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"Sweetheart" Arrangements Between Lenders and Their Title Lawyers-Are They Really?

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"SWEETHEART" ARRANGEMENTS BETWEEN LENDERS AND THEIR TITLE LAWYERS - ARE THEY REALLY? -

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INTRODUCTION

During the past two decades, with the advent of the consumer movement, the loan practices of banks and other lending institutions have come under increasing scrutiny by both federal and state legislative and regulatory bodies. This has led to a proliferation of statutes, rules, and regulations designed to remedy certain perceived deficiencies in consumer loan practices.[1] One of the more common practices that has come under attack recently is lending institutions requiring borrowers, in connection with home mortgage loans, to pay the fees of attorneys selected by the lending institution to perform legal services incident to making the particular loans involved. Critics have characterized this required attorney system as both unfair and anticompetitive[2] as well as a denial of "con-

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Jackson, Kelly, Holt & O'Farrell does not generally examine titles in connection with home mortgage loans for or on behalf of lending institutions. The firm does, however, represent the West Virginia Bankers Association as well as various lending institutions in West Virginia. In connection with such representations, Mr. Blair appeared before the Attorney General of West Virginia to voice the firm's clients' opposition to the proposed rules which are the subject of this article.

[1] The loan practices of lending institutions are governed by numerous federal laws and regulations. *See, e.g.*, The Community Reinvestment Act Regulations, 12 C.F.R. § 25 (1979); Equal Credit Opportunity, Regulation B, 12 C.F.R. § 202 (1979); Home Mortgage Disclosure, Regulation C, 12 C.F.R. § 203 (1979); Truth in Lending, Regulation Z, 12 C.F.R. § 226 (1979); Fair Housing Regulations, 12 C.F.R. § 338 (1979); Real Estate Settlement and Procedures, Regulation X, 24 C.F.R. § 3500 (1979). This ever growing list of rules has led one commentator to cite with some despair the admonition of James Madison:

> It will be of little avail to the people that laws are made by men of their own choice if the laws be so voluminous that they cannot be read; or so incoherent that they cannot be understood; or if they be repealed or revised before they are promulgated or undergo such increasing changes that no man who knows what the law is today, can guess what it will be tomorrow.

The National Law Journal, December 4, 1978.

[2] Clark Frame, former President of the West Virginia Trial Lawyers Association, in a written submission to the Attorney General of West Virginia characterized the required attorney system as "one of the most nefarious practices that one encounters in the legal system." According to Mr. Frame, the required attorney system denies the consumer the right to an attorney in whom he may have great confidence in one of the most important legal transactions in which he may ever be involved. Record of Written Submissions to the Attorney General of West Virginia Concerning the Required Attorney System, 50 (1979) [hereinafter cited as Written Submissions].

sumer sovereignty."[3] In addition, they have challenged it on antitrust grounds.[4]

One of the most recent attacks on this practice occurred in West Virginia where the State's Attorney General promulgated proposed rules[5] designed to eliminate it. In announcing these proposed rules, the Attorney General attacked what he characterized as "sweetheart" arrangements between lending institutions and certain title lawyers on the basis that those arrangements served to maintain noncompetitive prices for the legal services involved. Both the initial and revised versions of the rules[6] sought to eliminate this claimed restraint on competition by attempting to prevent lending institutions from requiring that any attorney other than one chosen or approved by the borrower perform the necessary title work incident to a home mortgage loan.

Curiously, the proposed rules do not attempt to regulate lending institutions directly, but instead are aimed primarily at attorneys.[7] Specifi-

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[3] *Id.* at 135. While a popular sounding phrase, the precise definition of "consumer sovereignty" is elusive.

[4] *See, e.g.,* Foster v. Maryland State Savings & Loan Ass'n, 590 F.2d 928 (D.C. Cir. 1978), *cert. denied,* 99 S. Ct. 842 (1979); Forrest v. Capital Bldg. & Loan Ass'n, 385 F. Supp. 831 (M.D. La. 1973), *aff'd,* 504 F.2d 891 (5th Cir. 1974), *cert. denied,* 421 U.S. 978 (1975).

[5] W. Va. Att'y Gen. Proposed Rule to Abolish the Required Attorney System in Title Searches Paid for by the Borrower, 14-2 W. VA. ADM. REG. (1978) [hereinafter cited as Proposed Rule].

[6] W. Va. Att'y Gen. Proposed Rule to Abolish the Required Title Examinations Paid for by the Borrower, 14-2 W. VA. ADM. REG. (1979) [hereinafter cited as Revised Proposal].

[7] The revised rules speak in terms of "title examiners" rather than simply attorneys in order to reach these occasional instances where title examinations are performed by professional abstractors. *See* Revised Proposal, *supra* note 6, § 101; W. Va. Att'y Gen. Commentary on Rule, 14-2 W. VA. ADM. REG. (1979) [hereinafter cited as Commentary]. Generally, however, title examinations in West Virginia are performed by attorneys.

By imposing sanctions against attorneys rather than lending institutions, the Attorney General apparently hoped to avoid questions of federal preemption as to federally regulated lenders as well as possible conflicts with the Commissioner of Banking for West Virginia who is charged with overseeing the activities of state chartered lending institutions. W. VA. CODE § 31A-2-4 (1975).

The West Virginia Attorney General's authority to regulate the manner or method by which individual attorneys conduct their practice may likewise be subject to the attack. As a number of individuals pointed out at the public hearings and in written submissions, the West Virginia Supreme Court of Appeals has repeatedly held that it is vested with the inherent and constitutional right to regulate and control the practice of law in West Virginia. *See generally* State ex rel. Partain v. Oakley, _ W.Va. _, 227 S.E.2d 314 (1976); Committee on Legal Ethics of W. Va. State Bar v. Graziani, _ W. Va. _, 200 S.E.2d 353 (1973), *cert. denied,* 416 U.S. 995 (1974). Whether the Court would permit a state agency to exercise concomitant jurisdiction over those activities is an open and contested point as was made clear by the West Virginia State Bar which stated:

> The proposed rule of the Attorney General would have the effect of regulating the practice of law in West Virginia. As a member of the executive branch of government, the Attorney General has no authority over the practice of law under the separation of powers doctrine. The regulation of the practice of law has been declared to be inherent in the Supreme Court of Appeals. The West Virginia State Bar vigorously opposes any attempt by the Attorney General or any other State official other than the Supreme Court of Appeals to regulate the practice of law.

Written Submissions, *supra* note 2, at 278.

cally, the proposed rules prohibit an attorney from accepting compensation incident to a home mortgage loan unless that attorney is chosen or approved by the borrower.[8] As a result, no attorney retained by a lending institution to certify the validity of the institution's lien on the property to be mortgaged as security for the home loan may accept compensation in connection with that representation without violating the proposed rules. The only exception would appear to be those instances in which the attorney receives assurances that the borrower will not bear the costs for these services either as a direct charge or in the form of higher origination fees, interest rates, or prepayment penalties.

The claimed legal basis for the proposed ban is two-fold. It is predicated upon the West Virginia Antitrust Act, which prohibits "every . . . combination . . . or conspiracy in restraint of trade or commerce,"[9] and upon the West Virginia Consumer Credit and Protection Act, which prohibits "unfair methods of competition" and "unfair or deceptive acts or practices."[10] Unfortunately, the proposed rules also are predicated upon a basic misconception of the role of the lending institution's attorney in mortgage loan transactions.

These proposed rules, if adopted,[11] may have a significant and adverse impact upon the costs of home mortgage loans in West Virginia.[12] Moreover, they reflect a growing trend among the states to restrict the right of lending institutions to employ legal counsel to perform services for them incident to a home mortgage loan and pass the cost of those services on to the borrower as a part of the cost of the loan. Virginia,[13] New Jersey,[14]

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[8] *See* Revised Proposal, *supra* note 6, §§ 3.04, 4.02.

[9] W. VA. CODE § 47-18-1 (Cum. Supp. 1979).

[10] W. VA. CODE § 46A-6-104 (1976).

[11] Originally, the rules were to become effective on February 16, 1979. *See* Proposed Rules, § 1.03. Following public hearings, however, the Attorney General did not file the proposed rules with the Secretary of State, but called for a one-year period of voluntary compliance. If voluntary compliance succeeds, the proposed rules will not be filed. If voluntary compliance fails, the Attorney General intends to seek the necessary legislative approval to implement those rules. *See* Revised Proposal, § 1.04. Prior approval by the Legislative Rule-Making Review Committee is mandated by § 29A-3-11 of the West Virginia Code. By electing to seek voluntary compliance, the Attorney General has avoided temporarily a possible confrontation in the Legislative Rule-Making Review Committee over adoption of the proposed rules as well as protracted litigation in the event the rules had been implemented.

[12] *See* text accompanying note 91 *infra*.

[13] VA. CODE § 6.1-330.23 (1979) provides in pertinent part:

> [A mortgage lender] may require the borrower to pay the reasonable and necessary charges in connection with making the loan, including the cost of title examination . . . . Provided, that in the case of loans on one to four family residences, the lender may not require the borrower to use the services of a particular attorney . . .; however, the lender shall have the right to approve any attorney . . . selected by the borrower; provided such approval is not unreasonably withheld. . . .

[14] N. J. STAT. ANN. § 46:10A-6 (1978 Supp.) provides in part:

> No . . . "lender" shall require a borrower of a loan to be secured by a mortgage on real estate to employ the services of the lender's counsel or an attorney specified

Rhode Island,[15] Maine[16] and South Carolina,[17] for example, have enacted legislation within the past four years restricting lending institutions' right to designate their own attorney in home mortgage situations. Finally, the Attorney General has suggested that his proposed rules serve as a model for federal regulations designed to eliminate these so-called "sweetheart" arrangements on a nationwide basis.[18]

The proposed rules raise serious questions regarding the propriety of proscribing the activity involved, the legality of their promulgation and implementation, and their likely effect on the cost of home mortgage loans. Careful analysis demonstrates that the practice which the Attorney General of West Virginia and the statutes in other jurisdictions seek to regulate is not unconscionable. Moreover, a ban of this practice, whether by statute or regulation, may be particularly ill-advised since it is likely to increase significantly the cost of home mortgage loans to borrowers.

ETHICAL CONSIDERATIONS

In issuing the proposed West Virginia rules, the Attorney General publicly declared that, if adopted, they could save home buyers in West Virginia up to $300 on the cost of financing a purchase.[19] This saving,

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by the lender but the borrower shall have the right to be represented in the transaction by an attorney at law of New Jersey of his own selection. The provisions of this act shall not preclude a lender from requiring that documents prepared in connection with a mortgage loan transaction prepared by a borrower's attorney to be submitted to the lender's attorney for examination and review and to require the borrower to pay a reasonable fee . . . for such service . . . .

[15] R. I. GEN. LAWS § 19-10-9 (1978 Supp.) provides:

Every [lender] which requires that a title attorney search the title of the subject real estate shall first permit the prospective mortgagor to select a qualified title attorney of his own choice to search the title of the subject real estate, provided the lending institution may require the prospective mortgagor to provide it with a title insurance policy in the amount of the mortgage. In the event the prospective mortgagor does not select a qualified title attorney, then the prospective mortgagor shall sign a waiver permitting the lending institution to select its own attorney.

[16] MAINE CODE ANN. Ch. 9-13, § 439 (1979 Supp.) provides:

Every financial institution . . . which requires that an attorney search the title of the subject real estate shall first permit the prospective mortgagor to select a qualified attorney of his own choice to search the title of the subject real estate, provided the financial institution may require the prospective mortgagor to provide it with adequate liability insurance or such other written policy requirements as the bank may deem necessary to protect its interests.

[17] S.C. CODE § 34-31-31 (1979 Supp.) states that "[n]otwithstanding any other provision of law, the borrower shall have the right to select the closing attorney."

[18] On March 30, 1979, letters were sent to the Chairman of the Federal Home Loan Bank Board, the Chairman of the Federal Deposit Insurance Corporation, the Chairman of the Federal Reserve Board and the Comptroller of the Currency suggesting that they may wish to amend their regulations to prohibit what he views as an unconscionable practice particularly where the attorney designated by the lending institution is also an officer, director, or major stockholder of that institution.

[19] Written Submissions, *supra* note 2, at 809-10, 813-14.

according to the Attorney General, would result from increased competition among attorneys and accompanying reductions in attorneys' fees charged to consumers.[20] Following public hearings, the Attorney General determined that the record "clearly indicated" that "sweetheart" arrangements cause injury to competition and are unfair to consumers and competitors.[21] Specifically, he stated that as a direct result of this practice, "[c]onsumers pay noncompetitive prices and are denied the opportunity to choose whom they must pay. Lawyers are denied the opportunity to compete with their services."[22] Moreover, the Attorney General concluded that "[n]o compelling interest by tied lawyers or lending institutions is justification for the practice."[23]

The Attorney General's "analysis" of the fact supporting the proposed rules ignored the principal issue surrounding the controversy over his proposal and similar state statutes. He relied instead on the simplistic assertion that since the borrower pays the attorney's fee he should have the right to select that attorney. While initially this appears logical, it fails to address the more fundamental question of whether lending institutions, which usually make a greater initial "investment" than the borrower does, should have the right to employ counsel in whom they have confidence to perform title examinations, and to pass the costs of those examinations on to the borrower as a cost of the loan. Basic to the resolution of this issue is the related question of whether the title lawyer represents the borrower or the lending institution in connection with the services he renders.

A number of borrowers who appeared at the public hearings on the proposed rules indicated that they believed their interests were, in fact, being represented by the lending institution's attorney.[24] Surprisingly,

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[20] Aside from the Attorney General's assertions that so-called "sweetheart" arrangements between lending institutions and certain attorneys restrict competition among attorneys and keep the price of title searches high, Proposed Rule, § 2.01, nothing has been offered to support the contention that the challenged practice adversely impacts upon the cost of home mortgage loans. No empirical study of the practice involved and its effect on costs has been cited, nor has there been any reasoned analysis of the effects of the proposal on these costs. The record indicates that there has been no careful analysis of the effect which either the practice sought to be banned or the ban itself will have upon the cost of home mortgage loans. The Attorney General, however, has attempted to sidestep this deficiency by simply stating that "[w]ithout regard to lower costs, competition itself is an appropriate goal" and that "in the long run competition will reduce costs." Commentary, *supra* note 7, at 380. *But see* Written Submissions, *supra* note 2, at 135. The abolition of the required attorney system may not necessarily result in lower costs. *See* text accompanying notes 83-84 *infra.*

[21] *See* Commentary, *supra* note 7, at 43. Whether the record justifies the conclusion reached by the Attorney General is, at the very least, questionable.

[22] *Id.* at 43.

[23] *Id.*

[24] *See id.* at 13-14. It may well be that few lenders inform the borrower in a meaningful way that the attorney being designated by the lender to certify title and prepare the necessary closing papers is, in fact, representing the lender and not the borrower. To the extent this problem does exist, however, it is clearly one of disclosure. Moreover, any confusion

however, some members of the bar were unsure of exactly who they represented. In some instances, they expressed the opinion that they represented *both* the borrower and the lender.[25] Yet, both the American Bar Association and the West Virginia State Bar have made clear that this type of dual representation may raise serious ethical problems if it impairs the independent professional judgment of the attorney, or is undertaken absent informed consent by both the borrower and the lender.[26]

In Legal Ethics Inquiry 78-7, the West Virginia State Bar Committee on Legal Ethics reviewed the propriety of precisely the type of arrangement which the Attorney General attacks.[27] There, a West Virginia attorney had complained of several incidents in which his clients sought home mortgage loans from one or more lending institutions and were told that an attorney selected by the lending institution would do the title examination and prepare the closing papers. The Legal Ethics Committee unequivocally rejected the complaining attorney's contention that this practice was both unethical and unconstitutional.

While it recognized that under certain circumstances, an attorney might represent both the borrower and the lender, the Legal Ethics Committee made clear that as a general rule:

> A lending institution may properly employ an attorney to perform services for it and to pay [sic] that attorney for such services, and, if it desires, to charge [sic] the person obtaining the loan with the cost of the loan including attorney fees. *In such case the attorney is the attorney for the lender and not the person obtaining the loan.* The borrower may employ an attorney of his own choice, at his cost, and obtain from him a title examination and have him present at the execution of the closing papers. The lenders' interests are substantial and they may impose this

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resulting from a failure of communication is not germane to a resolution of the question of whether lending institutions have a right to employ counsel to represent their interests in connection with loan closings and to pass the costs on to the purchaser of the loan.

[25] *See* Commentary, *supra* note 7, at 15-17.

[26] Of the attorneys expressing the opinion that they represented both the borrower and the lender in the mortgage loan transaction, it appears that few advised their "clients" of this dual representation and obtained their prior consent. *See* Commentary, *supra* note 7, at 13. An attorney should not represent both sides of the same transaction if the exercise of his independent professional judgment on behalf of either might be affected. The West Virginia Code of Professional Responsibility and the ABA Code of Professional Responsibility both specifically provide that a lawyer should decline employment opportunities if he might be involved in representing differing interests. *See* ABA CODE OF PROFESSIONAL RESPONSIBILITY (ABA CODE), DR 5-105(A); W. VA. CODE App., Code of Professional Responsibility, DR 5-105 (1975). An attorney should consider representing both sides of a transaction only if it is obvious that he can adequately represent the interests of each party to the transaction. ABA CODE, DR 5-105(c); W. VA. CODE App., Code of Professional Responsibility, DR 5-105(c). The attorney must then get the consent of both parties after a full and fair disclosure of all the facts and an appraisal of the possible effect on the exercise of his independent professional judgment. *Id.*

[27] 4 WEST VIRGINIA STATE BAR JOURNAL 158 (1978).

> or any other legally permissible requirement as a condition precedent to the making of the loan. The borrowers have the privilege of either accepting or rejecting the loan if they do not choose to accept the conditions under which it will be made.[28]

In reaching this conclusion, the State Bar relied heavily upon both formal and informal opinions of the American Bar Association's Committee on Ethics and Professional Responsibility,[29] all of which were generally in accord with its findings.

Clearly, an attorney must avoid possible conflicts arising out of his representation of both the borrower and the lender. In the absence of such dual representation, however, the question becomes whether the attorney selected by the lending institution represents its interests or owes his primary responsibility to the borrower who ultimately bears the costs for his services. In *Sibley v. Federal Land Bank of New Orleans*,[30] the United States Court of Appeals for the Fifth Circuit noted that an analysis of the role played by the outside attorney in mortgage loan transactions.clearly indicates that the attorney's "primary duty" is to the lending institution.

In *Sibley*, an attorney in Mississippi brought suit against the Federal Land Bank of New Orleans seeking injunctive relief and damages as a result of having been removed from the Bank's list of attorneys approved to examine and certify titles, record instruments, and close loans on its behalf. Sibley was joined in his complaint by the Mississippi State Bar which sought to require the Bank to establish objective standards for admission of Mississippi lawyers to its approved attorney list.[31]

The Federal Land Bank of New Orleans was a federally chartered institution which made long-term, first mortgage loans on farm land to farmers and ranchers in Mississippi, Alabama and Louisiana. Since 1922,

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[28] *Id.* at 159-60 [emphasis added]. The Committee went on to state:

> It would be proper for a lawyer to represent the borrower and the lender with the borrower's informed consent after full disclosure of the nature of the lawyer's relationship with the lender, provided also that the lawyer can in his considered opinion satisfy himself that his exercise of independent professional judgment on behalf of the borrower will not be adversely affected by his relationship with the lender. The lawyer should be scrupulous in answering this question and any doubt should be resolved against the multiple representation.

Id. at 163.

[29] *See* ABA Comm. on Professional Ethics, Informal Opinions, No. 643 (1963); ABA Comm. on Professional Ethics, Formal Opinions, No. 868 (1965); ABA Comm. on Professional Ethics, Informal Opinions, No. 954 (1966).

[30] 597 F.2d 459 (5th Cir. 1979).

[31] Brief for Appellee at 3, Sibley v. Federal Land Bank of New Orleans, 597 F.2d 459 (5th Cir. 1979). The Mississippi Bar's demands in *Sibley* that the bank establish an attorney list were similar to the West Virginia proposal. Under the proposed rules, a lending institution must base its list of approved attorneys upon enumerated "objective" criteria. Examples of such criteria are set forth in § 4.03(c) of the revised rules and include the existence of adequate malpractice insurance, a record without past errors, and a record without past tardiness.

the Bank had maintained a list of attorneys in the three-state area who were approved by the Bank to examine titles, record instruments, and close loans which it made. According to the Bank, attorneys on this list were selected based upon personal recommendations and by reference to publications such as the Martindale-Hubbell Law Directory.[32]

By 1974, the Bank's list of approved attorneys in the three states had grown to between 3,000 and 3,500 lawyers in 1,400 different firms. There had developed an increasing time lag between the filing of loan applications and the disbursement of loan proceeds which the Bank attributed, in part, to the large number of attorneys performing services for it. Consequently, the Bank that year elected to reduce the number of approved attorneys by seventy percent.[33] To accomplish this goal, the Bank's general counsel solicited opinions from its field personnel as to which attorneys should remain on the approved list. The general counsel reviewed the names of the attorneys submitted and formulated a final list. While the new list reflected subjective criteria such as the professional reputation of the attorneys, their competence in title practice and their promptness in handling title matters, the Bank admitted that in some instances arbitrary decisions had been made.[34]

In his prayer for relief, Sibley requested a permanent injunction against the Bank, enjoining it from denying, limiting or abridging the right of a person to choose his own attorney to perform the necessary legal services incident to a loan application. He further urged the Court to require the Bank to notify all applicants for loans that they were free to employ any competent attorney in connection with their loan application.[35]

According to both the plaintiff and the Mississippi State Bar, the Bank, by restricting its list of approved lawyers, had acted arbitrarily and capriciously in violation of the due process clause of the United States Constitution. Alternatively, they asserted that the Bank's action in reducing its list of approved lawyers had restricted competition among Mississippi attorneys in violation of the Sherman Act.[36] The Court rejected

[32] Brief for Appellee at 8, Sibley v. Federal Land Bank of New Orleans, 597 F.2d 459 (5th Cir. 1979).

[33] *Id.* at 9; 597 F.2d at 461.

[34] 597 F.2d at 461.

[35] Brief for Appellee, at 10-11, Sibley v. Federal Land Bank of New Orleans, 597 F.2d 459 (5th Cir. 1979). Like the prayer for relief in *Sibley*, the proposed West Virginia Rules would require that loan applicants be informed of their right to employ their own competent attorney in connection with loan transactions. Section 5 of the proposed Rules requires the title examiner to tell the borrower that he may select the title examiner. This disclosure would not be required if the title examiner knows or has reason to believe that the borrower has been informed of his right, or that the borrower chose or approved him, or knows that the lending institution that requested his services regularly informs borrowers of their rights. Also, if the title examiner renders fewer than five title opinions per year to any lenders requesting his services, he would be relieved of his duty to disclose. Proposed Rule, *supra* note 5, § 5.02.

[36] 597 F.2d at 462.

both contentions on the grounds that its determination that the attorneys on the approved list represented the Bank and not the borrower was dispositive of both issues. Thus, "[t]he Bank's selection of its *own* attorneys implicates neither the Constitution nor the Sherman Act."[37]

One significant fact which led the Court to conclude that the attorneys handling closings on loans made by the Bank represented the Bank and not the borrower was that, by the terms of its statutory and regulatory mandate, "[t]he principal function of the Federal Land Bank is to make first mortgage loans on farm lands. . . ."[38] In order for the bank to ascertain that its security meets this requirement, it must rely on the attorney who certifies title. As was succinctly pointed out, "[t]his reliance on the attorney's exercise of professional judgment and discretion is the *essence* of a *lawyer-client relationship.*"[39]

Statutory and regulatory mandates similar to those addressed in *Sibley* apply to institutions other than Federal Land Banks. National Banks are required to assure themselves that any home mortgage loans which they make are secured by a valid lien on the real estate.[40] In West Virginia, building and loan associations may not take a mortgage or deed of trust as security for a home loan "unless the title to such real estate is approved *by the attorney of the association.*"[41] Similarly, Federal Savings and Loan Associations and other lending institutions insured by the Federal Savings and Loan Insurance Corporation must maintain "an opinion signed *by such institution's attorney-at-law* . . . affirming the quality and validity of such institution's lien on the real estate" mortgaged as security on a home mortgage loan.[42]

Thus, legislative and regulatory requirements as well as the dictates of prudent business judgment have led many lending institutions to require that their attorneys examine and certify title to the mortgaged property, prepare the note and deed of trust or mortgage, and, after the loan closing, update the title and record the lien instrument. They thereby assure

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[37] *Id.*

[38] 12 C.F.R. § 600.20 (1980). Under the Farm Credit Act of 1971, 12 U.S.C. §§ 200-2259 (1976), loans made by a Federal Land Bank must be secured by first liens on the real estate. 12 U.S.C. § 2017 (1976). In order to properly serve their functions, federal land banks have broad statutory discretion, including the power to "conduct studies and make and adopt standards for lending." 12 U.S.C. § 2012(16) (1976); *see* 12 C.F.R. § 615.5060(a) (1979).

[39] 597 F.2d at 462 (emphasis added). *Cf. ABA Code* Ethical Consideration 4-1 (lawyer must preserve the "confidences and secrets *of one who has employed or sought to employ him*") (emphasis added) (footnote omitted).

[40] 12 U.S.C. § 371(a)(1) (1976).

[41] W. VA. CODE § 31-6-21 (1975) (empahsis added). Other states impose restrictions on regulated lenders similar to the West Virginia requirement that the building and loan association's attorney approve the title to the underlying real estate. *See* LA. REV. STAT. ANN. § 6:922(A) (Supp. 1980). In Louisiana, "[e]very loan [made by a building and loan association] on immovable property [shall] be secured . . . by vendor's privilege and first mortgage upon property within its primary lending area, unencumbered . . . accompanied by certificate of the attorney of the association to that effect."

[42] 12 C.F.R. § 563.17-1(c)(vii) (1979).

themselves that competent attorneys perform the work, that their interests are properly represented at all stages of the transaction, and that they have minimized the risk that the work performed is, in fact, defective.

Since the attorney who performs title work for a lending institution represents the lender, the cost of his services is clearly part of the cost of the loan, which rightfully falls on the borrower. Nevertheless, critics of the required attorney practice ignore this analysis and instead focus on collateral matters that are irrelevant to a resolution of the central issue raised by measures such as the proposed West Virginia rules. In his initial proposal and throughout the public hearings, the West Virginia Attorney General, for example, emphasized that the borrower and not the lending institution must pay for the attorney's services regardless of who the attorney represents. He pointedly asked one witness at the public hearings whether the witness knew "of any other area in which the person who pays the lawyer's fee has no right to select the lawyer."[43]

Obviously, a major premise underlying the Attorney General's proposed rules (and, no doubt, the various statutes referred to earlier) is that the individual who pays the attorney fees should have the right to select that attorney. Yet, in *Forrest v. Capital Building & Loan Association,*[44] the Court noted that it was a misapprehension of the facts to conclude that he who pays the legal fees owns the legal services and, therefore, has a right to select who renders them. As the Court in *Forrest* pointed out, the borrower has no contract with the lending institution's attorney. Moreover, the attorney works for, and generally certifies title solely to, the lending institution.[45] While the borrower must pay the fee of the attorney chosen by the lending institution, this merely represents an allocation of the costs of the loan to the party receiving the benefits of the loan. West Virginia's Attorney General, and other critics of the practice, have not recognized this fact, despite repeated judicial attention to this aspect of the problem.[46]

When viewed as a legitimate cost associated with making the loan, the borrower's payment of attorney's fees is no different from any other transaction in which the consumer pays either directly or indirectly all costs associated with the production of the product or the rendering of the service which he is purchasing. Rather than being unconscionable, with all the sinister implications attendant thereto, these so-called "sweetheart" arrangements which the Attorney General so vigorously attacks and which the cited statutes seek to prohibit represent nothing more than an exercise by the lending institutions of their fundamental right to select their own counsel.

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[43] *Transcript of Oral Testimony on Proposed Rules Taken in Charleston, West Virginia*, at 233 [hereinafter cited as *Charelston Transcript*].

[44] 385 F. Supp. 831 (M.D. La. 1973), *aff'd*, 504 F.2d 891 (5th Cir. 1974), *cert. denied*, 421 U.S. 978 (1975).

[45] *Id.* at 839.

[46] *See* note 4 *supra*.

THE PROPOSALS AND WEST VIRGINIA LAW

Irrespective of whether these arrangements between lending institutions and their attorneys are somehow unconscionable, the question remains whether this practice constitutes a violation of the laws of West Virginia and is, therefore, subject to regulation by the Attorney General. The claimed legal basis for West Virginia's proposed rules is twofold. They are predicated first upon the West Virginia Antitrust Act[47] which provides, in part, that "Every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce in this State shall be unlawful."[48] The Act further provides that the "establishment, maintenance or use of a monopoly or an attempt to establish a monopoly of trade or commerce . . . by any persons for the purpose of excluding competition or controlling, fixing or maintaining prices" is deemed unlawful.[49] The Rules are also predicated upon the provisions of the West Virginia Consumer Credit and Protection Act,[50] which prohibit any "unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce."[51] These provisions parallel portions of the Federal Trade Commission Act[52] and commonly are referred to as the Little FTC Act.

According to the Attorney General, the West Virginia Antitrust Act as well as the Little FTC Act form the blueprint for how the economic sector is to operate within West Virginia. The Antitrust Act is intended to prevent restraints of trade and promote competition in the West Virginia economy. In his opinion, the competition which is promoted by the antitrust laws is both an end unto itself, due to the economic freedom purportedly fostered, and a means to an end, such as lower prices, more competitors and greater market efficiency. The Little FTC Act, on the other hand, has a two-fold purpose according to the Attorney General. The prohibition of unfair methods of competition is aimed at promoting competition in the business sector to benefit both sellers and buyers, while the prohibition against unfair and deceptive practices seeks to protect consumers from practices over which they otherwise would have no control.[53]

Mere assertion of these principles does not justify prohibiting the required attorney system, however, unless it can be shown that it has spawned the evils the statutes seek to eliminate. There must be proof that this practice causes an unreasonable restraint of trade, or is immoral, unethical, or oppressive, or causes substantial injury to consumers or competitors. A careful analysis indicates that the practice possesses none of the foregoing characteristics and that its regulation is without any basis in law.

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[47] W. VA. CODE §§ 47-18-1 to 23 (Cum. Supp. 1979).
[48] *Id.* § 47-18-3.
[49] *Id.* § 47-18-4.
[50] *Id.* §§ 46A-6-101 to 108 (1976).
[51] *Id.* § 46A-6-104.
[52] 15 U.S.C. §§ 41-77 (1976).
[53] *See* Commentary, *supra* note 7, at 43.

Antitrust challenges to the required attorney system presume that home mortgage loans and title examinations made incident thereto are two separate and distinct transactions.[54] As such, lending institutions which require borrowers to pay an attorney selected by the lending institution to certify title as a condition to extending a home mortgage loan are predicating the extension of the loan upon the purchase of a second, unrelated product — the services rendered by the attorney. This, according to critics of the practice, constitutes a classic tying arrangement in violation of the State's antitrust laws.

While courts have not interpreted the West Virginia Antitrust Act, the Act itself provides that it shall "be construed liberally and in harmony with ruling judicial interpretations of comparable federal antitrust statutes."[55] Thus, in analyzing the validity of the Attorney General's assertions that the challenged practice constitutes an illegal tying arrangement, it is necessary to look to and be guided by judicial interpretations relating to similar practices under analogous federal statutes.

Federal court decisions have established that tying arrangements that have a pernicious effect on competition violate the provisions of the Sherman Antitrust Act.[56] The United States Supreme Court, in *Northern Pacific Railroad Co. v. United States*,[57] defined such tying arrangements as agreements to sell one product "but only on the condition that the buyer also purchases a *different* (or tied) product."[58] The essence of an unlawful tying arrangement is, therefore, the forced purchase of a second distinct and separate commodity with the desired purchase of a dominant tying product, which results in economic harm to competition in the tied market.[59] Thus, in order for there to be an illegal tying arrangement there must first exist two separate and distinct products.

Every court that has reviewed practices substantially similar or identical to a required attorney system has concluded unequivocally that separate products are not involved. In *Foster v. Maryland State Savings & Loan Assoc.*,[60] the United States Court of Appeals for the District of Columbia Circuit reasoned that:

> The loan review services performed by the selected law firm were provided to and paid for by the [lending institution] as an addi-

[54] *Id.* at 11. The assumption that home loans and related title examinations are separate transactions has no statutory, regulatory or judicial basis. *See* text accompanying notes 55-69 *infra*. In fact, the West Virginia Attorney General fails to specify in his commentary on the proposed rules how the challenged practice violates the antitrust laws.

[55] W. VA. CODE § 47-18-16 (Cum. Supp. 1979).

[56] 15 U.S.C. §§ 1-7 (1976). Section 3 of the Clayton Act (15 U.S.C. § 14 (1976)) prohibits tying arrangements involving "goods, wares, merchandise, machinery, supplies, or other commodities." It does not appear applicable, however, to situations involving the tying of services such as is alleged to exist here. C. HILLS, ANTITRUST ADVISER § 29 (2d ed. 1978).

[57] 356 U.S. 1 (1958).

[58] *Id.* at 5.

[59] Fortner Enterprises, Inc. v. United States Steel Corp., 394 U.S. 495, 509 (1969).

[60] 590 F.2d 928 (D.C. Cir. 1978), *cert. denied*, 99 S. Ct. 842 (1979).

> tional means of insuring the security of its loans. The attorney's fee charge collected by the [lending institution] to pay for these services was not demonstrably excessive, and did not enable the defendant to secure a profit. Pursuant to both federal regulation and Maryland state law, the [lending institution] was authorized to charge its borrowers for these legal expenses. Under these circumstances, [borrowers'] payment of the attorney's fee charge to the . . . lender represented an incidental and inseparable part of their "purchase" of the loans, rather than the "purchase" of a tied product.[61]

In *Foster,* the plaintiffs challenged, on antitrust grounds, Maryland State Savings & Loan Association's practice of requiring that purchasers of home mortgage loans either: (1) employ its law firm to certify title, procure the title binder, prepare the necessary loan documents and conduct the settlement proceedings; or (2) if the borrowers employed someone other than the lending institution's law firm, pay a $100.00 service fee to have the title binder reviewed and a mortgage or deed of trust prepared by counsel for the Association. According to the plaintiffs, this practice constituted an illegal tie-in.[62]

Prior to January 1, 1971, Maryland State Savings & Loan Association had followed the practice which the West Virginia Attorney General initially advocated. In essence, the Association had relied solely on the borrower's counsel for the preparation of the loan instruments and procurement of the title binder. This practice, however, proved unsatisfactory to the Association since many of the attorneys employed by the borrowers were inexperienced and unqualified in the field of title examinations and real estate settlements. Moreover, many borrowers had selected attorneys on the recommendation of real estate developers or brokers. These attorneys tended to be less concerned with the quality of the title being conveyed than with facilitating the sale of the property involved.[63] The savings and loan association consequently was seriously concerned about the validity of the security it was receiving for loans. Accordingly, in 1971, it began requiring borrowers to employ its law firm or reimburse the Association for the costs of retaining its attorneys to review the title binder prepared by the borrower's counsel and to prepare a mortgage or deed of trust.[64]

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[61] *Id.* at 931; *see* text accompanying notes 79-81 *infra.*

[62] Brief for Appellee at 6, Foster v. Maryland State Savings & Loan Ass'n, 590 F.2d 928 (D.C. Cir. 1978), *cert. denied,* 99 S. Ct. 482 (1979).

[63] *Id.* at 5-6. Like the defendant Association in *Foster,* many West Virginia lenders feared that under the original proposed rules the borrower's attorney, while perhaps economical, might lack the skills required to protect their interests. Moreover, they were concerned that as the borrower's attorney, he might be more concerned with facilitating the sale than insuring that the lender was properly secured.

[64] 590 F.2d at 931. If the borrower selected the Association's attorneys, no review charge was necessary.

At the close of the plaintiffs' evidence, the district court granted Maryland State Savings & Loan Association a directed verdict on the grounds that the evidence conclusively demonstrated that no tying arrangement or unlawful restraint of trade had been shown. The Court of Appeals affirmed the decision of the lower court, and made it clear that the lending institution had the right to insist upon its own counsel. In reaching this conclusion, the Court noted:

> The [lending institution's] decision to purchase legal services at a cost to [borrowers] was both legally authorized and *motivated by the legitimate business concern of insuring the security of its loans.* Incidental services purchased by the [lending institution] for legitimate business reasons cannot be viewed as a separate (or tied) product, merely because the buyer is charged for them. This is particularly true with respect to legal settlement services, since *they represent an indispensible method of consumating* [sic] *the loan transaction* from both the borrower's and the lender's viewpoint. [The borrower's] argument that such services should be regarded as a tied product simply ignores the fact that the [lending institution] has a *statutory right* to employ its own separate counsel to advise it and to charge the cost to its borrowers. We conclude, therefore, that no tying arrangement is involved in this loan practice.[65]

The *Foster* Court relied heavily upon the decision of the United States District Court for the Middle District of Louisiana in *Forrest v. Capital Building & Loan Association,* which was affirmed *per curiam* by the United States Court of Appeals for the Fifth Circuit.[66] In *Forrest,* attorneys brought suit against certain building and loan associations alleging that the associations had conspired to dominate the legal, notarial and title insurance business by requiring borrowers to use attorneys selected by the defendant lending institutions before granting borrowers home mortgage loans. The plaintiffs alleged that the credit or money advanced to borrowers was the tying product while the legal and notarial services required to consummate the credit transaction were the tied product.

The evidence in *Forrest* established that the defendant lending institutions had required that attorneys of their choice certify to them that the borrower had a good and merchantable title to the property to be pledged as security. The lending institutions refused to accept attorneys selected by the borrower to certify title. In rejecting the plaintiffs' contentions that this practice constituted an illegal tying arrangement, the court noted that:

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[65] 590 F.2d at 932-33 (emphasis added).

[66] 385 F. Supp. 831 (M.D. La. 1973), *aff'd,* 504 F.2d 891 (5th Cir. 1974), *cert. denied,* 421 U.S. 978 (1975).

> In the case at bar we find that *no two products exist.* The stipulations entered into by the parties show as an uncontroverted fact that the legal services are owned, contracted for, responsible solely to, and work exclusively for, the defendant [lending institutions]. These services are not for sale to the prospective borrower but are merely an incidental service required both by state law and federal regulation to consumate [sic] the loan.[67]

Even if critics of the required attorney systems, in the face of the foregoing decisions, could show that two separate and distinct products are involved, the system would not operate as a tying arrangement in violation of statutes such as West Virginia's antitrust laws. Statutory prohibitions against tying arrangements are designed to prevent a seller of two products from using his dominance in one product market to foreclose entry of potential competitors into the second product market. Thus, in order to establish an illegal tying arrangement, it must be shown that the alleged tying arrangement involves a seller who not only competes in the tying product's market but also "participates for profit in the area of competition to which the tied item belongs."[68]

While lending institutions compete in the field of home loans, clearly they do not compete or otherwise participate for a profit in the provision of legal services - the allegedly tied product. As such, neither their designation of an attorney to certify the validity of the security to be taken in exchange for a loan, nor the attorney's rendering of those services could, under any circumstances, be viewed as an illegal tying arrangement.[69]

Thus, in promulgating his proposed rules, the Attorney General was met with clear authority holding: (a) that no illegal tying arrangement exists where the purported seller does not, in fact, compete in the tied

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[67] *Id.* at 836 (emphasis added).

[68] Rodrique v. Chrysler Corp., 421 F. Supp. 903, 904 (E.D. La. 1976). *See also* Crawford Transport Co. v. Chrysler Corp., 338 F.2d 934 (6th Cir. 1964), *cert. denied,* 380 U.S. 954 (1965); Nelligan v. Ford Motor Co., 262 F.2d 556 (4th Cir. 1959).

[69] *See* Crawford Transport Co. v. Chrysler Corp., 338 F.2d 934 (6th Cir. 1964), *cert. denied,* 380 U.S. 954 (1965). In *Crawford,* Chrysler's dealers charged that the manufacturer engaged in an illegal tying arrangement by designating the carriers who delivered cars to the dealers, and charging the dealer for the associated delivery costs. Thus, like a borrower under a required attorney system, the dealers had no voice in choosing who rendered the service for which they were paying. The court based its decision that Chrysler's conduct was not an illegal tie-in on two facts. Chrysler did not own any transportation carriers and it had no financial interest in the carriers it used. *Id.* at 939. The court indicated that Chrysler had neither attempted to invade and dominate the carriers' business nor received direct profits from the transportation companies. *Id.*

The position of lending institutions is similar to Chrysler's in that they own no interest in the firms they designate to represent them. Nor is there evidence that lenders receive kickbacks or other renumeration from attorneys they designate under required attorney systems. Like Chrysler's conduct in *Crawford,* lenders' use of a required attorney system is not an illegal tying arrangement since absent a purpose to create or maintain a monopoly, the antitrust laws do not "restrict the long recognized right of . . . an entirely private business freely to exercise . . . independent discretion as to parties with whom [it] will deal." United States v. Colgate, 250 U.S. 300, 307 (1919).

product market; (b) that the attorney designated by the lending institution represents the lender and not the borrower; and (c) that charging the borrower for the services rendered in connection with that representation was a permissible allocation of the costs of the loan and not a violation of the antitrust laws. Unless willing to abandon the proposed rules, the Attorney General was, therefore, compelled to rationalize the basis for those rules in a manner not totally at odds with "ruling judicial interpretations of comparable federal antitrust statutes."[70] The Attorney General attempts to accomplish this by asserting that irrespective of who the lending institution's attorney represents, in West Virginia, unlike Maryland or Louisiana, the attorney renders *services* to *both* the borrower and the lender based on the assumption that the borrower and the lender both benefit from the attorney's representation of the lender.[71] This benefit purportedly distinguishes the *Foster* and *Forrest* decisions and affords the borrower the "right" to designate which attorney confers that "benefit."

The Attorney General's claimed distinction is, however, without legal significance. While an adept piece of rationalization, it fails to address the fact that lending institutions do not participate for a profit in the provision of legal services. More importantly, it totally ignores his own administrative record which is devoid of any evidence suggesting that lending institutions require the attorneys who they designate to render services to the borrower or require that the borrower be represented by the lender's attorney. To the contrary, as the West Virginia Bar Association Committee on Legal Ethics has pointed out, the borrower is free to employ an attorney of his choice, at his cost, to represent his interests.[72] To the extent the borrower elects not to employ his own counsel and chooses instead to rely upon the work of the attorney representing the lender, he is gambling that the attorney will perform the work in a competent manner since, absent prior agreement by the attorney to represent both parties, he owes no legal duty to the borrower.

Given these circumstances, the borrower may well benefit indirectly from the services performed by the attorney representing the lender. He may, however, suffer since defects which might be significant to the borrower might not be disclosed in a title opinion rendered by a lender's attorney if the defects do not materially affect the loan value of the property. Irrespective of whether the borrower derives some benefit from the services of an attorney representing the lender, a careful reading of both the *Foster* and *Sibley* decisions makes clear that neither court considered this purported benefit relevant to a determination of whether the challenged practice involves an illegal tying arrangement.

In *Sibley*, for example, the court specifically drew attention to the fact that the borrowers involved benefited from the legal services being ren-

[70] W. VA. CODE § 47-18-16 (Cum. Supp. 1979).

[71] Commentary, *supra* note 7, at 17-18.

[72] *See* text accompanying note 28 *supra*.

dered. Yet the fact that those services were being rendered in connection with the attorney's representation of the lending institution rather than the borrower was dispositive of the antitrust claims.[73] The required attorney system operates the same way in West Virginia. Attorneys render their title services in connection with their representation of the lending institution incident to the loan transaction, and not as a separate and distinct product. Consequently, there is no tying of two products. Accordingly, the practice does not violate the West Virginia Antitrust Act, and the proposed West Virginia rules, to the extent they are premised on the antitrust laws, lack any legal foundation.[74]

In his Commentary on the proposed rules, the Attorney General appears to recognize that the antitrust laws may not offer a sound basis for his proposed ban on "sweetheart" arrangements. As he points out, however, the proposed rules have also been promulgated pursuant to the State's Little FTC Act which covers a much broader array of practices.[75] Yet, it would be a grave error to presume that the rather expansive terms of the Little FTC Act confer upon the Attorney General *carte blanche* to proscribe activities of lenders or their attorneys.

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[73] 385 F. Supp. at 836.

[74] The Third Circuit's decision in Mortensen v. First Fed. Sav. & Loan Ass'n, 549 F.2d 884 (3d Cir. 1977) has been suggested as support for the position that West Virginia's regulation of required attorney systems is not governed by the analysis used in *Foster* and *Forrest*. Commentary, *supra* note 7, at 17-18. In *Mortensen*, the plaintiffs alleged that the defendant lending institution and its law firm tied legal services to home loans in violation of the Sherman Act and the Federal Home Loan Bank Board's regulations.

The trial court had granted the defendant's motion to dismiss for lack of subject matter jurisdiction and failure to state a claim upon which relief could be granted. 549 F.2d at 888-89. On appeal, the plaintiffs challenged the district court's standard for ruling on a motion to dismiss in an antitrust case where the jurisdictional requirement of conduct in or affecting interstate commerce is inextricably related to the substantive merits of the claim. *Id.* at 890. The Third Circuit reversed the dismissal, holding that plaintiff's complaint alleged sufficient interstate factors. *Id.* at 896.

The district court also had dismissed the complaint on the grounds that the alleged violations of Federal Home Loan Bank Board regulations were within the Board's primary jurisdiction. *Id.* at 898. Under 12 C.F.R. § 563.35(a)(3) (1979), regulated lenders may not condition a loan by requiring the borrower to contract with a specific person for legal services rendered to the borrower. Section 563.35(d), however, permits lenders to require borrowers to pay for the lender's attorney's services in connection with the loan. The parties in *Forrest*, *see* notes 66-67, had stipulated that the legal services in question were rendered to the bank. Thus, no issue was raised as to alleged violations of the Federal Home Loan Bank Board's regulations. 549 F.2d at 899 & n.12. Since the parties in *Mortensen* had not entered into a similar stipulation, the *Forrest* decision afforded no guidance to the Third Circuit in resolving this claim. *Id.* Thus, the complaint alleged facts which rendered the claim within the Board's primary jurisdiction.

Although the *Mortensen* court thus distinguished *Forrest*, its decision, like the *Forrest* court's, did not address the merits of the claim that the lender's attorney provided services to the borrower. Therefore, *Mortensen* does not provide any indication of how the court would have decided the issue. Moreover, the Fifth Circuit's subsequent decision in Sibley v. Federal Land Bank of New Orleans, 597 F.2d 459 (5th Cir. 1979), answers the question left open by *Forrest* and *Mortensen*, holding that the attorney who searched the title provided services to the lending institution. *See* text accompanying notes 36-39 *supra*.

[75] Commentary, *supra* note 7, at 18-19.

Like the West Virginia Antitrust Act, the Little FTC Act has not been subjected to judicial interpretation. Nevertheless, since its terms roughly parallel those of the Federal Trade Commission Act, the guidelines applicable to the FTC Act may likewise control the Little FTC Act. Apparently based upon that premise, the Attorney General solicited and received the views of the Federal Trade Commission's Bureau of Consumer Protection on his proposed rules. Those views were presented by Lewis H. Goldfarb, the Assistant Director for Credit Practices, at the public hearing on the proposed rules in Martinsburg, West Virginia.[76]

As Mr. Goldfarb candidly admitted at the outset, the FTC has had only limited experience in matters incident to real estate settlement practices. The Real Estate Settlement and Procedures Act, which requires disclosure of settlement charges and prohibits kickbacks among the parties, is, for example, enforced by the Department of Housing and Urban Development. Real Estate settlement abuses by federally chartered lending institutions likewise do not fall within the jurisdiction of the FTC. Regulation of those activities is solely within the province of the various agencies charged with regulating the practices of lending institutions.

Despite its limited experience, the Bureau of Consumer Protection's staff concluded that so-called "sweetheart" arrangements are unfair and deceptive trade practices and that the Attorney General's proposed rules are prudent and equitable to all parties. In reaching this conclusion, the staff relied on certain standards which the FTC had published previously for evaluating "unfairness." These standards measure the "unfairness" of a practice according to:

> (1) Whether the practice, without necessarily having been previously considered unlawful, offends public policy as it has been established by statute, common law, or otherwise;
> (2) Whether it is immoral, unethical, oppressive or unscrupulous; [and]
> (3) Whether it causes substantial injury to consumers (or competitors or other businessmen).[77]

The staff based its conclusion that required attorney systems are "unfair" on three findings. First, the staff found that the specified attorney has no incentive to charge a competitive fee, and that the borrower cannot shop for an attorney who will charge less for services. Second, the staff concluded that the attorney is motivated to act in the best interests of the lender though most borrowers assume the specified attorney represents their interests. According to the FTC's staff, this constitutes a conflict of interest since the interests of borrowers and lenders do not always coincide. Finally, the staff found that a required attorney system damages

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[76] Written Submissions, *supra* note 2, at 137.

[77] *Id.* at 143. *See also* Statement of Basis and Purpose of Trade Regulation Rule 408, Unfair or Deceptive Advertising and Labeling of Cigarettes in Relation to the Health Hazards of Smoking, 29 Fed. Reg. 8234, 8355 (1964).

the competitive position of non-designated attorneys by limiting their ability to engage in price competition.[78]

While the foregoing "findings" of the staff cogently set forth the basis for their ultimate conclusion and, to a large degree, reflect the underlying premise of the proposed West Virginia rules, those "findings" fail to withstand scrutiny when tested against the FTC's own standards.

According to the FTC's standards the initial point of inquiry is whether the practice under review offends public policy as it has been established by statutes, common law or otherwise. In the case of the so-called "sweetheart" arrangement, the practice, far from offending public policy, has long been sanctioned by both legislative and regulatory action. For example, the Federal Home Loan Bank Board's rules and regulations governing insured lending institutions specifically provide that:

> In connection with a loan on a home . . . occupied or to be occupied by the borrower, an insured institution or subsidiary thereof may require such borrower to *reimburse it for legal services rendered by its attorney or to directly pay such attorney for such services* . . . .[79]

In addition, the West Virginia Legislature has authorized lending institutions to collect reasonable amounts from home loan borrowers to cover, among other things, the cost of title reports.[80] These specific authorizations are consistent with concomitant legislative and regulatory mandates to lending institutions not to extend home mortgage loans without ascertaining, through *their* attorneys, that those loans are properly secured.[81]

The only basis cited by the FTC's Bureau of Consumer Protection in support of its claim that the challenged practice violates public policy is the fact that the attorney involved represents both the borrower and the lending institution, thereby creating a clear conflict of interest.[82] Yet, the attorney designated by the lending institution can ethically represent both parties under certain circumstances. Moreover, as both the *Sibley* and *Forrest* courts pointed out, where such dual representation is not involved, the attorney customarily represents and certifies title exclusively to the lending institution. The borrower's payment of the attorney's fees associated with that representation constitutes nothing more than an allocation of the costs of the loan.

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[78] Written Submissions, *supra* note 2, at 145-47. In addition to stating the basis on which the FTC labeled the required attorney systems unfair, the FTC justified its opposition to the system by asserting that lenders could protect their interests through less restrictive means. Specifically, the FTC's staff believed that lending institutions would be secured adequately if their attorney simply reviewed title documents prepared by the borrower's attorney. The staff recommended that lending institutions be permitted to charge borrowers for the cost of reviewing the documents. New Jersey has adopted a system similar to the FTC staff proposal. *See* text accompanying notes 95-96 *infra*.

[79] 12 C.F.R. § 563.35(d); *see* note 74 *supra*.

[80] W. VA. CODE § 31A-4-30 (1975). *See also* MD. CODE ANN. art. 23, § 161GG (1973).

[81] *See* text accompanying note 28 *supra*.

[82] *See* text accompanying notes 24-39 *supra*.

Recognition of the fact that the attorney's fee is one of the costs of making a loan undermines the remaining findings of the Bureau of Consumer Protection, as well. First, the staff asserts that the system injures borrowers because the attorney's fees that are passed through to them are often excessive. This erroneously assumes, however, that competing lending institutions have no incentive to hold down the costs associated with consummating the loan transaction. The evidence submitted at the public hearings held by the Attorney General makes clear, however, that lending institutions compete with one another in the area of home mortgage loans and closing costs.[83]

The incentive to hold down closing costs likewise undermines the staff contention that "sweetheart" arrangements place non-specified attorneys at a competitive disadvantage. Lending institutions, like all other consumers of legal services, are sensitive to the cost of those services. When *all other factors are equal,* lenders can be expected to select the most inexpensive, competent provider of those services to represent their interests. Moreover, no attorney has the right to demand to represent any individual, including a particular lending institution. Lending institutions, like all consumers of legal services, have a right to be represented by counsel of their choosing.

Accordingly, applying the FTC's own "unfairness" standards, so-called "sweetheart" arrangements do not constitute an unfair trade practice. Absent such a showing or a showing that the challenged practice violates the antitrust laws, the Attorney General lacks the legal authority to regulate lenders or their attorneys in the manner contemplated under the proposed rules.[84]

IMPACT OF THE PROPOSALS

The dubious legal validity of regulatory measures designed to eliminate the required attorney system magnifies the importance of a final consideration. Will the proposed West Virginia rules and similar state statutes prove to be the panacea which critics of the system predict - generating direct and substantial savings to the home buyer while increasing competiton among competent attorneys in the area of title examinations? While any analysis of the probable future effect of the proposed

[83] The Real Estate Settlement Procedures Act (RESPA), 12 U.S.C. §§ 2602-17 (1976) affords borrowers protection against "excessive attorney's fees" allegedly associated with required attorney systems. RESPA requires lending institutions to disclose to the borrower the estimated cost of all legal fees that will be incurred in connection with making the loan. 12 U.S.C. § 2604 (1976). Thus, borrowers have the means to compare factors other than interest rates when seeking a home loan.

[84] *See also* Foster v. Maryland State Sav. & Loan Ass'n, 590 F.2d 928 (D.C. Cir. 1978), *cert. denied,* 99 S. Ct. 842 (1979). The *Foster* trial court held that even if a required attorney system constituted a tying arrangement, the practice was not necessarily illegal. Where such loan practices are instituted solely for a legitimate business purpose, they are not an unreasonable restraint of trade prohibited by the Sherman Act, but instead comport with the lender's right to select its own counsel. *Id.* at 933.

West Virginia rules and similar state statutes is necessarily somewhat speculative, a review of the economic and business realities surrounding home mortgage loans indicates that the proposed rules may have an adverse impact upon both lending institutions and borrowers.

The West Virginia rules seek indirectly to prohibit lending institutions from requiring that any attorney other than one chosen or approved by the borrower perform necessary title work incident to a home mortgage loan. Initially, the Attorney General sought to achieve this goal by prohibiting attorneys from accepting fees for title work unless selected by the borrower. In essence, he advocated granting to the borrower virtually unfettered authority to select the attorney to perform the legal services necessary to consummate the loan he was purchasing.

As initially promulgated, the proposed West Virginia rules granted lending institutions only the right to reject "the borrower's first choice for the attorney or law firm" provided the lender made a written explanation for such rejection "based on reasonable criteria." Numerous individuals appearing at the public hearings on these rules expressed the opinion that this purported grant of authority to lending institutions was virtually meaningless. First, the initial proposal nowhere defined "reasonable criteria." Any number of factors could bear upon the decision to accept or reject a particular attorney yet many criteria, such as the attorney's promptness in handling little matters, his experience in the area, and his general professional reputation, are largely subjective in nature. Moreover, they are merely indicia of the only factor pertinent to selecting counsel, namely the perceived competency of the attorney to perform the necessary title search and render an adequate title opinion, and therefore cannot be viewed as determinative. In addition, the "reasonable criteria" contemplated by the revised rules fail to give any consideration to the character or general reputation of the attorney involved. For example, an individual attorney, while competent, may have certain character flaws which would lead a lending institution to conclude that it should not have any dealings with him.

Even where a lending institution might believe an attorney selected by a borrower is unqualified in the field of title examinations, it would be understandably reluctant to render a "written explanation" that any rejection of that attorney was based upon factors bearing on his professional competency for fear of possible civil action for libel.[85] This point

[85] Banks would be reluctant to reject a borrower's attorney on grounds of incompetence for several reasons. In addition to subjecting themselves to possible civil actions for libel, they could incur the animosity of the public. If a rejected attorney is a member of a racial, ethnic or other minority, public opinion, to which lending institutions are highly sensitive, could turn against the institution. Moreover, there arises the possibility of state and federal intervention, on human grounds, regardless of the legitimacy of the lending institution's claim that the rejected attorney is incompetent to perform title services. The legal and public relations ramifications of civil and governmental challenges would circumscribe the effectiveness of any regulatory standard of competency. *See* Written Submissions, *supra* note 2, at 22-23.

was driven home during the public hearings when an attorney was asked if he had ever been rejected by any lending institution to do title work. Summarizing the basic fear of lending institutions he responded, "[I]f I were . . . they would have a nice lawsuit in their teeth."[86]

In order to avoid the likelihood of such suits, various individuals appearing at the public hearings advised the Attorney General that rather than reject *any* attorney selected by the borrower, they or their client lending institutions simply would require title insurance in all cases in order to insure the validity of their security and to comply with applicable regulations.[87] This alternative, far from reducing the costs to borrowers, would in most instances increase them.[88]

Following the public hearings, the Attorney General apparently recognized that the initial version of his proposed rules might either increase the costs incurred by borrowers or decrease the quality of title examinations thereby jeopardizing the secured position of the lending institutions. In an effort to minimize the likelihood of these results, the initial proposal was amended in a number of respects. The most significant of these changes are contained in Sections 4.03(b) and 4.03(c) of the amended proposal.

Those sections permit lending institutions to establish a list of "approved" attorneys which they would be willing to accept to do the necessary title work incident to a home mortgage loan. In formulating the list, however, lending institutions must ultimately include either a minimum of fifteen attorneys or one half the members of the bar in the county where the lending institution is situated. Moreover, to the extent any list consists of less than all practicing attorneys within the county in which the lending institution is located, admission to that list must be based upon "specific criteria related to the title examiner's willingness and *ability* to do title examinations for and consistent with the policies of the lending institution." As examples of these criteria, the amended rules list the adequacy of available malpractice insurance, the level of experience the attorney exhibits, the attorney's record of past errors, and his record for expeditiously performing services.

While somewhat more liberal than the original version, the revised rules are no less objectionable from the standpoint of lending institutions,

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[86] *Charleston Transcript*, *supra* note 43, at 256.

[87] *See Charleston Transcript*, *supra* note 43, at 139, 163 & 225; Written Submissions, *supra* note 2, at 7, 10, 12, 17, 27, 31, 194, 304, 307, 309-10, 312, 315, 329, 348, 621, 623 & 628. In response to the repeated assertion that the proposed rules virtually would compel lenders to require title insurance, one proponent of the rules noted he would "have a very strong antitrust concern if banks actually got together to make a decision on whether to impose title insurance. . . ." A uniform title insurance requirement, however, would reflect nothing more than concern among lending institutions for insuring the validity of their security, and not conscious lender collusion. *See Charleston Transcript*, *supra* note 43, at 226.

[88] The hearings conducted incident to the promulgation of the proposed West Virginia rules included testimony that title insurance requirements would increase the cost to borrowers on a $50,000 loan by almost $250. *Charleston Transcript*, *supra* note 43, at 138-40.

which still must publicly pass upon the competency of individual lawyers.[89] Moreover, regardless of what factors may be looked to in ascertaining the "ability" of any individual lawyer, those factors are necessarily subjective and, therefore, subject to challenge. There is simply no reasonable way to determine beyond peradventure whether an attorney who has practiced for two years is more qualified to conduct a title search than one who has practiced only eighteen months. The same dilemma plagues a determination of the adequacy of malpractice insurance, or an effort to establish a record of "tardiness." The nebulous standards contained in the revised rules will place lending institutions in the precarious position of defining the standards' scope at their own peril.

The revised rules fail to address these questions for obvious reasons. Each determination is largely subjective and must vary depending upon the lending institution, the individual attorney, and the circumstances involved. Yet, the answer to each question reflects upon the perceived competency of the attorney to perform the legal work involved. Thus, the revised rules continue to place lending institutions in the position of passing upon the professional competency of the attorneys in their area.

In essence, statutory and regulatory measures like the proposed West Virginia Rules require lending institutions to assume the role of bar examiners, passing judgment on who is qualified to practice law in the area involved. The *Foster* court rejected as unduly burdensome the notion that lenders should be forced to perform these judgmental functions. While recognizing that a lending institution might be able to expand its required attorney list to include several lawyers or firms, the court voiced its belief that

> [T]he defendant's failure to do so amounted on this record to a legitimate exercise of business judgment that is outside the scope of the antitrust laws. The defendant makes loans to borrowers having diverse interests and differing needs for legal services. To require an assessment of those interests and needs, and in turn an examination of the qualifications and competency of counsel to conduct loan settlements, *would be to impose an unreasonable burden upon the defendant.* The antitrust laws do not require the defendant to set up the *board of surrogate law examiners* that would inevitably be required to implement the plaintiffs' alternative.[90]

The lending institution's customers probably would bear the substantial costs associated with reviewing and passing upon the professional qualifications of each attorney located in a particular county.[91] Moreover, there

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[89] *See* text accompanying notes 85-88 *supra.*

[90] 590 F.2d at 934 [emphasis added].

[91] Lending institutions might try to recover the costs of continuously reviewing the qualifications of each local attorney from the borrower who is receiving the loan involved through higher interest rates, origination fees or other similar charges. However, many lend-

also would be a substantially increased risk of legal action, like the suit in *Sibley*, instituted by attorneys not approved by the lending institution. The cost of defending these suits likewise may be borne ultimately by the consumer.

Thus, the revisions of the West Virginia proposal do not diminish the likelihood that lending institutions will permit the borrower to select any attorney to examine title and simply require title insurance in order to insure the validity of their security. The policy normally would be a mortgage policy, protecting only the lender. Therefore, unless the borrower obtained an owner's title insurance policy he would not be afforded insurance protection. Far from enhancing the so-called "sovereignty" of the borrower, these proposed rules will serve only to further complicate the home loan process and increase the cost to the consumer.

The various statutes that states have adopted in an effort to eliminate required attorney systems raise similar questions regarding their ultimate impact upon the availability and cost of home mortgage loans. The Virginia statute, for example, provides "that in the case of loans on one to four family residences, the lender may not require the borrower to use the services of a particular attorney . . . however, the lender shall have the right to approve any attorney . . .; selected by the borrower; provided such approval is not unreasonably withheld."[92] This statutory provision roughly parallels the initial version of the proposed West Virginia rules and similarly raises more questions than it answers regarding the purported right of approval granted the lender. Upon what basis, for example, might a lender disapprove an attorney selected by the borrower? The only readily apparent basis is the perceived qualification of the attorney involved. Yet, that is largely a subjective judgment. Moreover, even where a lender genuinely doubts the competency of a particular attorney and his ability to protect the lender's interests, it may nevertheless be reluctant to disapprove that attorney for fear of possible civil action. Given the possibility of such litigation, lenders may elect to require title insurance where no such insurance was required before.

While the New Jersey statutory approach appears somewhat more circumspect than Virginia's, it too may ultimately raise the cost of home mortgage loans. The New Jersey statute prohibits required attorney systems but allows lending institutions to require borrowers to submit documents prepared in connection with a mortgage loan transaction to the lender's attorney for approval, and to pass the cost of reviewing the documents on to the borrower.[93]

Statutes like New Jersey's ostensibly strike a balance between the interests of the borrower and the lender. Nevertheless, in West Virginia and other areas where title insurance has not, to date, been involved, the ben-

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ing institutions already charge the maximum rate allowed. Inability to recover the costs from any source will reduce the attractiveness of making home loans.

[92] *See* note 13 *supra*.

[93] *See* note 14 *supra*.

efits resulting from a review of the "documents" prepared by the borrower's attorney, particularly the title opinion (to the extent it is a document within the meaning of the statute), may be more illusory than real. Obviously, the only means of verifying the accuracy of a title opinion is to duplicate the title search which serves as the underlying basis for that opinion. Yet the New Jersey statute would appear to preclude the lender from recovering that expense, an expense directly attributable to the cost of making the loan involved. In order to avoid incurring such nonrecoverable expense items, lenders may again simply result to title insurance and have their attorneys review the title binder procured by the borrower's attorney in order to ascertain any relevant exceptions in the policy.[94]

Efforts to prohibit required attorney systems, including the West Virginia Attorney General's proposed rules, may prove counter-productive. If these efforts result in title insurance being required, the cost of home mortgage loans will increase. If title insurance is not required, lending institutions will incur increased risks of defective title examinations. Thus these efforts may well prove a boon for title insurance companies while not materially benefiting either the borrower or the lender. Before implementing West Virginia's proposed rules, the Attorney General must assure that all of the competing interests involved are adequately protected and that the regulatory scheme will not, in fact, inure to the detriment of those it is intended to protect. Similarly, federal regulatory agencies and state legislatures contemplating similar prohibitions should avoid the temptation to rush blindly forward in the name of "consumerism," and instead must seriously weigh the possible benefits against likely detrimental effects of regulating the legal service aspect of home mortgage loans.

CONCLUSION

The underlying basis for the Attorney General's proposed rules in West Virginia, and similar regulatory measures in other states, represents a fundamental misunderstanding of the role of the lender's attorney in home mortgage loans. Moreover, it represents a clear invasion of what the Fifth Circuit in *Forrest* characterized as "the basic and fundamental right of all persons to use counsel of their own choice . . . ."[95] The attorney designated by the lender generally represents only the lender. The borrower pays the fees of that attorney just as he pays all other costs associated with making the loan. His payment of those fees merely represents an allocation of the costs of the loan to the party receiving the benefits of the loan.

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[94] The defendant lending institution in Foster v. Maryland State Sav. & Loan Ass'n, 590 F.2d 928 (D.C. Cir. 1978) had offered borrowers the option to employ the lender's attorney, or to employ their own and pay the defendant the cost it incurred in having the title binder reviewed and preparing the mortgage or deed of trust. *See* text accompanying notes 60-65 *supra*. Neither option, nor the defendant's practices together, constituted an illegal tie-in or an unreasonable restraint of trade. 590 F.2d at 932-33, 935.

[95] 504 F.2d at 891.

Once that fact is recognized, there is no basis for concluding that the challenged practice violates established principles of antitrust law. This has been clearly established by the courts in *Sibley, Foster,* and *Forrest.* Similarly, there is no basis for concluding that the lender's exercise of its right to be represented by counsel is either unfair or deceptive. To the contrary, the practice has itself been sanctioned by the rules and regulations governing both state and federally chartered lending institutions in West Virginia and elsewhere.

The required attorney system ensures the lending institution that its lien is secure. This, in turn, enables the borrower to obtain the mortgage loan. In serving this vital function, the system does not violate either antitrust laws or consumer principles. Therefore, attempts to regulate required attorney systems must be viewed as unnecessary of governmental regulation under the guise of consumer protection.

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