# CORPORATIONS, BANKING, AND SECURITIES LAW SECTION
## South Carolina Bar

January 4, 2008

Task Force on Closing Responsibilities
c/o David H. Whitener, Jr., Esq.
Whitener & Wharton, PA
2001 Park Street
Columbia, South Carolina 29201

Re: Comments of the Corporation, Banking, and Securities Section of the Bar to the Preliminary Report of the Task Force on Closing Responsibilities in Relation to Commercial Real Estate Transactions

Dear David:

I am writing you to provide you with the comments of the Corporation, Banking, and Securities Law Section (the "Section") to the Preliminary Report of the Task Force on Closing Responsibilities. The comments relate primarily to the proposals relating to commercial real estate transactions.

These comments were prepared by are and being submitted on behalf the Section by the Section's Task Force on UPL in Commercial Transactions. The members of this Task Force are Sharon Bramlett, Jennifer Cheek, John Moore, James K. Price, Mark S. Sharpe, and James W. Sheedy.

The Section understands the stated purpose of the Task Force on Closing Responsibilities is to provide for consumer protection to the public in connection with real estate matters. The Section recognizes the importance of such protection, and recognizes and affirms the role of South Carolina counsel in South Carolina residential real estate transactions. Although beyond the scope of this letter, the Section expresses concern that the South Carolina residential real estate transaction proposals are overly limiting and restrictive on consumers and closing attorneys, and that South Carolina should be looking for ways to make residential real estate closings more economical and efficient for consumers, without compromising needed protections.

The Section opposes the commercial real estate transaction proposals. The proposals do not adequately consider the differences in the manner in which commercial transactions are conducted and the context in which commercial transactions occur. The Section believes the proposals are unnecessary and unworkable, and expand current South Carolina law without judicial or legislative sanction. The Section further believes that the proposals will have adverse and unintended

consequences, which will be to the detriment of the commercial bar and the users of legal services in commercial transactions.

## GENERAL COMMENTS

The Section opposes the proposals for the following reasons:

A. The Parties in Commercial Real Estate Transactions Are Sophisticated.

The parties to commercial real estate transactions are sophisticated parties, able to make meaningful evaluations of risk. By definition, the transactions are business transactions, and although there is a "user" of legal services, there is no "consumer" in the traditional sense. The parties, including institutional lenders, have, or have access to, and can afford sophisticated counsel.

B. All Parties Are Typically Represented By Counsel; There Is No Single "Closing Attorney."

In a typical commercial real estate transaction, all parties have separate counsel. This is unlike the practice in residential transactions, where there is typically a single "closing attorney," who, although representing the homeowner/borrower, owes duties to the lender, and may in addition prepare seller documents and represent the buyer.

The proposals, by implicitly imposing closing duties on a single closing attorney, do not reflect the existence of separate representation. Likewise, the proposals do not reflect the resulting fact that in commercial transactions closing duties are expressly allocated among the counsel to the respective parties. The need for flexibility in the allocation of closing responsibilities is discussed more fully below.

C. No Empirical Evidence of Widespread Problems in Commercial Real Estate Transactions.

The Section is not aware of empirical evidence of widespread client protections problems in commercial real estate transactions. This is likely because of a combination of factors noted elsewhere in this letter, such as sophistication of the parties and the presence of separate representation of the parties. By its nature, commercial real estate does not lend itself to a high volume, low margin law practice, with the resulting quality pressures. Informal discussions with insurers lead the Section to believe that the bulk of malpractice and other claims in real estate relate to high volume residential real estate practices handled predominately by paralegals and not to commercial real estate transactions. The Section believes, absent evidence of client protection problems, there is no need to extend the proposals to commercial transactions.

D. The Proposals Confuse UPL Issues in Multi-Jurisdictional Practice with Consumer Protection Issues and General UPL Issues.

The Section believes that the proposals confuse issues relating to the multi-jurisdictional practice of law with those of consumer protection and the unauthorized practice of law generally. The unauthorized practice of law issues in residential real estate closings principally relate to the rendering of legal services by lay persons or lay organizations. In commercial transactions, however, where all parties are typically represented by counsel, the UPL issues generally relate to multi-jurisdictional practice. To the extent that there is an issue in this regard, it is to what extent out-of-state counsel may, incidental to representation of clients in their home states, participate in South Carolina transactions, and not the provision of legal services by lay persons.

The Section believes that the issue of multi-jurisdictional practice[1] is a complex and nuanced area, as is evidenced by the provisions of Model Rule of Professional Conduct 5.5, adopted in South Carolina as Rule of Professional Conduct 5.5 in Supreme Court Rule 407. The Section believes that the proposals would effectively amend Rule 5.5, without either a demonstrated need or a demonstrated benefit, and without a studied deliberation or report as to the advisability of such a change to a carefully crafted rule, and without due consideration of the market realities of the role of title insurers and the use of electronic communications in commercial transactions.

For example, where there is an informed decision by a sophisticated party (such as a commercial lender) to select sophisticated counsel of its choosing in a particular transaction, irrespective of the state of admission of such counsel, with the necessary skills for the representation, what policy is served by requiring local counsel, likely with no particular expertise, as a matter of course? While policy matters such as this are certainly debatable, these issues should be addressed by considered changes directly to Rule 5.5, and not by indirect ad hoc rule making.

E. The Proposals Are Inappropriate as to All Commercial Real Estate Activities.

The Section opposes the proposals as to all commercial real estate activities. The Section further believes, however, that any proposals are especially inappropriate with respect to commercial real estate financing activities as opposed to purely conveyancing activities. Lenders are sophisticated parties, fully able to protect their interests and recognize the need for their own counsel, and in fact typically have sophisticated counsel in commercial transactions. The financing documents in commercial real estate transactions are typically prepared by counsel to the lender. The lenders typically do not rely on borrower's counsel. To the extent that the proposals are aimed at protecting consumers and members of the general public, lenders are the least in need of protection.

[1] Of course, the multi-jurisdictional issues here relate strictly to transactional legal matters and not to court appearances, where the concept of multi-jurisdictional practice has very limited relevance.

F. The Proposals Do Not Reflect The Reality of Current Commercial Real Estate, by Not Allowing for Flexibility in the Scope of Representation and the Allocation of Duties Among Counsel and Parties.

The proposals do not reflect the realities of commercial practice, in which closing tasks are allocated among various counsel. It is unusual for South Carolina counsel to perform all of the listed tasks, and the proposals limit the ability for the South Carolina counsel to negotiate the scope of a given representation. As a practical matter, South Carolina counsel in many cases would not have the negotiating leverage, and its client would not have the underlying economic interest, necessary to allow that counsel to negotiate a predominate role in the closing. The Section further believes that well-negotiated engagement letters adequately address the underlying concerns intended to be addressed by the proposals.

G. The Proposed Rules Will Increase the Cost of Commercial Real Estate Transactions and Financing in South Carolina.

The typical structure of a commercial loan transaction involves lender counsel and South Carolina borrower counsel. There may also be a seller's counsel. In many cases, the borrower will have general, corporate, or regular outside counsel in addition to South Carolina counsel. If the borrower, seller, and lender are all out-of-state persons, which is frequently the case in larger loans, each may have out-of state counsel. The lender's counsel will most likely be out-of-state counsel. The effect of the proposed rules would be to require that each out-of-state party or counsel retain local South Carolina counsel as well. In practice, the borrower pays the costs and fees of lender counsel; requiring an extra layer of local counsel will simply increase the cost to the borrower and to the seller (which may pass the cost on the borrower), with no concomitant benefit to the borrower. Further, the risk of defective loan or security documents would not be on the borrower, but on the lender, a truly sophisticated party.

H. The Proposed Rules Will Have An Adverse Impact on Capital Inflows into South Carolina, by Making Financing Transactions More Difficult.

To the extent that the proposals preclude efficient allocation of tasks and duties in commercial closings, require additional layers of representation, increase costs, and generally make commercial closings more cumbersome or expensive, the proposals will inhibit capital flows into South Carolina.

I. The Proposals Will Impose Additional Liabilities and Sources of Liability on South Carolina Lawyers, without Any Concomitant Increase in Protections to the Users of South Carolina Commercial Lawyers' Services.

The Section notes that the duties of attorneys to their clients are set forth in detail in the rules of professional conduct adopted by the Supreme Court, and applicable statutory provisions, as well as set forth in applicable case law on the law of lawyers and the related professional standards of care

for negligence and malpractice cases. The imposition of a new set of black letter duties and rules over this existing scheme is ill considered. The rules of professional conduct are the product of extensive study and revision, and the professional standards of care in the case law are the product of the common law and/or legislative process. There is no reason to circumvent these considered processes by imposing arbitrary rules having little benefit to the consumers of legal services.

J. The Proposals Will Require South Carolina Attorneys To Undertake Duties As To Which Professional Liability Insurance Is Not Readily Available.

The Section understands that many of the specific activities relating to title matters and title mechanics set forth in the proposals are not covered by many existing professional liability policies, at least without endorsement. As a result, the proposals may result in increased and uninsured exposure for South Carolina attorneys in malpractice litigation.

## COMMENTS ON THE SPECIFIC PROPOSALS

The Section has the following comments on the specific proposals.

1. Only A Lawyer Licensed In South Carolina May Certify Title To Real Estate And Issue Title Opinions.

The Section does not oppose this provision, and understands this to be existing law.

2. Only Lawyers Licensed In South Carolina May Prepare Deeds.

The Section believes that a blanket prohibition on the preparation of deeds by out-of-state counsel is unnecessary in commercial real estate transactions. In practice, seller counsel and/or buyer counsel, who may not be admitted in South Carolina, prepare deeds for use in South Carolina, or at least dictate the form of the deed. The Section sees little risk in this practice, and to the extent there is risk, it is risk knowingly assumed by a sophisticated, represented party, and thus consumer protection is not implicated. More importantly, this is an issue that should be addressed by the multi-jurisdictional practice rules in Rule 5.5 of the Rules of Professional Conduct, rather than by ad hoc rule making.

3. Only Lawyers Licensed In South Carolina May Draft, Oversee The Drafting, Or Review And Approve Loan Closing Documents To Be Used In A Real Estate Closing In South Carolina, Including The Legal Description Used In The Documents.

This proposal is inconsistent with current practice in larger loans, and impractical. In practice, national lenders use counsel of their choosing, frequently New York, Chicago, Charlotte, or Atlanta law firms to draft loan documents. The lenders are sophisticated parties, and have sophisticated counsel. The only parties at risk are the lenders, and thus there are no consumer protection issues implicated in this approach.

National lenders are going to have their financing documents prepared by their regular outside counsel.[2] Part of the reason is expertise; the reality is that, if for no other reason that the volume of the work, national counsel are frequently more experienced than most South Carolina counsel in the drafting of certain specialized financing documents.

For example, much commercial financing is now in the form of conduit financing, in which the loans are ultimately packaged and sold to investors as part of a "securitization" process. The financing documents for these transaction must meet, among other things, the requirements of the rating agencies that rate the investments into which the financings are packaged. Few if any South Carolina law firms have the expertise to reflect current rating agency requirements, for the simple reason that most of that work is done by money center lenders and their counsel.

To the extent that there are multi-jurisdictional practice issues in this approach, those issues should be addressed directly through amendment to Rule 5.5, and not through "back-door" changes made to Rule 5.5.

4. South Carolina Counsel Must Approve The Loan Documents.

In addition to the expertise issue discussed above, there are a number of issues raised by the "review and approve" requirement. First, what is the nature or purpose of the approval? Is "approval" a determination that the documents are in compliance with South Carolina law? If so, does compliance with South Carolina law mean simply recordability? Or is the purpose of the review and approval to establish the enforceability of the documents, or to establish that the documents include customary provisions generally applicable to lenders? Does delivery of an opinion as borrower's counsel suffice as "review and approval?"

The concept of enforceability is complex; and there is an extensive body of law on this question in the legal opinion field. Opinions on enforceability are particularly complex; it is meaningless to speak simply of enforceability.

On whose behalf is the South Carolina counsel to render such approval? Is the approval rendered on behalf of the borrower? If so, is it appropriate for borrower counsel to be advising the lender of potential document deficiencies that would redound to the borrower's benefit? Does the obligation of South Carolina counsel to review and approve the documents result in South Carolina counsel having a duty to the other parties to the transaction represented by other counsel?

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[2] The Section does not believe that the multi-jurisdictional practice rule of Rule of Professional Conduct 5.5 necessarily precludes or should preclude the preparation of financing documents by out-of-state counsel in a commercial transaction, where among other factors that counsel is not present in the state and does not have a presence in the state. Likewise, the Section does not believe that State v Buyers Services Co., Inc., 292 S.C. 426, 357 S.E.2d 15 (1987) and its progeny preclude such activity in commercial transactions.

Imposing a duty on the South Carolina lawyer to "approve" the loan documents imposes potential liability on that lawyer, even for matters that, as noted, may be beyond the lawyer's expertise. If the South Carolina lawyer approves a document with a legal or non-legal "defect," does this not impose additional liability on the lawyer to one or more parties?

Based on the foregoing, the Section recommends that the requirement that a South Carolina attorney must review and approve "loan closing documents" be deleted as unnecessary and unworkable.

5. South Carolina Counsel Must Approve The Legal Description.

The Section believes this requirement is unnecessary. As a practical matter, the legal description in a real estate transaction will be identical to that used in the title insurance policy issued in connection with the transaction, which will in turn be based upon a title examination prepared by a South Carolina lawyer.

Further, as discussed above, the role of the South Carolina lawyer in the transaction may be limited, by agreement of the parties and counsel, and may not extend to review of the legal description. Counsel to out-of-state lenders frequently have peculiar requirements relating to legal descriptions in the financing documents, such as the creation of an entirely new metes and bounds description from a new plat of survey, without reference to the descriptions in the chain of title or to recorded plats. What South Carolina party is at risk if there is a deficiency in such a description? The only party at risk is the lender, a sophisticated party, with its own counsel.

The proposed rule is not clear as to in what capacity the South Carolina counsel is to review the legal description. Is it as counsel to the borrower or the lender? Or counsel to the "deal"? If done as counsel to the borrower, is not the South Carolina counsel assuming a duty to the lender he or she would not otherwise have? If as counsel to the borrower, why is borrower's counsel being required to provide advice to the lender, a separately represented party?

Finally, upon what basis is approval to be made? Does approval simply signify that the legal description is in recordable form, with the required derivation, tax map references, etc.? Or does approval effectively require an opinion as to the accuracy of the description or that the description will be adequate to convey the property intended? If the latter, then the proposal imposes substantial potential liability on the approving South Carolina counsel, and is likely to be beyond the scope of the agreed upon representation in a particular case.

6. South Carolina Counsel Must Be Responsible for the Actual Closing of the Transaction.

As noted, the role of South Carolina counsel in many commercial transactions may be limited. The South Carolina lawyer may be retained to provide a title opinion, but nothing else. Or the South Carolina counsel may be retained simply to provide an opinion as to certain matters of South Carolina law. There is no logical or practical reason such limited involvement should be

precluded. The proposed rules, however, do just that, by effectively requiring the South Carolina lawyer to be in charge of the closing.

In many large commercial financing transactions, for example, the lender may be taking collateral in multiple states as part of a single transaction, and the South Carolina financing may be but a small part of the overall transaction. Likewise, purchases and sales of real estate may involve the simultaneous acquisition or disposition of multiple property in multiple states. It is not practical to make South Carolina counsel responsible for closing either type of transaction, and it is not reasonable to require South Carolina to be the nexus of entire transaction, when that role may not be justified by the underlying economics of the transaction.

7. The South Carolina Lawyer Must Be Responsible For Explanation of The Pertinent Issues Relating To The Transaction.

This proposal fails to recognize the reality that each party in a commercial transaction is likely to be represented by its own counsel. The practical effect of this proposal is therefore either to require that the South Carolina counsel explain the transaction to its own client (which may in fact be out-of-state counsel), which is a self-evident and existing duty, or that the South Carolina counsel explain the transaction to another party represented by separate counsel, which results in other ethical and liability issues. The Section believes that these types of general duties are best left to the Rules of Professional Conduct and applicable professional liability standards as developed in the common law.

8. The South Carolina Lawyer Must Be Responsible For Signatures, Witnesses, and Notarizations, Even When Done Out-of-State.

The requirement that the South Carolina lawyer "be responsible" for proper signatures, witnesses, and notarizations is impractical, unnecessary, and frequently impossible. First, the role of South Carolina counsel in the transaction may be limited, and such approval may not be in the scope of the lawyer's representation.

Second, as a practical matter, witnesses to out-of-state parties (such as the lender) and related notarizations are largely beyond the control of the South Carolina counsel, and there is no reason that the South Carolina lawyer need have control over out-of-state witnesses. Third, such a duty may be beyond the expertise of South Carolina counsel. For example, a South Carolina lawyer may have no knowledge of the intricacies of foreign attestations. Fourth, there are ethical considerations with respect to responsibility for signatures, witnesses, and notarizations that South Carolina counsel was not physically present to observe.

Finally, this proposal would impose additional standards of care on the attorney. If there is a defect (such as one arising from a peculiarity of the notary laws of a foreign jurisdiction), this proposal would make South Carolina counsel "responsible," even where the closing takes place out-of-state. The Section believes that such duties and liability issues should be left to existing law.

9. The South Carolina Lawyer Must Be Responsible For Proper Authorizations.

The Section does not believe a rule in this area is appropriate or workable. Not only does this proposal impose additional standards of care on the attorney, it imposes unreasonable and unworkable standards. Further, to the extent that the entity the authorizations of which are in issue is a foreign entity, a determination of proper authorization as to the entity will be beyond the expertise of the South Carolina lawyer.

The proposals provide no guidance as to the meaning of "proper authorizations." Is the South Carolina lawyer to effectively opine, at the risk of liability, that each of the parties has duly authorized the delivery of the documents? Does this duty extend to authorizations by parties represented by other counsel?

The requirement of "proper authorization" is potentially extraordinarily burdensome. There is a whole body of literature on opinions and related matters as to the due diligence and legal liability attendant to determining when a document has been properly authorized. The question of due authorization subsumes determinations of incumbency of directors, officers, partners, etc., the scope of their authority, the procedural and substantive regularity of purported authorizing meetings, resolutions and actions, the governing organizational law of the jurisdiction of organization, the authenticity of signatures, and even the regularity of the organizational process of the parties to the instruments. This area is further complicated by federal and State regulation relating to the authority of officers to execute instruments binding on their entities.

A determination of proper authorization is therefore a potentially massive undertaking. In practice, depending on the agreed upon scope of representation, formal and detailed opinions of counsel are negotiated and delivered on precisely these issues. The role of various counsel in rendering these opinions and making these determinations is carefully negotiated and allocated among counsel.

The Section further suggests that "proper authorization" is not in fact a legal question as much as a factual question and it is inappropriate for this requirement to be imposed upon counsel. The potential liability imposed upon a South Carolina attorney by a rule that such attorney make a determination of authorizations issues is extraordinary. The Section does not believe it appropriate to make changes to professional liability doctrines on such an ad hoc basis.

10. The South Carolina Lawyer Must Oversee the Recording of The Pertinent Documents.

This proposal does not recognize the fact that the role of South Carolina counsel in any given closing may be limited, such that recordation may be beyond the scope of the counsel's assigned duties. Many transactions involve the simultaneous funding and closing of multiple properties, and it may be necessary to coordinate recording through a national title insurance company (which would arrange for recording through its licensed South Carolina attorney agents).

11. South Carolina Counsel Must Review And Approve Any Powers Of Attorney Used In The Transaction.

The proposal likewise fails to recognize that the role of South Carolina counsel in any given transaction may be limited, and that each party in a commercial transaction will typically have has its own counsel. On whose behalf is the approval of the powers of attorney to be made, and to what parties does the attorney assume duties as part of such approval? Is the South Carolina attorney to approve powers of attorney to be executed by its client, to be executed by others in connection with instruments in favor of its client, or all powers of attorney in the transaction, irrespective of their impact on the South Carolina attorney's client? Is South Carolina counsel to review and approve the validity of powers of attorney executed pursuant to the laws of other States?

The proposal again limits the ability of the South Carolina attorney and the parties and counsel to a commercial transaction to negotiate their respective roles. There is no reason to require that the South Carolina counsel review and approve the form of any power of attorney used in the transaction, unless that is part of his engagement. In practice, to the extent a power of attorney is important to one party in a commercial transaction, there is likely to be negotiated an opinion from counsel to the related principal. Finally, the proposal would, by ad hoc rule, add a new source of liability and standard of care upon lawyers.

12. South Carolina Counsel Must Disburse All Funds Relating to The Transaction Paid to Third Parties, With The Exception Of Disbursements Made By Title Companies and Insured Financial Institutions.

The Section strongly believes that it is necessary to allow for nationally recognized title insurance companies and insured financial institutions to make disbursements. The Section further believes that lead counsel in multi-jurisdictional transactions should be permitted to make disbursements. The Section does not understand these practices to be currently prohibited in commercial transactions, and the Section is concerned that the inclusion of this proposal not be construed to suggest that the these practices are now prohibited in commercial transactions.

National lenders and commercial parties, as a matter of prudence, cannot be expected to and will not entrust hundreds of millions of dollars in transactional proceeds to non-institutional disbursing entities, such as law firms without the net worth or financial resources to avoid financial risk.

The proposed requirement that the South Carolina attorney disburse all of the funds relating to a commercial real estate transaction also ignores the limited role the South Carolina attorney may have in any given transaction, as discussed at length above.

**CONCLUSION**

The Section strongly opposes the adoption of the Preliminary Report of the Task Force on Closing Responsibilities in Relation to Commercial Real Estate Transactions. The Section also recommends that there be more discussion and input as to the Residential Real Estate Transactions proposals, and that effort be made to develop economical and effective/protective non-purchase money residential real estate closing procedures.

Thank you for this opportunity to comment. The Section's Task Force is available at your convenience to discuss the above in greater length and answer any questions you may have.

Sincerely,

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Chairman,
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