

**New Jersey  
N2K Hour:**

**Ethical  
considerations  
for Real Estate  
Transactions.**

**Webinar Presentation:  
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# The Unauthorized Practice of Law (UPL)

- Title Insurance Companies and their Agents are expressly prohibited by the Title Insurance Act from engaging in the “practice of law”:
- **N.J.S.A. 17:46B-13** states the following: No title insurance company and no title insurance agent shall engage in the practice of law or render legal services, legal advice or legal opinions. Nothing in this act shall be construed to permit or authorize acts by a title insurance company or title insurance agent which may now or hereafter be prohibited by the Supreme Court of the State of New Jersey.

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

- **N.J.S.A. 2C:21-22** makes the Unauthorized Practice of Law (UPL) a crime. It states the following:
  - 1.a. A person is guilty of a crime of the fourth degree if the person knowingly engages in the unauthorized practice of law.
  - 1.b. A person is guilty of a crime of the third degree if the person knowingly engages in the unauthorized practice of law and: (1) Creates or reinforces a false impression that the person is licensed to engage in the practice of law; or (2) Derives a benefit; or (3) In fact causes injury to another.

# 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.
- Although it is not often clear and despite the words in the Title Insurance Act, it may be difficult to know when one is crossing the line; however, a review of some applicable case law may be relevant and 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 title company (1) made mortgages directly as named mortgagee; (2) placed mortgages for other lenders and issued title on those loans; and (3) insured titles.

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

- In carrying out these activities, the title company customarily drew bonds and mortgages necessary for the purpose of making loans.
- 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. He declined to grant injunctive relief and dismissed the complaint against the title company.

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

- 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 the proper showings of character and competency and who are at all times subject to rigid rules of conduct”.
- 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.

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

- The New Jersey Constitution of 1947 vests in the Court the exclusive jurisdiction over the admission to 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.
- Although beyond the scope of today's webinar, to find the NJ court rules governing the practice of law, please see NJ Court Rule 1:21.



# 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 (“Ludlam”) like his father and grandfather before him, searched and abstracted titles in Cape May Court House.
- Since his father’s death in 1957, Ludlam 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.

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

- 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 NJ Supreme Court affirmed the judgment enjoining Ludlam from drafting legal instruments and from carrying on a conveyance business.
- The drafting of legal instruments was proscribed 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 a 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, and of course, litigation followed.
- At the suggestion of the NJ Supreme Court, the NJ State Bar Association filed this class action against the NJ Association of Realtor Boards.

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

- 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 of sale of residential one to four family homes or vacant one-family lots in transactions in which they may earn a commission or fee.
- 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.

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

- If neither buyer or 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.
- Except as permitted by the settlement, the practice of preparing contracts or leases continues to be declared the unauthorized practice of law.

## Opinion 26

- The opinion set-forth in the case of *In re Opinion No. 26*, 139 N.J. 323, underlines the current practice regarding closing practices in New Jersey.
- **The question presented**: Whether brokers and title company officers who guide, control and handle all aspects of residential real estate transactions, where neither seller or buyer are represented by counsel, are engaged in the unauthorized practice of law.
- The following issues were addressed in Opinion 26:
  1. Closing without an attorney is not the unauthorized practice of law so long as the broker and the title officer conform to specific conditions and provide specific disclosures.

## Opinion 26 (cont.)

2. Disclosure language is intended to warn the consumer of the risks of proceeding without counsel.
3. The Opinion was decided based solely on the 'public interest'; balancing risks and benefits.
4. 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 the settlement.
5. 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.)

6. A title company may clear standard title objections such as marital status issues and money liens paid at closing, but not issues such as easements, restrictions, covenants, or other serious legal objections.
7. 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.
8. “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 Court stated that “The record clearly shows that the South Jersey practice has been conducted without any demonstrable harm to sellers and 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.”
- **Important questions for the Settlement Agent:**
  - 1. Has the Notice Requirement under Opinion 26 been met?
  - 2. What if a serious title objection arises at closing and the parties are not represented by Counsel?
  - 3. Have you been asked to prepare documents or to recommend an Attorney?

## Opinion 26 (cont.)

- 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.
- 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 will be out of his or her area of competency. In the southern NJ closing, 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 involves 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 or 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

- Despite the many prohibitions set-forth in Section 8 of the RESPA law, Section 8 does permit the creation of Affiliated Business Arrangements as long as certain “safe harbor” provisions are met.
- In the title insurance business, we are most familiar with these as joint ventures between title agents and realtors, or mortgage lenders, or developers.
- The applicable “safe harbor” requirements are as follows:
  - A. Disclosure must be given to the consumer describing the existence of the affiliated arrangement at or before the time the referral is made, in the form prescribed by the regulations.

## **Affiliated Business Arrangements**

- B. The consumer must not be 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
- C. The only thing of value received from the arrangement is a return on the ownership interest (such as corporate dividends or LLC distributions as applicable, in accordance with owner's percentage ownership interest).
- An Affiliated Business Arrangement Disclosure Statement form, as a separate document, must be executed by the consumer and kept in the agent's file.

# Affiliated Business Arrangements

- 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 must advise the consumer that the consumer is not required to engage the affiliated entity for title purposes.
- Criteria C. seeks to ensure that the amount paid to the affiliate is not based on the volume of referrals, which could constitute a sham enterprise.



# Affiliated Business Arrangements

- In addition to the RESPA Section 8 “safe harbor” provisions, HUD has promulgated standards to help determine whether an affiliated business is a legitimate business or a sham enterprise:
  1. Is the business sufficiently capitalized and have a sufficient net worth typical in the industry?
  2. Does the business have its own employees or does it utilize employees of one of the parent companies of the affiliation?
  3. 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

4. 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?
5. Does the business provide the normal services (sometimes referred to as core services) that are normally provided in the industry?
6. 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

7. 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

- 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 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

- 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 cannot be forced to use entity, and 3. Distributions are based on the percentage of ownership.

## Summary

- From both an ethical and legal standpoint, the settlement agent must be aware of its proper role in the process.
- A settlement agent must not prepare settlement documents or give legal opinions regarding the effects or consequences associated with policy exceptions or coverage provisions.
- Unauthorized Practice of Law issues often arise and the settlement agent must be prepared to defer to the attorney. In a South Jersey style closing, it may be necessary to stop a closing to enable the parties to consult with legal Counsel.

## Summary

- The provisions of Opinion 26 constitute the state of the law regarding closings without lawyers.
- 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; however, the proposed HUD considerations are an important guide.

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