is used consistently. If the record is improper, consider whether curative deeds will be needed. If the entity has changed name, consider whether filing of the official name change is required (or desirable) locally. Be sure not to assume a transfer by operation of law just because the old and the new entity appear related!
- Assure that the "obligation" is clearly identified, *especially identifying on the deed of trust the actual borrowers under the note if different from the grantors of the deed of trust (and owners of the property).* This can occur when owners of a company pledge their personal land as collateral or when only one spouse is borrowing funds. Otherwise, the deed of trust secures a debt of the "grantor" which does not exist! In re Foreclosure of Enderle, 110 N.C.App. 773, 431 S.E.2d 549 (1993); Putnam v. Ferguson, 1998 N.C.App. LEXIS 829 (Ct.App. 1998)
- Conveyances (including mortgages) by unmarried minors must be approved by order of a Superior Court judge. N.C.G.S. 35A-1301. Otherwise, they are voidable at the option of the infant, without consideration, for a period of 3 years after reaching majority, marrying (See N.C.G.S. 39-13.2) or becoming competent (if later). In addition, the statutes of limitations for color of title, adverse possession, etc., are held in

abeyance until the minor reaches majority, marries or becomes competent (if later). N.C.G.S. 1-17 *et seq.*

c. Key Errors

Some examples of costly errors in communication, disclosure or professional judgment surrounding closings are identified on **Exhibit C**, attached hereto (with many thanks to Margaret Burnham, as above mentioned).

d. Notary Acknowledgments

Notarization of documents must comply with the provisions of Chapter 10A of the North Carolina General Statutes, including, specifically, the newly revised provisions effective January 1, 2002, which address attorneys and their staffs, as follows:

> § 10A-9. Powers and limitations
>
> . . .
>
> (g) A notary public who is not an attorney licensed to practice law in this State who advertises the person's services as a notary public in a language other than English, by radio, television, signs, pamphlets, newspapers, other written communication, or in any other manner, shall post or otherwise include with the advertisement the notice set forth in this subsection in English and in the language used for the advertisement. The notice shall be of conspicuous size, if in writing, and shall state: "I AM NOT AN ATTORNEY LICENSED TO PRACTICE LAW IN THE STATE OF NORTH CAROLINA, AND I MAY NOT GIVE LEGAL ADVICE OR ACCEPT FEES FOR LEGAL ADVICE." If the

advertisement is by radio or television, the statement may be modified but must include substantially the same message.

(h) A notary public who is not an attorney licensed to practice law in this State is prohibited from representing or advertising that the notary public is an "immigration consultant" or expert on immigration matters unless the notary public is an accredited representative of an organization recognized by the Board of Immigration Appeals pursuant to Title 8, Part 292, Section 2(a-e) of the Code of Federal Regulations (8 CFR 292.2(a-e)).

(i) A notary public who is not an attorney licensed to practice law in this State is prohibited from rendering any service that constitutes the unauthorized practice of law**.**

(j) A notary public required to comply with the provisions of subsection (g) of this section shall prominently post at the notary public's place of business a schedule of fees established by law, which a notary public may charge. The fee schedule shall be written in English and in the non-English language in which the notary services were solicited, and shall contain the notice required in subsection (g) of this section, unless the notice is otherwise prominently posted at the notary public's place of business.

§ **10A-12.** Enforcement and penalties

(a) Any person who holds himself or herself out to the public as a notary or who performs notarial acts and is not commissioned is guilty of a Class 1 misdemeanor.

(b) Any notary who takes an acknowledgment or performs a verification or proof without personal knowledge of the signer's identity or without satisfactory evidence of the signer's identity is guilty of a Class 2 misdemeanor.

(c) Any notary who takes an acknowledgment or performs a verification or proof knowing it is false or fraudulent is guilty of a Class I felony.

(d) Any person who knowingly solicits or coerces a notary to commit official misconduct is guilty of a Class 1 misdemeanor.

(e) For purposes of enforcing this Chapter, the law enforcement agents of the Department of the Secretary of State have statewide jurisdiction and have all of the powers and authority of law enforcement officers when executing arrest warrants. The agents have the authority to assist local law enforcement agencies in their investigations and to initiate and carry out, on their own or in coordination with local law enforcement agencies, investigations of violations of this Chapter.

(f) The Secretary of State, through the Attorney General, may seek injunctive relief against any notary public who violates the provisions of this Chapter. Nothing in this Chapter diminishes the authority of the North Carolina State Bar.

(g) A violation of G.S. 10A-9(h) or (i) constitutes a deceptive trade practice under G.S. 75-1.1.

A new notary statutory proposal which will significantly increase the acknowledgment, reporting, recordkeeping and assurances required of notaries

should be reviewed with care. The current draft (as of this writing) is available on-line at the web site of the Secretary of State of North Carolina, on the "Notary Public Section", under "Notary Public Statute Revision Draft (7/2002), at: http://www.secretary.state.nc.us/notary/default.asp

e. Forms

Practice Tip: Marital status, open estate and other indemnity forms are a good way of "flushing out" the truth from some clients. They emphasize the importance of the issue. They are also proof that the attorney did discuss the issue with the client, in the event the client later claims otherwise.

f. Good Funds Settlement Act, RPC 191 and Requirement of a "First Lien"

The ethical obligations of the attorney, IN MANDATORY CHRONOLOGICAL ORDER, have been long-established and must repeated as follows:

1. To receive "good funds";
2. To update the title to assure "first lien" status and record the documents, pursuant to implied or express representation agreements of clients (seller, buyer, lender) and title insurers;
3. Then, and only then, to disburse all proceeds.

Title must be updated and documents recorded immediately! N.C.G.S. 47-18 and 47-20 provide protection against the rights and claims of third parties as well as parties to the transaction by recordation of instruments vesting title in bona fide purchasers for value. Only immediate recording can assure that those bona fide purchasers and mortgagees are the ones involved in this transaction! A few examples:

- Judgment was docketed in next week's court session where one-week delay in recording.
- Equity line lender mailed in multiple deeds of trust, recorded after "closing" but prior to recordation of new deed of trust.
- "Seller" conveyed (and purchaser mortgaged) all of large tract other than lots previously deeded to others, after closing of individual lot but before recording.

The attorney's ethical obligations to update and record, assuring first lien status, are specifically addressed in multiple ethical opinions. RPC 44 (July 15, 1988), entitled "Attorney's Obligation to Follow Closing Instructions, *Opinion rules that a closing attorney must follow the lender's closing instruction that closing documents be recorded prior to disbursement*," provides in relevant part as follows:

> The attorney may not ethically ignore the lender's instruction that recordation must precede disbursement. CPR 100 made it clear that any attorney involved in the closing of an ordinary residential real property transaction represents both the borrower and the lender in the absence of clear notice to all concerned that such is not the case. Rule 10.2(E) requires a lawyer holding client funds in trust to deliver those funds to interested third persons as directed by the client. In the situation described in the inquiry, it is clear that the attorney, having received funds in trust from his client, the lender, is obliged to disburse those funds at a time which is consistent with the lender's instructions. Moreover, it is fair to

> say that any lawyer receiving client funds with the present knowledge that he or she does not intend to comply with the instructions for the handling of those funds, would violate Rule 1.2(c) by engaging in conduct involving dishonesty, fraud, deceit or misrepresentation.
>
> It should also be noted that the disbursement of loan proceeds before the title is updated and the Deed and Deed of Trust are recorded could be prejudicial, not only to the lender as a client of the attorney, but also to other interested parties in the transaction to whom the lawyer may owe fiduciary duties, such as the title insurer and his own liability insurance carrier. Such conduct, at least insofar as the client is concerned, could be viewed as prejudicial to the client and thus a violation of Rule 7.1(a)(3).

RPC 86 (April 13, 1990) set the standard that the attorney could "disburse against provisionally credited funds only when he or she reasonably believes that the underlying deposited instrument is virtually certain to be honored when presented for collection."

Expanding upon the above opinion, the leading opinion regarding disbursement is RPC 191 (October 20, 1995, Revised January 24, 1997). Because of its importance, this opinion is set forth in full below:

> Editor's Note: RPC 191 originally became a formal opinion of the State Bar on October 20, 1995. The opinion sets forth the duty of a closing lawyer to disburse from the trust account only in reliance upon the deposit of specified negotiable instruments which have a low risk of noncollectibility. On June 21, 1996, the North Carolina General Assembly

ratified the Good Funds Settlement Act, G.S. Chapter 45A, which became effective October 1, 1996. The act sets forth the duty of a settlement agent for a residential real estate closing to disburse settlement proceeds from a trust or escrow account only in reliance upon the deposit of specified negotiable instruments. There was some inconsistency between the list of negotiable instruments against which disbursement was permitted in the Act and a similar list in RPC 191. To correct this, RPC 191was revised to reference the list of acceptable negotiable instruments found in the Act.

Disbursements Upon Deposit of Funds Provisionally Credited to Trust Account

Opinion rules that a lawyer may make disbursements from his or her trust account in reliance upon the deposit of funds provisionally credited to the account if the funds are deposited in the form of cash, wired funds, or by specified instruments which, although they are not irrevocably credited to the account upon deposit, are generally regarded as reliable.

Introduction: In the wake of the financial failure of an out-of-state mortgage lender, the State Bar received numerous requests to reexamine prior ethics opinions CPR 358 and RPC 86 which permitted a lawyer to issue trust account checks against funds which, although uncollected, were provisionally credited to the lawyer's trust account by the financial institution with which the trust account was maintained. RPC 86 cautioned that the closing lawyer should disburse against provisionally credited funds only when the lawyer reasonably believed that the underlying

deposited instrument was virtually certain to be honored when presented for collection. Nevertheless, lawyers did accept, deposit, and disburse against the residential loan proceeds checks of the out-of-state mortgage lender that failed. Some of these checks were ultimately dishonored and charged back against the trust accounts of the closing lawyers. In the meantime, some trust account checks issued for the closings were presented for collection and paid, resulting in the use of funds deposited by other clients to pay the closing checks presented for payment.

Inquiry: In the typical residential real estate closing, the lending institution that finances the purchase of the property delivers the loan proceeds to the closing lawyer in the form of a check drawn upon a financial institution which may or may not be located in North Carolina. Loan proceeds are seldom delivered to the closing lawyer in the form of wired funds. Similarly, the real estate agent sometimes delivers the earnest money to the closing lawyer in the form of a check drawn on his or her trust account and the buyer sometimes delivers a personal check to the closing lawyer to cover the difference between the loan amount and the buyer's obligations. May a closing lawyer deposit such checks in his or her trust account and, if the depository bank will provisionally credit the lawyer's trust account, immediately disburse against the items before they have been collected?

Opinion: Yes, but only upon the conditions set forth in this opinion.

A lawyer (1) may disburse funds from a trust account only in reliance upon the deposit of a financial instrument specified in the Good Funds Settlement Act, G.S. Chap. 45A (the Act), which became effective on October 1, 1996, and the securing of provisional credit for the deposited item, and (2) as an affirmative duty, must immediately act to protect the property of the lawyer's other clients by personally paying the amount of any failed deposit or securing or arranging payment from other sources upon learning that a deposited instrument has been dishonored. It shall be unethical for a lawyer to disburse funds from a trust account in reliance upon the deposit of a financial instrument that is not specified in the Act, regardless of whether the item is ultimately honored or dishonored.

In reliance on CPR 358 and RPC 86, many closing lawyers deposit the checks from the lender, the real estate agent, and the buyer into their trust accounts, receive provisional credit for the items from the depository bank and immediately disburse funds from their trust accounts in accordance with the schedule of receipts and disbursements prepared for the closing. There is typically some delay, generally three to four days but in some instances as much as fifteen days, between the time of the deposit of the checks of the lender, the buyer, and the real estate agent into the lawyer's trust account and the time when the funds are irrevocably credited to the lawyer's trust account by the depository institution. Because of the time lag between the deposit and the collection of the checks, the closing lawyer runs the risk that a check may be ultimately dishonored and

charged back against the trust account of the closing lawyer, resulting in the use of the funds of other clients on deposit in the trust account to satisfy the disbursement checks from the closing.

A lawyer who receives funds that belong to a client assumes the responsibilities of a fiduciary to safeguard those funds and to preserve the identity of the funds by depositing the funds into a designated trust account. Rule 10.1 of the Rules of Professional Conduct. It is a lawyer's fiduciary obligation to ensure that the funds of a particular client are used only to satisfy the obligations of that client and are not used to satisfy the claims of the lawyer's creditors. Rule 10.1 and comment. Furthermore, Rule 10.2 of the Rules of Professional Conduct requires a lawyer to maintain complete records of all funds or other property of a client received by the lawyer and to render to the client appropriate accountings of the receipt and disbursement of any of the client's funds or property held by the lawyer. Rule 10.2(e) recognizes a lawyer's obligation to pay promptly or deliver to the client, or to a third person as directed by the client, the funds in the possession of the lawyer to which the client is entitled. Strictly interpreted, these rules would appear to require a lawyer not to disburse upon items deposited in his or her trust account until the depository bank has irrevocably credited the items to the account. Requiring a closing lawyer to postpone disbursement until all items have been credited to the lawyer's trust account would result in inconvenience, delay, and could have an adverse effect on the economy. Nevertheless,

there is some risk that certain instruments, such as ordinary commercial checks, may be uncollectible in any given transaction. Conversely, there are financial instruments that are generally regarded as extremely reliable. In fact, other state bars that have considered the issue have held that there are certain financial instruments for which the risk of noncollectibility is so slight as to make it unnecessary to prohibit a closing lawyer from disbursing immediately against such items before they are collected. *See* Virginia State Bar Legal Ethics Opinion 183 and Rule 5-1.1(g) of the Rules Regulating the Florida Bar. Similarly, the North Carolina Good Funds Settlement Act permits a "settlement agent," or person responsible for conducting the settlement and disbursement of the proceeds for a residential real estate closing, to disburse against uncollected funds but only if the deposited instrument is in one of the forms specified in the Act. Notwithstanding the fact that some of the forms of funds designated in the Act are not irrevocably credited to the lawyer's trust account at the time of deposit, the risk of noncollectibility is so slight that a lawyer's disbursement of funds from a trust account in reliance upon the deposit into the account of provisionally credited funds in these forms shall not be considered unethical. However, a closing lawyer should never disburse against any provisionally credited funds unless he or she reasonably believes that the underlying deposited instrument is virtually certain to be honored when presented for collection. A lawyer may immediately disburse against collected funds, such as cash or wired funds, and may

immediately make disbursements from his or her trust account in reliance upon provisional credit extended by the depository institution for funds deposited into the trust account in one or more of the forms set forth in G.S. §45A-4.

The disbursement of funds from a trust account by a lawyer in reliance upon provisional credit extended upon the deposit of an item into the trust account which does not take one of the forms prescribed in the Act constitutes professional misconduct, regardless of whether the item is ultimately honored or dishonored. However, a lawyer who disburses in reliance upon provisional credit extended upon the deposit of an item prescribed in the Act shall not be guilty of professional misconduct if that lawyer, upon learning that the item has been dishonored, immediately acts to protect the property of the lawyer's other clients by personally paying the amount of any failed deposit or securing or arranging payment from sources available to the lawyer other than trust account funds of other clients. An attorney should take care not to disburse against uncollected funds in situations where the attorney's assets or credit would be insufficient to fund the trust account checks in the event that a provisionally credited item is dishonored.

To the extent that CPR 358 and RPC 86 are inconsistent with this opinion, they are overruled. However, there are provisions in both opinions that remain operative. Specifically, the provision of CPR 358 that prohibits a lawyer from disbursing against the " in the trust account during the time

> lag between the deposit of the checks of the lender, the buyer, and the real estate agent and the time when these items are irrevocably credited to the account unless provisional credit for the items is extended by the depository institution remains in effect. If provisional credit is not extended by the depository institution, the disbursing lawyer is using the funds of other clients to cover the closing disbursements until the deposited items are collected in violation of Rule 10.1.
>
> It should be emphasized that this opinion shall apply to any disbursements from the trust account against items which are not irrevocably credited to the account upon deposit, whether such disbursements are for the purpose of closing a real estate transaction or for the purpose of concluding some other transaction or matter.

Mortgage company checks were specifically (almost) addressed in RPC 232 (October 17, 1996), entitled “Disbursement Upon Deposit of Mortgage Company Check Pursuant to an Agreement Purporting to Make Check Certified" (known as an “Immediately Available Funds Procedure Agreement"; see opinion for specific terms). The opinion states, quite simply, without further explanation: “*See* Good Funds Settlement Act, G.S. §45A-1 *et seq*. (effective October 1, 1996).”

Chapter 45A of the North Carolina General Statutes, known as the “Good Funds Settlement Act” was enacted effective October 1, 1996, revised effective July 1, 2002 , to cover all closings of “real estate transactions involving a one- to four-

family dwelling or lot restricted to residential use," no matter by whom closed and disbursed. The key provisions of the statute are set forth below:

> § 45A-4. Duty of settlement agent. The settlement agent shall cause recordation of the deed, if any, the deed of trust or mortgage, or other loan documents required to be recorded at settlement. The settlement agent shall not disburse any of the closing funds prior to the recordation of any deeds or loan documents required to be filed by the lender, if applicable, and verification that the closing funds used to fund disbursement are deposited in the settlement agent's trust or escrow account in one or more forms prescribed by this Chapter. Unless otherwise provided in this Chapter, a settlement agent shall not cause a disbursement of settlement proceeds unless those settlement proceeds are collected funds. Notwithstanding that a deposit made by a settlement agent to its trust or escrow account does not constitute collected funds, the settlement agent may cause a disbursement of settlement proceeds from its trust or escrow account in reliance on that deposit if the deposit is in one or more of the following forms:
>
> (1) A certified check;
>
> (2) A check issued by the State, the United States, a political subdivision of the State, or an agency or instrumentality of the United States, including an agricultural credit association;
>
> (3) A cashier's check, teller's check, or official bank check drawn on or issued by a financial institution insured by the Federal Deposit Insurance

Corporation or a comparable agency of the federal or state government;

(4) A check drawn on the trust account of an attorney licensed to practice in the State of North Carolina;

(5) A check or checks drawn on the trust or escrow account of a real estate broker licensed under Chapter 93A of the General Statutes;

(6) A personal or commercial check or checks in an aggregate amount not exceeding five thousand dollars ($5,000) per closing if the settlement agent making the deposit has reasonable and prudent grounds to believe that the deposit will be irrevocably credited to the settlement agent's trust or escrow account;

(7) *(Effective until July 1, 2002)* A check drawn on the account of or issued by a mortgage banker registered under Article 19 of Chapter 53 of the General Statutes that has posted with the Commissioner of Banks a surety bond in the amount of at least three hundred thousand dollars ($300,000). The surety bond shall be in a form satisfactory to the Commissioner and shall run to the State for the benefit of any settlement agent with a claim against the licensee for a dishonored check.

(7) *(Effective July 1, 2002)* A check drawn on the account of or issued by a mortgage banker licensed under Article 19A of Chapter 53 of the General Statutes that has posted with the Commissioner of Banks a surety bond in the amount of at least three hundred thousand dollars ($300,000). The surety bond shall be in a form satisfactory to the Commissioner and

shall run to the State for the benefit of any settlement agent with a claim against the licensee for a dishonored check.

§ 45A-5. Duty of lender, purchaser, or seller. The lender, purchaser, or seller shall, at or before closing, deliver closing funds, including the gross or net loan funds, if applicable, to the settlement agent either in the form of collected funds or in the form of a negotiable instrument described in G.S. 45A-4(1) through (7), provided that the lender, purchaser, or seller, as applicable, shall cause that negotiable instrument to be honored upon presentment for payment to the bank or other depository institution upon which the instrument is drawn. However, in the case of a refinancing, or any other loan where a right of rescission applies, the lender shall, no later than the business day after the expiration of the rescission period required under the federal Truth-in-Lending Act, 15 U.S.C. § 1601, et seq., cause disbursement of loan funds to the settlement agent in one or more of the forms prescribed by provisions in this Chapter.

§ 45A-7. Penalty. Any party violating this Chapter is liable to any other party suffering a loss due to that violation for that other party's actual damages plus reasonable attorneys' fees. In addition, any party violating this Chapter shall pay to the party or parties suffering a loss an amount equal to one thousand dollars ($1,000) or double the amount of interest payable on any loan for the first 60 days after the loan closing, whichever amount is greater.

RPC 78 (October 20, 1989), entitled “Conditional Delivery of Trust Account Checks, specifically addresses and prohibits “*conditional delivery of trust account checks to real estate agent before depositing loan proceeds against which checks were to be drawn,*” in a situation where the lender required updating and recording (or “first lien” status) prior to disbursement of loan proceeds. The opinion states, in relevant part:

> The attorney may not ethically deliver trust account checks to the real estate agent, even if such delivery is made "in trust" or "conditionally," until the attorney has recorded the closing documents and deposited the closing proceeds in his trust account.
>
> Arguably, the conditional delivery of the trust account checks would not violate the lender's instructions, because the Attorney is, in fact, recording before depositing and disbursing the lender's funds. Those funds have not been "disbursed." *See* RPC 44.
>
> However, by delivering to the real estate agent checks drawn on the trust account when the account has either (i) no funds or (ii) trust funds belonging to others, the Attorney violates Rules 10.1 and 10.2. Under those rules, funds deposited in a trust account are funds received by the Attorney as a fiduciary, which must be held and disbursed only for the benefit of those entitled to them, in accordance with appropriate instructions. Accordingly, Attorney cannot violate or delegate his fiduciary duty by putting into the hands of an unrelated third-party a check, regular on its face, drawn on a trust account containing only the

> funds of others. Similarly, Attorney cannot ethically deliver checks drawn on an account with insufficient funds, in violation of the law and the implicit requirement imposed by Rule 10.2(F).
>
> . . . Reference is made to RPC 44. As a general matter, the ultimate liability created under a title insurance policy or professional liability insurance policy will be irrelevant to a determination of the ethical issues, which must be judged independently of legal liability and insurability.

However, once the conditions of closing have been met, the attorney must complete the disbursement, pursuant to RPC 17 (regarding failure to pay in full a lien against developer-seller, discussed above) and 99 Formal Ethics Opinion 9 (October 22, 1999), entitled "Lawyer's Obligation to Disburse Closing Funds" which provides in relevant part, that:

> [O]nce a closing lawyer records the deed to property, the lawyer must comply with the conditions placed on the delivery of the deed by the seller. If the seller delivered the executed deed to the lawyer upon the condition that the deed would only be recorded if the purchase price was paid, the lawyer has fiduciary responsibilities to the seller even if the seller is not the lawyer's client. *See, e.g.*, RPC 44 (conditional delivery of loan proceeds). If title has passed to the buyer, the lawyer must satisfy the conditions of the transfer of the property by disbursing the sale proceeds. The buyer must take appropriate legal action to have the sale rescinded.

3. Post-Closing Follow up

a. Generally

Post-Closing follow up is critical, not to be postponed until the attorney or staff has "free time" to deal with these issues. Many claims are a result of post-closing followup not being consistently followed, whether insured closing claims or problems that could have been appropriately dealt with immediately after closing but not 6 months or two years down the road when the borrower is in default or the noteholder is a distant investor. *Recall that the lender's written closing instructions are the obligation of the attorney and require specific time lines to deliver the closing package, a "first lien", a title policy and to deal with all the other contingencies of closing.*

Specific issues include:

- Avoiding delayed delivery of the closing package to lender
- Timely completion of outstanding items from incomplete closing packages
- Cancellation of manufactured home title
- Record cancellations of existing deeds of trust (especially equity lines), judgments or other liens paid at closing
- Record subordinations of equity lines
- Forwarding final opinions to the title insurer for issuance of the final title insurance policy

Requirement of Cancellation of Record of Deeds of Trust

99 Formal Ethics Opinion 5 (July 23, 1999), entitled "Obtaining Canceled Deed of Trust Following Residential Real Estate Closing, *Opinion rules that whether*

the lawyer for a residential real estate closing must obtain the cancellation of record of a prior deed of trust depends upon the agreement of the parties," which provides in relevant part:

> Although Rule 1.3 of the Revised Rules of Professional Conduct states that "a lawyer shall act with reasonable diligence and promptness in representing the client," whether there is a duty to obtain paid loan documents from a lender depends upon the lawyer's agreement with the new lender and the borrower. The lawyer's engagement letter, the lender's loan closing instructions, and the lawyer's representations to the clients establish the expectations of the clients. However, Rule 1.2(c) specifically permits a lawyer to limit the objectives of a representation with the client's consent. To avoid any misunderstanding, the lawyer must explain any limitations on her representation. Specifically, if she does not intend to obtain the cancellation of record of the paid deed of trust, she must so advise her clients.

Most attorneys demand these cancellations as has been the practice for years, simply as a routine and fundamental matter of representing a client. However, in recent days, a few attorneys have taken the position they are not responsible for this critical part of the closing process. The above opinion, 99 FEO 5, makes clear that cancellation is a standard of practice unless *all* clients give *informed consent* otherwise. Some of the key reasons include:

(1) The parties relying upon the attorney's post-closing follow up and cancellation include all clients (seller, buyer and new lender in the typical

residential transaction) and the title insurer which is asked to issue new policies without exception. In addition, the comprehensiveness of the disclosure is critical to those clients' ability to make an *informed* consent. Are the borrower or lender advised that they are not being provided marketable title or that a future closing or foreclosure may be significantly delayed, might even require litigation in order to render the title marketable? Is the seller informed that they may be a necessary party in future litigation to cancel the lien?

(2) The defeasance clauses in many deeds of trust are not among the statutorily recognized cancellation methods provided in N.C.G.S. 45-37.

(3) Cancellation, release, subordination must be recorded in order to be effective in protecting all interested parties. A simple "payoff" is just one term of an ongoing contract that is not complete until the final document is recorded. Failure to obtain this final recordation often leads directly to litigation – in which *the attorney may become a necessary party or a witness or both!* And this situation is on the increase!

(4) Failure to obtain and record satisfactory subordination allows prior lienholder to foreclose and extinguish the currently intended "first" lien or purchase – and, of course, no request for notice is filed by the new lender which has specifically instructed that it is to be a first lien. This is especially prevalent on uncanceled equity lines or situations where the servicer and the holder of the prior lien have a dispute, and the servicer was paid at the closing.

(5) Investors and guarantors (VA, FHA and others) will require the original insured lender to repurchase the loan for failure of marketable title.

(6) Owners are unable to deliver marketable title to potential purchasers, with or without a title insurer being willing to "insure over." This is often used as leverage for a hesitant or highly conscientious purchaser to back out of a purchase.

(7) Sellers who have paid the lien expect that the record will be clear of any outstanding liabilities for which they still appear to be liable.

(8) In situations of failure to obtain release of a developer lien, the amount required to release the property at some later date may significantly exceed the coverage of even the title policy.

C. USE OF PARALEGALS AND STAFF

Rule 5.3 of the Revised Rules of Professional Conduct, Responsibilities Regarding Nonlawyer Assistants, and multiple ethical opinions govern oversight of the assistants involved in a transaction, whether independent or an employee, as follows:

> With respect to a nonlawyer employed or retained by or associated with a lawyer:
>
> (a) a partner in a law firm shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that the nonlawyer's conduct is compatible with the professional obligations of the lawyer;

(b) a lawyer having direct supervisory authority over a nonlawyer shall make reasonable efforts to ensure that the nonlawyer's conduct is compatible with the professional obligations of the lawyer; and

© a lawyer shall be responsible for conduct of such a nonlawyer that would be a violation of the Rules of Professional Conduct if engaged in by a lawyer if:

(1) the lawyer orders the conduct involved; or

(2) the lawyer has direct supervisory authority over the nonlawyer and knows of the conduct at a time when its consequences can be avoided, but fails to take reasonable action to avoid the consequences.

Comment [1] Lawyers generally employ nonlawyers in their practice including secretaries, investigators, law student interns, and paraprofessionals. Such nonlawyers, whether employees or independent contractors, act for the lawyer in rendition of the lawyer's professional services. A lawyer should give such nonlawyers appropriate instruction and supervision concerning the ethical aspects of their employment, particularly regarding the obligation not to disclose information relating to representation of the client, and should be responsible for their work product. The measures employed in supervising nonlawyers should take account of the fact that they do not have legal training and are not subject to professional discipline.

In addition, Rule 5.4 Professional Independence Of A Lawyer, provides that:

> (a) A lawyer or law firm shall not share legal fees with a nonlawyer, except that:
>
> . . .
>
> (4) a lawyer or law firm may include nonlawyer employees in a compensation or retirement plan even though the plan is based in whole or in part on a profit-sharing arrangement.
>
> (b) A lawyer shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law.
>
> (c) A lawyer shall not permit a person who recommends, engages, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.
>
> (d) A lawyer shall not practice with, or in the form of, a professional corporation or association authorized to practice law for a profit, if:
>
> (1) a nonlawyer owns any interest therein, except that a fiduciary representative of the estate of a lawyer may hold the stock or interest of the lawyer for a reasonable time during administration; or
>
> (2) a nonlawyer has the right to direct or control the professional judgment of a lawyer.

RPC 147 (January 15, 1993), entitled "Percentage Bonuses for Paralegals" provides that "*an attorney may not pay a percentage of fees to a paralegal as a bonus.*"

Three critical ethical opinions regarding requirements of physical presence of attorneys at closing, and therefore, the limits of ability to delegate closing functions to nonlawyer assistants, are 99 Formal Ethics Opinion 13, 2001 Formal Ethics Opinion 4 and 2001 Formal Ethics Opinion 8. All are under re-consideration by the North Carolina State Bar in October, 2002, pursuant to pressure from the Department of Justice and the Federal Trade Commission.

Regarding the abstracting of title, the leading opinions are RPC 29 and RPC 216. RPC 29 (October 23, 1987**),** entitled **"**Purchase and Use of Title Abstracts" held that:

> "For an attorney to rely on an abstract or title search by a nonlawyer not supervised by the attorney or the firm does not constitute adequate preparation under the circumstances for rendering of a title opinion or drafting a deed in reliance on the information disclosed by this title abstract or search. An attorney is required to supervise and evaluate the nonlawyer assistant. An attorney relying on nonlawyer assistants, whether employed by his firm or contracted with, must make reasonable efforts to ensure that the nonlawyer's conduct is compatible with the lawyer's professional obligations, including his ethical obligations as required by Rule 3.3(a)

RPC 216 (July 18, 1997), entitled "Using the Services of an Independent Title Abstractor," expanded upon the above opinion as follows:

> A lawyer may use nonlawyers to assist him or her in the rendition of the lawyer's professional services. Comment to Rule 3.3 of the Rules of Professional Conduct. There is no requirement in the Rules of Professional Conduct that such nonlawyer assistants must be employees of the lawyer's firm. However, the lawyer must be able to meet his or her ethical responsibilities with regard to the supervision of a nonlawyer assistant regardless of whether the nonlawyer assistant is employed within the firm or as an independent contractor. The lawyer is responsible for the competent representation of clients, and therefore, the lawyer is also responsible for the work product of nonlawyer assistants. Rule 6(a)(1). Before hiring or contracting with a nonlawyer assistant to perform title searches, Attorney A should take reasonable steps to ascertain that the nonlawyer is competent. Attorney A must also give the nonlawyer appropriate instruction and supervision. Comment to Rule 3.3 and RPC 29.
>
> . . .
>
> It is impossible for a lawyer to supervise adequately the work of a nonlawyer, pursuant to the requirements of Rule 3.3, if the lawyer is not himself or herself competent in the area of practice. Moreover, it is incompetent representation of a client, in violation of Rule 6, for a lawyer to adopt as his or her own an opinion on title prepared by a nonlawyer or

> to render a legal opinion on title if the lawyer's opinion is not based upon knowledge of the relevant records and documentation and the lawyer's own independent professional judgment, knowledge, and competence in real property law. *See* RPC 29.

RPC 216 continues, providing that the attorney is not required to identify the name of the independent searcher or the fee, *unless the client inquires*. However, the attorney is responsible for assuring the paralegal performs a conflicts check and maintains strict confidentiality under the requirements of the Revised Rules of Professional Conduct applicable to the attorney.

Regarding hiring disbarred attorney as nonlawyer assistants, 98 Formal Ethics Opinion 7 (April 16, 1998), entitled "Employment of Disbarred Lawyer" provides, in relevant part, as follows:

> Rule 5.5 (d) of the Revised Rules of Professional Conduct provides:
>
> A lawyer or law firm employing a disbarred or suspended lawyer as a law clerk or legal assistant shall not represent any client represented by the disbarred or suspended lawyer or by any lawyer with whom the disbarred or suspended lawyer practiced during the period on or after the date of the acts which resulted in disbarment or suspension through and including the effective date of disbarment or suspension.
>
> When a disbarred lawyer is employed by another law firm, the disbarred lawyer may attract clients from his former practice to the hiring law firm.

As a consequence, it may be difficult for the disbarred lawyer to avoid the unauthorized practice of law with respect to these former clients. More problematic, however, is the possibility that the hiring law firm may be in collusion with the disbarred lawyer to employ the disbarred lawyer in exchange for the disbarred lawyer's delivery of his former clients to the hiring firm. If so, the firm is showing disrespect for the decision of the DHC and is encouraging unauthorized practice by the disbarred lawyer. Provided all clients of XYZ Law Firm fully understand that the disbarred lawyer is not acting as an attorney but merely as a paralegal, and, provided further, that, after the employment of Former Attorney A, XYZ Law Firm accepts no new clients who were clients of ABC Law Firm during the period of Former Attorney A's misconduct, XYZ Law Firm may employ him as a paralegal. Care should also be taken to follow the recommendations in Comment [2] to Rule 5.5 relative to the supervision of a disbarred lawyer and related matters.

Rule 5.5(c) provides:

> A lawyer or law firm shall not employ a disbarred or suspended lawyer as a law clerk or legal assistant if that individual was associated with such lawyer or law firm at any time on or after the date of the acts which resulted in disbarment or suspension through and including the effective date of disbarment or suspension.

> The rule was adopted to prevent a disbarred lawyer from continuing to practice law as if no order of disbarment was entered. In Comment [3] to the rule, it is observed that it would be "practically impossible for the disciplined lawyer to confine himself or herself to activities not involving the actual practice of law if he or she were employed in his or her former office setting and obliged to deal with the same staff and clientele."
>
> This inquiry [under Rule 5.5©] is different from the preceding inquiries because the disbarred lawyer[Former Attorney B] is proposing to work as a non-lawyer at a firm [Attorney C] where he formerly worked as a lawyer. Under these circumstances, the existing relationships with staff and clients are more likely to undermine the prohibition on the unauthorized practice of law by the disbarred lawyer. Therefore, Attorney C may not employ Former Attorney B.

D. UNAUTHORIZED PRACTICE OF LAW

1. Definition of Practice of Law

The following key services must be performed by licensed NC outside counsel, under North Carolina General Statutes Sections 84-2.1, 84-5 and 58-26-1(a):

- Preparation of legal documents
- Abstracting, rendering an opinion on or certifying title to real estate
- Providing legal advice to buyers, sellers, lenders – during closing or otherwise

Pursuant to N.C.G.S. § 84-2.1. "Practice law" is defined, in relevant part, as follows:

> The phrase "practice law" as used in this Chapter is defined to be performing any legal service for any other person, firm or corporation, with or without compensation, specifically including the preparation or aiding in the *preparation of deeds, mortgages, . . . ; abstracting or passing upon titles, . . .* or assisting by advice, counsel, or otherwise in any legal work; and to advise or give opinion upon the legal rights of any person, firm or corporation . . . *[emphasis added]*

With regard to attorneys providing legal advice on matters outside their state of licensing, whether employed by a corporation or in private practice, Rule 5.5 Unauthorized Practice Of Law, provides as follows: "(a) A lawyer shall not practice law in a jurisdiction where doing so violates the regulation of the legal profession in that jurisdiction."

2. Liability of the Title Insurance Underwriter:

RPC 201, Inquiry #10: May a lawyer for a title insurance company issue a title insurance policy based upon Attorney's certification of title if Attorney is providing legal services to customers of Real Estate Company as an employee or in-house counsel for Real Estate Company? Opinion #10: If an attorney for a title insurance company knows that Attorney is providing legal services to customers of Real Estate Company in violation of G.S. 84-5, which prohibits a corporation from engaging in the practice of law, the attorney for the title insurance company may not aid in this practice. Rule 3.1(a).

3. House Counsel may not represent third parties

However, pursuant to N.C.G.S.§ 84-5, employees of a corporation (or other non-legal-professional entity), even attorney-employees, are prohibited from providing legal advice to third parties. N.C.G.S. 84-5 provides, in relevant part, as follows:

> (a) It shall be unlawful for any corporation to practice law or appear as an attorney for any person . . . or hold itself out to the public or advertise as being entitled to practice law; and no corporation shall organize corporations, or draw agreements, or other legal documents, or draw wills, or practice law, or give legal advice, or hold itself out in any manner as being entitled to do any of the foregoing acts, by or through any person orally or by advertisement, letter or circular. . . Provided, however, this section shall not apply to corporations authorized to practice law under the provisions of Chapter 55B of the General Statutes of North Carolina.
>
> . . .
>
> (b) Nothing in this section shall prohibit an attorney retained by a corporation, whether or not the attorney is also a salaried employee of the corporation, from representing the corporation or an affiliate, or from representing an officer, director, or employee of the corporation or an affiliate in any matter arising in connection with the course and scope of the employment of the officer, director, or employee. Notwithstanding the provisions of this subsection, the attorney providing such representation shall be governed by and subject to all of the Rules of Professional

Conduct of the North Carolina State Bar to the same extent as all other attorneys licensed by this State.

Exception: A bank employee who "prepares a legal document in connection with a business transaction in which the corporation has a primary interest, the corporation being authorized by law and its charter to transact such business, does not violate the statute, for his act in so doing is the act of the corporation in the furtherance of its own business." State v. Pledger, 257 N.C. 634, 127 S.E.2d 337 (1962) Any attorney or employee doing so is best advised to assure that the borrower is fully informed that they are not being represented by the bank employee, and that if they have any legal questions or need legal advice, they should consult their own outside counsel.

Some relevant opinions regarding in-house counsel in the insurance (including title insurance) context include:

- CPR 19. House counsel for an insurance company may not represent an insured in prosecuting a subrogation claim. *See, also*, Gardner v. North Carolina State Bar, 316 N.C. 285; 341 S.E.2d 517 (1986).
- CPR 325. House counsel of a savings and loan association may not represent a subsidiary of the savings and loan association acting as trustee for a deed of trust in foreclosure.
- RPC 151. Although a corporate insurer acting through its employees cannot practice law and appear on behalf of others, a lawyer who is a full-time

employee of an insurance company may represent the company in an action where the company is a named party

- CPR 326. House counsel for an insurance company may not represent the insured in defense of a third party claim or in prosecution of a subrogation claim.

RPC 9 (July 25, 1986), entitled "Representation of Lenders and Borrowers by Corporate House Counsel" holds that "*house counsel for a mortgage bank may not represent other lenders and borrowers while serving as house counsel,*" providing in relevant part as follows:

> If Attorney A is employed as house counsel for X Corp., which merely originates the mortgage loans and does not have any propriety interests of its own, Attorney A may not ethically be employed as house counsel for X Corp. and, in that capacity, represent either the lenders or the borrowers in closing loans originated by X Corp. Where Attorney A is paid as and acts as house counsel for a corporation which has no proprietary interest in the transaction, his representation of the lenders, investors, or borrowers in that capacity may constitute the unauthorized practice of law by the corporation which employs him. Attorney A would be acting in violation of Rule 3.1 (a) in aiding a person, in this case X Corp., in the unauthorized practice of law. Additionally, for the lenders, the investors, or borrowers to pay a fee to X Corp. for this service performed by Attorney A would constitute the division of legal fees by Attorney A with a nonlawyer, specifically X Corp., in violation of Rule 3.2.

RPC 40 (April 17, 1989), entitled "Lender Preparation of Closing Documents", provides that "for the purposes of a real estate transaction, an attorney may, *with proper [advance] notice[emphasis added]* to the borrower, represent only the lender, and that the lender may prepare the closing documents." And this continues to be so even if the closings are facilitated by a title insurance company retaining the local counsel on behalf of the lender, under RPC 41 (January 13, 1989).

E. WITNESS CLOSINGS

A "Witness Closing" typically involves an attorney being requested to simply oversee the signing of the documents, being assured by the lender or or entity retaining them that they will not be liable for certain (or any) legal representation, possibly including some form of indemnity. The documents are drawn elsewhere by other parties and the title research is provided by others. 98 Formal Ethics Opinion 8 (April 16, 1998), entitled "Participation in a Witness Closing", provides specifically as follows:

> *Opinion rules that a lawyer may not participate in a closing or sign a preliminary title opinion if, after reasonable inquiry, the lawyer believes that the title abstract or opinion was prepared by a non-lawyer without supervision by a licensed North Carolina lawyer.*
>
> Inquiry #1: Lender is located in another state but provides home loans to North Carolina residents. Lender asks Attorney, a licensed North Carolina lawyer, to close a loan for certain borrowers. Lender indicates that the

following services will be required from Attorney: (1) oversight of the execution of the loan documents; (2) acknowledgment by an appropriate witness of the signatures of the borrowers on the documents; (3) recordation of Lender's deed of trust; (4) copying the loan documents without review; and (5) disbursement of the loan proceeds. Lender procures title insurance from an out-of-state title insurance company which issues title insurance binders in reliance upon the notes of a title abstractor. Attorney suspects that the title search was done by a non-lawyer who was not supervised by a North Carolina lawyer.

This type of closing is sometimes called a "witness closing." May Attorney participate in the closing?

Opinion #1: No. Rule 5.5(b) provides, "[a] lawyer shall not assist a person who is not a member of the bar in the performance of activity that constitutes the unauthorized practice of law." N.C. Gen. Stat. §84-2.1 defines "practice [of] law" as, among other things, "abstracting or passing upon titles." Attorney must make a reasonable inquiry concerning the preparation of the title search and/or the title opinion. If Attorney believes, after making this reasonable inquiry, that a non-lawyer abstracted the title and/or gave a title opinion on the property without the proper supervision of a licensed North Carolina attorney and this unauthorized practice will be furthered by Attorney's participation in the closing under the conditions prescribed by Lender, she may not participate in the closing. However, Attorney may participate in the closing if Attorney's reasonable inquiry

indicates that the statute was not violated.

Inquiry #2: What duty does Attorney have to the borrowers?

Opinion #2: If Attorney's representation is not prohibited by Rule 5.5(b), Attorney's duty to the borrowers is to ensure that her limited role in the closing is well understood and the borrowers agree to this limited role. *See* Rule 1.2(c). If she represents the borrowers, as well as Lender, she must competently represent their interests even if the objectives of her representation are limited. *See* Rule 1.1. Competent representation may include disclosure of any concerns that she may have about the preparation of the title opinion and the risks of relying upon the opinion. If Attorney does not represent the borrowers, they must be so advised and told that they should obtain separate legal counsel. *See* RPC 210. Attorney may represent the borrowers and Lender if she can do so impartially and without compromising the interests of any client. *Id* .

Inquiry #3: What duty does Attorney have to Lender?

Opinion #3: If Attorney's representation is not prohibited by Rule 5.5(b), Attorney must competently represent the interests of Lender. See Rule 1.1. Competent representation may include disclosure of any concerns that she may have about the preparation of the title opinion and the risks of relying upon the opinion.

Inquiry #4: Title Insurance Company is located in another state but wants to write policies in North Carolina. Title Insurance Company contracts with a paralegal who is an independent contractor to search titles in North

Carolina. Title Insurance Company asks Attorney to sign a preliminary opinion based upon the paralegal's abstract of title and/or preliminary opinion. Attorney has not reviewed the paralegal's title notes and did not supervise the paralegal's title research. May Attorney sign the preliminary opinion?

Opinion #4: No, a lawyer has a duty to supervise any non-lawyer who assists her regardless of whether the non-lawyer is an employee of the lawyer, an independent contractor, or employed by another. Rule 5.3 and RPC 216. Execution of a preliminary title opinion that was prepared by an unsupervised non-lawyer is assisting the unauthorized practice of law in violation of Rule 5.5(b).

F. LENDERS CONDUCTING CLOSINGS

Lenders have long been authorized to oversee closings with borrowers of their own loans under the conditions of the case of State v. Pledger, 257 N.C. 634 at 637; 127 S.E.2d 337 at 340 (1962), wherein the North Carolina Supreme Court stated:

> A person who, in the course of his employment by a corporation, prepares a legal document in connection with a business transaction in which the corporation has a primary interest, the corporation being authorized by law and its charter to transact such business, does not violate the statute, for his act in so doing is the act of the corporation in the furtherance of its own business.

Lender should be cognizant of, set in place safeguards for and provide significant training to employees handling closings of the stricture of many of the above provisions governing attorneys, including but not limited to:

- Lenders' own in-house counsel may be liable for performing or aiding and abetting in the unauthorized practice of law, jeopardizing their licenses.
- Lenders must establish closing procedures to define limits of authorized representations and adequately train personnel regarding:
    - The definition (or lack of clear definition) of giving legal opinions or the unauthorized practice of law in the closing context
    - Closing operating procedures, including notarization, addressing title issues and other "risk areas", many of which are listed earlier in this manuscript
    - Recognizing and addressing (curing) title issues at or before closing
    - Recognizing the need for independent counsel
    - Disclaimers regarding representing borrowers, or advising them regarding their legal rights or needs (such as title insurance, surveys)
    - Provision for post-closing follow up to assure that *they* have adequately recorded and assured first lien status, if they are to be protected by the public records systems and avoid future liability to borrowers for improperly clouding their title

- An independent attorney's opinion is still required for title insurance coverage. The failure to obtain title insurance will leave the lender at risk for losses.

G. **Foreclosures**

Handling a foreclosure sale is clearly the practice of law, pursuant to G.S. 84-6, which provides as follows:

> § **84-6.** Exacting fee for conducting foreclosures prohibited to all except licensed attorneys
>
> It shall be unlawful to exact, charge, or receive any attorney's fee for the foreclosure of any mortgage under power of sale, unless the foreclosure is conducted by licensed attorney-at-law of North Carolina, and unless the full amount charged as attorney's fee is actually paid to and received and retained by such attorney, without being directly or indirectly shared with or rebated to anyone else, and it shall be unlawful for any such attorney to make any showing that he has received such a fee unless he has received the same, or to share with or rebate to any other person, firm, or corporation such fee or any part thereof received by him; but such attorney may divide such fee with another licensed attorney-at-law maintaining his own place of business and not an officer or employee of the foreclosing party, if such attorney has assisted in performing the services for which the fee is paid, or resides in a place other than that where the foreclosure

> proceedings are conducted, and has forwarded the case to the attorney conducting such foreclosure.

However, an attorney serving as trustee under a foreclosure may resign, a substitute trustee may be appointed and the attorney may continue to represent the lender pursuant to RPC 90 (October 17, 1990), which provides, in relevant part, as follows:

> It has long been recognized that former service as a trustee does not disqualify a lawyer from assuming a partisan role in regard to foreclosure under a deed of trust. CPR 220, RPC 82. This is true whether the attorney resigns as trustee prior to the initiation of foreclosure proceedings or after the initiation of such proceedings when it becomes apparent that the foreclosure will be contested.
>
> . . .
>
> [However,] a lawyer serving as trustee may not simultaneously participate in the negotiation of a loan modification or workout agreement as attorney for the lender. RPC 82. An attorney serving as trustee may, however, draft and preside over the execution of documents evidencing a modification or workout agreement negotiated between the lender and borrower. Under such circumstances, the trustee would not be representing the interests of either and would be engaged in no partisan activity in conflict with the obligation to be impartial. It is possible that a lawyer who resigns as trustee to perform some partisan service for the lender, such as the

negotiation of a modification agreement, may thereafter be reappointed as trustee and initiate foreclosure proceedings.

EXHIBIT A: ALTA CLOSING PROTECTION LETTER (3-27-87)

[TITLE INSURANCE COMPANY LETTERHEAD]

DATE

LENDER'S NAME AND ADDRESS

Re: Closing Protection Letter

When title insurance of Title Insurance Company is specified for your protection in connection with closings of real estate transactions in which you are to be the lessee or purchaser of an interest in land or a lender secured by a mortgage (including any other security instrument) of an interest in land, the Company, subject to the Conditions and Exclusions set forth below, hereby agrees to reimburse you for actual loss incurred by you in connection with such closings when conducted by an Issuing Agent (an agent authorized to issue title insurance for the Company) or an Approved Attorney (an attorney upon whose certification of title the Company issues title insurance) and when such loss arises out of:

1. Failure of the Issuing Agent or Approved Attorney to comply with your written closing instructions to the extent that they relate to:
    a. the status of the title to said interest in land or the validity, enforceability and priority of the lien of said mortgage on said interest in land, including the obtaining of documents and the disbursement of funds necessary to establish such status of title or lien, or
    b. the obtaining of any other document, specifically required by you, but not to the extent that said instructions require a determination of the validity, enforceability or effectiveness of such other document, or
    c. the collection and payment of funds due you, or
2. Fraud or dishonesty of the issuing Agent or Approved Attorney in handling your funds or documents in connection with such closings.

If you are a lender protected under the foregoing paragraph, your borrower in connection with a loan secured by a mortgage on the one-to-four family dwelling shall be protected as if this letter were addressed to your borrower.

Conditions and Exclusions

1. The Company will not be liable to you for loss arising out of:
    a. Failure of the Approved Attorney to comply with your closing instructions which require title insurance protection inconsistent with that set forth in the title insurance binder or commitment issued by the Company. Instructions which require the removal of specific exceptions to title, or compliance with the requirements contained in said binder or commitment shall not be deemed to be inconsistent.
    b. Loss or impairment of your funds in the course of collection or while on deposit with a bank due to bank failure, insolvency or suspension, except such as shall result from failure of the Issuing Agent or

the Approved Attorney to comply with your written closing instructions to deposit the funds in a bank which you designated by name.

c. Mechanic's and materialmen's liens in connection with your purchase or lease or construction loan transactions, except tot he extent that protection against such liens is afforded by a title insurance binder, commitment or policy of the Company.

2. If the closing is to be conducted by an Approved Attorney, a title insurance binder or commitment for the issuance of a policy of title insurance of the Company must have been received by you prior to the transaction of your final closing instructions to the Approved Attorney.

3. When the Company shall have reimbursed you pursuant to this letter, it shall be subrogated to all rights and remedies which you would have had against any person or property had you not been so reimbursed. Liability of the Company for such reimbursement shall be reduced to the extent that you have knowingly and voluntarily impaired the value of such right of subrogation.

4. Any liability of the Company for loss incurred by you in connection with closings of real estate transactions by an Issuing Agent or Approved Attorney shall be limited to the protection provided by this letter. However, this letter shall not affect the protection afforded by a title insurance binder, commitment or policy of the Company.

5. Claims shall be made promptly to the Company at its principal office _____. When the failure to give prompt notice shall prejudice the Company, then liability of the Company hereunder shall be reduced to the extent of such prejudice.

6. The protection herein offered does not extend to real property transactions in the States of Florida, Iowa, Nebraska, New Hampshire, New Jersey, New Mexico, New York, Texas, Vermont, Virginia and Wisconsin.

The protection herein offered will be effective upon the receipt by the Company of your acceptance in writing, which may be made on the enclosed copy hereof and will continue until cancelled by written notice from the Company.

Any previous Insured Closing Service letter or similar agreement is hereby cancelled, except as to closings of your real estate transactions regarding which you have previously sent (or within 30 days hereafter send) written closing instructions to the Issuing Agent or Approved Attorney.

TITLE INSURANCE COMPANY

By: _____ (Title)

Accepted: (Date) _____

LENDER'S NAME

By: _____ By: _____(Title)

_____

Print Name of Individual Signing Above

EXHIBIT B:

CHICAGO TITLE INSURANCE COMPANY
NORTH CAROLINA

Owners Need Surveys - Still!
(Or, The Risks To You and Your Client of Lender's "Survey Coverage Without a Survey)

CHICAGO BULL Volume 1, Edition 5

You have heard it a hundred times. In gathering information about a closing, you ask either the real estate broker or the owner about whether you should obtain a survey. Their response: "My broker told me I do not have to have a survey. The title insurance company will cover it. " To assist in lowering costs, the practice of providing lender's coverage without a new survey was developed in residential transactions. In the absence of a current survey, the customary practice is to issue the loan policy without a survey exception. And now this has expanded into commercial properties (under $5 million) as well! But the owner will not be covered, even in those situations where the lender might be! The owner's policy contains an exception for easements, setbacks and other matters which would have been shown on a survey. Below are a few examples of situations that arise all too often where the owner really needed a survey, for title insurance and other reasons! In many of these cases, the lender could have avoided delinquencies and other problems if they, too, had obtained an actual survey to identify problems at or before closing.

1. **Access:** Does the owner have "reasonable," "legal" or any right of access at all? Is this clear from the public record? Is the physical access within this legal access? Some examples: The driveway is actually across the property line on the neighbor's property or in an exclusive right-of-way for the benefit of an unfriendly neighbor. Physical access is over a private road, even though they abut a public road, and no one is sure who is responsible for maintenance of the private road, if anyone. Does your owner need a search of and title insurance coverage for a critical appurtenant easement? Is the access actually located in (but not recorded in the Registry of) the adjoining county? (NOTE: Physical access used may not be the same as the "legal" or "reasonable" access covered by a title policy.)

2. **Acreage:** Was actual acreage important to your owner in determining the value of the property? Will the sale violate a subdivision ordinance? Loss through an acreage discrepancy of even one acre of land to be developed for an office park may have serious financial ramifications for your client's development plan!

3. **Waterfront?** Does the property extend to the lake's high water mark or is it just lake view?. Have creeks moved, rivers or beaches eroded? Is there any filled area? Or are there areas that have been excavated (for a boat dock, for example) placing the areas outside the lot's boundary which the plat sets at an elevation and not a location (common on power company lakes)? Is the lot even above water?

4. **Utilities:** Electrical, sewer or other rights-of-way, either underground or currently underutilized, whose location or size would be clearly apparent on a survey, may inhibit or prevent contemplated construction or replacement of improvements on the property. Wells or septic fields may be located on other nearby properties, for which appurtenance conveyances, easements and maintenance agreements may be needed to protect your buyer.

5. **Road rights-of-way:** Where are your improvements in relation to the actual state- or city-claimed

right-of-way, including gas pumps, signs, needed parking areas?

6. **Setbacks, buffers:** Can you identify and protect your buyer with regard to any violations?

7. **Governmental exclusions:** Illegal subdivisions, revised flood zones, street widenings or other governmental matters not covered by a title insurance policy may be shown or made apparent on a survey. New sidewalks or sewer lines (indicating potential assessments not yet billed) may be indicated.

8. **Boundary lines:** Remember the rules of construction. Abutters' claimed boundaries are a "permanent monument" with clear priority over metes and bounds. Do your owner's expectations match these presumptions? Is it even the same "dirt" your owner thinks they are buying? Are the parties contracting for one rental home, where the old legal description into the seller actually included two homes?

9. **Wrong property altogether!** The owner has good title to (and a good title policy coverage on) Lot 1 of Happy Homes Subdivision. Unfortunately the house they thought they bought was on Lot 2. And by the time this was determined, Lot 2's title was in chaos after intestate decedents' estates, minor heirs and foreclosures had intervened.

10. **Old improvements:** Existing building in a very old subdivision was substantially destroyed by casualty. It could not be rebuilt in compliance with current zoning ordinance without seeking (and obtaining) a variance, the outcome of which is uncertain.

11. **Old plats:** One of last undeveloped lots in a 1920's subdivision was purchased (without survey). Several years later when the owners planned to begin construction, a new survey using new technology reflected the remaining lot area to be 10% less than originally thought, causing serious revision of the building plans and substantial cost.

12. **Encroachments by others:** A neighbor's stone wall cuts off 10' strip from the side of the owner's property. Or an old driveway still in use for access to mobile home in the woods actually crossed rear portion of lot in new upscale neighborhood. (FYI: Trespass is not a title issue, but a tort!)

13. **Encroachments by your owner:** New owner of adjoining property demands removal of fence encroaching onto their property.

14. **Improvements:** Is this a mobile home, requiring verification of title cancellation, permanent foundation, property tax listing, etc.? Is there evidence of recent construction which might indicate a risk of mechanics' liens arising post-closing?

15. **Marketability and re-sale:** Maybe your owner does not care, but the next person purchasing from them may care enough to back out of the contract or at least delay the closing until a matter can be resolved – at your owner's expense!

16. **Liability:** Most importantly, if the owner does not obtain their own survey, they have no privity with the surveyor – and no claim against a surveyor for any inaccuracies in a prior survey.

The surveyor is a critical link between your legal assessment of title and the actual "dirt" your client believes they are purchasing. The surveyor can save you and your client untold misery in the future. Many of the above cases have also caused losses to lenders, due to delays in foreclosures, joinder as necessary parties in lawsuits or disruptions in their borrowers' desire to make payments pending resolution of problems, often not covered by their title policies because not purely title problems.

So, the next time your owner says "my broker told me . . .," perhaps you'll have a few more examples to add to your stock of advice to them! And maybe a Waiver of Survey Affidavit form such as the attached might be in order!

Happy Closings!

EXHIBIT C: CLOSING ERRORS

- Not obtaining owner's title insurance coverage or *enough* coverage
    - Loan policy coverages decrease as the loan is paid down. They provide no owner's coverage. And even in the event of a title problem, if the owner has sufficient equity (through payments made over time, adding value through development or building or simply inflation) in the property to assure the payoff of the loan, no loss may be payable at all! First Commerce Realty vs. Peninsular Title Insurance Co., 355 So.2d 510 (Fla.App. 1978)
    - Even on an owner's policy, what if the new owner has added value (such as a developer)?
- Not obtaining coverage amendments needed (for business or estate planning)
- Not addressing non-title issues and risks
- Failure to follow lender's written closing instructions
- Failure to pay off pre-existing liens or obtain cancellation after closing
- Recording simultaneously or in incorrect order
- Failure to obtain or advise lender to obtain updated coverage through a foreclosure proceeding
- Failure to "freeze" and obtain cancellation of equity line deeds of trust
- Failure to obtain assignment of policy or new coverage on conveyance to new entity above
- Failure to adequately advise client what is not covered and the impact on the client's plans and ownership rights
- Failure to advise or obtain adequate coverage of necessary easements
- Liability for nominal damages, even if no ultimate title loss. Title Ins. Co. of Minn. V. Smith Debnam Hibbert and Pahl, 119 N.C.App. 608, 459 S.E.2d 801 (1995) *aff'd in part*, 342 N.C. 887, 467 S.E.2d 241 (1996); Nick v. Baker, 125 N.C.App. 568, 481 S.E.2d 412 (1997).
- Failure to disclose to a seller that purchase money financing is non-recourse
- Failure to include or have seller represented re: release provisions in purchase money deed of trust
- Failure to disclose and document tax prorations or other negotiated matters between parties
- Not obtaining *written* verification of changes to closing instructions
- Conflict – interest in property
- Separate representation of seller in purchase money financing. Broyhill v. Aycock & Spence, 102 N.C.App. 382, 402 S.E.2d 167, *aff'd per curiam*, 330 N.C. 438, 410 S.E.2d 392 (1991); Cornelious v. Helms, 120 N.C.App. 172, 461 S.E.2d 338 (1995), *rev. den.* 342 N.C. 653, 467 S.E.2d 709, *reconsideration dismissed* 342 N.C. 894, 462 S.E.2d 909 (1996).

- Failure to include in a "second" lien purchase money mortgage that it is intended to be a "second" lien. Carolina Builders Corporation v. Howard-Veasey Homes, Inc., 72 N.C.App. 224, 324 S.E.2d 626 (1985)
- Failure to check identification of parties to closing
- Break in chain of title
- Not understanding and fully explaining HUD to client
- Earlier transactions not authorized by organizational documents
- Earlier gift deed not recorded within 2 years
- Wrong legal description on closing documents:
- Whole subdivision instead of single lot
- Wrong lot
- Failure to obtain written escrow instructions, incl. release and interpleader provisions. Proposed 98 Formal Ethics Opinion 11
- Failure to obtain joinder of spouse
- Failure to assure all officers, directors, members, etc., required to execute or consent have joined in transaction
- Deed of trust fails to reveal that borrowers and owners are not identical
- Deed of trust fails to include future advance language in compliance with N.C.G.S. 45-67, *et seq*.
    - Current amount
    - All advances within 15 years
    - Maximum principal amount
- "Purchasing" entity not in good standing or even in existence with Secretary of State (Owner's coverage)
- Seller entity not in good standing or even in existence with Secretary of State (Owner or Loan coverage)
- Borrower entity not in good standing or even in existence with Secretary of State (Loan coverage)
- Erroneously relying on N.C.G.S. 47-36.1 for other than "clerical error" corrections. See Jordan v. Crew, 125 N.C.App. 712, 482 S.E.2d 735 (1997); Green v. Crane, 96 N.C.App. 654, 386 S.E.2d 757 (1990).
- Failure to update through recording, inc. temporary index, clerk's office and taxes. NOTE: The owner may not be insured as recordation of earlier documents are "constructive notice", creating a pure malpractice claim!
- Failure to adequately supervise staff
- Failure to check actual *documents* of record, and relying solely on the index
- Not searching Uniform Commercial Code financing statements
- Missed deeds of trust
- Lack of familiarity with different county courthouses and city procedures
- Property in multiple counties but only one searched. Rowe v. Walker, 114 N.C.App. 36, 441 S.E.2d 156, *aff'd per curiam* 340 N.C. 107, 455 S.E.2d 160 (1995); Howell v. Clyde, 127 N.C.App. 717, 493 S.E.2d 323 (1997)
- Not checking plat, incl. marginal notations
- Missed that slayer statute or divorce severed tenancy by entireties

- Failure to provide copies and explain title and closing issues with client
- Missed restrictions, easements, lease or other matters contained in deed
- Failure to check legal description against plat, tax map, survey
- Not providing title opinion (and Bar form exclusions) to client!
- Updating from wrong back policy, or not reviewing the prior policy
- Errors or failure to check variations in names, especially on computerized indexes
- Failing to carry forward exceptions from title notes to title opinion
- Failure to assure title to intended access, maintenance responsibilities
- Failure to check title in all counties in which the property is located (more later)
- Failure to check title to appurtenant easements needed
- A title searcher should review all documents in the chain of title to assure no portion of the property or no restrictions or encumbrance which would affect the property are contained in prior conveyances. Looking only at the index books has led to several claims recently where portions of additional tracts were conveyed, or a metes and bounds description was given which was partially the current lot and partially the adjoining lot. In the case of Stegall v. Robinson, 81 N.C.App. 617, 344 S.E.2d 803 (1986), a set of restrictions and scheme of development encumbering the entire development were contained only in a deed to one of the lots. The principles of Reed v. Elmore, 246 N.C. 221, 98 S.E.2d 360 (1957), were again reaffirmed in Gregory v. Floyd, 112 N.C.App. 470, 435 S.E.2d 808 (1993), in which a "beach" area was held dedicated to other lot owners' use and enjoyment, though the plat was not mentioned in the particular deed.