

DELAWARE STATE BAR ASSOCIATION
COMMITTEE ON PROFESSIONAL ETHICS

OPINION 1978-3

We have been requested to give an opinion on the ethical propriety of the employment of in-house counsel by certain borrower-owned cooperatives or credit associations ("the Associations") whose purpose is to provide a source of agricultural credit to farmers and rural homeowners at the least possible cost.

In furtherance of this aim of cost reduction, the Associations are considering the employment of in-house counsel to: (1) conduct real estate title searches for the Associations; (2) provide the Associations with title certifications as to the lien position on title searches; (3) prepare financing statements, security agreements, loan agreements and perfect security interests in personal property for the Associations; (4) conduct loan settlements for the Associations; and (5) perform such other legal duties and provide legal advice to the Associations as may periodically be required.

The Associations would pay in-house counsel a salary to be set by the Associations' boards of directors. Although borrowers would make no direct payments for attorneys' fees, the loan service fee, set by the boards of directors, would in all likelihood be increased to cover the cost incurred by the Associations in having their own in-house counsel. The borrower would, of course, have the option of obtaining his own attorney to represent him at settlement and to protect his interests regarding the loan transaction, but would be required to pay his own attorneys' fees directly.

In the written request for this opinion, the Associations recite as follows:

"Borrowers from either or both of the Associations would make no direct payment for attorney fees. However, the Associations would in all likelihood increase their present loan service charge to borrowers to cover the increased cost incurred by the Associations having their own in-house counsel. The loan service fee would be set by the Board of Directors. It is projected that the fee could be

kept at a minimal percentage of the loan and would in actuality represent a reduced closing cost to the borrower since the borrower would no longer be required to pay an attorney's fee for the title search or other charges associated with loan closings."

OPINION

If the proposed plan is seen simply as the shifting of the burden of the Associations' legal costs to the borrower it is ethically permissible, but only after full disclosure of the nature and effect of the relationship to the borrower; however the arrangement proposed does not appear to accomplish its purpose as it will not provide the borrower the legal protection afforded by an attorney/client relationship, and if it is to be pursued such facts must be fully disclosed to the borrower to avoid confusion.

DISCUSSION

Initially, the matter may be analyzed in the following two steps: (1) whose lawyer is in-house counsel? and (2) who is paying for his services?

The first question is easily answered. The matters being transacted are ones in which the borrower and the lender have conflicting interests. As we point out below, the Associations' in-house counsel may not furnish representation to the borrower. Thus, the lawyer in question, being on salary with the Associations represents only the lender. The fact that the borrowers are members of the Associations does not alter the result or the conflict; indeed, it serves potentially to obscure the situation to a layman and make clarification essential.

The second question appears equally easily answered: Since the Associations would in all likelihood increase their service charges to cover the services of in-house counsel, the borrower will be paying for legal work done for the Associations. There is nothing inherently wrong with shifting legal costs in a transaction where the fact is openly disclosed and the payments are freely made by a party who understands that he is not thereby obtaining legal advice but is simply paying the other side's fees. Such cost shifts, in which one party pays for

the other party's lawyer occur frequently in, for example, corporate transactions and settlements of claims in litigation.

If the proposal is simply a fee shifting device and it is done openly, the lawyers who participate are not in breach of ethics.

We do not wish, however, to be understood to acquiesce in the following statement taken from the Associations' letter:

"It is projected that the fee could be kept at a minimal percentage of the loan and would in actuality represent a reduced cost to the borrower since the borrower would no longer be required to pay an attorney fee for the title search or other charges associated with the loan closing."

If the borrower does not retain a lawyer himself, he will not be legally represented. The lawyer who does the work will not be the borrower's lawyer nor will that lawyer owe him a duty of care or confidence. In short, the borrower will be unrepresented in the transaction and must appreciate that fact. It would be unethical for in-house counsel to permit any confusion on the part of the borrower with regard to this state of affairs.

The situation described in Delaware Supreme Court Interpretative Guideline No. 1 to DR2-103 has some helpful analogies. There the Supreme Court of Delaware requires a lawyer referred to a borrower by a lender to make clear his status as the "regular lawyer for the lender" and may not act for the borrower unless freely selected after such full disclosure. At least one way that situation differs from the one presented here is that, after the disclosures and free selection the borrower does, in fact, have his own lawyer. Here he will not.

We do not understand that the Associations purport to furnish representation to the borrower. If they did, such representation would amount to the unauthorized practice of law by the Associations. Except for professional service corporations registered with the Delaware Supreme Court, corporations may not ethically provide legal services to the public.

What is proposed, then, is that the itemized services are to be performed for the Associations and the cost of the services shifted to the buyer. If the buyer remains unrepresented in the transaction, he may well not pay as much money as if he hired his own lawyer, but it would be unethical for the lawyer for the Associations to permit the borrower to believe, as the above quoted statement may be read to imply, that what money the borrower pays in shifted costs obtains him any protection by legal representation. If the borrower obtains legal representation, the net result may well be more expensive for the borrower under the Associations' proposal.

Thus, the situation suggested here involves no ethical breach by the in-house counsel for the Associations if each borrower is carefully advised that (1) unless he retains his own lawyer he will be unrepresented by counsel; (2) the lawyer who is doing the legal work is the Associations' lawyer and will owe the borrower no legally enforce-able duty of fidelity, due care or confidentiality; (3) if errors or omissions are made by the lawyer the borrower may not be able to recover damages from the lawyer for malpractice; (4) an actual conflict of interest exists between the borrower and lender and should such conflict give rise to open disagreement, such as a disagreement over the loan terms, the lawyer will act for the Associations and the borrower will have to seek his own counsel; (5) such disagreements between borrower and lender are not infrequent; and (6) a trained lawyer representing the-buyer would be much more likely to discern problems in the transaction from the borrower's point of view than would the borrower acting for himself.

December 14, 1978