

## **Legal Ethics in Commercial Real Estate**

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The role of the real estate attorney continues to change. These days, the commercial real estate attorney is often called upon to serve in dual roles as the transaction attorney and as a business consultant to the client given the attorney's access to current business trends and market information gained in the prior real estate transactions in which the attorney was involved. Similarly, the real estate attorney is often called upon as a technical expert in order to understand the many issues contained in each of the contracts involved in a commercial real estate transaction. Specifically, in order to effectively negotiate construction contracts, the attorney needs an understanding of the construction process. In order to discuss insurance provisions and recommend appropriate insurance coverage, the real estate attorney needs an understanding of commercial liability and torts. In order to effectively negotiate financing terms, the real estate attorney needs an understanding of commercial lending. Given this continuing evolution, the commercial real estate attorney must be cognizant of several relevant ethical standards that are specifically important in land transactions.

### **Disclosure Requirements Model Rules of Professional Conduct**

The ABA Model Rules of Professional Conduct, Rule 1.6 regarding confidentiality of information states:

- (a) *A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).*

- (b) *A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:*
1. *to prevent reasonably certain death or substantial bodily harm;*
  2. *to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyers services;*
  3. *to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyers' services;*
  4. *to secure legal advice about compliance with these Rules;*
  5. *to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client;*
  6. *to comply with other law or a court order.*
  7. *to detect and resolve conflicts of interest arising from the lawyer's change of employment or from changes in the composition or ownership of a firm, but only if the revealed information would not compromise the attorney-client privilege or otherwise prejudice the client*

Neither the ABA Model Rules of Professional Conduct nor the New Jersey Rules of Professional Conduct offer much in the way of guidance to the transactional attorney since the focus of the conduct of attorneys covered by these rules largely involves litigation matters. Accordingly, there is debate within the legal community regarding the application of the New Jersey Rules of Professional Conduct as it relates to disclosure requirements. For example, a seller in a real estate transaction has an obligation to disclose environmental contamination which is present on the property. However, it is questionable whether this same obligation extends to the seller's attorney. Specifically, it has been argued that to require attorneys to

disclose a discharge pursuant to New Jersey environmental regulations is contrary to the attorney's duty to maintain their client's confidential information.<sup>1</sup>

Likewise, there are very few statutorily mandated disclosures in commercial transactions as compared to the breadth of disclosures required in residential transactions. Federal laws dictate certain environmental disclosures. One such example is the disclosure regarding asbestos in the workplace found in the Code of Federal Regulations. CFR 1926.1101(n)(6) states that, "where the building owner has communicated and received information concerning the identification, location and quantity of ACM [asbestos-containing material] and PACM [presumed asbestos-containing material], written records of such notifications and their content shall be maintained by the building owner for the duration of ownership and shall be transferred to successive owners of such buildings/facilities."

Some states have required further environmental disclosures. One such example can be found in the legislation of the State of Washington. In 2010, Washington State became the first to require the seller of commercial real estate to disclose the environmental condition of such property to the buyer. RCW Code 64.06.013 requires disclosures related to substances, material or products in or on the property that may be environmental concerns, such as asbestos, formaldehyde, radon gas, lead-based paint, fuel, chemical storage tanks, contaminated soil or water, legal or illegal dumping sites, illegal drug manufacturing sites and other environmental hazards, as well as compliance with the ADA, existing easements, and leased parking space.

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<sup>1</sup>See Olson and Kneis, Reporting Releases From Clients' Underground Storage Tank Systems: Should Attorneys Have the Hot Line on Speed Dial?, 21 Seton Hall L. Rev. 1041 (1991), suggesting the requiring attorneys to disclose releases conflict with duties of client confidentiality.

When conducting a commercial real estate transaction, attorneys should research any required disclosures in their state and be mindful of the fact that the growing societal concerns with environmental conditions and other property conditions may have brought about state-based regulation.

### **Dealing with Unrepresented Parties**

The ABA Model Rules of Professional Conduct, Rule 4.3 regarding dealing with an unrepresented party, states:

*In dealing on behalf of a client with a person who is not represented by counsel, a lawyer shall not state or imply that the lawyer is disinterested. When the lawyer knows or reasonably should know that the unrepresented person misunderstands the lawyer's role in the matter, the lawyer shall make reasonable efforts to correct the misunderstanding. The lawyer shall not give legal advice to an unrepresented person, other than the advice to secure counsel, if the lawyer knows or reasonably should know that the interests of such a person are or have a reasonable possibility of being in conflict with the interests of the client.*

Additionally, in a comment to Rule 4.3, it is further stated:

*An unrepresented person, particularly one not experienced in dealing with legal matters, might assume that a lawyer is disinterested in loyalties or is a disinterested authority on the law even when the lawyer represents a client. In order to avoid a misunderstanding, a lawyer will typically need to identify the lawyer's client and, where necessary, explain that the client has interests opposed to those of the unrepresented person.*

*The Rule distinguishes between situations involving unrepresented persons whose interests may be adverse to those of the lawyer's client and those in which the person's interests are not in conflict with the client's. In the former situation, the possibility that the lawyer will compromise the unrepresented person's interests is so great that the Rule prohibits the giving of any advice, apart from the advice to obtain counsel. Whether a lawyer is giving impermissible advice may depend on the experience and sophistication of the unrepresented person, as well as the setting in which the behavior and comments occur. This Rule does not prohibit a lawyer from negotiating the terms of a transaction or settling a dispute with an unrepresented person. So long as the lawyer has explained that the lawyer represents an adverse party and is not representing the person, the lawyer may*

*inform the person of the terms on which the lawyer's client will enter into an agreement or settle a matter, prepare documents that require the person's signature and explain the lawyer's own view of the meaning of the document or the lawyer's view of the underlying legal obligations.*

Rule 4.3 of the ABA Model Rules and R.P.C. 4.3 of New Jersey are very similar in that they both clearly establish that the attorney has the responsibility to disclose to the unrepresented party the attorney's role in the matter and establishes a duty to the attorney to correct any misunderstanding that the unrepresented party may have regarding the attorney's role in the matter. Although it is uncommon that a party to a commercial real estate transaction is unrepresented by legal counsel, the attorney involved in the transaction with an unrepresented party should be mindful of the ethical obligations during such isolated instances.

### **Multiple Representations During Transactions**

The ABA Model Rules of Professional Conduct, Rule 1.7 regarding conflicts of interests with current clients states:

- (a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:
  - 1. the representation of one client will be directly adverse to another client, or*
  - 2. there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.**
- (b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:
  - 1. the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;*
  - 2. the representation is not prohibited by law;**

3. *the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and*
4. *each affected client gives informed consent, confirmed in writing.*

The Model Rules of Professional Conduct note several examples wherein Rule 1.7 was violated in the real estate context. While some examples do not apply directly to commercial real estate transactions, the same overarching conflicts of interest could arise in a commercial context. The Model Rules of Professional Conduct also note excerpts from various ethical opinions which shed further light on the applicability of Rule 1.7.

It should be noted that unlike the ABA Model Rule, New Jersey's RPC 1.7 provides that a government agency cannot waive the existence of a conflict of interest.<sup>2</sup> RPC 1.7 is different from the Model Rule since New Jersey requires that in order to waive a conflict it requires each affected client's consent after full disclosure of the circumstances and consultation with the client. Whereas, the Model Rule only requires consent following consultation and does not full disclosure. Furthermore, it should be noted that New Jersey continues to follow the appearance of impropriety doctrine<sup>3</sup> as contained in RPC 1.7(c). Under the appearance of impropriety standard, an attorney may be precluded from representing a particular client if the representation would create an appearance of impropriety even if there is no actual conflict of interest.

It should be noted that when an attorney is presented with a conflict situation within the meaning of RPC 1.7(a) or (b), that the attorney must obtain client consent in addition to establishing a reasonable belief that neither the relationship with the adverse client nor the

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<sup>2</sup>See RPC 1.7 subparagraphs (a) (2) and (b) (2)

<sup>3</sup>See Matter of Petition for Review of Opinion No. 569, 103 N.J. 325, 329-330 n.4 (1986).

present representation will be adversely affected. The Debevoise Committee Report, which is a report of the New Jersey Supreme Court Committee on the Model Rules of Professional Conduct, states that the New Jersey Rule incorporates a combined subjective and objective test for determining when conflicts of interest would prevent representation.<sup>4</sup>What is required, according to the Committee Report, is a subjective judgment consistent with an objective standard of reasonableness. Accordingly, an attorney may not merely rely upon his or her own subjective belief that he or she can adequately represent multiple clients; a reasonably prudent objective attorney must be able to draw the same conclusion under the same circumstances.<sup>5</sup>Accordingly, pursuant to RPC 1.7(a)(1), the inquiry and analysis by the attorney as to whether the dual representation is appropriate is critical since the attorney must reasonably and objectively believe that the representation will not be adversely affected by the conflict. However, notwithstanding the attorney's belief along with the client's consent, the representation may still be challenged as unreasonable in light of the facts and circumstances of the conflict.

In those cases where an attorney has represented multiple parties involving sophisticated commercial real estate transactions within New Jersey, the courts have held that the attorney's representation was impermissible notwithstanding the client's consent. For example, Opinion 682 of the Adv. Comm. on Prof. Ethics, 147 N.J. 360, 368 (1997) involved an attorney serving as agent for a title insurance company while simultaneously representing the purchaser of real estate in a transaction in which the company would be issuing a title policy. The New Jersey

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<sup>4</sup>Report of the New Jersey Supreme Court Committee on the Model Rules of Professional Conduct, N.J.L.J., July 28, 1983, supp. at 5.

<sup>5</sup>See Id. at 5-6, and See Michels, *New Jersey Attorney Ethics* (Gann Law Books, Newark, 2012), Section 19:1-1.

Supreme Court outlined the problem with the conflict of interest presented to the attorney in representing both the title company and the purchaser in the following manner:

*In the most basic terms, the purchaser seeks the maximum possible protection, as the success of any future claim depends on limiting exceptions and obtaining the most comprehensive coverage to protect against loss. The title company's interest is opposed to that of the purchaser; it strives to limit liability as much as possible in the event of a claim under the policy.*

Similarly, Baldassare v. Butler, 254 N.J. Super. 502 is a case involving an attorney involved in the dual representation of the buyer and seller in a commercial real estate transaction. Although the attorney obtained consent from both parties, the court held that the dual representation was impermissible. The court reasoned that it is improper for an attorney to represent both parties in commercial real estate transactions involving large sums of money and complex provisions which may be contained in the contract.

It should be noted that in several of the cases where a client's consent to a conflict has been disregarded, the court has invoked the appearance of impropriety doctrine in determining that the representation is impermissible. For example, in Reardon v. Marlayne, Inc., 83 N.J. 460, 477 (1980), a case involving an attorney who obtained client consent, the New Jersey Supreme Court held that the representation was impermissible notwithstanding the consent. The court reasoned that that in matters involving an appearance of impropriety, there is a duty to the general public as well as to the parties involved in a particular case. Consequently, the Reardon Court refused to permit the consent of a client to operate as a waiver in a situation that seemed to involve both an actual conflict and an appearance of impropriety<sup>6</sup>.

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<sup>6</sup>Id. at 475, 477



The Model Rules of Professional Conduct, Rule 1.8 regarding specific conflicts of interest with current clients states:

- (a) a lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:*
  - 1. the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;*
  - 2. the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and*
  - 3. the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.*
- (b) A lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client gives informed consent, except as permitted or required by these Rules.*
- (c) A lawyer shall not solicit any substantial gift from a client, including a testamentary gift, or prepare on behalf of a client an instrument giving the lawyer or a person related to the lawyer any substantial gift unless the lawyer or other recipient of the gift is related to the client. For purposes of this paragraph, related persons include a spouse, child, grandchild, parent, grandparent, or other relative or individual with whom the lawyer or client maintains a close, familial relationship.*
- (d) Prior to the conclusion of representation of a client, a lawyer shall not make or negotiate an agreement giving the lawyer literary or media rights to a portrayal or account based in substantial part on information relating to the representation.*
- (e) A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that:*
  - 1. a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter; and*
  - 2. a lawyer representing an indigent client may pay court costs and expense of litigation on behalf of the client.*
- (f) A lawyer shall not accept compensation for representing a client from one other than the client unless:*
  - 1. the lawyer gives informed consent;*

2. *there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and*
  3. *information relating to representation of a client is protected as required by Rule 1.6.*
- (g) *A lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of or against the clients, or in a criminal case an aggregated agreement as to guilty or nolo contendere pleas, unless each client gives informed consent, in a writing signed by the client. The lawyer's disclosure shall include the existence and nature of all the claims or pleas involved and of the participation of each person in the settlement.*
- (h) *A lawyer shall not:*
1. *make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless the client is independently represented in making the agreement; or*
  2. *settle a claim or potential claim for such liability with an unrepresented client or former client unless that person is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel in connection therewith.*
- (i) *A lawyer shall not acquire a proprietary interest in the cause of action or subject matter or litigation the lawyer is conducting for a client except that the lawyer may:*
1. *acquire a lien authorized by law to secure the lawyer's fee or expenses; and*
  2. *contract with a client for a reasonable contingent fee in a civil case.*
- (j) *A lawyer shall not have sexual relations with a client unless a consensual sexual relationship existed between them when the client-lawyer relationship commenced.*
- (k) *While lawyers are associated in a firm, a prohibition in the foregoing paragraphs (a) through (i) that applies to any one of them shall apply to all of them.*

Although there are limited number of cases involving commercial real estate transactions, most of the violations by attorneys under either ABA Model Rule 1.8 or New Jersey RPC 1.8 are related to misuse of client funds, taking improper advantage of parties in a real estate transaction and in those cases where an attorney has breached a fiduciary duty while participating as a

business principal in a real estate transaction. Additionally, it has been argued that an attorney who assists a client in circumventing a due on sale clause may be acting in an unethical manner.<sup>7</sup>

The ABA Model Rules of Professional Conduct, Rule 1.9 regarding duties to former client's states:

- (a) A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing.*
- (b) A lawyer shall not knowingly represent a person in the same or a substantially related matter in which a firm with which the lawyer formerly was associated had previously represented a client,*
  - 1. whose interests are materially adverse to that person; and*
  - 2. about whom the lawyer had acquired information protected by Rules 1.6 and 1.9(c) that is material to the matter; unless the former client gives informed consent, confirmed in writing.*
- (c) A lawyer who has formerly represented a client in a matter or whose present or former firm has formerly represented a client in a matter shall not thereafter:*
  - 1. use information relating to the representation to the disadvantage of the former client except as these Rules would permit or require with respect to a client, or when the information has become generally known; or*
  - 2. reveal information relating to the representation except as these rules would permit or require with respect to a client.*

Similar to the other model rule of professional conduct and New Jersey Rules of Professional Conduct, there is little guidance provided under ABA Model Rule 1.9 relating to dealing with former clients. However, attorneys are mindful to obtain former and current client waivers when required. Also, it should be noted that changing law firms does not exempt an

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<sup>7</sup>See Roszkowski, Drafting around Mortgage Due-on-Sale Clauses: The Dangers of Playing Hide-and-Seek, 21 Real Prop. & Tr. J. 23 (1986).

attorney from compliance with this Rule in both obtaining the requisite waivers and maintaining client confidentiality.

### **Examples of Ethical Issues in Real Estate Transactions**

In his presentation titled *Ethics and Professional Responsibility in Real Estate Transactions*, Attorney Michael J. Brody gave several examples of varying ethical situations that an attorney may face when handling such transactions. Some of the ethical situations include dual representations of clients, representation of clients with adverse interests, unrepresented persons, clients with competing interests, hidden conflicts and disclosure.

#### **Dual Representation as a Conflict of Interest**

**Fact Situation 1:** A law firm has a longstanding relationship with Client C and a similar longstanding relationship with client D. Client C and Client D want to form a partnership to build a commercial office building.

- a. It would seem that the law firm cannot represent both Client C and Client D in the formation of the partnership. Each, after all, is a different client, with different issues wants and needs.
- b. The law firm should decline representation of both Client C and Client D and recommend that each seek different counsel for the purposes of preparing the partnership agreement, and, as an added precaution have another counsel prepare the partnership agreement.
- c. It is not uncommon that clients will want their law firm to represent them, even in the face of apparent conflicts of interest. The law firm would need to advise in writing,

signed by all parties, both Client C and Client D that: (1) the law firm represents both clients; (2) there is no unanimity of interest as between Client C and Client D; and (3) as a result, a situation may arise in which interests of Client C may not be the same as, or even adverse to, the interest of Client D.

**Fact Situation 2:** A law firm has a longstanding relationship with Client E and a similar longstanding relationship with Client F. Client E and Client F have formed partnership AB represented by other, separate counsel. The partnership has purchased a commercial office building. Client E and Client F would like the law firm to represent partnership AB in loan negotiations with the lender M. We might even make this hypothetical more complex by adding that the lender wants Client E and Client F to guarantee the loan.

- a. It would seem that the law firm could, with waivers of conflicts and consents to representation, represent partnership AB.
- b. Again, the law firm would need to advise in writing, signed by all parties, both Clients E and Client F that: (1) the law firm represents, or has represented, both Client E and Client F; (2) there is unanimity of interest between Client E and Client F; and (3) as a result, a situation may arise in which the interests of Client E differ from and may be adverse to the interests of Client F.

### **Representation of a Client with Adverse Interests in Unrelated Transactions**

**Fact Situation:** The Law firm represents a client; let us say a borrower, who is borrowing from a lender that the law firm has been representing in unrelated transactions.

Although not as obvious a conflict as the direct dual representation, in cases where a law firm wishes to represent a client in an unrelated transaction which is adverse to another client of the law firm, a conflict nevertheless exists which requires that a waiver be obtained from both clients.

- a. Where the adverse interest involves a real estate transaction the waiver is frequently granted.
- b. However, where the existing adverse relationship involves litigation or bankruptcy, the representation of the adverse party may be impossible or invisible.

### **Unrepresented Persons**

**Fact Situation:** The attorney is representing a party to the transaction and one or more of the other parties are not represented by counsel. This often occurs in uncomplicated real estate loan transactions [as opposed to commercial transactions]. In those instances, it is absolutely essential that the attorney who is representing a party go on record in writing to the other party advising that the other party has their own counsel.

- a. If the attorney who is preparing the documents is representing only his or her own client, the attorney should advise the other party to have the documents reviewed by such party's attorney.
- b. A signed waiver is again highly advisable.

## Representing Clients with Competing Interests

**Fact Situation:** Two clients are attempting to purchase the same office building. This is an obvious conflict which may require withdrawal from representation on behalf of both perspective purchasers.

### Hidden Conflicts

**Fact Situation:** One partner in a law firm represents a tenant who desires to lease a parcel of land for a large retail store. Unbeknownst to that partner, another partner in the same firm is representing the arch competitor of the first attorney's client which is attempting to lease the same parcel of land. It suddenly dawns on the two partners through a casual conversation that the situation exists as described.

- (a) The law firm will find itself in a true predicament because neither attorney can reveal to his or her client the interest of the other partner's client.
- (b) This very situation has been debated at several ethics programs and apparently the only safe answer is for the law firm under such circumstances to withdraw on behalf of both clients without revealing the reason for the withdrawal. This is not likely to make either of the clients very happy.

### Disclosure

**Fact Situation 1:** The attorney has knowledge that the borrower is making a material misrepresentation to the lender. If the attorney were to notify the lender, the attorney would violate the attorney's duty of confidentiality. Yet there is a strong basis in the ABA Model Rules

for suggesting that an attorney cannot be involved in a scheme or plan to defraud. If the attorney's client refuses to make disclosure where the attorney believes that there is fraud or misrepresentation involved, must the attorney immediately resign from representation?

**Fact Situation 2:** The attorney has knowledge through an environmental report that a property which is about to be used as security for a loan has environmental problems, which would, if brought to the attention of the lender, delay or possibly kill the closing. If the client refuses to reveal the problem, the attorney may decide to resign from the representation. However, under these circumstances there is the additional problem of potential liability to third parties and the possibility of violation of state or local laws for failure to report conditions which are required to be reported. If the client refuses to reveal the facts, the attorney may have an additional duty to bring these facts to the attention of the appropriate authorities in circumstances where laws may be violated or there may be danger to third parties.