



NEW YORK STATE BAR ASSOCIATION

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COMMITTEE ON PROFESSIONAL ETHICS

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Wayne M. Ozzi, Esq.
Chairman, Professional Ethics Committee
Richmond County Bar Association
152 Stuyvesant Place, Suite 203
Staten Island, New York 10301

Re: Inquiry No. 43-09

Dear Mr. Ozzi:

Your ethics inquiry has been considered by the Committee. Your inquiry concerns N.Y. State 817 (2007), which you said "has caused a good deal of concern among real estate practitioners" in your county and statewide.

In essence, your inquiry is whether a lawyer may ethically participate in a residential real estate transaction where the sales contract, the HUD-1 Settlement Statement and the transfer tax return each show that the amount of the sales price has been increased in an amount equivalent to the amount of the seller's concession.

To make your inquiry more concrete, you suggested that our Committee consider your question in light of the following hypothetical: Seller's attorney is presented with a binder calling for a contract for the sale of a single family home for \$300,000, with a mortgage contingency clause for \$285,000, representing 95% financing. Before the contract is prepared, the buyer's loan officer (i.e., lender) contacts the seller's attorney asking that the contract be prepared containing the following language: (1) the selling price should be increased by \$18,000, to \$318,000, to reflect a seller's concession of 6%; (2) a sum certain seller's concession of \$18,000 will to be applied to buyer's closing costs or otherwise; and (3) the mortgage contingency clause should be increased to mortgage of \$302,100 (representing 95% financing).

The seller's attorney and the buyer's attorney defer to the loan officer, an individual licensed by the New York State Banking Department who has been engaged by the buyer to procure the mortgage loan. The loan officer asks the seller's attorney to put in writing that the above formula fully meets underwriting guidelines and was initiated by the loan officer. The sales contract also expressly states that the sales price has been increased by a sum equivalent to the seller's concession, clearly indicating that the price the seller agreed to receive was \$300,000. A similar disclosure is set forth in the HUD-1 Settlement Statement, on

the Real Property Transfer Tax Return and on the Real Property Transfer Report in connection with the sale of the real property.

In N.Y. State 817 (2007) this Committee opined that a lawyer's participation in a residential real estate transaction that includes a "seller's concession" and a "grossed up" or increased sales price is ethically prohibited unless the transaction is entirely lawful, the gross-up is disclosed in the transaction documents and no parties are misled to their detriment. That opinion did not hold that a seller's concession or gross up was improper. The opinion was based on a full disclosure in the transaction documents of the actual nature of the purchase price so that no interested person would be misled.

In essence we concluded that it is dishonest, fraudulent, deceptive and a misrepresentation under Rule 8.4(c) [formerly DR 1-102(A)(4)] to have the transaction documents in a residential real estate transaction contain an untrue statement of a material fact or omit a material fact which makes the statements contained therein materially misleading.

Our opinion N.Y. State 817 states in paragraph 14:

[A] lawyer may not ethically participate in such a "gross up" of the actual purchase price and concomitant seller's concession unless there is neither deception nor misrepresentation at work in a transaction and its predictable consequences. At a minimum this means that the gross-up (and not merely the grossed-up purchase price) must be disclosed in the transaction documents. We are persuaded that merely reporting "a seller's concession" may imply either that the seller has agreed to reduce the purchase price he or she would otherwise have obtained or that the reported sales price is the actual price of the property, less certain costs the seller has agreed to pay. If neither of these is the case, then reporting a concession, without more, is misleading under DR 1-102 [now Rule 8.4].

In reaching this conclusion we were aware of New Jersey Opinion 710 (2006) and its December 22, 2006 clarification published at 187 N.J.L.J 2 (2007).¹ See fn.4 and 8 to N.Y. State 817. We are also cognizant of the further clarification of New Jersey Opinion 710 reported at 193 N.J. 419, 939 A. 2d 794 (2008). Nothing contained in those opinions is inconsistent with N.Y. State 817 or with this opinion.

In your current inquiry, we are advised that the mortgagee bank is generally furnished with copies of the contract of sale with its riders and addenda (if any), the HUD-1 Settlement Statement, the closing statement, the mortgage, the note, a mortgage title policy and the deed. It is assumed that the real property will be assessed based upon the \$318,000 "disclosed" selling price, not the \$300,000 actual price, unless it is made clear to the assessor that the "real" sales price was \$300,000. See RP-5217 Real Property Transfer Report Instructions paragraph 13 (requiring that the seller's concession to be deducted to reach the actual or full sales price).

¹ The December 22, 2006 clarification of New Jersey Opinion 710 (2006) is available at <http://www.judiciary.state.nj.us/notices/2006/n061222a.htm>.

The factual pattern in your inquiry is unlike the circumstance where the seller reduces the selling price by \$18,000 after a building inspection discloses some defects in the structure that require remediation to the extent of \$18,000. There the \$300,000 initial selling price is reduced to \$282,000 and is not "grossed up" (i.e., increased) by a like amount. This is a distinction with a difference. The increase in the selling price to offset the seller's concession could well be characterized as a subterfuge to satisfy the refusal of the lender bank to make the loan on a \$300,000 agreed selling price.

The problem is not the seller's concession, but rather the "gross up" of the selling price. That gross up, if not expressly disclosed as such, is the type of dishonesty, fraud, deceit, and misrepresentation proscribed by Rule 8.4(c). A lawyer who knowingly participates in a real estate transaction that fails to expressly disclose the gross up of the sales price in exchange for the seller's concession in the transaction documents violates the provisions of Rules 8.4(b),(c),(d) and 3.4(a)(6) [formerly DR 1-102(A)(3), (4), (5) and DR 7-102(A)(7)].

The fact that this procedure may have been suggested or initiated by a loan officer or other employee at the mortgagee bank does not relieve the lawyer from the necessary disclosure. In fact, it makes the disclosure even more important to avoid the participation in the deception. No function other than to misrepresent the purchase price can be ascribed to the gross up. Essentially, your inquiry poses a simple question -- are the Rules violated when a seller and buyer and their attorneys engage in the device of a seller's concession, accompanied by a like increase in the purchase price, that perpetrates a fraud on the ultimate mortgage investor. If all the documentation discloses that the gross up is an increase in price equivalent to the seller's concession, there is no ethical violation or misrepresentation because everyone later in the chain of mortgage title or interest should therefore be apprised of the circumstances surrounding the original loan.

Applying the above principles to the facts in this opinion we are left with the determination of whether the express disclosure of the fact of the gross up of the sales price in the contract of sale with an express meaningful full disclosure in the HUD-1 Settlement Statement and in all other documents where the purchase price is stated is sufficient. The basic fact, as set forth in the fact section above, is that the bank will not lend the requested amount without the gross up.

The vice is the failure to disclose the fact that the grossed-up sales price resulted from the seller's concession. A seller's concession by itself is not inappropriate. The deception is canceled by the full express disclosure of the true nature of the transaction. Where all documents that refer to the sales price expressly state that the sales price has been increased by a sum equivalent to the seller's concession, the lawyer's ethical duty has been satisfied.

We are aware that disclosing the connection between the gross-up and the seller's concession may result in the bank being unwilling or unable to extend the amount of mortgage money the buyer needs. However, that does not change our opinion because the obligation of buyer's lawyer under Rule 1.1 to competently represent his client is conditioned upon compliance with the Rules prohibiting a lawyer from assisting a client in conduct that is fraudulent or contrary to a Rule. Rules 1.2(d); 3.4(a)(6).

In sum, when each document in a residential real estate transaction that contains both a seller's concession and a grossed-up sales price states that the sales price has been

increased by a sum equivalent to the seller's concession, there is no deception and therefore no ethical violation.

The foregoing is an informal response, not a formal opinion, and is based solely upon the information submitted and the representations set forth in your inquiry. It shall have no effect as precedent insofar as any other state of facts is concerned.

Very truly yours,

Roy D. Simon
Chair

c: Richard Rifkin, Esq.