

**New Jersey
N2K Hour:**

**Ethical
Considerations
for Real Estate
Transactions**

Webex Presentation,
April 21, 2020

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The Unauthorized Practice of Law (UPL)

- The title agent, acting as settlement agent, must be aware of its proper role and, in particular, must be cognizant of the danger of engaging in the unauthorized practice of law (UPL).
- What constitutes UPL can be confusing and determining whether one's conduct crosses the line can be difficult.
- One might say if it looks like a duck, smells like a duck and quacks like a duck, it's UPL. However, a review of some applicable case law may be more relevant than the above and more helpful in reaching a correct conclusion.

The Unauthorized Practice of Law (UPL) (cont.)

*New Jersey State Bar Association v.
Northern New Jersey Mortgage Associates,
32 N.J. 430 (1960) and 34 N.J. 301 (1961)*

- The Facts of the Case: In 1955, the State Bar Association sought to enjoin the Mortgage Associates and Abstract Company from engaging in conduct which allegedly constituted the unauthorized practice of law.

The Unauthorized Practice of Law (UPL) (cont.)

- The title company (1) made mortgages directly as named mortgagee; (2) placed mortgages for other lenders; and (3) insured titles.
- In carrying out these three activities, the title company “customarily drew bonds and mortgages necessary for the purpose of making loans.

The Unauthorized Practice of Law (UPL) (cont.)

- It maintained supplies of deed forms, corporate resolutions, satisfactions of mortgages, etc., “for the convenience of the bar” and would sometimes prepare documents as a “courtesy”.
- The trial judge held that the proofs did not ‘preponderate’ that the title company was practicing law.
- The NJ Supreme Court disagreed with the trial court, holding that the title company was engaging in the practice of law which is “...strictly confined to individual attorneys who have been licensed upon proper showings of character and competency and who are at all times subject to rigid rules of conduct”.

The Unauthorized Practice of Law (UPL) (cont.)

- These restrictions are designed to serve the public interest by protecting “the unwary and the ignorant from injury at the hands of persons unskilled or unlearned in the law”.
- A title company may not participate in the preparation of legal instruments or in the taking of other steps necessary to remove objections to title or cure defects therein.
- While the title company cited statutes that “at least implied” that its activities were authorized; the Supreme Court rejected those arguments stating:

The Unauthorized Practice of Law (UPL) (cont.)

- The New Jersey Constitution of 1947 vests in the Court the exclusive jurisdiction over the admission to the practice of law and that the Legislature may not constitutionally authorize the practice of law by anyone not duly admitted to the bar by this court.

The Unauthorized Practice of Law (UPL) (cont.)

*Cape May County Bar
Association v. John Ludlam,
45 N.J. 121 (1965)*

- The Facts of the Case: John Ludlam like his father and grandfather before him, searched and abstracted titles in Cape May Court House.

The Unauthorized Practice of Law (UPL) (cont.)

- Since his father's death in 1957, he was the sole proprietor of what he called a "title searching and conveyancing business". He admits drawing deeds, notes and mortgages but denies that such acts constitute the practice of law. He is not an attorney.
- Ludlam asserts that the conveyancers profession was recognized under English common law as separate from the practice of law and that public policy in New Jersey recognizes the independent profession of conveyancing.
- The Cape May Bar Association brought suit seeking to enjoin Ludlam's activities.

The Unauthorized Practice of Law (UPL) (cont.)

- The NJ Supreme Court affirmed the judgement enjoining Ludlam from drafting legal instruments and from carrying on a conveyancing business.
- The drafting of legal instruments was prescribed to all but licensed attorneys and Ludlam's performance of these services was the unauthorized practice of law.

The Unauthorized Practice of Law (UPL) (cont.)

*New Jersey State Bar Association v.
New Jersey Association of Realtor Boards,
186 N.J. Super. 391 (1982)*

- The Facts of the Case: A licensed real estate broker was charged with the disorderly persons offense of engaging in the unauthorized practice of law for preparing a contract of sale for a residential real estate transaction he negotiated, and for submitting the contract to the buyer and seller for signature. This litigation followed.

The Unauthorized Practice of Law (UPL) (cont.)

- At the suggestion of the NJ Supreme Court, the NJ State Bar Association filed this class action against the NJ Association of Realtor Boards.
- As the litigation ensued, protracted settlement discussions resulted in the entry of a consent judgment.
- The NJ Supreme Court approved a settlement on the following terms: Licensed realtors shall be permitted to prepare contracts for the sale of residential one to four family homes or vacant one-family lots in transactions in which they have a commission or fee interest.

The Unauthorized Practice of Law (UPL) (cont.)

- Each such contract must contain a clause making the contract subject to review by an attorney for the buyer or seller within three business days.
- If neither buyer nor seller exercises the right to have an attorney review the contract within the time permitted, the contract would be binding as written.
- The parties may agree in writing to extend the time for attorney review.
- The settlement terms also apply to residential leases for a term of one year or longer.

The Unauthorized Practice of Law (UPL) (cont.)

- Except as permitted by the settlement, the practice of preparing contracts or leases continues to be declared the unauthorized practice of law.

Opinion 26

- In re Opinion No. 26, 139 N.J. This Opinion underlines the current practice regarding closing practices in New Jersey.
- The question: Whether brokers and title company officers who guide, control and handle all aspects of residential real estate transactions where neither seller nor buyer are represented by counsel, are engaged in the unauthorized practice of law.
- The following issues were addressed by the Opinion:
 - Closing without an attorney is not the unauthorized practice of law so long as the broker and title officer conform to specific conditions and provide specific disclosures.

Opinion 26 (cont.)

- Disclosure language is intended to warn the consumer of the risks of proceeding without counsel.
- The Opinion was decided based solely on the ‘public interest’; balancing risks and benefits.
- The broker must advise the parties of their right to proceed with counsel and the title officer must insure that the disclosures were given, before conducting a settlement.
- After proper disclosures, a real estate broker may order a title search and abstract and attend to the ministerial functions of preparing to close.

Opinion 26 (cont.)

- A title company may clear standard title objections such as marital status and money liens paid at closing, but not easements, covenants or other serious legal objections.
- Lawyers hired by the broker or title company may not prepare deeds except at the specific request of the party for whom the document is to be prepared.
- “The public interest does not require that the parties be deprived of the right to choose to proceed without a lawyer.”

Opinion 26 (cont.)

- “The record clearly shows that the South Jersey practice has been conducted without any demonstrable harm to sellers or buyers, that it apparently saves money, and that those who participate in it do so of their own free will, presumably with some knowledge of the risk.”
- Consideration must be given to the proper handling of the loan package. In the southern part of the state there may well be no attorney present.

Opinion 26 (cont.)

- In that event at what point does explanation of the closing documents become UPL? The same issue can arise in the north if the buyer's attorney has the title agent go through the package with the lender.
- In either case, if there is a legal question or a legal issue which arises, the title company closer is out of his or her element. In the south, it may be necessary to stop the closing so legal guidance can be obtained.

Opinion 26 (cont.)

- Another situation that often arises involves the necessity of full disclosure to the lender.
- Quite often at closing, the parties will want to make some kind of change which implicates the closing figures which the lender has previously approved.
- This often takes the form of an agreed upon adjustment for inspection issues or may even be a recalculation of an adjustment for taxes or water and sewer.
- Whatever the change is to be, adherence to proper ethics requires that the lender be informed and give approval.

Opinion 26 (cont.)

- Compliance with all of the regulatory guidelines is of course also crucial for settlement agents because of both ethical and practical considerations.
- When the TRID changes were promulgated in conjunction with Dodd Frank several years ago, settlement agents had to learn that procedure.
- The changes also mandated a heightened concern regarding consumer privacy and the use and maintenance of Non-Public Information (NPI). The difficulty in complying with these regulations certainly had an impact on the continuing trend whereby lawyers in the north are utilizing title companies as settlement agents.

Affiliated Business Arrangements

- RESPA prohibits the payment and receipt of fees for the referral of business when no actual services are rendered.
- This prohibition applies to transactions involving residential real estate and includes in its prohibition unearned fees or kickbacks as well as fees for sharing or splitting.
- Terms used in the statute such as “federally related mortgage” and “settlement services” are broadly defined to include virtually every consumer transaction. Commercial transactions are not included in the prohibitions and are generally not the province of federal law.

Affiliated Business Arrangements (cont.)

- The RESPA law does have provisions, however, which provide a “safe harbor” for the creation of Affiliated Business Arrangements. In the title insurance business we are most familiar with these as joint ventures between title agents and realtors.
- The applicable provisions establishing the requirements are as follows:
- Disclosure/notice is given to the consumer at or before the time cash referral is made, in the form prescribed by the regulations.

Affiliated Business Arrangements (cont.)

- The consumer is not required to use any particular provider of settlement services (that is the consumer is not steered or required to use an affiliated entity providing settlement services) and
- The only thing of value received from the arrangement (other than reasonable payments for goods, facilities or services actually furnished) is a return on the ownership interest (such as corporate dividends or LLC distributions, as applicable, in accordance with the owner's percentage ownership interests).
- An Affiliated Business Arrangement Disclosure Statement form, as a separate document, must be developed to comply with the first requirement.

Affiliated Business Arrangements (cont.)

- The RESPA regulations require that this form be given to the consumer within 3 days of the referral and that the form be kept for 5 years.
- The form will need to advise the consumer that the affiliated entity does not have to be utilized which is in accordance with the 2nd requirement.
- The third criteria seeks to ensure that the amount paid to the affiliate is not based on the volume of referrals, which would constitute a sham.

Affiliated Business Arrangements (cont.)

- In addition to the requirements we have just discussed, HUD has promulgated standards to help determine whether the affiliated business is a sham as follows:
 - Is the business sufficiently capitalized and have a sufficient net worth typical in the industry?
 - Does the business have its own employees or does it utilize employees of one of the parent companies of the affiliation?
 - Does the business manage itself or does one or more of the affiliated partners manage the day to day operations of the business?

Affiliated Business Arrangements (cont.)

- Does the business have its own separate office location or is it located at the address of one of the affiliate partners? If so, does it pay market value rent for the space?
- Does the business provide the normal services (sometimes referred to as core services) that are normally provided in the industry?
- Assuming the business provides core services, does it perform them itself or contract them out? Who does it contract them out to? If to a partner of the affiliation, is a fair market price paid?

Affiliated Business Arrangements (cont.)

- Does the business compete in the market place for business other than that which is attributable to the affiliation?
- These guidelines are designed to be utilized to distinguish legitimate arrangements from those which are in fact shams, created only to provide a mechanism to pay referral fees as illegal kickbacks.
- The CFPB has indicated that it believes the guidelines are useful and should be utilized. However, this view is certainly not universal and the actual requirements for establishing a legitimate Affiliated Business Arrangement are not entirely clear.

Affiliated Business Arrangements (cont.)

- In fact, the Sixth Circuit in the case of *Carter v. Welles-Bowen, Realty Inc.*, 736 F2nd 732 (2013) specifically refused to enforce HUD's 10 factor Affiliated Business Arrangement Policy Statement.
- The case involved a challenge by a putative class of consumers to an affiliated business of a realtor and the title underwriter.
- The plaintiffs conceded that the entity met the 3 point test of the statute itself (Section 8(c) 4) but that it failed to meet the 10 factor test which was necessary in order not to be categorized as a sham.

Affiliated Business Arrangements (cont.)

- The CFPB was on the brief with the DOJ, defending the 10 point test promulgated by HUD in 1996.
- The Court upheld the findings of the District Court decision that HUD's policy statement was "unconstitutionally vague" in that it did not state how the factors were to be weighed and how many had to be met.
- The Court concluded that what was required was that the entity meet the three pronged test of the statute:
 1. Disclosure
 2. Consumer can't be forced to use entity.
 3. Distributions are based on percentage of ownership.

Summary

- From both an ethical and legal standpoint, the settlement agent must be aware of its proper role in the process.
- Unauthorized Practice of Law issues often arise and the settlement agent must defer to the attorney. In south jersey, it may be necessary to stop a closing to enable the parties to consult an attorney.
- The appropriate conduct of the settlement agent is crucial to protect the interest of the consumer, including the proper handling of non-public information.
- The provisions of Opinion 26 constitute the state of the law regarding closings without lawyers.

Summary (cont.)

- The creation of legitimate Affiliated Business Arrangements provide a safe harbor regarding the illegal and unethical payments of referral fees.
- The appropriate creation and structure of an affiliated business arrangement is not entirely clear and is subject to change.

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