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# TRANSFERRING NORTH CAROLINA REAL ESTATE

## PART II: ROLES, ETHICS, AND REFORM

DALE A. WHITMAN\*

As we have seen in Part I of this article,<sup>1</sup> prevailing practices in the transfer of North Carolina real estate are seriously deficient in their substantive protection of the buyer. Part II will explore whether these practices also violate the norms of professional conduct and will conclude with some proposals which should ameliorate both the substantive and ethical deficiencies which face the real estate buyer. Before doing so, however, it seems appropriate to discuss in some detail the roles of various actors in the typical transaction and the types of persons who fill those roles.

### ROLES IN REAL ESTATE TRANSACTIONS

If *A* and *B* agree that *B* is to buy *A*'s land for a determined price, there is nothing to prevent them from concluding the transaction without any outside aid. But such transactions seldom occur. Instead, because the parties are likely to have limited time, funds, and expertise, a variety of professionals and businessmen are likely to intervene. The functions to be served by these individuals may be catalogued as follows:

1. *The finding function.* Although *A* may own and wish to sell precisely the real estate that *B* would like to buy, the chances of their meeting in the marketplace are small without outside help. This market-assistance function may be served by an employee of either party, but more frequently it is fulfilled by an employee of the seller if he is, for example, a builder of tract houses. Probably the most common marketing intermediary is the licensed real estate broker or his employee, the licensed salesman. Attorneys are also entitled to perform this function<sup>2</sup> and do

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<sup>1</sup> Whitman, *Transferring Real Estate in North Carolina, Part I: How the System Functions*, 49 N.C.L. REV. 413 (1971) (hereinafter cited as *Part I*).

<sup>2</sup> N.C. GEN. STAT. § 93A-2(c) (1965). However, an attorney who runs both a brokerage service and a law practice from the same office or who uses one practice to feed clients to the other would run afoul of the ethics committee. N.C. STATE BAR COUNCIL, OPINIONS, No. 399 (1962), reported, THE NORTH CAROLINA STATE BAR,

so occasionally, but they are more likely to be active in high-dollar commercial transactions than in housing sales.

2. *The lending function.* Commonly, *B* will not have sufficient cash to pay the full purchase price for *A*'s property. He may seek financing directly from *A* in the form of a long-term installment sale contract or by paying part of the purchase price to *A* in the form of a promissory note, which *A* will probably require to be secured by a deed of trust on the land. Whether the seller will be interested in assisting the buyer's financing of the purchase depends principally on the seller's current needs for cash and his ability to take advantage of the potential tax saving arising from the deferral of the gain on the sale.<sup>3</sup> In the majority of cases, *A* prefers to realize his full gain immediately; so unless there is an existing loan which *B* wishes to assume or take subject to, *B* must seek financing from a third-party source. The commercial lenders most active in North Carolina are savings and loan associations, mortgage bankers, and commercial banks (probably in that order, although their relative proportions of activity in the market tend to vary widely with changes in the money market).<sup>4</sup> A loan from such a commercial institution will probably be evidenced by a promissory note secured by a deed of trust.

3. *The title assurance function.* *B* may be satisfied by *A*'s bare statement that the title being transferred is "clear," or *B* may require that *A* make explicit representations about the state of title in some form of warranty deed. But in North Carolina it is customary (except, perhaps, in loan-assumption transactions)<sup>5</sup> for the buyer to obtain an attorney's title search, a requirement which will be imposed by virtually every third-party lender even if the buyer himself prefers to forego it. Spurred on by the unmarketability of lawyer-searched mortgages in the national secondary market,<sup>6</sup> lenders are increasingly requiring title insurance as

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STATUTES, RULES AND REGULATIONS, CANONS OF ETHICS AND OPINIONS II-97 (Melott ed. 1970) [hereinafter cited respectively as N.C. OPINIONS and Melott].

<sup>3</sup> INT. REV. CODE of 1954, § 453; P. ANDERSON & R. WILSON, TAX PLANNING OF REAL ESTATE 107-19 (1968).

<sup>4</sup> As the money supply tightens, commercial banks tend to withdraw from mortgage lending and to seek the more profitable consumer and business loans. See Martin, *A Case for Regulation Q*, 3 J. FED. HOME LOAN BANK BOARD 1 (Oct. 1970).

<sup>5</sup> Real estate salesmen commonly advise purchasers who assume existing loans to obtain only a "limited search"—i.e., one covering the period since the loan was made. Letter to Louis C. Allen, Jr. from Herbert L. Toms, Jr., President, First Title Insurance Co., Dec. 15, 1970. In some cases, assuming buyers probably forego any title search as an economy measure.

<sup>6</sup> See Hunter, *Fannie Mae—Lady on a Tightrope*, 50 TITLE NEWS 12, 13 (No. 1, 1971).

a backstop for the lawyer's search. Note carefully that, in every title search, the state plays an important role by providing a depository of public records.

4. *The closing function.* The consummation of a real estate transaction is apt to be quite complicated. There may be existing encumbrances to be discharged; prorations of taxes, insurance, rents, and the like to be computed; fees and charges to be made; and signatures on various papers to be obtained. If *A* and *B* are knowledgeable, they may be able to work out all of these matters without outside help, but it is more likely that they will use the services of the same attorney who made the title search to handle the closing.

5. *The advisory function.* Because of the complexity of most real estate transactions and the infrequency with which ordinary citizens enter into them, both *A* and *B* may need advice about the legal, financial, and practical consequences of the transaction to them. For several reasons, *B*'s need for such advice is usually considerably more serious than *A*'s. The incidence of any title defect will fall most directly and immediately upon *B*. When a new loan is being made, it is *B* who assumes new financial responsibilities. Moreover, *B* may be entering into such a transaction for the first time in his life, while *A* probably has had at least one prior experience in the real estate market.

Who will give the advice *B* needs? The initial impulse is to nominate the lawyer for this task. He is likely to be able to discuss both financial and legal problems with the buyer, and his position in the transaction seems, on its face, most closely aligned with the buyer himself. In reality, the lawyer makes only a meager contribution to the advisory function in most transactions.<sup>7</sup> However, both the broker and lender also give the buyer some advice. Of all the functions in the transaction, it is the function of giving competent advice which is most likely to go unfilled. The discussion below will show why this is so.

#### ETHICAL PROBLEMS

The major ethical issues in the area of real estate transactions may be conveniently divided into three types: first, fee-cutting by lawyers; second, the activities of non-lawyer professionals, principally realtors, which have been thought by the bar to constitute the unauthorized practice of law; and third (and least discussed by the bar itself) the conflicts

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<sup>7</sup> See generally *Part I*.

of interest which beset the lawyer who purports to represent more than one party to a transaction.

It is not easy to imagine a more flagrant form of economic self-protectionism than that represented by minimum fee schedules for real estate transactions. Such schedules, usually adopted by county bar associations and then approved by the relevant district bar organizations, appear to be nearly universally operative in North Carolina; ninety-nine percent of the real estate lawyers responding to the questionnaire distributed as part of the research for this article<sup>8</sup> stated that they were aware of such a schedule in their locales. The leaders of the organized bar have generally considered consistent under-cutting of the schedules an unethical practice and have made from time to time what can be fairly described as threats of disciplinary action against non-conforming attorneys.<sup>9</sup> Such action appears to be fairly widespread; twenty-three percent of the lawyers answering the questionnaire knew of local cases of actual or threatened discipline for non-compliance with real estate fee schedules.

Whether non-conformance is in reality unethical has not yet been decided, for the ultimate authority to define unethical behavior rests in the North Carolina Supreme Court,<sup>10</sup> which has never decided a case involving minimum fee schedules. Pending such a decision, two lines of authority appear relevant to a discussion of the ethical question: the opinions of the Committee on Professional Ethics of the American Bar Association and the ethics opinions of the Council of the North Carolina State Bar. Neither set of opinions is binding upon the supreme court although it seems likely that the North Carolina State Bar's opinions would be given greater weight by the Court since the State Bar Council is vested with statutory authority to discipline practicing attorneys, subject to judicial review.<sup>11</sup>

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<sup>8</sup> The questionnaire was mailed to nearly one thousand attorneys, believed to include every active practitioner in nine selected North Carolina counties. About four hundred replies were received; of these replies, 197 were sufficiently complete to be usable. See *Part I* at nn.11-14.

<sup>9</sup> See, e.g., letter to members of Wake County Bar Association from R. C. Howison, Jr., president, Dec. 3, 1968, stating the association's intention to take disciplinary action against any attorney who deliberately and repeatedly violates the fee schedule.

<sup>10</sup> The State Bar Council has power to promulgate rules and canons of professional ethics and conduct, N.C. GEN. STAT. § 84-23 (1965), and to hear charges and administer punishment for violations, N.C. GEN. STAT. § 84-28 (1965), subject to the respondent attorney's right to appeal to the state judicial system. See, e.g., *North Carolina State Bar v. Frazier*, 269 N.C. 625, 153 S.E.2d 367 (1967); *In re Burton*, 257 N.C. 534, 126 S.E.2d 581 (1962).

<sup>11</sup> See statutes cited note 10 *supra*.

The two sets of opinions present an interesting contrast, particularly since, with the exception of the most recent ABA opinion,<sup>12</sup> they both purport to be derived essentially from Canon 12 of the Canons of Ethics, which reads identically in the ABA and North Carolina versions.<sup>13</sup> The text of the canon includes a list of six factors which "it is proper to consider" in fixing the amount of a fee; one such factor is "the customary charges of the Bar for similar services." The canon also provides:

In determining the customary charges of the Bar for similar services, it is proper for a lawyer to consider a schedule of minimum fees adopted by a Bar Association, but no lawyer should permit himself to be controlled thereby or to follow it as his sole guide in determining the amount of his fee.<sup>14</sup>

The early ABA opinions took the quoted language quite literally and held that no minimum fee schedule could be obligatory on the individual lawyer. This view reached its apogee in 1939 when the ABA Committee observed that although full freedom to set fees might result in inadequate compensation, resultant reductions in the quality of legal services and injury to the profession and the administration of justice, "[t]here appears to be no remedy for the situation because a lawyer has the right to contract for any fee he chooses so long as it is not clearly excessive."<sup>15</sup> By 1961, the ABA Committee had substantially retreated from the position described above. The committee gave lip service to the language of Canon 12, but it concluded that "[t]he habitual charging of fees less than those established in suggested or recommended minimum fee schedules, or the charging of such fees without proper justification, may be evidence of unethical conduct. . . ."<sup>16</sup> An informal decision of the ABA Committee in 1962<sup>17</sup> and the most recent formal opinion on the subject, issued in 1970,<sup>18</sup> appear to take a similar course. They state that

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<sup>12</sup> ABA OPINION No. 323 (1970), *reported*, 56 A.B.A.J. 1087 (1970). This opinion is based on the new ABA Code of Professional Responsibility—specifically, Ethical Consideration 2-18 and Disciplinary Rule 2-106. But there is nothing to suggest that an opinion based on Canon 12 would have differed.

<sup>13</sup> ABA CANONS OF PROFESSIONAL ETHICS No. 12 (the ABA CANONS have been replaced by the CODE OF PROFESSIONAL RESPONSIBILITY); NORTH CAROLINA CANONS OF PROFESSIONAL ETHICS No. 12, *reported*, Melott VI-26 [hereinafter cited as N.C. CANONS].

<sup>14</sup> N.C. CANON No. 12, note 13 *supra*.

<sup>15</sup> ABA COMM. ON PROFESSIONAL ETHICS, OPINIONS, No. 190 (1939) [hereinafter cited as ABA OPINIONS]. Earlier formal opinions on the point include ABA OPINION No. 28 (1930), and ABA OPINION No. 171 (1937).

<sup>16</sup> ABA OPINION No. 302 (1961).

<sup>17</sup> ABA INFORMAL OPINION No. 585 (Aug. 16, 1962).

<sup>18</sup> ABA OPINION No. 323, *supra* note 12.

setting fees below the minimum schedule is never of itself a sufficient cause for disciplinary action; but that the practice may be evidence of unethical behavior; and that this evidence is admissible, if coupled with extrinsic evidence of an unethical purpose, for the purpose of attempting to prove unethical conduct. The committee does not suggest what "extrinsic evidence" might be pertinent or what particular kind of "unethical purpose" is suggested by reducing fees below the customary schedule. Yet without such evidence, even an habitual failure to follow the fee schedule cannot, in the current committee's judgment, afford a basis for disciplinary action.

It is not easy to divine from the ABA opinions the nature of the impropriety that fee-cutting is supposed to evidence. The principal fear expressed by the committee has been a reduction in the quality of services performed. Thus, an attorney charged with unethical fee-cutting might well make a defense in the ABA view by showing that the services rendered had been of high quality despite the low fee charged. In the last paragraph of its 1970 opinion, the committee makes quite explicit its disapproval of the efforts of local bar officials to enforce fee schedules against unwilling members:

[T]he Committee hopes that . . . the practice on the part of certain state and local bar associations of suggesting that fee schedules are or can be mandatory and that disciplinary action will be taken merely for failing to follow them, absent other evidence of misconduct, will be abandoned once and for all.<sup>19</sup>

The opinions of the North Carolina State Bar Council are far more strict on the matter of minimum fee schedules than the ABA opinions discussed above. Again, the early opinions are "soft" on non-compliance; in 1955 the Council thought the schedules were "not . . . obligatory,"<sup>20</sup> and in 1957 it held that while members "should conform," "there is no Canon of Ethics . . . requiring them to do so."<sup>21</sup> But beginning in 1959, the Council has consistently held that deliberate and repeated under-cutting of the fee schedule is unethical as an improper form of solicitation of business.<sup>22</sup> The Counsel's most elaborate opinion,<sup>23</sup> issued in 1968, praised

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<sup>19</sup> *Id.*

<sup>20</sup> N.C. OPINION No. 158 (1955), Melott II-28.

<sup>21</sup> N.C. OPINION No. 211 (1957), Melott II-43.

<sup>22</sup> N.C. OPINION No. 630 (1968), Melott II-173; N.C. OPINION No. 496 (1965); Melott II-128; N.C. OPINION No. 372 (1962), Melott II-86; N.C. OPINION No. 287 (1959), Melott II-63; N.C. OPINION No. 278 (1959), Melott II-61. Some other state ethics committees have reached a similar conclusion. See

at great length the bar's practice of establishing minimum schedules and held that an attorney who refused to charge a subdivider the minimum fee of forty dollars per lot for handling construction loans was guilty of an unethical practice, despite the attorney's defense that, in a large subdivision with several dozen or perhaps several hundred lots, such a fee would be excessive. Again the Council used the "solicitation-of-business" rationale for its decision: it observed that "such action is done for the purpose of obtaining, or retaining, the legal business of the client rather than conforming to Canon 12."<sup>24</sup>

This statement is truly mind-boggling. Every practitioner knows that each decision on the billing of clients is made for the purpose of retaining the client's business; indeed, Canon 12 announces that "The character of the employment, whether casual or for an established and constant client," is one of the factors properly to be considered in fixing fees.<sup>25</sup> Apparently Canon 12 no longer means what it specifically says—that "no lawyer should permit himself to be controlled" by a minimum fee schedule.<sup>26</sup> The State Bar Council has done a thorough and impressive job of erasing Canon 12.

But does any of this matter? Is it likely that the fees actually charged would be materially different if minimum fee schedules were considered as merely advisory by all members of the Bar? Probably not. Our questionnaire respondents did not regard their real estate work as a high-profit operation even though nearly all of them billed at least as high as the minimum fee schedule amount.<sup>27</sup> Nearly half of them felt that single-

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Woleslagel, *Price Cutting for Legal Services as a Violation of Legal Ethics*, 35 KAN. B.A.J. 19 (1966).

<sup>25</sup> N.C. OPINION No. 630 (1968), Melott II-173.

<sup>24</sup> *Id.*, Melott II-175.

<sup>26</sup> N.C. CANON No. 12, Melott VI-26.

<sup>27</sup> *Id.*, *But cf.* new page SS-2.1, HANDBOOK ON OFFICE MANAGEMENT AND FEES, approved by the Board of Governors of the North Carolina Bar Ass'n, which states: "H. The attorney, in his discretion, may reduce the fee computed under A above by 20% when the examination covers a lot in a subdivision consisting of 25 or more lots." NORTH CAROLINA BAR ASS'N, BAR NOTES, Feb. 1971, at 90. Even such a reduced rate might actually be an overcharge where the attorney is working on a large subdivision.

Furthermore, it should be noted that the North Carolina Bar Association is a voluntary group in which approximately ninety percent of North Carolina attorneys hold membership. Its schedule of minimum fees are recommendations only. Ethical standards are promulgated and discipline is enforced by the North Carolina State Bar, a statutory agency in which membership is required as a prerequisite to practice in the state. Opinion 630 was issued by the latter.

<sup>27</sup> No attorney stated that he used a personal schedule lower than the bar's in single-family-home work, and ninety percent stated that they followed the bar schedule. The remainder used a higher schedule, an hourly rate, or some other method. In



family-home-purchase work was presently less profitable than other phases of law practice, and even non-single-family work was considered more profitable by only about one-fourth of the respondent attorneys.

Also significant are the direct expressions of opinion by the questionnaire respondents. About thirty-five percent of the attorneys felt that their local fee schedules were either too low or too inflexible, while only two percent thought them too high in amount, and about two-thirds of the attorneys thought they were about right. Although only fifty-three percent of the attorneys regarded the schedules as legally binding (a point on which a large minority evidently disagrees with the State Bar Council), nearly ninety percent thought that they were morally binding, and ninety-eight percent thought it in the best economic interest of attorneys to follow them in most or all cases. Thus, aside from special cases where greater flexibility is needed, the schedules would probably be followed quite consistently even if they did not purport to be legally enforceable.

One area in which many existing fee schedules badly need greater flexibility is that involving minimum-fee requirements for work performed in connection with construction loans. Flexibility is needed, for example, when an attorney is representing a subdivider who is building one hundred houses on separate lots carved out of a single piece of acreage. If in this situation the construction lender requires a separate loan, secured by an independent deed of trust, to be arranged for each lot, the attorney supposedly must charge the minimum fee for each loan. By contrast, if the lender is willing to take a blanket deed of trust with a partial release provision as security for a single large construction loan, the attorney is free under the typical fee schedule to make whatever charge (above the single-loan minimum) he feels is appropriate—perhaps several hundred dollars—but, in any event, a charge much lower than the aggregate of the fees if there were individual construction loans on each lot.

Of course, the amount of work for the attorney is somewhat greater where an individual construction loan on each lot is involved, but the additional work is probably far too small an increment to justify the fee required by the bar schedule.<sup>28</sup> Here, at least, is an area in which the practice would probably change sharply if the bar were to abandon its minimum-fee enforcement efforts. And since the builder must pass on

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other types of real-estate transactions, the methods used were more varied, but only one percent of the attorneys used a schedule lower than the bar's.

<sup>28</sup> This was precisely the attorney's argument rejected by the Bar Council in N.C. OPINION No. 630 (1968), Melott II-173.

his legal expense to the home buyer in the form of increased housing prices, the present system results in an effective subsidy for lawyers at the expense of individual consumers of housing—a subsidy which cannot be justified as being based on sound public policy.

County-wide or district-wide minimum fee schedules create an additional problem: the jurisdiction-hopping lawyer. Few individual home buyers are likely to take advantage of this lawyer's services, but he has great attraction to subdividers and other purchasers of commercial property. Suppose a developer doing business statewide desires to subdivide land in Wake County. If the minimum fee schedule in that county seems excessively high, what will prevent him from retaining an attorney in Mecklenburg County who will travel to Raleigh, handle the title work, and bill on the basis of the Mecklenburg fee schedule? This practice is quite widespread; twenty percent of the lawyers responding to our questionnaire knew of such cases. The usual minimum fee schedule makes no reference to the problem, so it is difficult to determine whether such a practice is technically unethical. The licensed attorney is ordinarily entitled to practice anywhere within the state, and if he is willing to take the additional time which may be required to familiarize himself with the land records of a strange county, there can be no objection to his working there. But the following question is still unanswered: Does the minimum fee schedule "run with the land" or is it binding only on attorneys who normally practice within the jurisdiction where the real estate is located?

A more objectionable, but less frequent, practice is the importation into North Carolina by out-of-state land buyers of their home-state attorneys to search titles in North Carolina.<sup>29</sup> Although the law is not yet clear in the general area of out-of-state practice,<sup>30</sup> it ought to be regarded as unauthorized in the title-search area. It is one thing to say that a lawyer from Charlotte is competent to search titles in Wake County and quite another to say that a lawyer from New York or Chicago can adequately do so. Title records and practices simply vary too much from state to state. The fact that the client knows his lawyer is not admitted to practice in North Carolina is immaterial; one purpose of the unauthorized practice concept is to protect erstwhile clients from themselves.

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<sup>29</sup> Only two percent of our questionnaire respondents indicated that they knew of cases in which out-of-state attorneys had been brought in to do title work.

<sup>30</sup> See Nahstoll, *Freedom to Practice Law in Another State*, 55 A.B.A.J. 57 (1969); Note, *Unauthorized Practice Statutes and the Rights of Out-of-State Attorneys*, 40 S. CAL. L. REV. 569 (1967); Note, *Practice of Law by Out-of-State Attorneys*, 20 VAND. L. REV. 1276 (1967).

Perhaps the most hotly contested ethical issue in real estate law in recent years has been the allegation of the bar that certain functions performed by real estate brokers and salesmen constitute unauthorized practice of law.<sup>81</sup> In a purely technical sense, it can hardly be questioned that the broker who prepares contracts of sale for the signature of laymen is practicing law. The brokers respond to this contention by claiming that there is a virtual necessity for them to have the power to bind in writing parties who have reached an oral agreement;<sup>82</sup> they feel, probably quite accurately, that if an attorney must review the contract before it is executed, delay and lost sales will result.

Most of the cases decided recently on this issue have held that brokers may properly fill in printed contract forms and submit them for the parties' signatures.<sup>83</sup> A few cases have gone further and allowed brokers to prepare deeds and mortgages as well.<sup>84</sup> The Arizona Supreme Court took an unusually restrictive view disallowing even the completion of contract forms by realtors,<sup>85</sup> but the decision was overturned by the voters in a constitutional amendment which appears to give the brokers very broad powers to draft all instruments incident to real estate sales.<sup>86</sup>

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<sup>81</sup> See *State Bar v. Arizona Land Title & Trust Co.*, 90 Ariz. 76, 366 P.2d 1 (1961); *Chicago Bar Ass'n. v. Quinlan & Tyson, Inc.*, 34 Ill. 2d 116, 214 N.E.2d 771 (1966); *State v. Indiana Real Estate Ass'n.*, 244 Ind. 214, 191 N.E.2d 711 (1963); Baier, *The Developing Principles in the Law of Unauthorized Practice re Real Estate Brokers*, 9 ST. LOUIS U.L.J. 127 (1964); Resh, *The Role of the Lawyer and the Realtor in Real Estate Transactions*, 33 UNAUTH. PRAC. NEWS 29 (No. 3, 1967).

To a lesser extent the unauthorized-practice charge has been made against escrow companies [see *Oregon State Bar v. Security Escrows, Inc.*, 377 P.2d 334 (Or. 1962)] and title insurers [see Balbach, *Title Assurance: A New Approach to Unauthorized Practice*, 32 UNAUTH. PRAC. NEWS 15 (No. 4, 1966); Payne, *Title Insurance and the Unauthorized Practice of Law Controversy*, 53 MINN. L. REV. 423 (1969); Payne, *Title Insurance, the Legislatures and the Constitution*, 35 UNAUTH. PRAC. NEWS 1 (No. 1, 1969); Annot., 85 A.L.R.2d 184 (1962)].

<sup>82</sup> Since this argument obviously does not have great public appeal, the realtors' promotional literature has emphasized the saving of expense if no lawyer is required. See, e.g., *Reasons Why You Should Vote Yes on Proposition No. 103*, 28 UNAUTH. PRAC. NEWS 257 (1962). See also Nelson, *Drafting of Real Estate Instruments: The Problem from the Standpoint of the Realtors*, 5 LAW & CONTEMP. PROB. 57 (1938).

<sup>83</sup> See cases cited note 31 *supra*. The older cases are collected by the court in *State v. Indiana Real Estate Ass'n.*, 244 Ind. 214, 191 N.E.2d 711 (1963).

<sup>84</sup> See *Conway-Bogue Realty Inv. Co. v. Denver Bar Ass'n.*, 135 Colo. 398, 312 P.2d 998 (1957); *Ingham County Bar Ass'n v. Walter Neller Co.*, 342 Mich. 214, 69 N.W.2d 713 (1955); *State ex rel. Reynolds v. Dinger*, 14 Wis. 2d 193, 109 N.W.2d 685 (1961).

<sup>85</sup> *State Bar v. Arizona Land Title & Trust Co.*, 90 Ariz. 76, 366 P.2d 1 (1961).

<sup>86</sup> The amendment and the problems it raises for brokers are discussed in Bernstein, *The Arizona Realtors and the 1962 Arizona Constitutional Amendment*, 29 UNAUTH. PRAC. NEWS 169 (1963).

Under the present North Carolina practice, the broker or salesman almost invariably prepares the contract, but deeds and deeds of trust are usually provided by the attorney. While a deed may seem superficially more "legalistic" than a contract, and thus more in need of a lawyer's attention, the realities of the situation are precisely to the contrary. There are no published North Carolina decisions commenting on this practice, but other courts have evaluated the practice. The opinion of Justice Underwood, dissenting in *Chicago Bar Association v. Quinlan and Tyson, Inc.*, put the matter aptly:

Actually, the contract between the parties is the fundamental instrument in a real-estate transaction and determines their future rights and obligations. It seems to me somewhat anomalous to permit the broker to prepare the controlling agreement but not those which it controls. Be that as it may, the practical result of this decision will be a binding contract executed by the parties without informed consideration of the serious questions involved. . . .<sup>37</sup>

Nearly every attorney who takes seriously an obligation to represent buyers of real estate has encountered executed contracts, prepared by brokers and salesmen, which made him bite his tongue and fervently wish that he could have advised his client before the contract was signed. The buyer's position is further endangered by the common North Carolina practice whereby neither the broker nor the lawyer assumes any genuine obligation to represent the buyer.<sup>38</sup>

A number of real estate lawyers responding to our mail questionnaire commented that the brokers should not be allowed to prepare real estate sales contracts. Such a flat prohibition might be an attractive mode of reform if the attorneys were willing to take a solid role in representation of property buyers. But, as a practical matter, the political power of the brokers is almost surely sufficient to obstruct such an effort. A more viable approach, described in detail below,<sup>39</sup> is a cooperative effort between

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<sup>37</sup> 34 Ill. 2d at 124-25, 214 N.E.2d at 776.

<sup>38</sup> On the lawyer's representation, see generally *Part I*. The broker has some duty of representation to the party who employed him. See *Eastburn v. Joseph Espalla, Jr. & Co.*, 215 Ala. 650, 112 So. 232 (1927); *Carver v. Lykes*, 262 N.C. 345, 137 S.E.2d 139 (1964); NATIONAL ASSOCIATION OF REAL ESTATE BOARDS, INTERPRETATIONS OF THE CODE OF ETHICS 73 (1963) (Article 11). In most cases the employing party is the seller. The position of a broker who did not procure the original listing, but who secures a buyer and shares the commission by virtue of a multiple-listing agreement, is ambiguous as to representation. Article 13 of the NAREB Code of Ethics implies that a broker may not simultaneously represent conflicting parties.

<sup>39</sup> See text at notes 108-09 *infra*.

the organized associations of lawyers and realtors to fairly apprise property buyers of the serious nature of the contract and their need for an attorney before signing.

The most serious ethical issue raised by the typical real estate transaction is the conflicting role assumed by the attorney himself. Consider the following observation by the president of a title insurance company to its approved attorneys:

All of us know that a certifying attorney in North Carolina is placed in an almost impossible situation. The real estate salesman or developer often sends the matter to the attorney and he feels that the attorney is representing the seller. We like to think that the attorney is representing the lender and the title insurance company. Finally, the purchaser is paying the fee and thinks he is the client.<sup>40</sup>

Do attorneys in ordinary single-family home transactions believe that they represent more than one party? The responses received to our questionnaire suggest that they do,<sup>41</sup> but it is strongly arguable that the attorneys' opinions on the point are immaterial. It is manifestly true that the single attorney who usually handles such a transaction in fact performs services for at least two of the parties, the buyer and the lender, and frequently serves the seller as well. Even in the frequent cases in which no title certificate is sent to the buyer and the attorney clearly represents the lender,<sup>42</sup> the work of preparation and recordation of the deed and the computation of prorations and disbursements seems enough to constitute the buyer a client of the attorney. No lengthy demonstration should be required to establish that the three principal parties—the seller, the buyer, and the lender—in fact have conflicting interests, although the discussion below will explore the nature and depth of the conflicts.

But an attorney who represents conflicting parties is not necessarily guilty of an unethical practice. State Bar Canon of Ethics 6 states, "It is

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<sup>40</sup> Letter to approved attorneys from Herbert L. Toms, Jr., President, First Title Insurance Company, June 4, 1970.

<sup>41</sup> The questionnaire asked: "In the typical single-family home purchase in which you are the only attorney, whom do you regard as your clients? (Check more than one if applicable)."

The responses were as follows:

Seller—21.5%  
 Buyer—88.7%  
 Broker—5.1%  
 Lender—33.3%

Since the responses total nearly 150 percent, plainly many attorneys regarded themselves as representing two or more parties.

<sup>42</sup> See *Part I* at n.70.

unprofessional to represent conflicting interests, except by express consent of all concerned given after a full disclosure of the facts."<sup>43</sup> A somewhat fuller discussion of the disclosure requirement is contained in the new ABA Code of Professional Responsibility, Ethical Consideration 5-16:

In those instances in which a lawyer is justified in representing two or more clients having differing interests, it is nevertheless essential that each client be given the opportunity to evaluate his need for representation free of any potential conflict and to obtain other counsel if he so desires. Thus, before a lawyer may represent multiple clients, he should explain fully to each client the implications of the common representation and should accept or continue employment only if the clients consent. If there are present other circumstances that might cause any of the multiple clients to question the undivided loyalty of the lawyer, he should also advise all of the clients of those circumstances.<sup>44</sup>

As the discussion below will show, the implications and hazards of multiple representation are manifold and complex, and a full disclosure of these risks to clients will take substantial thought, time, and effort. Yet even Canon 6 clearly seems to require such an explanation to be made in every case *before* the attorney may proceed to represent the parties.

In North Carolina such disclosure is not in fact made by most attorneys. Our questionnaire asked each attorney whether, in single-family home purchases, he customarily explained to the buyer that he represented the lender and/or the seller (if, in fact, he did so) and that he could not continue representation of the buyer if a conflict developed. Only thirty-seven percent of the attorneys responding indicated that they habitually made such an explanation. Another fifty-nine percent said they would make an explanation only if a real conflict appeared to be developing, while an amazing four percent said they would make no explanation at all. Of course, it is meaningless to wait until a "real conflict appears." The conflict is intrinsic in the situation, and the fact that it does not surface is in many cases the best evidence that the attorney has failed in his duty to one or more of the clients.

Let us assume the simple, typical case in which *A* is selling land to *B*,

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<sup>43</sup> NORTH CAROLINA CANON No. 6, Melott at VI-8.

<sup>44</sup> AMERICAN BAR ASSOCIATION, CODE OF PROFESSIONAL RESPONSIBILITY 20 (1970). The new ABA code has not been adopted by the North Carolina State Bar at this writing, but a number of other states have adopted it. See generally *Symposium—The ABA Code of Professional Responsibility*, 48 TEXAS L. REV. 255 (1970).

who is obtaining a new loan from *L*, to be secured by a deed of trust on the land, with both owner's and lender's policies of title insurance to be issued. A catalogue of the usual conflicts of interest in such a situation follows.

1. *Seller v. Buyer, Lender, and Title Insurer.* The conflicts in this area are most obvious. The seller and buyer have opposing goals in almost every feature of the transaction: price, terms, the geographic extent of land to be conveyed, the nature of the title, the sufficiency of warranties of title and of condition of any improvements, and the like. In many of these matters, the interest of the lender who will take a deed of trust on the realty is as plainly adverse to that of the seller as is the buyer's interest. And the title insurer is in inherent conflict when any possible title objection can be raised.

The attorney's ethical problem is greatly exacerbated if he has previously represented the seller in the acquisition of the land and especially if the seller is also a subdivider for whom the attorney has done the base-title and construction-loan work. At least two types of problems arise here. The first derives from the attorney's more or less intimate knowledge of the land's title and the seller's business activities. Suppose, for example, the attorney knows of currently unpaid materialmen whom the seller hopes to pay, but who, if unpaid, might file liens on the property. If the attorney discloses this information to the buyer or lender, is he not breaching his duty to the seller? And if he declines to disclose, is not his duty to the buyer or lender breached? Other kinds of knowledge present the same issue: The attorney may know that the homes are defectively constructed; that the land drains poorly; that municipal subdivision approval was not properly obtained; that there are ancient, technically enforceable possibilities of reverter outstanding; or that the subdivider is so close to insolvency that he is unlikely to finish street-paving and lighting projects which he has promised to the early buyers of homes in the tract. By assuming to represent both parties, the attorney has damned himself regardless of whether or not he chooses to disclose such matters.

The attorney's ethical predicament is all the more serious if he has a "deal" for fee-cutting with the subdivider. Such an arrangement may work as follows: The attorney does the base-title and construction-loan work for the subdivider with the understanding that individual buyers of lots will be referred to the attorney as the lots are sold. In return, the attorney may do the subdivider's work at a lower fee than normally charged; or, alternatively, the attorney may agree to charge a lower fee

to the individual-lot buyers than normal, thus cutting their closing costs and making the subdivider's offering more attractive to buyers.

About fifteen percent of the questionnaire respondents indicated that they had made referral arrangements with subdividers in the past, and five percent indicated that they had done the subdivider's legal work for a lower fee than normal in consideration of the referrals; no attorney replying to the questionnaire stated that he had given a fee concession to individual-lot buyers in return for the referral arrangement.<sup>45</sup> The first-mentioned type of fee-cutting arrangement has been condemned by the ethics opinions of the North Carolina State Bar,<sup>46</sup> but not on grounds of conflict of interest. Instead, the State Bar opinions display their customary preoccupation with enforcement of minimum fee schedules and regard the fee-cutting itself as the unprofessional feature of such an arrangement. Actually, it is strongly arguable that the reduction in fees should be encouraged as a matter of public policy in line with the general goal of reducing housing costs. Obviously, an attorney who has done the base-title work on a one-hundred-lot subdivision can afford to provide down-dated title opinions to individual-lot buyers for a fraction of the normal fee, and aside from economic protectionism by the Bar, it is difficult to see why he should not be allowed to do so.

But the real danger in such an arrangement is the obvious impropriety involved when an attorney with strong and continuing allegiance to one client purports to represent another client with adverse interests in the transaction. No amount of "full disclosure" by the attorney can alleviate the conflict. Therefore, referral arrangement with subdividers should be barred entirely. Since the State Bar Council has ruled the fee-cutting feature of the referral arrangement unethical, a complete avoidance of this form of dual representation will cost the buyer no more and will assure him independent advice about the land he is buying.<sup>47</sup>

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<sup>45</sup> This was the effect of the arrangement described in N.C. OPINION No. 630 (1968), Melott II-173, but the fee-concession feature of the arrangement was not discussed in the opinion.

<sup>46</sup> N.C. OPINION No. 517 (1966), Melott II-135; *see also* N.C. OPINION No. 630 (1968), Melott II-173. *But cf.* new page SS-2.1, HANDBOOK ON OFFICE MANAGEMENT AND FEES, *supra* note 26.

<sup>47</sup> Only one published judicial opinion has been found dealing with the subdivider-buyer conflict: *In re Kamp*, 40 N.J. 588, 194 A.2d 236 (1963), holding the attorney's conduct improper. But the case against the attorney was unusually strong. He claimed to represent both buyer and seller, but he made no title search and refused to give any information to another attorney engaged by the buyer to search the title. *See also* ABA OPINION No. 224 (1941), ABA INFORMAL OPINION No. 886; NEW JERSEY ADVISORY COMM. ON PROFESSIONAL ETHICS, OPINIONS, No. 51, *reported*, 87 N.J.L.J. 705 (1964); *Annot.*, 17 A.L.R.3d 835 (1968).



2. *Buyer v. Lender*. It is frequently assumed that the buyer and his lender have such coincidental interests that there can be no ethical impropriety in an attorney representing both of them.<sup>48</sup> It is true that both are concerned about the state of the title—the buyer because he intends to possess the land and the lender because it may need to foreclose upon and market the land in the event of a loan default. Yet, even on title matters, the interests of the buyer and the lender may not truly coincide. For example, whether zoning or restrictive covenants prevent the use of the property for home occupations, such as a beauty shop or an architect's office, may be crucial to the buyer but unimportant to the lender. Similarly, small liens may disturb the lender very little, especially if its loan-to-value ratio is relatively low; but the buyer, who will have to discharge the liens, is vitally concerned with them. Moreover, as Part I of this study has shown,<sup>49</sup> the form of title assurance commonly varies, with the lender getting, in many cases, both a certificate of title and a title insurance policy while the buyer gets neither.

Title matters aside, the buyer-borrower and the lender are distinctly adverse regarding the terms of the loan itself. Might the buyer get a better interest rate or smaller "points" or fees elsewhere? May he prepay the loan without penalty? What grace period is allowed him in the event of default? Is he required to pay taxes and insurance into an impound account which yields him no interest? Are unreasonable charges being made for appraisal, "loan processing," "commitment fees," or any of the dozen other "services" lenders sometimes use to extract an extra pound of flesh from borrowers?

An interesting ethical problem is presented by the "due on sale" clause, not yet common in North Carolina, but widely used in other jurisdictions. The clause provides that the lender may accelerate the loan and declare it entirely due and payable in the event the borrower sells the property.<sup>50</sup> The effect is to preclude an assumption of the loan by a new

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<sup>48</sup> Excellent discussions of the borrower-lender conflict are found in T. SMEDLEY, *PROFESSIONAL RESPONSIBILITY PROBLEMS RELATING TO MORTGAGE TRANSACTIONS* (1966); Payne, *101 Home Buyers: The Consumer, the Conveyancing Process, and Some Questions of Professional Conduct*, 16 ALA. L. REV. 275, 326 (1964). See also *In re Kamp*, 40 N.J. 588, 194 A.2d 236 (1963), in which the court suggests that full disclosure of the borrower-lender conflict is ethically required; accord, ABA INFORMAL OPINIONS 837 & 643.

<sup>49</sup> *Part I* at n.70.

<sup>50</sup> In the absence of such a clause, it is uniformly held that a mortgagor may freely transfer his title even though it continues to be subject to the mortgage. *Gregg v. Williamson*, 246 N.C. 356, 98 S.E.2d 481 (1957); G. OSBORNE, *MORTGAGES* § 247 (2d ed. 1970).

owner unless the lender consents, and consent, in a rising money market, is frequently conditioned upon an increase in interest rate or the exaction of an "assumption fee" to compensate the lender for permitting the loan to continue at its original interest. Such a clause is a material advantage to a lender in a rising interest market and equally disadvantageous to the borrower. The clauses have been variously treated by other courts,<sup>51</sup> but no North Carolina decision has considered their validity. If a North Carolina lender begins using such a clause, how is the attorney who represents both lender and borrower to react to it? The attorney's position seems absolutely untenable.

The problem raised by confidential information is present again in the buyer-borrower situation. Suppose, for example, a buyer who intends financing his purchase with an FHA-insured loan confides to the attorney that the money for his down payment is in reality coming from a second loan to be made by the realtor to the buyer and secured by an unrecorded deed of trust. FHA regulations, which the lender must enforce, prohibit secondary liens on FHA purchases.<sup>52</sup> Should the attorney report this information to the lender or keep silent? The questionnaire posed this situation to nearly two hundred North Carolina real estate attorneys. Their answers were a mass of confusion. Some attorneys said they would refuse to go forward with the transaction, others state that they would report this information to the lender, and still others said that they would close the transaction and say nothing. The confusion is inevitable, for the attorney has constructed a situation from which there is no escape.

The buyer's conflict with the lender is ethically more difficult in cases where the attorney has some continuing relation with the lender. Such relations are quite common; on the average, the attorneys responding to our questionnaire received all or a definite part of the single-family-home-title work of 2.13 lenders. Frequently, a lender will have a single

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<sup>51</sup> *Hill v. Day*, 231 Ark. 550, 331 S.W.2d 38 (1960) (clause void); *Coast Bank v. Minderhout*, 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964) (clause upheld); *Cherry v. Home Sav. & Loan Ass'n*, 276 Cal. App. 2d 574, 81 Cal. Rptr. 135 (1969); *Peoples' Savings Ass'n v. Standard Indus., Inc.*, 257 N.E.2d 406 (Ohio App. 1970) (clause upheld); J. HETLAND, CALIFORNIA REAL ESTATE SECURED TRANSACTIONS § 4.55 (Calif. Cont. Educ. Bar 1970); *Olds, Transfer of Interest of Land Mortgages*, 5 HOUSTON L. REV. 221 (1967); Comment, *Debtor-Selection Provisions Found in Trust Deeds and the Extent of Their Enforceability in the Courts*, 35 S. CAL. L. REV. 475 (1962).

The proposed FNMA/FHLMC standard-form conventional deed of trust contains a due-on-sale clause. 4 CLEARINGHOUSE REV. 496 (1971). If the clause is retained in the final version, its use may become much more common in North Carolina. See note 105 *infra*.

<sup>52</sup> 24 C.F.R. § 203.32 (1970).

attorney or a list of attorneys who the lender insists must close every loan the lender makes. Such a situation is an enviable one from the lawyer's viewpoint, and it would be economically suicidal for him to jeopardize it by actually negotiating on the buyer's behalf against the lender or by questioning the substance of language in the lender's "standard form" note or deed of trust. One is reminded of that final line from Ibsen's *Hedda Gabbler*: "People don't do such things!"

The State Bar Council's ethics opinions appear to find no fault with the lender's referral arrangement—provided, of course, that the minimum fee schedule is fully observed;<sup>53</sup> indeed, one opinion of the council, overruling a contrary earlier view,<sup>54</sup> approves the practice even when the attorney to whom the business is referred is also an officer in the lender's business.<sup>55</sup> But not every investigator has taken the State Bar's lenient view of lender's lawyer-referral lists. At least two important studies of the savings and loan industry have criticized the close ties and resultant conflicts between lenders and title-search personnel,<sup>56</sup> and the Federal Home Loan Bank Board has recently issued regulations which may be construed to prohibit the use of lawyer-referral lists by federally insured savings and loan associations.<sup>57</sup>

3. *Buyer v. Title Insurer*. The attorney's relation to the title insurance company may also impair his service to the realty buyer. Plainly this would be so if he received an undisclosed rebate from the company of a portion of the insurance premium,<sup>58</sup> but only 2.6 percent of the attorneys replying to our questionnaire said they had ever received such fees. Yet it should not be assumed that other lawyers have no financial interest in the well-being of title companies, for many such companies are directly affiliated with mortgage lenders, particularly commercial banks. Thus,

<sup>53</sup> N.C. OPINION No. 507 (1966), Melott II-132; N.C. OPINION No. 496 (1965), Melott II-128; N.C. OPINION No. 448 (1964), Melott II-111.

<sup>54</sup> N.C. OPINION No. 374 (1962), Melott II-87.

<sup>55</sup> N.C. OPINION No. 434 (1963), Melott II-107.

<sup>56</sup> I. FRIEND, STUDY OF THE SAVINGS AND LOAN INDUSTRY, SUMMARY AND RECOMMENDATIONS 16 (Fed. Home Loan Bank Board 1969); AD HOC SUBCOMMITTEE REPORT ON HOME FINANCING PRACTICES AND ABUSES, 116 CONG. REC. E 7227 (daily ed. July 31, 1970).

<sup>57</sup> 35 Fed. Reg. 18039 (1970); see *Regulations, Rulings, and Opinions*, 4 J. FED. HOME LOAN BANK BOARD 24 (No. 1, 1971). The regulation forbids the granting of a loan on the condition that "[t]he borrower contract for any of the following with any specific firm, agency, or person:

(3) Legal services, including title examination . . . ." But the regulation appears to reserve to the lender the right to require that its own attorney close the loan.

<sup>58</sup> See American Bar Association Formal ABA OPINION No. 304 (1962).

the attorney who holds a favored position as one of a select group of closing attorneys for a given bank will hardly quibble with that bank's "kept" title company over policy coverage or language, nor is he likely to urge the buyer to utilize a different title company which might offer broader coverage.

### *Ethics in Summary*

The foregoing discussion suggests that, in professional responsibility as in substantive protection, the novice real estate buyer is the neglected man. "His" attorney has continuous and profitable relationships with developers and lenders but only an ephemeral and relatively insignificant contact with the individual buyer. If the attorney purports to represent the buyer at all, he does so in a context so fraught with inherent conflict that the representation is likely to be merely nominal.

### CRITERIA FOR REFORM

Thus far, this study has shown that current real estate practice is quite unsatisfactory: it fails to protect the buyer who most needs and expects protection,<sup>59</sup> and it places the attorney in serious conflict with the mores of his profession—conflict which rests in an uneasy truce but is essentially unresolved. But changes can and should be made. Their precise nature will be the topic of the remainder of this article.

At the outset, it is necessary to express two criteria for reform. The first is that whatever is proposed must stand the test of politics—the art of the possible. In the arena of real estate practice the only politically practical reforms are those which do not impinge on presently institutionalized interests more than is necessary to protect the public interest. The bar, the lenders, the brokers, and the title insurers are all powerful lobbies, and no reformer can sensibly ignore them. This is not to say that those interest groups hold ultimate power or must be paid obeisance, but their probable reactions to every proposal must be carefully assessed.

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<sup>59</sup> An instructive comparison of British and American practice is found in Newman, *A Typical House-Purchasing Transaction in the United Kingdom*, 15 *AM. J. COMP. L.* 797 (1967). The author concludes that

while American practice is geared to giving maximum protection to an institutional mortgagee, English practice centers around the needs of the buyer. The purchaser has his own solicitor to advise him throughout and can sue him if the title turns out to be unsatisfactory. The solicitor for the mortgagee does not, as in the United States, control the transaction. The purchaser gains valuable protection from the fact that his solicitor acts prior to the initial contract and not after it as in the United States.

*Id.* at 805.

The second criterion of a reform program is that it be confined to the necessary. There are many features of the current North Carolina practice which are laudable: its moderate cost,<sup>60</sup> fairly high speed, and consistency from county to county. Furthermore, the present cast of characters has developed skills and abilities which, to the extent they can be efficiently used, should not be abandoned. Reform can be constructed so as to keep the best features of the system (perhaps even to improve them) and to correct the worst.

Based on these criteria, some preliminary observations and suggestions for reform can be made. The first suggestion is that there be a disposal of the Torrens system. Since North Carolina has had a title-registration system for fifty-five years and general use of it has been negligible,<sup>61</sup> one is drawn to two possible conclusions: either the state's system is somehow defective so that owners are afraid to use it, or they have decided that it is uneconomic to do so. Since there has been no noticeable movement to correct alleged defects, the latter explanation seems the logical one. It is vain to call for a "conversion" to the Torrens system, for nobody will voluntarily respond. The torrenization of a title would easily cost two or three times the amount, in attorney's fees and title insurance premiums, of a conventional transfer of title.<sup>62</sup> No party to a given transaction will incur the additional expense willingly.<sup>63</sup>

The answer in certain counties of England and Wales has been compulsory Torrenization: Every previously unregistered land parcel must be registered within two months after transfer; thus, in one "generation" of title transfers, the entire jurisdiction is converted.<sup>64</sup> The approach is theoretically sound, but in North Carolina it would founder on political grounds. The present title "industry," composed of the bar and the title

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<sup>60</sup> See note 110 *infra*.

<sup>61</sup> Only five percent of the real estate lawyers responding to our questionnaire had ever registered a Torrens title, and only one lawyer had registered as many as eight titles. However, the use of Torrens registration appears to be somewhat more prevalent than the five-percent figure might suggest. See *Part I* at 461.

<sup>62</sup> The costs of registering a ten-thousand-dollar residential lot have been estimated to range from a low of 435 dollars (plus abstract) in Ohio to 945 dollars in Hawaii. Fiflis, *Land Transfer Improvement: The Basic Facts and Two Hypotheses for Reform*, 38 U. COLO. L. REV. 431, 473 (1966).

<sup>63</sup> This is essentially the conclusion reached by Cribbet, *Conveyancing Reform*, 35 N.Y.U.L. REV. 1291, 1303 (1960).

<sup>64</sup> *Id.* at 1294. See also Barnsley, *Compulsory Registration of Title—The Effect of Failure to Register*, 32 CONVEY. (n.s.) 391 (1968), for a commentary on problems encountered under the British system. It is also significant that, aside from the Torrens system, England has never had a recording system of the American type. See generally Fiflis, *English Registered Conveyancing: A Study in Effective Land Transfer*, 59 Nw. U.L. REV. 468 (1964).

insurers, would oppose it simply because it would render their services obsolete. Nor would public support be probable, for subsidization would be necessary, and the public would bear the costs of conversion directly and quickly. And a conversion to Torrenization would almost surely spell the end of any role for attorneys in real estate transfers, rather than emphasize the bar's advocacy function of which the public is so much in need. Torrenization is not the answer in North Carolina.<sup>65</sup>

Another type of reform is suggested by the presently operating association of certain lawyers in Mecklenburg County, who have formed a "pool" of title abstracts accumulated over the years by the various members and made available to any other member for a nominal fee. A lawyer using the pool studies his fellow-member's abstract and then consults the Register of Deeds only to down-date the title to the time of closing. The attorney saves time, although the fee paid by the buyer is not reduced.<sup>66</sup>

This system is appealing, but its obvious disadvantage is that one attorney is relying on another's accuracy and care as reflected in the abstract. Even if membership is exclusive, the quality of abstracts is certain to be variable. And there is apparently no clear basis for asserting liability for error against an occasionally careless member. A sound system of title assurance should be available to the entire bar and the public and should not have the propensity for the perpetuation of error inherent in the Mecklenburg scheme.

The proposals made in the remaining pages of this paper are not heroic. They merely call for the modernization of present methods and a return to proper notions of professional responsibility. They result in the displacement of no one although they contemplate some degree of realignment of function among present professional real estate personnel. While some of the suggestions are novel, nearly all have precedent in other jurisdictions. They deserve serious consideration.

### *Improving Public Records*

In the United States, the maintenance of publicly accessible records of land ownership has always been recognized as a proper and necessary function of government.<sup>67</sup> Yet the format of organization of those records

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<sup>65</sup> See Fiflis, *Land Transfer Improvement: The Basic Facts and Two Hypotheses for Reform*, 38 U. COLO. L. REV. 431, 473 (1966).

<sup>66</sup> Nor could it be under the State Bar Council's ethics opinions. See notes 21-30 *supra*.

<sup>67</sup> See 4 AMERICAN LAW OF PROPERTY §17.40, at 527 (A.J. Casner ed. 1952); Haskins, *The Beginning of the Recording System in Massachusetts*, 21 B.U.L. REV. 281 (1941).

in most states, including North Carolina, is sadly deficient and constitutes a major barrier to effective assembly of title information. A reorganization of the public records should be the first order of business in a program of conveyancing reform.

The reordering of public land records should be based on two fundamental concepts. First, records should be indexed, insofar as possible, by parcel rather than by name of owner. Second, all records relating to a parcel should be available from one source, and records not revealed by that source should not be legally binding on the land or its owners.

Any lawyer who has searched titles under both name-index and parcel-index systems (as has the author) cannot fail to be profoundly impressed by the ease and efficiency of the parcel-index method. Virtually every title insurer which maintains its own "title plant" uses a tract or parcel index.<sup>68</sup> Even absent electronic or mechanical aids, a search in a parcel-index system can produce a chain of title quickly: the searcher merely consults the page in the "lot book" or index corresponding to the parcel he is searching. There he finds a complete listing of every recorded document affecting the land. He then pulls from the shelf the books containing the copies (or, in the usual title insurer's plant, abstracts) of the individual instruments and checks their validity in the usual way. Of course, it is still necessary to make checks for other title matters—such as judgment liens, pending litigation, bankruptcies, and estate administrations—which are usually indexed by name rather than by parcel. But the total process can be handled in a fraction of the time required to construct a chain of title and make a search of "conveyances out" under the traditional grantor-grantee index system.<sup>69</sup>

If the tract-index system is so clearly superior, why is it not more widely used by governments? The probable answer can be derived from history. In earlier years, when conveyances were few and chains of title short, the grantor-grantee index seemed more adequate, and efficiency seemed a less significant goal. Moreover, the grantor-grantee index needs no system identifying parcels of land; it is up to the title searcher to read all instruments to or from the relevant parties and to scrutinize their

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<sup>68</sup> See Zerwick, *The Title Plant . . . Creation and Maintenance*, in PERSPECTIVE: AMERICA'S LAND TITLE INDUSTRY 26 (American Land Title Ass'n, undated). There is a small but discernible trend toward conversion of official recording systems to tract indices. See, e.g., N.D. CENT. CODE § 11-18-07 (1960); OKLA. STAT. ANN. tit. 19, § 291 (1962); R. POWELL, REAL PROPERTY ¶ 918 (abr. ed. 1968).

<sup>69</sup> Zerwick, *supra* note 68.

legal descriptions to determine whether they affect the land being searched.<sup>70</sup> This is often a time-consuming and error-producing endeavor, but that has been thought to be no concern of the record-keepers. It is true that, even under a tract-index system, the searcher will want to check for accuracy the land descriptions in the instruments which the index tells him are relevant, but he need not scan the descriptions in dozens or hundreds of documents that turn out *not* to be relevant to the title being searched. In effect, under the tract-index system, an initial determination of the relevance of every document to every possible parcel of land is made by the indexer when the document is submitted for recordation.

Since a tract-index system requires that every parcel of land be given some identifying label, what labeling system should be used? There are a variety of possibilities including, among others, streets and house numbers, lot and block numbers from recorded plats, and longitude and latitude. Professors Cook and Howe<sup>71</sup> advocate the use of the State Plane Coordinate System (SPCS), which was developed by the United States Coast and Geodetic Survey in 1932 at the request of the North Carolina Department of Highways.<sup>72</sup> Under this system a unique number can be assigned to every existing parcel of land with the digits of the number bearing a relation to the actual location of the land on the earth's surface rather than being merely arbitrary. When existing parcels are subdivided, new numbers, still related to the land's actual location can be assigned to each of the resulting lots. The numerical system would be keyed to large-scale maps which would show accurately the boundaries of each tract. Once the system is established, it would be possible to convey land merely

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<sup>70</sup> The duty to search all recorded documents indexed in the name of a relevant grantor for possible applicability to the land in question was imposed by *Reed v. Elmore*, 246 N.C. 221, 98 S.E.2d 360 (1957), criticized in Webster, *Doubt Reduction Through Conveyancing Reform—More Suggestions in the Quest for Clear Land Titles*, 46 N.C.L. REV. 284, 295-305 (1968). See also *St. Luke's Episcopal Church v. Berry*, 2 N.C. App. 617, 163 S.E.2d 664 (1968), in which the court refused to hold the searcher bound by language in an out-of-chain deed implying a restriction on the land being searched. The impact of *Reed* is further diluted by *Marrone v. Long*, 7 N.C. App. 451, 173 S.E.2d 21 (1970). This controversy would become irrelevant under a tract-index system.

<sup>71</sup> R. HOWE, FUNDAMENTALS OF A MODERN SYSTEM OF LAND PARCEL RECORDS (1968); PROCEEDINGS OF THE TRI-STATE CONFERENCE ON A COMPREHENSIVE, UNIFIED LAND DATA SYSTEM (CULDATA) (R. Cook & J. Kennedy, Jr. eds. 1967); Cook, *Land Law Reform: A Modern Computerized System of Land Records*, 38 U. CIN. L. REV. 385 (1969); Cook, *American Land Law Reform: Modernization of Recording Statutes*, 13 CASE W. RES. L. REV. 639 (1962).

<sup>72</sup> See N.C. GEN. STAT. § 102-1 to -14 (1965); Cook, 38 U. CIN. L. REV., *supra* note 71, at 401.



by referring to the parcel's number without any necessity for writing a full legal description.<sup>73</sup>

But the surveying and mapping process needed would be expensive and time-consuming. It is not necessary to wait until this is completed to institute a tract index for land records. As a temporary expedient, the numbers customarily used by county assessors to identify parcels for tax purposes can be used, and conversion to the more accurate SPCS system can take place as the numbering and mapping under SPCS is completed.

In an age of electronic data processing, it would be foolish to create a tract-index system using paper books and indices. Instead, computer facilities should be created to serve the entire state—perhaps on a centralized basis or, alternatively, with regional computers, whichever is shown to be most efficient. The computer's memory would contain abstracted information or full copies of every recorded document,<sup>74</sup> and upon request the computer would print out the documents related to any given parcel. Each Register of Deeds office would be equipped with a "terminal"—that is, an electric teletypewriter or other device for producing "hard" (i.e., paper) copies—connected by telephone lines to the computer.

It would be possible to build the computer's memory gradually, simply

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<sup>73</sup> See *Improvement of Land Records*, 1 REAL PROP. PROB. & TR. J. 191 (1966).

<sup>74</sup> There are several alternative forms of storage of document text in the computer's memory. The most conventional are photographic: microfilm, microcards (opaque), and microfiche (transparent cards). These have the advantage of being complete duplicates of the original papers with virtually no possibility of error. Their disadvantage is a relatively slow access time (measured in minutes). Interview with Mr. Stanley E. Dunin, vice president, HW Systems, Los Angeles, California, March 15, 1971. Mr. Dunin's firm operates a computer-title-search facility using microfilm storage in Los Angeles for five title insurance companies. Some features of this system are described in Balocca, *Perspective: Plant Computerization*, 49 TITLE NEWS 4 (No. 12, 1970). A microfiche system of two hundred thousand cards recently installed by Nassau County, New York, is described in *Progress in Land Data Systems*, 2 REAL PROP. PROB. & TR. J. 342 (1967).

Another approach is to translate the documentary text into an electronic "language" which can be stored in an electronic or electro-optical memory—for example, a magnetic drum, disc, or tape or laser-read disc. Access times are faster, but the initial translation must be by manual operator or optical reader, both of which may introduce error and are much more expensive than a photographic process. See Billman, *An Investment in the Future*, 48 TITLE NEWS 4 (No. 7, 1969). This approach is more attractive if standard-form, machine-readable documents predominate. See text at notes 103-105 *infra*.

Because the author is inexpert in the technology and the state of the art is advancing rapidly, it seems unwise to make a firm recommendation here as to the best form of memory.

by beginning at a fixed point in time and compiling in the memory all new documents recorded after that date. Under such a procedure, the system would become fully usable only after a protracted period of time. Another alternative is to begin by feeding large quantities of existing recorded documents to the system. The initial task of placing this information in the computer's memory would be laborious; it would be necessary to prepare and feed into the machine copies or abstracts of all documents recorded within, say, the last twenty years.<sup>75</sup> Each day as additional documents were recorded, local personnel would feed them, via local equipment, to the computer. The memory would thus be continuously updated. Similarly, the computer could be programmed to automatically erase information which grows so old that it is no longer needed.

In addition to the input of recorded documents described above, there are two other categories of data which the computer would have to memorize. The first consists of information which is keyed to a specific parcel of land but not ordinarily recorded in the same manner as deeds and mortgages. An illustrative list would include:

1. Tax and special assessment liens of all applicable jurisdictions.
2. Mechanics' and materialmen's liens.
3. Financing statements on fixtures filed under the UCC index.
4. Current zoning.
5. Approvals for subdivision by the relevant local governments.
6. Notices of violation of housing and building codes.
7. Locations of mapped or proposed highways, street widenings, and other public improvements.
8. Designation of areas for urban renewal, concentrated code enforcement, or other special programs.
9. Eminent domain actions.

It is essential to the success of the system that an estoppel be created by statute against persons or agencies who have interests of the types described above but who do not inform the system of them.<sup>76</sup> In some cases,

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<sup>75</sup> This period would be correlated to a marketable title statute. See text at notes 78-79 *infra*. To be precise, it is necessary to go back to the latest deed which precedes the beginning of the twenty-year period. See Webster, *The Quest for Clear Land Titles—Making Land Title Searches Shorter and Surer in North Carolina via Marketable Title Legislation*, 44 N.C.L. REV. 89, 107 (1965).

<sup>76</sup> A bill making property tax certificates issuable by and binding on local governments is pending in the North Carolina General Assembly at this writing. H.81 (1971 sess.). See *Part I* at n.91. The English law makes the statements of local authorities on many of these points conclusive. See Newman, *A Typical House-*

such as tax liens and mechanics' liens, this "estoppel" would be relatively simple; in other cases, such as mapped public improvements, it would not be easy to devise a sanction against the agency which failed to inform the system of its plans. It may be enough to provide by statute that such information "shall" be given to the computer by the appropriate agency. In any event, it is crucial that, as nearly as possible, *all* information on the legal status of the land be available on *one* computer printout.

The last major category of data which the computer would have to memorize is that keyed to *name* rather than tract. Examples include the names of parties to pending litigation, judgments, general liens, estate administrations, bankruptcies, and the like. These names should be accompanied by identifying numbers to help resolve confusion caused by identical or similar names; every document and proceeding which could relate to land should be required by law to bear the Social Security numbers of Internal Revenue Service numbers of the parties. The computer could be programmed to make a search of the name index as an automatic part of every title search.

One last item of information which does not fit precisely in any of the categories of data mentioned thus far is a document that makes no reference to specific land but only refers to a previously recorded document. However, the title search would not be impeded should such a "blank" document pop up because the recorded document referred to could be picked up automatically by a cross-indexing system built into the computer.

A delicate question arises as to whether private lawyers should have the right to record in the computer's memory state-of-title comments on a given parcel for the benefit of later searchers. On balance, this practice would seem to be beneficial since it might cause a realty buyer to discover a title problem which his own attorney might not otherwise have noticed. This privilege should be limited to licensed attorneys who should insert comments only on defects which they believe in good faith to impair marketability. Attorneys who make such comments should be absolved of any liability for slander of title.<sup>77</sup> It would be most helpful if the North Carolina Bar Association would create a standing committee on title standards which could publish guidelines to create some unanimity of opinion among

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*Purchasing Transaction in the United Kingdom*, 15 AM. J. COMP. L. 797, 799 (1967).

<sup>77</sup> Liability is extremely improbable in any event since malice is an element of the tort. See *Lawing v. Wheeler*, 232 N.C. 517, 61 S.E.2d 341 (1950); *Cardon v. McConnell*, 120 N.C. 461, 27 S.E. 109 (1897).

title lawyers regarding the types of defects which render a title unmarketable.

Even if existing recorded data are feed to the computer, there is certainly no reason to feed in every presently recorded *document*, but to avoid this necessity, it is essential that a sound marketable title statute be adopted with a relatively short limitation period—perhaps twenty years.<sup>78</sup> The general effect of such legislation would be to make documents recorded somewhat more than twenty years in the past irrelevant. Previously enacted marketable title statutes in other states have been less than fully effective, but there is no technical reason why they cannot be made practically airtight.<sup>79</sup>

If the suggestion, made later in this article,<sup>80</sup> that owner's title insurance be made assignable inter vivos for a reasonable period after issuance were adopted, it would be most desirable to require that the computer system be informed of every title policy issuance. A search would then disclose the existence of recently issued policies, and it would be unnecessary to check documents in the chain of title recorded earlier than the latest point in time when a policy was issued. Every search would become, in effect, an update from the time of the most recent issuance of a previous title policy. Of course, in many cases the amount of coverage of the old policy would be inadequate to cover the current value of the property, but hopefully the title insurers would be willing (and certainly should be permitted by law) to rely on the earlier search and policy (even of another company) as satisfactory evidence of the title as of that earlier date.

Placing the foregoing program into effect would mean an enormous change in the usual procedure for examining a title in North Carolina. The attorney would have no need to visit the courthouse. He could request a current printout on a given tract of land by telephone and could receive it by mail the following day. He could examine it in the comfort of his office. If information in the printout suggest a need to examine full copies of the documents and the system did not supply them as a matter of course, they could be requested by telephone and delivered within a

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<sup>78</sup> See Webster, *supra* note 75. Under the English statute, as to unregistered land, a thirty-year chain of title is marketable, and a recent proposal would reduce the period to fifteen years. See Payne, *Title Insurance and the Unauthorized Practice of Law Controversy*, 53 MINN. L. REV. 423, 468 n.141 (1969). Seventy-six and one-half percent of attorneys responding to our questionnaire stated they favored marketable title legislation.

<sup>79</sup> Payne, *In Search of Title (Part II)*, 14 ALA. L. REV. 278 (1962).

<sup>80</sup> See text at note 95 *infra*.

day.<sup>81</sup> The local Register of Deeds would bill the attorney for the services utilized. The certificate of title would be prepared and sent to the client in a far more complete and accurate form than is usual today and with far less wasted effort.

Of course, the problem of machine and programming error would have to be dealt with. It would seem wise to assign a portion of the charges made for the use of the system to an insurance fund to be used to pay losses from system error. The maximum claim should be limited by statute to some figure sufficient to cover the cost of most single-family houses—perhaps thirty thousand dollars. Title insurance could cover losses in excess of this level, but it seems desirable to impose a moderate risk of liability on the system in order to give its administrators an incentive to eliminate error. At least in the early years when the loss insurance fund is not built up adequately, the general credit of the state should be subject to liability for losses.<sup>82</sup>

What impact will the proposed system have on the costs of conveying? To begin with, the attorney's fee would be greatly reduced.<sup>83</sup> Attorneys commonly regard fees in real estate sales as compensatory of two factors: first, the time expended and, second, the risk of loss assumed by the lawyer. Under the computerized system, both of the factors would be reduced by at least one-half. Assume that legal fees would also be cut in half and that the savings would be applied toward the operation of the computer system in the form of user fees. Would those fees be sufficient to amortize the capital costs of the system, maintain it in daily operation, and contribute to an actuarially sound insurance fund?

No firm answer can be given without more data than are presently available to the author. Much of the equipment for the system can be leased, avoiding a large capital outlay and allowing the acquisition of more modern facilities from time to time without creating a problem of disposal of old hardware. The principal initial costs would be for pro-

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<sup>81</sup> If the system were designed to use an electronic form of text storage, photographic records should also be made as a back-up.

<sup>82</sup> A provision for general liability is necessary to avoid a debacle like that occurring in the California Torrens system in which a single claim exhausted the insurance fund and precipitated the repeal of the Torrens act. See *Gill v. Johnson*, 21 Cal. App. 2d 649, 69 P.2d 1016 (1937); 6 R. POWELL, REAL PROPERTY ¶921 (1968).

<sup>83</sup> Here, it would seem, the State Bar Council must finally give way and allow a reduction in fees. The lawyers who received our questionnaire were asked whether they favored a computer-assisted title-search procedure of the type described here. Of those responding, 71.6 percent were favorable, and 51.8 percent indicated that they would cut their fees, the most common amount mentioned being fifty percent.

gramming and input storage of existing recorded documents. Personnel in the present Register of Deeds offices would need retraining to use the new system, and it would be necessary to continue to operate the present system during some reasonable start-up time. It is probable that the system could be made self-supporting in the long run, but initial costs would have to be absorbed by the General Assembly. However, the investment would not be disproportionate to the benefits accruing to the public.

Not only lawyers and their clients would benefit from the system. The computer could also memorize nonlegal data on land parcels and could assemble and manipulate such data with great versatility. Such matters as actual land use, structural condition of buildings on the land, soil type, and even neighborhood crime rate could be included. The availability of this information in such a convenient form would be of immense value to city planners, engineers, architects, highway designers, tax assessors, and others.<sup>84</sup>

Because of the importance of state-wide consistency in the system, the necessity for retraining large numbers of public employees, and the large variety of bodies that would have to supply data to (and utilize the services of) the system, it would seem wise to establish by legislation a state-wide agency with authority to operate the system and to make the necessary regulations to assure compatibility of inputs and outputs for all agencies involved.

It should be emphasized that the proposal made here is *not* an extension of governmental activity into a previously private field. There never has been any question that the maintenance of land-title records is a proper state function. Even in those states (and North Carolina is not among them) in which private title insurers or abstractors maintain their own records, the state also maintains records, and the result is unfortunate and uneconomic duplication. But for North Carolina the issue is plain: will the state continue to maintain these crucial public records in an obsolete and inefficient format, or will it bring them into the twentieth century? Whatever the resolution of the suggestions made in the remainder of this

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<sup>84</sup> See generally Grimm, *The Scientific Urban Planning System*, 2 LAW & COMPUT. TECH. 19 (No. 1, Jan. 1969); Lottes, *The Georgia Urban Information System*, 2 LAW & COMPUT. TECH. 10 (No. 9, Sept. 1969). The United States Department of Housing and Urban Development has recently funded development of a computerized urban data system for Charlotte, N.C. See 5 REAL PROP. PROB. & TR. J. 310c (1970). But no decision has been made at this writing on whether land-title information will be included. Letter to the author from Randall Spackman, project staff member, Feb. 20, 1971.

article, the modernization of records stands independently as an exigency of first priority.

### *Title Insurance Revisions*

The scheme, described above, of electronic processing of title data should function in conjunction with a system of title insurance. Preserving the present function of title insurers has a number of advantages. The most obvious advantage is that title insurance provides coverage of risks—such as forgery, adverse possession, lack of delivery, and most others<sup>85</sup>—which no system of recording can eliminate. Furthermore, title insurance can absorb losses caused by system error in excess of the coverage provided by the state insurance fund discussed above. In addition, the present “approved attorney” system provides a useful vehicle for certifying particular attorneys as qualified to handle title matters: Professional ethics prohibit attorneys from identifying themselves as especially competent in any specific field of practice.<sup>86</sup>

Some consideration should be given to the creation of a bar-operated title insurance firm.<sup>87</sup> The Florida Bar company’s experience suggests that premium expense to insureds can be materially reduced below present commercial rates by such a company.<sup>88</sup> However, it is absolutely essential, in order to avoid the egregious conflict of interest present in the Florida system,<sup>89</sup> that any excess premiums collected above costs of operation and necessary reserves be returned to the insureds rather than to the bar. As experience with such a company grows, it should be possible to reduce premiums to a point at which the company would be truly non-profit. The author has been told that the North Carolina Bar Association considered the creation of a bar-related title company several years ago but abandoned the effort when favorable rulings from the Internal Revenue

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<sup>85</sup> See *Part I* at nn.55-69; Fiflis, *supra* note 62, at 452-53. The precise coverage depends, of course, on the policy’s language. See *Part I* at nn.97-98.

<sup>86</sup> N.C. Canon No. 27, Melott VI-44, does allow publication by an attorney in approved legal directories of “special branches of the profession practiced.” See N.C. OPINION No. 646 (1969), Melott II-181, expanding this privilege to cover statements in cards announcing new professional associations but forbidding the recitation of prior experience or qualifications.

<sup>87</sup> See Balbach, *Title Assurance: A New Approach to Unauthorized Practice*, 32 UNAUTH. PRAC. NEWS 15 (No. 4, 1966).

<sup>88</sup> See Payne, *Title Insurance and the Unauthorized Practice of Law Controversy*, 53 MINN. L. REV. 423, 465 n.135 (1969); Rush, *Title Assurance—A Bar Responsibility*, 38 FLA. B.J. 78 (1964); Yelen, *Lawyers’ Title Guaranty Funds: The Florida Experience*, 51 A.B.A.J. 1070 (1965).

<sup>89</sup> See Rosenberg, *The Lawyer’s Role in a Real Estate Transaction*, 46 TITLE NEWS 64 (No. 1, 1967).

Service were not obtained. Perhaps a restructuring along the lines mentioned above would answer IRS objections or would make the rulings unnecessary. At least the possibility should be re-explored.

If commercial title insurers continue to operate in the state, certain actions need to be taken. First, a serious and comprehensive study should be made by the state Insurance Commission of premium levels, claims paid, and profits of the companies. Existing data on these matters are extremely weak, and it is most difficult to say whether premiums are presently excessive.<sup>90</sup> Rate regulation should be instituted if needed to assure the public that premium rates are fair.<sup>91</sup>

The Insurance Commission should also take strong action to strengthen the substantive coverage provided by title insurance policies. A broad-form policy, such as the 1970 ALTA form<sup>92</sup> or one even more extensive, should be required by statute and regulation. The introduction of the computer-assisted title-search procedure described above would help reduce search error and resultant claims paid, and claims are already a relatively small element in the expense of operating a title insurance firm.<sup>93</sup> It would, therefore, be reasonable to require a company to assume all title risks except those arising after the policy is issued, those which the insured himself imposed on the property, and those which the insured knew of but did not disclose. If the computer-assisted title-search procedure be adopted, consideration should also be given to compelling the coverage of some police-power matters—such as zoning, subdivision approval, and code violations.<sup>94</sup> And title insurers should be compelled by statute or (preferably) regulation to underwrite only actual title searches rather

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<sup>90</sup> See Johnstone, *Title Insurance*, 66 YALE L.J. 492 (1967). Some general information is given by Jensen, *1969 Profit Average Again at 13 Per Cent*, 49 TITLE NEWS 6 (No. 12, 1970).

<sup>91</sup> New legislation would be needed for this purpose since the Insurance Commission presently has no authority to regulate rates or policy terms of title insurance. The existing regulation is confined primarily to capitalization and reserves requirements and examination of books. N.C. GEN. STAT. §§ 58-132 to -137 (1965 & Supp. 1969).

The lack of rate and policy regulation is typical; few states go farther. See E. ROBERTS, *PUBLIC REGULATION OF TITLE INSURANCE COMPANIES AND ABSTRACTERS* (1961); Roberts, *Title Insurance: State Regulation and the Public Perspective*, 39 IND. L.J. 1 (1963); Note, *The Title Insurance Industry and Government Regulation*, 53 VA. L. REV. 1523 (1967).

<sup>92</sup> See *Part I* at nn.97-98.

<sup>93</sup> Most estimates place losses at one to four percent of premium income. See Fiflis, *supra* note 62, at 442; Jensen, *supra* note 90; Johnstone, *supra* note 90, at 501, 518-20.

<sup>94</sup> See *Part I* at 452 (1970 ALTA policy form omits coverage of defects in title created by the police power).



than be allowed to write policies on a casualty basis. The scope of the required search should be set by guidelines issued after consultation between the Insurance Commissioner and the bar.

Traditional owner's title insurance has two additional inadequacies which could be changed in the insured's favor. The first is the non-assignability of policy coverage. Most policies provide that only the original insured and the takers of his land upon his death are covered; *intervivos* transferees are not.<sup>95</sup> Thus, the insurer's exposure to risk may continue for twenty or thirty years, if the insured holds the property that long, while the insurer's risk is reduced "prematurely" if the insured sells the property in a year or two. A much more reasonable procedure would be to allow the assignment of coverage by the initial insured to subsequent owners with a provision that coverage would expire in the hands of any successor owner twenty years from the date of the policy's issuance. Very little additional risk would be imposed on insurers by this provision since the great majority of claims are made during the first few years following issuance.<sup>96</sup> The advantage of the procedure is that successor purchasers would not need to obtain full searches when buying previously insured property; instead, a search back to the date of issuance of the outstanding policy, plus an assignment of that policy to the purchaser, would provide ample protection. This simple change would answer a commonly heard criticism of nearly all title-assurance schemes—that they require a major duplication of search effort when property is sold several times in rapid succession. Even under the computer-assisted search procedure proposed in this article, a five-year or ten-year search and legal opinion is plainly cheaper than a twenty-year search and legal opinion.

The other inadequacy of traditional owner's insurance is that the dollar amount of its coverage can quickly become insufficient because of appreciation in land value, construction of improvements, or reduced value of coverage due to monetary inflation. Of course, the careful insured can return to the insurance company periodically and buy greater dollar coverage for an additional premium, but probably few insureds (and

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<sup>95</sup> The 1970 ALTA owner's policy defines "insured" to include those who succeed to the interest of such insured by operation of law *as distinguished from purchase* including, but not limited to, heirs, distributees, devisee's, survivors, personal representatives, next of kin, or corporate or fiduciary successors. (emphasis added)

<sup>96</sup> See Deatly, *One Man Looks at Public Regulation*, 42 TITLE NEWS 5, 9 (No. 3, 1963) (eighty percent of losses occur within five years of policy date, and ninety percent occur within ten years).

virtually no owners of single-family homes) are wise enough to do so. The result is that within a few years after the policy's issuance, most policyholders are seriously underinsured.

The construction of improvements on insured land is essentially non-predictable, so it would be difficult to write coverage of the improvements' value into the policy. But appreciation in land value and the inflation of the dollar are both likely to be with us for the indefinite future. While the precise amount of these factors cannot be predicted, a title policy could readily be written which would cover them up to some maximum annual increment—for example, five percent per year for the first ten years of coverage with no increase thereafter. Such coverage would never be allowed to exceed the actual dollar value of the property from year to year and would expressly exclude any improvements constructed after issuance of the policy.

The precise nature of policy changes such as those described herein should be determined by the Insurance Commission only after a thorough study of the present economic picture of the title insurance industry. The figures given above are only illustrative, but the concepts would go far toward providing owners with solid indemnification for title losses.

### *Reforming Closing Procedures*

Two significant goals—additional protection for the parties and ease of administration for the lawyer—would be served by the closing attorney's assumption of the formal role of escrowee.<sup>97</sup> Protection would be augmented by the fact that "closing" of an escrow and legal transfer of title is deferred until every condition of the escrowee's instructions is fulfilled.<sup>98</sup> One of these conditions could be the making of a final title search immediate prior to recordation of the closing documents. If the final

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<sup>97</sup> A question may arise whether an attorney is acting inconsistently if he is both an escrowee and an attorney for a party—the buyer, for example. Two undesirable consequences might be feared: that the attorney would be in violation of professional ethics or that the delivery of a deed to him as escrowee would immediately vest title in his client, the buyer. Modern authority suggests that neither result will follow if the parties clearly understand that, in receiving the deed, the attorney is acting as an escrowee rather than a mere agent of the buyer. See *Progressive Iron Works Realty Corp. v. Eastern Milling Co.*, 155 Me. 16, 150 A.2d 760 (1959); *Levin v. Nedelman*, 141 N.J. Eq. 23, 55 A.2d 826 (1947), *rev'd on other grounds*, 142 N.J. Eq. 769, 61 A.2d 76 (1948); 28 AM. JUR. 2d *Escrow* §§ 13, 14 (1966). The North Carolina Supreme Court did not comment on the fact that the buyer's attorney had acted as an escrowee in *Sutton v. Davis*, 143 N.C. 474, 55 S.E. 844 (1906). It would be a simple matter to resolve any uncertainty by legislation. A limitation on an attorney preventing him from acting as an escrowee is useless and wasteful.

<sup>98</sup> Cf. *Board of Educ. v. Union Dev. Co.*, 159 N.C. 162, 74 S.E. 1015 (1912).

down-date disclosed defects of title which went on the record after the preliminary title search, no transfer of legal title can occur until the defect is cleared.

From the attorney's viewpoint, escrow is ideal since it avoids the necessity of holding a closing which all the parties must attend. Instead, documents and checks can be deposited with the attorney as convenient; when all matters are in readiness, the attorney (or a paraprofessional employed by him) goes to the courthouse, makes the final title down-date, and records the documents. Each party is protected against the possibility that he might perform without the required performance by the other side and also against the other's death or incompetence.<sup>99</sup> The Bar Association can and should prepare standard form escrow instructions with blank provisions to accommodate the details of particular transactions and with language adequate to protect the attorney's position. Such forms are widely used in a number of states.

#### *Clarifying Ethical Issues*

At the core of the ethical problems discussed earlier in this article is the failure of the lawyer to identify his client. The principal cure is acceptance and enforcement of the view that an attorney in a real estate transaction should normally have only one client and that the client's identity should be clearly established at the transaction's outset. A consensus on this view is unlikely without the official sanction of the State Bar Council, which should be strenuously encouraged by its own members and by the North Carolina Bar Association to promulgate such a ruling. Only in the most unusual cases wherein a showing is made of the parties' sophistication and of their knowledgeable waiver should this rule be breached. And it is precisely parties of this sort who are ordinarily most aware of the need of individual representation and who employ their own counsel in any event.

Of course, the party most in need of counsel is usually the buyer. While no rule can compel that he be represented in every case, any attorney involved in a transaction should go to substantial lengths to advise the buyer of his need for counsel. In the large majority of cases in which there is presently only one lawyer involved in the transaction, there is no reason why that lawyer should not represent the buyer. This situation is

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<sup>99</sup> Upon fulfillment of all conditions, the passage of title is said to "relate back" to the time the deed was originally placed in the escrowee's hands; the intervening death or incompetence of the grantor is immaterial. *Craddock v. Barnes*, 142 N.C. 89, 54 S.E. 1003 (1906).

not inconsistent with the proposal above that the attorney act as escrowee, for an escrowee may well have simultaneous duties of honesty to all parties and of representation to one of them.<sup>100</sup>

Similarly, there is no objection to a buyer's attorney providing a lender with a certificate of title or procuring title insurance for him. It is quite common in many commercial transactions for one party's attorney to provide another party with a written opinion stating that specific legal requirements have been satisfied. The title opinion is not essentially different; the lawyer's duty to the nonclient party is limited to the accuracy of those matters stated in the opinion. The truth is that, beyond the need for honest supervision of closings and competent certificates of title, lenders in routine real estate transactions have no need for legal representation. Nonlegal employees of institutional lenders, working with familiar forms and procedures, are at least as capable of protecting the lender's interests as is the average lawyer.

But if the present borrower-lender conflict is to be prevented it will take more than a mere statement by the lawyer that he represents the buyer alone. It will also be necessary that the present lenders' practice that allows only a small group of local lawyers to close all loans be abandoned. So long as this practice persists, it is fatuous to suppose that the lawyer favored by the lender will be zealous in representing borrowers against the hand that feeds him. If forbidden to use such attorney-referral lists, the lenders may insist that they have their right to have persons of proven competence certifying their titles and closing their loans. The answer to this objection lies in the "approved attorney" system of title insurance which prevails in North Carolina. A lawyer who has satisfied one or more recognized title companies of his competence should be regarded as qualified *per se* to certify titles and close transactions in which loans are being made. Indeed, as to the title-certifying function, title insurance (which more and more is being required by lenders) in effect backstops the lawyer's work, virtually eliminating risk to the lender. At most the lender should have only the right to reject a particularly objectionable lawyer.<sup>101</sup>

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<sup>100</sup> See note 97 *supra*.

<sup>101</sup> A related problem occurs when a lender making a new loan requires a mortgagee's title insurance policy to be obtained from its affiliated title company. If the lender-lawyer tie-in is disentangled, the lender-insurer tie-in is no longer objectionable on grounds of legal ethics, but it is still potentially unfair to the borrower, who may be forced to choose between the owner's policy issued by the "kept" insurer (which may add little to the borrower's expense but give minimal coverage) and an independently issued owner's policy (which may have more comprehensive cov-

What agencies can change the existing lender-attorney relationship? A ruling by the State Bar Council would do the job, but the Council's past opinions evidence not the slightest inclination to treat the existing relationship as unethical. Nonetheless, the Council should be urged to re-examine and reverse its prior holdings. Another group of agencies that could take action for change are those regulating lenders. As to state-chartered banks and savings and loan associations, the appropriate state agencies could adopt the necessary regulations; the Federal Reserve Board and the Federal Home Loan Bank may be willing to act regarding federally chartered lenders. Mortgage bankers pose a greater problem, for they are essentially unregulated. But perhaps the greatest hope for change would lie in an increasing awareness by the bar itself of the unsoundness of present procedures and in an abandonment by the bar of those procedures.

Effective reform of the present ethical conundrum would require that lawyers no longer represent both buyers and sellers in the same transactions. And in the case of large-scale sellers, such as builders or subdividers, or in other cases in which the lawyer has a continuing relation with the seller, the lawyer should not represent the buyer even though he disclaims representation of the seller in the particular transaction. The need of sellers for legal representation is ordinarily not great,<sup>102</sup> particularly since at least one broker in the transaction will usually owe his principal duty to the seller. And when sellers wish to employ independent counsel, their legal fees will usually be relatively low since a seller's lawyer need not search a title or supervise a closing. The State Bar Council should be called upon to rule firmly against the buyer-seller conflict.

Consider the freedom resulting to the buyer's lawyer when the inhibitions of these conflicts of interest are removed. He can negotiate on his client's behalf for better sale terms and more favorable financing; he can recommend title insurance and point out the variations in coverage of different insurers. He can advise the buyer at the outset what the closing costs are likely to be and may suggest ways to minimize them. He can

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erage but will cost a full owner's premium—currently two dollars and fifty cents per thousand). This problem should be dealt with by the relevant regulatory agencies. Federally insured savings and loan associations appear to be forbidden to require a particular company's title insurance by 35 Fed. Reg. 18039 (1970).

<sup>102</sup> Aside from the need to be credited honestly with all of the sales proceeds due him, the seller ordinarily needs advice only in assuring that the warranties (of title and other matters) he gives do not go beyond what he is sure he can deliver. See Musser, *Why Clients Need Attorneys at Settlement*, 13 PRAC. LAW. 35 (No. 6, 1967).

scrutinize title from a buyer's rather than merely a lender's viewpoint. In short, he can behave like an advocate rather than a scrivener or book-keeper. Such a change is plainly in the best tradition of the legal profession.

### *Standardizing Procedures*

Great savings in time and substantial benefits to the parties in real estate transactions can be obtained by employing well-drafted standard forms if adequate provisions are made for their modification as necessary in individual transactions. A committee to prepare such forms and procure their acceptance by all of the professionals active in real estate transfers should be created, and its representatives should be selected from the bar, brokers, FHA and VA, lenders, title insurers, developers, and special representatives of the consuming public. Among the types of documents which can and should be standardized are the following:

1. *Deed Forms.* The typical form of warranty deed now in use is an extravaganza of obscure and obsolete verbiage. Many states have long used statutory deed forms which are very brief and which use special key words that, under some of the statutes, imply all customary warranties.<sup>103</sup> Such forms quickly become familiar to all who work in the real estate industry, and variations and additions can be spotted easily. Such forms particularly lend themselves to an electronically assisted title-search procedure and could be printed in a standardized, machine-readable form.

2. *Deed-of-Trust Forms.* North Carolina already has a provision permitting the recordation of master forms of documents and allowing subsequent short-form instruments to refer to them.<sup>104</sup> Under this provision, total recordation costs are reduced because the full text of long documents need not be recorded again for each transaction. But this procedure has not been widely used in the state, probably because there is much variation in the language of trust deeds used by various lenders. A committee of the type described above should be able to create a deed-of-trust form with language satisfactory to all lenders and to the FHA and VA.<sup>105</sup> By voluntary agreement, the lenders could then use this form and could record only the short version thereof making reference to the previously recorded

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<sup>103</sup> See R. POWELL, REAL PROPERTY ¶ 886 (abr. ed. 1968).

<sup>104</sup> N.C. GEN. STAT. § 47-21 (1966).

<sup>105</sup> At this writing an effort is being made by the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC) to create standard mortgage, deed of trust, and promissory note forms for conventional (non-FHA/VA) loans to be purchased by FNMA and FHLMC on their secondary markets. The proposed forms have been criticized as too harsh on borrowers. See 4 CLEARINGHOUSE REV. 468 (1971).

long version. Modifications for individual transactions would again be easy to spot. The parties would be provided with full copies of the long version, and the Bar Association might even prepare a pamphlet explaining to laymen their rights and duties under it.

3. *Title Insurance Applications.* The title insurers should have little difficulty creating standardized application forms and, thereby, easing the administrative work of attorneys approved by more than one title company. This procedure would reduce the tendency of some lawyers to make additional charges to clients for procuring title insurance.<sup>106</sup> And the Bar Association could readily adopt a certificate-of-title form containing parallel language for use in transactions in which title insurance is not used or in which the parties prefer to receive attorneys' certificates as well.<sup>107</sup>

4. *Contracts of Sale.* Although there is little reason to suppose that realtors and their employees can be prevented from drafting contracts of sale, there is hope for improving the quality of those contracts. The presently used form contracts distributed by the North Carolina Association of Realtors are far from being the worst forms the author has seen, but they need substantial improvement. Particular inadequacies exist with respect to title insurance, nature of the deed to be used, risk of damage, remedies for default, form of purchase-money security, special assessments, personal property, and other matters. A cooperative effort by the industry committee suggested above should result in a far better contract form. One highly desirable feature would be a blank space in which a broker could stipulate which party he represents.

Additionally, the contract should call to the attention of the parties their need for competent counsel. The California form adopted by the State Bar and the California Real Estate Association in 1967 (after long dispute between the two groups)<sup>108</sup> prominently displays the following legend:

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<sup>106</sup> The results of our questionnaire indicate that slightly less than one-third of the attorneys make an extra charge (commonly twenty-five dollars) for making application for title insurance.

<sup>107</sup> It would not be hard to improve on existing title certificate forms in use by the bar, particularly regarding the clear stipulation of matters not covered by a record search. See *Part I* at nn.70-83.

<sup>108</sup> See Armstrong, *New C.R.E.A. State Bar Marketing Contract*, 43 L.A.B. BULL. 165 (1968); *Real Estate Purchase Contract and Receipt for Deposit*, 42 CAL. B.J. 487 (1967). A similar agreement was reached in Chicago. See LeSuer, *Real Estate Broker Lawyer Accord*, 48 CHI. B. REC. Oct., 1966 at 7; Standing Committee on Unauthorized Practice of the Law, *Illinois Real Estate Broker-Lawyer Accord*, 32 UNAUTH. PRAC. NEWS 1 (No. 3, 1966); Legis. Note, 19 DEPAUL L.

A REAL ESTATE BROKER IS THE PERSON QUALIFIED TO ADVISE ON REAL ESTATE. IF YOU DESIRE LEGAL ADVICE CONSULT YOUR ATTORNEY.

The California form adds another warning with respect to the complex factors bearing on the way title is taken:

THE MANNER OF TAKING TITLE MAY HAVE SIGNIFICANT LEGAL AND TAX CONSEQUENCES. THEREFORE, GIVE THIS MATTER SERIOUS CONSIDERATION.

Given the well-known propensity of North Carolina brokers to advise married persons to take title in the entirety—a manner of taking which is not universally advantageous<sup>109</sup>—the warning is highly appropriate. But even if a buyer takes such legends seriously (and a majority probably do not), it will do no good unless the bar stands ready to represent buyers free of conflicting interests. If this can be accomplished, the revision of the contract form would be a highly worthwhile enterprise.

### *Reducing Closing Costs*

The cost of transferring real estate in North Carolina is not inordinately high in comparison to other jurisdictions,<sup>110</sup> and none of the

REV. 319 (1969). See also Committee on Unauthorized Practice of Law, *New York Attorney Reports Possible Compromise with Realtors—A Uniform Binder Agreement*, 28 UNAUTH. PRAC. NEWS 96 (1962).

<sup>109</sup> Many complicated factors are involved in any decision on the form—joint tenancy with right of survivorship, tenancy in common, tenancy by the entirety, or title in the name of the husband or wife alone—in which married persons should take title. Among those factors are the following: devolution of the property upon the death of either spouse [*see generally* Lee, *Tenancy by the Entirety in North Carolina*, 41 N.C.L. REV. 67 (1962)], claims of creditors of either party against the property [*see generally* *Id.*], and gift and estate tax consequences [*see generally* P. ANDERSON & R. WILSON, *TAX PLANNING OF REAL ESTATE* (5th ed. 1967)].

<sup>110</sup> It may be instructive to compare title and settlement costs in North Carolina with similar costs in southern California where procedures are radically different. In California transfers, an attorney is rarely utilized by any party. Closings are handled by commercial escrow companies, and title insurance is almost invariably obtained. On residential property costing twenty thousand dollars and subject to a new eighteen-thousand-dollar loan, the relative costs are approximately as follows:

<i>North Carolina</i>		<i>California</i>	
Attorney's fee	\$225	Escrow fee	\$ 97
Title insurance (ALTA owner's and lender's)	45	Title insurance (ALTA lender's; CLTA owner's)	168
Total	\$270	Total	\$265



reforms urged in this article should appreciably increase that cost. But in light of the serious difficulty encountered by many families of low and moderate income in financing the purchase of a home, it is important to consider the specific manner in which transfer costs are allocated between buyer and seller. Under present custom, the seller absorbs the

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One major factor that makes the "total" figures appear in close agreement is that the title insurance premium shown for California will buy an ALTA lender's policy, but only a California Land Title Association (CLTA) owner's policy. The major difference in the policies is the CLTA's lack of coverage of matters which an inspection or survey would disclose. However, if an ALTA lender's policy is being obtained, the California title company will in fact send an employee to make a visual inspection of the property in question, and if it appears advisable because of improvements near the property line, will also obtain a new or recent survey. Thus, while the CLTA-insured owner is not technically insured against such visible matters, there is a good chance that they will be revealed to him by the company's inspector or by the lender. In southern California, it is uncommon (when single-family homes are involved) and much more expensive to obtain an ALTA *owner's* policy; to obtain such a policy would raise the total given above from 265 dollars to 370 dollars. Another variable in closing costs is the cost of a survey, which is much more commonly required by insurers in North Carolina than those in California. The figures above assume no new survey is needed.

Only two generalized studies of title and settlement costs are known to the author, and both share one important defect: they do not explicitly separate the cost of settlement supervision from other fees usually charged home buyers. The earlier study is J. DUCEY & K. BERLIANT, *LOAN CLOSING COSTS ON SINGLE-FAMILY HOMES IN SIX METROPOLITAN AREAS* (Housing and Home Finance Agency, 1965). This work suffers from another defect—it does not use a standardized price and mortgage amount for comparison despite the fact that many title and settlement fees vary with price and loan amounts. The other study—Payne, *Ancillary Costs in the Purchase of Homes*, 35 *Mo. L. Rev.* 455 (1970)—uses a standard twenty-thousand-dollar purchase with a sixteen-thousand-dollar loan. Professor Payne found that mean costs of title assurance in his nationwide study ranged from 235 dollars to 267 dollars depending on the type of lender and the lender's requirements. But apparently some charges would have to be added to these figures to account for escrow fees or lawyers' fees for supervising settlement in order to make them comparable to the figures for North Carolina and California given above. Payne regards North Carolina as a medium-to-high-cost state, but his figures show a mean cost for establishing title in North Carolina ranging from 180 dollars to 283 dollars, again depending on the type of lender involved; thus, the North Carolina figures vary little from the national means.

Another factor tending to make the data less reliable is the practice in some locales (but not in California or North Carolina) whereby lenders provide settlement services and then pass on the cost to the borrower in the form of slightly higher financing fees.

On closing costs in general, see also *BUILDING THE AMERICAN CITY, REPORT OF THE NATIONAL COMMISSION ON URBAN PROBLEMS* 451 (1968); Gulledge, *Housing America in the '70's*, 50 *TITLE NEWS* 8 (No. 1, 1971). HUD and VA are required to submit a special report to Congress on the standardization and reduction of closing costs by July 24, 1971. See *The Emergency Home Finance Act*, Pub. L. No. 91-351, title VII, §701 (July 24, 1970). See 12 *U.S.C.A.* §1710 (Supp. 1971).

brokerage commission and sometimes the transfer tax. The buyer pays the attorney's fee, recording costs, title insurance premium, loan fees, and mortgage insurance premium. Taxes, hazard insurance premiums, utilities, and rents are prorated. Can any of the costs which custom now imposes on the buyer reasonably be shifted to the seller? The obvious one is the title insurance premium. It is quite logical to assert that a seller should pay for his buyer's title assurance.

Why is this shift in title premium payment desirable? The reason is simply that the seller usually has a ready fund from which to pay the the premium—the proceeds of the sale, which nearly always exceed the amount of his brokerage commission and the indebtedness on the property. If the payment of title insurance premiums by the seller becomes a general custom, the change in the long run increases no one's costs since the seller will save, when he buys his next house, the approximate amount he paid toward title insurance on the sale of the previous property.<sup>111</sup> But the great advantage of the change would be that the buyer, who is often pushed to the outer limits of his resources to make a down payment and cover other closing costs, would be relieved of at least one expense; thus, families of somewhat limited resources could afford to buy.

Even if it be assumed that the seller, under such a custom, will simply add the title insurance premium to the asking price of the house, the change would still be beneficial to the buyer, for it would allow him, in effect, to finance the title premium as a part of his long-term debt instead of paying it in cash at the closing. It is true that in the short run a shift to this custom would impose a double charge on some sellers who would pay a title premium both at the time of purchase and at the time of sale. But the burden would be small to a seller who receives several thousand dollars in capital gains on the sale (indeed, the premium could be applied to reduce the seller's capital gain for federal tax purposes),<sup>112</sup> and the benefit to home-buyers of modest means would make the change well worthwhile. Such a change would not be difficult if the brokers and the bar were agreed on its benefits.

#### CONCLUSION

The suggestions above do not solve every real estate problem, but

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<sup>111</sup> Of course, builders and subdividers will not recoup the cost of the title insurance in the same manner as a single-family home seller who is going to buy another home somewhere in North Carolina. But the builders and subdividers will merely add this cost on to the price of the property they sell.

<sup>112</sup> Treas. Reg. § 1.1034-1(b)(4)(i) (1957) (sale of personal residence); Treas. Reg. § 1.263(a)-2(c) (1958) (sale of capital assets in general).

they go a long way toward modernizing an archaic and poorly functioning system. As new problems arise and old ones are better recognized, an industry committee of the type described could study and correct them. The fact that real estate law has a medieval heritage is no reason for its continued fixation on that age.