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April 11, 2012

Via Electronic Mail and Hand Delivery

Alice Neece Mine, Esq.
Assistant Executive Director and Ethics Counsel
North Carolina State Bar
208 Fayetteville Street
PO Box 25908
Raleigh, NC 27611

Re: Request for Formal Ethics Ruling

Dear Ms. Mine:

On February 8 of this year I submitted a request for a formal ethics ruling, copying the request to Lender Processing Services, Inc. ("LPS") and to four North Carolina law firms identified by LPS as approved "service providers."

By letters of March 9 and March 23, Raleigh attorney Michael Weddington communicated with you on behalf of LPS. On March 9 Mr. Weddington stated that within the next ninety days the LPS business model would "undergo a fundamental change" that would "obviate the need for assessment by the State Bar Ethics Committee of the questions posed in the Request." On March 23, Mr. Weddington provided a more substantive response, also indicating that certain of the "Assumed Facts" had already changed.

I have inquired whether LPS is willing to share its current or its new forms of attorney agreement for review and comment. I have not heard back.

I ask that the State Bar review LPS's practices, current and prospective.

I. OVERVIEW.

The request for the formal ethics ruling was prompted by review of the complaint in the Nevada Attorney General's recent (December 15, 2011) lawsuit against LPS, a copy of which (without exhibits) is enclosed ("AG Complaint"). The Assumed Facts were based on the terms of the LPS

"Network Agreement" (also enclosed) which was attached to the AG Complaint as Exhibit J. In short:

- Historically, at least, LPS has required attorneys to pay substantial "admin fees" in order to receive referrals for legal work performed for LPS's clients. See AG Complaint, pp. 33-35; and Exhibit C to the "Exhibit J Network Agreement."

- Historically, at least, LPS has required counsel to route communications through LPS and allow LPS to direct things and supply affidavits and other documents. See AG Complaint, pp. 24-33, and sections II.B and C, below.

- LPS was responsible for much of the "robo-signing." See AG Complaint pp. 9-23 and section II.C, below.

- Federal financial regulators concluded, as one of their principal findings, that the robo-signing problem arose as the result of "critical weaknesses in oversight and monitoring of foreclosure attorneys." See section II.D. I don't purport to know precisely what this means, but that's what they said.

Under the recently announced National Mortgage Settlement,[1] robo-signing has been stopped prospectively as to loans owned or serviced by five major banks. However the purpose behind robo-signing was speed ("efficiency") in foreclosures. Efforts to achieve speed ("efficiency") in foreclosures present issues of client communication, control and loyalty. Because of the substantial cost of foreclosures to investors who finance mortgage loans, sustainable loan modifications, rather than foreclosures, are, for investors, the financially preferable method for resolving mortgage defaults. In addition to fiduciary duties, loss mitigation is affirmatively required under a complicated patchwork matrix of statute, regulation, consent decree and program requirement that put foreclosing parties and their representatives under a duty to pursue loss mitigation. See section II.E.

Service providers such as LPS operate under financial incentives that favor expeditious foreclosure, and act under a divergence (conflict) of financial interest. LPS has recently (February 29, 2012) acknowledged that slowdowns in foreclosures have had a substantial adverse financial effect on LPS earnings. See section II.F. It is in LPS's financial interest for foreclosure proceedings to move forward expeditiously.

Historically, at least, LPS has some role in or influence over the selection, evaluation and retention of foreclosure attorneys. See AG Complaint, section V (pp. 24-32), titled "LPS Misrepresents its Role and Services by Unlawfully Directing the Work of Network Attorneys." A summary is provided by the subheadings within section V of the AG Complaint:

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[1] http://www.nationalmortgagesettlement.com/.

A. LPS' Foreclosure Timelines Undermine the Integrity and Accuracy of Work by Network Firms

B. Membership in the LPS Network Requires Law Firms to Sacrifice their Professional Judgment and Autonomy

C. LPS Obstructs Communication between Network Firms and their Servicer Clients

These matters appear to present substantial issues under the Rules of Professional Conduct.

II. BACKGROUND AND SOURCE OF "ASSUMED FACTS."

A. Lender Processing Services.

LPS, a public company listed on the NYSE, provides "default management services." "We offer lenders, servicers and their attorneys certain administrative and support services in connection with managing foreclosures." See LPS 10-K filed February 29, 2012; p. 4.[2] According to LPS, its "Desktop" application "is currently the leading mortgage default management application in the U.S." *Id.*, p. 6.

Last year (2011), LPS revenues from the sale of default management services declined markedly, from \$1.14 billion and \$1.06 billion in 2009 and 2010, to \$816 million in 2011. *Id.*, pp. 4-5. The principal reason for this revenue decline was foreclosure *delay*. Per the LPS 10-K:

> [T]he weaker economy and housing market have tended to increase the volume of consumer mortgage defaults, which can favorably affect our default management operations, in which we service residential mortgage loans in default. . . . However, various pieces of government legislation aimed at mitigating the current downturn in the housing market and lenders' efforts to comply with the requirements of that legislation and the requirements of consent orders entered into by a number of large lenders during 2011 have delayed foreclosure starts and *slowed the pace at which foreclosures are processed, which has adversely affected the results of our default management operations*.

Id., p. 8 (emphasis added). Also see additional quotes from LPS 10-K in section II.E, below.

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2 http://www.sec.gov/Archives/edgar/data/1429775/000142977512000002/lps12311110-k.htm.

B. LPS Interactions with Foreclosure Lawyers.

Part of what LPS does is interact with foreclosure lawyers. LPS interactions with lawyers have been the subject of judicial criticism. In a decision rendered August 24, 2011, the Third Circuit described and criticized the LPS process:

> This case is an unfortunate example of the ways in which overreliance on computerized processes in a high-volume practice, as well as a failure on the part of clients and lawyers alike to take responsibility for accurate knowledge of a case, can lead to attorney misconduct before a court.
>
> * * * *
>
> HSBC [holder of the mortgage] does not deign to communicate directly with the firms it employs in its high-volume foreclosure work; rather, it uses a computerized system called NewTrak (provided by a third party, LPS) to assign individual firms discrete assignments and provide the limited data the system deems relevant to each assignment.[FN5] The firms are selected and the instructions generated without any direct human involvement. The firms so chosen generally do not have the capacity to check the data (such as the amount of mortgage payment or time in arrears) provided to them by NewTrak and are not expected to communicate with other firms that may have done related work on the matter. Although it is technically possible for a firm hired through NewTrak to contact HSBC to discuss the matter on which it has been retained, it is clear from the record that this was discouraged and that some attorneys, including at least one Udren Firm attorney, did not believe it to be permitted.

In re Taylor, 655 F.3d 274, 279 (3d Cir. 2011). Footnote 5 to the foregoing quote concerns LPS:

> FN5. LPS is also not involved in the present appeal, as the bankruptcy court found that it had not engaged in wrongdoing in this case. However, both the accuracy of its data and the ethics of its practices have been repeatedly called into question elsewhere. *See, e.g.*, *In re Wilson*, 2011 WL 1337240 at *9 (Bankr. E.D.La. Apr. 7, 2011) (imposing sanctions after finding that LPS had issued "sham" affidavits and perpetrated fraud on the court); *In re Thorne*, 2011 WL 2470114 (Bankr. N.D.Miss. June 16, 2011); *In re Doble*, 2011 WL 1465559 (Bankr. S.D.Cal. Apr. 14, 2011).

Id.

C. “Robo-Signing.”

One of the problems with foreclosures handled by LPS has been so-called “robo-signing.” *In re Wilson*, 2011 WL 1337240 (Bankr. E.D.La. Apr. 7, 2011), cited in the above-quoted footnote, stated:

> As part of its default services, LPS executed Affidavits of Default in support of Motions for Relief from Stay. LPS testified that it was just one of the services that LPS provided to clients. The affidavit is typical. It purports to be executed under oath before a notary and two (2) witnesses. It provides the name and title of the affiant and represents that the affiant has personal knowledge of the facts contained in the affidavit. In fact, it is a sham.

2011 WL 1337240, at *8-9 (footnotes omitted). The opinion then goes on for three pages discussing the affidavit process and its shortcomings, concluding: “In short, the affidavit was nothing other than a farce . . . .” *Id*. at *12.

The problem described in *In re Taylor* was apparently not an isolated aberration. On April 13, 2011, LPS entered into a consent order with four federal regulatory agencies, the Office of the Comptroller of the Currency (“OCC”), the Office of Thrift Supervision (“OTS”), the Federal Deposit Insurance Corporation and the Federal Reserve Board.[3] The consent order followed an investigation and report by three of the agencies. The agencies report found that part of the problem was lack of “oversight” of law firms.

> The lack of sufficient oversight of DMSPs [Default Management Service Providers], coupled with the contractual deficiencies, led to instances in which employees of those DMSPs signed foreclosure affidavits without personally conducting the review or possessing the level of knowledge of information that they attested to in those affidavits. Employees of DMSPs, like the employees of the servicers themselves, executed documents in a manner contrary to the notary’s acknowledgement and verification of those documents. In addition, in limited instances, employees of DMSPs signed foreclosure-related documents on behalf of servicers without proper authority. *Because some of the servicers relied on DMSPs to oversee their third-party vendor law firms*, the contractual deficiencies and lack of oversight of DMSPs contributed to the *weaknesses identified above regarding the oversight of third-party vendor law firms*.

Federal Reserve, OCC and OTS, “Interagency Review of Foreclosure Policies and Practices” (April 2011), p. 10 (emphasis added).[4] Also see Congressional Oversight Panel, “Examining the

3 http://www.occ.gov/news-issuances/news-releases/2011/nr-occ-2011-47f.pdf.

4 http://www.occ.gov/news-issuances/news-releases/2011/nr-occ-2011-47a.pdf. Certainly the agencies’ language was milder than the language the judge used (“executed contrary to the notary’s

Consequences of Mortgage Irregularities for Financial Stability and Foreclosure Mitigation" (Nov. 16, 2010).[5]

D. Agency Findings of Inadequate Attorney Oversight.

The concluding words of the foregoing quotation concerning weaknesses of "oversight" over law firms conclude that the robo-signing problem arose, in part, because *lawyers* were not being adequately *monitored*. This finding of inadequate oversight over foreclosure lawyers, whatever it means, was one of the report's principal findings: the first sentence of the report's "Summary of Review Findings" reads

> The reviews found critical weaknesses in servicers' foreclosure governance processes, foreclosure document preparation processes, and *oversight and monitoring of third-party vendors, including foreclosure attorneys*.

Interagency Review, *supra* n. 4, at, p. 2 (emphasis added).

E. The Duty to Avoid Foreclosure.

With LPS in the middle of attorney-client communications, homeowners do not receive the full benefit of mortgage servicers' duties to avoid foreclosures. Attorneys working with servicers or service providers such as LPS have the obligation to facilitate foreclosure avoidance, both because foreclosure avoidance is in their ultimate client's (the investors') best interest, and also because of the jumble of statutes, regulations, consent decrees, insurance requirements and programs commitments that impose a legal duty to avoid foreclosure if possible.

Sources for this legal duty to avoid foreclosure include:

- Mortgage loan servicers operating in North Carolina are subject to a general requirement under *state* law to "negotiate with the borrower" "to attempt a resolution or workout to the delinquency."[6]

- The recent National Foreclosure Complaint, ¶¶ 56 and 58, alleged that five major banks had "violated *federal* laws, program requirements and contractual requirements

acknowledgement" vs. "farce"), but they were looking at the same robo-signing problem. The agencies confirmed that the issue was pervasive. LPS was singled out for special mention. *Id*., p. 10.

[5] http://cybercemetery.unt.edu/archive/cop/20110402010313/http://cop.senate.gov/documents/cop-111610-report.pdf.

[6] N.C. Gen. Stat. § 53-244.110(7).

governing loss mitigation," and detailed nineteen ways in which these banks had "failure to discharge their required loan modification obligations."[7]

- The Consent Judgment in the National Foreclosure Settlement confirmed a duty to do loan modifications (concessions) based on whether the loan modification would be net present value-positive.[8]

The losses sustained by investors when defaulted mortgage loans proceed through foreclosure are enormous: 56% - 67% per one study, 50% - 80% in another estimate.[9] The benefit to investors when loans are successfully modified are substantial. Because of the cost/benefit tradeoff for investors, and because the investors are the ultimate intended beneficiaries of the deeds of trust and of the agency relationships and fiduciary duties that attend mortgage servicing and foreclosure, mortgage modifications must be preferred over concluding foreclosures notwithstanding the contrary interests of service providers such as LPS.

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7 https://d9klfgibkcquc.cloudfront.net/Complaint_Corrected_2012-03-14.pdf (emphasis added).

8 Consent Judgment, Exhibit A ("Settlement Term Sheet"), p. A-16, § IV.A.2. The link to the consent judgment is at http://www.nationalforeclosuresettlement.com/.

The summary of the settlement with these five institutions describes extensive procedural rights and other "Enhanced Loss Litigation Protection for the Borrower," including rights of appeal. See section II at http://www.atg.wa.gov/uploadedFiles/Home/About_the_Office/Cases/National_Mortgage_Settlement/Servicing%20Standards%20Highlights.pdf.

9 See data calculations by Professor Alan M. White of Valparaiso University School of Law, based on the Corporate Trust Services ("CTS") dataset. The CTS dataset, four million loans, is described at J.M. Collins and C.K. Reid, "Who Receives a Mortgage Modification? Race and Income Differentials in Loan Workouts," http://www.frbsf.org/publications/community/wpapers/2010/who-receives-mortgage-modification.pdf. The data examine completed foreclosures from November of 2008 through May of 2011, and find losses as a percentage of the loans' original balance ranging between 56.14% and 67.11%. The data files are available on Professor White's web site at http://www.valpo.edu/law/about-us/full-time-faculty/alan-m-white/alan-white-data-files. The data are contained in the file Foreclosures and Modifications – Securitized Mortgage Data through May 25, 2011 (columns AB through AE). Since these loss percentages are based on *original* loan balances, which do not include accrued and unpaid interest, they may *understate* investor losses.

In accord is Dr. Laurie S. Goodman's testimony, "National Mortgage Servicing Standards and Conflicts of Interest," at p. 2 ("foreclosure is, without question, the worst outcome for both investors and borrowers. . . . [A]n investor typically suffers a loss on his investment in the mortgage loans of between 50-80% of the balance of the loan amount after the home is sold and the various costs are deducted.") http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=484c5b2b-6924-459f-898e-3ae075feeb15.

Successful loan modification programs require expertise and patience on the part of the investors' representatives. Attorneys pursuing foreclosures should do so with an overriding attention to loan modification as the preferred outcome and should act pursuant to a client relationship that does not depend on conflicted intermediaries.

F. Investor-LPS Conflicts of Interest.

Even though loan modifications are in *investors*' best interest and *borrowers'* best interest, loan modifications are not in *LPS*'s best interest. It is in LPS's financial interest that defaults lead to foreclosures, and that foreclosures be completed expeditiously. This sort of conflict of interest apparently pervades the mortgage foreclosure services industry.

Recent law review articles have described various ways in which the interests of mortgage investors and servicers diverge, and the consequences of these conflicts of interest. One such article, by Adam J. Levitin and Tara Twomey, "Mortgage Servicing," 28 *Yale J. on Reg.* 1 (2011),[10] states that it "presents the first comprehensive overview of the residential mortgage servicing business." *Id.*, p. 90. The following quotes are among this article's conclusions:

> The economics of the servicing industry often discourage the restructuring of defaulted mortgage loans, even when it would be value-maximizing for mortgage investors.
>
> [T]he principal-agent problem in mortgage servicing has rendered dysfunctional the loss mitigation component of the servicing, and this has been a critical factor in exacerbating the current foreclosure crisis.
>
> [S]ervicers are frequently incentivized to foreclose on defaulted loans rather than restructure the loan, even when the restructuring would be in the investors' interest. The costs of this principal-agent conflict are not borne solely by MBS investors. The principal-agent conflict in residential mortgage servicing also has an enormous negative externality for homeowners, communities, and the housing market.

Id., pp. 4, 8, 90. Also see Diane E. Thompson, "Foreclosing Modifications: How Servicer Incentives Discourage Loan Modifications," 755 *Wash. L. Rev*. 86 (2011);[11] and the written testimony of economist Laurie S. Goodman "National Mortgage Servicing Standards and Conflicts of Interest."[12] The conclusions drawn include not only that servicers are economically

[10] http://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=1497&context=facpub&sei-redir=1&referer=http%3A%2F%2Fwww.google.com%2Furl%3Fsa%3Dt%26rct%3Dj%26q%3Dadam%2520j.%25.

[11] http://digital.law.washington.edu/dspace-law/bitstream/handle/1773.1/1074/86WLR755.pdf.

[12] *Supra*, n. 9. Dr. Goodman's other recent publications about mortgage modifications address the *types* of modifications that are successful: "The Case for Principal Reduction," *Journal of Structured Finance*

discouraged from doing loan modifications, but also that servicers find it economically advantageous to place defaulted homeowners in mortgage modifications that will be *unsuccessful*. Levitin & Twomey, *supra*, pp. 5, 70, 79-81.

As noted above, the sample of four million loans showed losses to investors on completed foreclosures of 56% - 67%; the quote from Dr. Goodman puts investor losses for completed foreclosures at 50% - 80%.[13] However notwithstanding these loss levels for investors, LPS's own financial interests are best served by having foreclosures move forward expeditiously. In its February 29, 2012 10-K,[14] p. 25, LPS referred to the

> decrease in our default management services due to lower foreclosure volumes *resulting from continued delays due to increased regulatory scrutiny and monitoring*, including consent orders entered into by a number of large servicers, judicial actions and voluntary delays by servicers.

Also see *id*. p. 19, where LPS refers to HAMP's "adverse effect on the processing of delinquent loans," and 10-K statements quoted in section II.A, above.

G. The Foreclosure Attorney's Role in North Carolina.

Ultimately, in North Carolina, it is the foreclosure attorney, acting on behalf of trustees on deeds of trust, who "pulls the trigger" on foreclosures by filing the foreclosure action and appearing before the clerk to ask that the foreclosure be ordered. Only North Carolina attorneys may pursue North Carolina foreclosures.

Trustees on deeds of trust, and their counsel, are required to be neutral:

> There are a number of ethics opinions that hold that a lawyer serving as trustee in a contested foreclosure proceeding may not act as the advocate for the beneficiary or the grantor in an adversarial proceeding arising from or connected with the deed of trust because the trustee is a fiduciary and, when exercising his discretion in the foreclosure, must play an impartial role relative to both parties. RPC 3, RPC 64, RPC 82, RPC 90, 04 Formal Ethics Opinion 3. *See also* N.C. Gen. Stat. § 45-21.16(c)(7)b (notice to the debtor must contain a statement that a trustee is "a neutral party and, while holding that

(Fall 2011); and "Modification Success-- What have We Learned?," *Journal of Fixed Income* (Fall 2011). *See* http://www.iijournals.com/doi/abs/10.3905/jsf.2011.17.3.029 and http://www.iijournals.com/doi/abs/10.3905/jfi.2011.21.2.057.

[13] *See* link at n. 9, above.

[14] *See* link at n. 2, above.

> position in the foreclosure proceeding, may not advocate for the secured creditor or for the debtor in the foreclosure proceeding").

2008 Formal Ethics Opinion 11. The requirement of trustee neutrality is fundamental:

> The relaxation of the strict rules equity imposes upon the mortgagor in relation to deeds of trust is *predicated upon the theory that the trustee is a disinterested third party acting as agent both of the debtor and of the creditor, thus removing any opportunity for oppression by the creditor and assuring fair treatment to the debtor*.

Mills v. Mutual Bldg. & Loan Ass'n, 216 N.C. 664, 668-69, 6 S.E.2d 549, 551-52 (1940) (emphasis added).

This duty of neutrality by the trustee-- the "disinterested third party acting as agent both of the debtor and the creditor"-- is consistent with a duty to facilitate loss mitigation through mortgage modification.

While the trustee and trustee's counsel are required to be neutral in order to protect the interests "both of the debtor and the creditor," one group of participants in the foreclosure process whose interests are *not* supposed to be represented by the trustee or by counsel are providers of "default management services" such as LPS.

Because LPS is not the ultimate beneficiary of attorneys' duties in connection with foreclosure, and because of the divergence of economic interest between LPS and the beneficial owners of mortgage loans, all LPS roles affecting attorney selection, retention or communication should be subject to close examination, as should any other LPS role that affords a *de facto* ability to influence mortgage foreclosure speed or fail to encourage loan modifications.

III. <u>HOW THE "EXHIBIT J" NETWORK AGREEMENTS VIOLATE THE RULES OF PROFESSIONAL CONDUCT</u>.

Mr. Weddington's letter of March 23, 2012 states at pp. 1-2 that several "points of correction" should be made to the Assumed Facts in order to have these Assumed Facts correspond to LPS's current form of Network Agreement.[15] It is impossible to address the accuracy of a party's characterizations of a document when the document cannot be reviewed. However two of the purported corrections are inconsistent with the language of the "Exhibit J" version of the Network Agreement:

[15] These corrections refer to things that have changed since 2007: the "Exhibit J" Network Agreement contains exhibits dated October, 2007, indicating this form of Network Agreement was in use at least through that date.

- Mr. Weddington's March 23 letter states that part of numbered paragraph 2 of the Assumed Facts is inconsistent with the actual terms of Network Agreements, because the Network Agreements provide that the clients make the decisions about what matters will be referred. However section 2 of the Exhibit J Network Agreement states "*[LPS] may decide* which matters are to be referred to the Firm."

- Mr. Weddington's March 23 letter states that part of numbered paragraph 3 of the Assumed Facts, stating '[b]oth the holder of the mortgage and ABC Services will be XYZ Law Firm's clients," does not accurately describe LPS's arrangements. However the first "Whereas" paragraph of the Exhibit J Network Agreement states "the Firm wishes to provide *to [LPS]* and its Clients various legal services . . . ." Further, Exhibit A, section I, paragraph A states "[t]he Firm shall *provide [LPS]* and its clients with competent legal representation . . . ."

Based on the "Exhibit J" Network Agreement, the following Rules of Professional Conduct appear to be in issue.

A. Solicitation.

Section II of Exhibit A to the Exhibit J Network Agreement lists "services to be provided by [LPS] to the Firm." Paragraph "B" of this section states "[LPS] shall develop and implement marketing services to obtain clients for the Network." This aspect of the Network Agreement appears to contemplate solicitations that are contrary to Rule 7.3.

RPC Rule 7.3(a) generally prohibits (1) in-person solicitations of professional employment, (2) live telephone solicitation, (3) real-time electronic solicitation, (4) written, recorded or electronic solicitations that do not include a legend in capital letters "this is an advertisement for legal services."

The Annotations to the Model Rules state:

> Lawyers may not use other people to solicit for them, and Rule 7.3 is sometimes invoked along with either Rule 7.2(b) (prohibiting paid recommendations) or Rule 8.4 (prohibiting use of third persons to violate rules) to prohibit the practice.

ABA *Annotated Model Rules of Professional Conduct,* p. 556 (7th ed. 2011). Rule 8.4 states "It is professional misconduct for a lawyer to: (a) violate or attempt to violate the Rules of Professional Conduct . . . through the acts of another."

In 2006 FEO 7 the State Bar considered an ethics inquiry concerning a lawyer's participation in a "for-profit networking organization. The opinion states in part "the lawyer may not give

anything of value to a person for recommending the lawyer's services . . . and may not engage in in-person solicitation of prospective clients either directly or by use of an agent."
Even for non-profit lawyer referral services, one of the conditions is that "employees of the referral service do not initiate contact with prospective clients and do not engage in live telephone or in-person solicitation of clients." Rule 7.2(d)(5).

B. Paying for Recommendation.

Exhibit B to the Network Agreement calls for payments by the law firm to LPS. Part of what LPS delivers is employment or a recommendation of employment. The Network Agreement does not limit payments to "the reasonable costs of advertisements or communications permitted by" Rule 7.2, and ABC Services is not a "not-for-profit lawyer referral service." Payment of amounts to ABC Services for referral of legal work therefore appears to be prohibited by Rule 7.2.

Rule 7.2(b) states:

> (b) A lawyer shall not give anything of value to a person for recommending the lawyer's services except that a lawyer may
>
> (1) pay the reasonable costs of advertisements or communications permitted by this Rule;
>
> (2) pay the usual charges of a not-for-profit lawyer referral service that complies with Rule 7.2(d), or a prepaid or group legal services plan that complies with Rule 7.3(d); and
>
> (3) pay for a law practice in accordance with Rule 1.17.

An Annotation to Rule 7.2 notes that Comment [5] states that "[a] lawyer may compensate employees, agents and vendors who are engaged to provide marketing or client-development services, such as publicists, public-relations personnel, business-development staff and website designers," adding "but other payments remain forbidden." The Annotation goes on to summarize seven ethics opinions and one case which address the extent of permitted payments, making clear that payments must be limited to "costs of advertising." ABA *Annotated Model Rules of Professional Conduct* (7th ed. 2011), pp. 546-47.

In 2004 FEO 1 the State Bar opined that participation in an "on-line legal matching service" could be proper under certain circumstances, but "the lawyer may not give anything of value to a person for recommending the lawyer's services (with certain limited exceptions not relevant here), and may not engage in in-person solicitation of prospective clients either directly or by use of an agent." The Bar further opined that "a participating lawyer may pay a proportionate share of the reasonable costs of operating the service."

In RPC 10 (1986), the Bar considered an inquiry concerning a "private lawyer referral service." Consistent with current Rule 7.2(d), the Bar opined that such a referral service is required to be non-profit organization.

C. Fee Sharing.

Exhibit B to the Network Agreement calls for payments by the law firm to LPS. The payment arrangements appear to constitute a violation of the prohibition against fee sharing.

Rule 5.4(a) provides a lawyer "shall not share legal fees with a nonlawyer." North Carolina Rule 5.4(a) is substantially identical to Rule 5.4(a) of the Model Rules of Professional Conduct. The official annotation to Model Rule 5.4 states:

> Rule 5.4 is intended to protect a lawyer's independent professional judgment by limiting the influence of non-lawyers on the lawyer-client relationship. See ABA Formal Ethics Op. 95-392 (1995).

ABA *Annotated Model Rules of Professional Conduct* (7th ed. 2011), p. 456.

The Restatement counterpart of Rule 5.4(a) is found in section 10(3) of the Restatement, which provides that "[a] lawyer or law firm may not share legal fees with a person not admitted to practice as a lawyer . . . ." Comment "b" to this section states in part:

> [L]awyer-code limitations on law firm structure and practices . . . are prophylactic in nature and are designed to safeguard the professional independence of lawyers. *A person entitled to share a lawyer's fees is likely to attempt to influence the lawyer's activities so as to maximize those fees*.

Restatement (Third) The Law Governing Lawyers (2011), p. 98 (emphasis added).

The concept of "fee-sharing" in the Rules of Professional Conduct is not limited to a mechanical percentage division of lawyer fee receipts. Rather, the prohibition extends to "any benefit, reward or profit." According to ABA Formal Ethics Op. 95-392, the opinion referenced in the official annotation to ABA Model Rule 5.4:

> "An attorney is considered to be sharing legal fees with a nonlawyer or forming a partnership with a nonlawyer for the practice of law if the employing corporation reaps *any benefit, reward or profit from the attorney's provision of legal services* to third parties." Dallas Bar Association, Legal Ethics Committee, Opinion 1982-3 (1982). *This Committee agrees* with these views . . . .

Id. (emphasis added).

In *In re Bass*, 227 B.R. 103 (Bankr. E.D. Mich. 1998), the court considered an arrangement by which a law firm compensated paralegals based on the number of bankruptcy cases filed per week:

> Castle's payment scale . . . reveals that legal assistants conducting initial consultations receive a base salary of $375 per week for a minimum of 15 bankruptcy cases filed by Castle. Each additional bankruptcy filing, up to 39 filings, results in an increase in base salary of $25 per week. A $40 bonus is given for the 25th filing, with increases in the bonus in $10 increments up to the 39th filing. The result is that if Castle files 15 cases per week, the legal assistant receives a weekly salary of $375. Thirty-nine filings per week results in the maximum salary of $1,150.

227 B.R. at 109. Even though this arrangement did not involve a division of fees received, the court held the arrangement was contrary to the Rules of Professional Conduct:

> Although Castle's compensation package for its legal assistants is not based on a percentage or share of fees received, it is directly tied to the filing of particular cases and is likely to encourage the solicitation of clients or the unauthorized practice of law, two activities the prohibition against fee sharing is designed to prevent. The legal assistants conducting initial consultations at Castle have a "vested pecuniary interest in [the] attorney's disposition of [the] case that could possibly take preeminence over [the] client's best interest." *South Carolina Bar*, 367 S.E.2d at 18.

227 B.R. at 110, *citing In re Anonymous Member of the South Carolina Bar*, 295 S.C. 25, 367 S.E.2d 17 (S.C. 1988).

D. <u>Independent Professional Judgment</u>.

Rules 1.8(f), 2.1 and 5.4(c) require that lawyers exercise "independent professional judgment." In addition, Rule 1.2(a)(1) provides "[a] lawyer shall abide by a client's decision whether to settle a matter," and Rule 1.4(a) requires lawyers to "inform" and "consult with" "the client."

An annotation to ABA Rule 2.1 notes:

> Although issues of independence recur in the insurance defense context, the possibility that a lawyer's independent professional judgment may be compromised by allegiances to others can arise in a variety of other situations, too. *Frequently they involve allegiances to people or entities who are sources of ongoing business for the lawyer*.

ABA *Annotated Model Rules of Professional Conduct* (7th ed. 2011), p. 285 (emphasis added). Also see *In re Computer Dynamics Inc.*, 252 B.R. 50, 63 (Bankr. E.D.Va. 1997) ("The professional judgment of a lawyer should be exercised, within the bounds of the law, solely for the benefit of his client and *free of compromising influences and loyalties.* Neither his personal interests, the interests of other clients, *nor the desires of third persons should be permitted to dilute his loyalty to his client.*"-- emphasis by court); *Geauga Cty. Bar Assn. v. Patterson*, 919 N.E.2d 206, 210 (Ohio 2009) ("insufficient attorney-client communication and case preparation, nonattorney promotion of the lawyer's legal services, the aiding of the unauthorized practice of law, and the sharing of legal fees. Together, these failings signal the surrender of an attorney's ability to exercise independent professional judgment on a client's behalf and manifest an overarching breach of the lawyer's duty of loyalty to the client.")

One way in which attorney relationships with LPS may raise "independent professional judgment" issues involves verification of information:

> [A]n attorney must, in her independent professional judgment, make a reasonable effort to determine what facts are likely to be relevant to a particular court filing and to seek those facts from the client. She cannot simply settle for the information her client determines in advance-- by means of an automated system, no less-- that she should be provided with.

In re Taylor, supra, 655 F.3d at 284. A separate but related way in which attorney relationships with LPS may raise "independent professional judgment" issues arises from the conflict between LPS business interest in prompt conclusion of foreclosures and the legal obligations and investor interest in foreclosure avoidance, described above.

The Exhibit J Network Agreement's provisions discourage client communication. It provides that all communications concerning instituting the foreclosure or settling the foreclosure proceeding shall be exclusively with LPS. See Network Agreement, Exhibit A, section II, paragraphs L and M. A separate section of the Agreement authorizes direct communication where "in the professional opinion of the Firm, [direct contact with the mortgage holder] is necessary." Network Agreement section 7. However the cases at pp. 4-5, above (*In re Taylor, In re Wilson*) found that, in practice, direct communication between the lawyer and the client was discouraged.

CONCLUSION

In North Carolina, lawyers are essential participants in the foreclosure process.

Only the State Bar is in a position to determine the extent to which LPS's business practices present problems under the North Carolina Rules of Professional Conduct. See RPC 0.2[7] ("The rules are designed to provide guidance to lawyers and to provide a structure for regulating conduct through disciplinary agencies. They are not designed to be a basis for civil liability."). *Cf.* N.C. Gen. Stat. § 75-1.1(b) (North Carolina consumer protection statute excluding "learned professions" from its coverage). Indeed, investigation of lawyers' roles in foreclosure has been held by Florida courts to be beyond the power of that state's attorney general. *Office of Atty.*

Gen. v. Shapiro & Fishman, LLP, 59 So.3d 353, 356 (Fla. App. 2011); *Law Office of David J. Stern, P.A. v. State*, 2011 WL 6183590 (Fla. App. 2011).

North Carolina statutes grant the State Bar power not only over lawyers, but also over any persons who engage in "unauthorized or unlawful practice of law" or who engage in solicitation or division of fees. N.C. Gen. Stat. §§ 84-27, -38. Also see N.C. Gen. Stat. § 84-23(a), final sentence ("Council may do all things necessary in the furtherance of the purposes of this Article that are not otherwise prohibited by law.")

For the reasons set out above, I respectfully submit that LPS's conduct, past and prospective, is worthy of the Bar's consideration. No other federal or state agency is seeking to ensure that this conduct is consistent with the rules governing practices affecting lawyers.

Thank you for considering these comments.

Very truly yours,

J. Jerome Hartzell
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Enclosures

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