

HOW TO INITIATE FORECLOSURE OF A LAW LICENSE

By Katherine Jean

Following the collapse of the housing market, the Office of Counsel thought our readers might be interested to learn what happens to lawyers who participate in fraudulent real estate transactions. Lawyers can participate in several ways, including as buyers or sellers. This article will focus on closing lawyers who facilitate fraudulent real estate transactions. Often their participation takes the form of false statements on HUD-1 Settlement Statements.

12 U.S.C. § 3500.8 provides that "[t]he settlement agent shall use the HUD-1 settlement statement in every settlement involving a federally related mortgage loan in which there is a borrower and a seller." The HUD-1 must reflect all receipts and disbursements connected with a "federally related" loan. The definition of a "federally related mortgage loan" is expansive and, with limited exceptions, includes all mortgage loans obtained in connection with the purchase of residential real estate. 12 USCS § 2602(1). It is a crime to knowingly make false statements on a HUD-1. Title 18 U.S. Code Section 1001 and Section 1010.

Fraudulent conduct by closing lawyers comes in many varieties, including the following:

Phantom Down Payments: The buyer's loan application indicates that the buyer is borrowing 80% of the purchase price of the property and is bringing 20% of the purchase price to closing from her own money. In fact, the buyer does not contribute any money to the purchase price, 100% of which comes from the loan. This means that the actual purchase price is only 80% of the "contract sales price" shown on page 1 of the HUD-1. It also means that any representation at the bottom of page 1 that the transaction included "cash from borrower" is false. One lawyer told us she put false information about cash from buyers on HUD-1s because the seller told her he had "forgiven" the buyers' down payments. A private agreement between buyer and seller does not excuse false representations on a HUD-1. If the seller is willing to sell the property for 80% of the "contract sales price," the property is almost certainly worth no more than 80% of the contract sales price. The fact that the lender's collateral is worth substantially less than the lender was led to believe must be disclosed on the HUD-1. The lender also requires the buyer to put some of his own money into the transaction so the buyer will be more personally invested and thus less likely to default on the loan. The HUD-1 must accurately reflect actual receipt and disbursement of the buyer's money and cannot falsely state that money changed hands when it didn't.

"Payoffs" of Non-existent Mortgages: The HUD-1 indicates that some portion of the loan proceeds are used to pay off an existing first or second mortgage but no such mortgage exists. Instead, those funds are given to a third party who has no legitimate role in the transaction. The third party is often the person orchestrating the fraudulent transaction and arranging for the financing. The lender must be notified and any payment to a third party must be reflected on the HUD-1. The HUD-1 cannot reflect that money is being disbursed to satisfy a mortgage that doesn't exist.

Loan Proceeds Routed to Third Parties: The HUD-1 shows a disbursement of \$80,000 to the seller as net sales proceeds. From his trust account, the closing lawyer instead issues one check for \$20,000 to the seller and another check for \$60,000 to a third party whose name does not appear on the HUD-1. The fact that the seller is giving away \$60,000 of his net sales proceeds to a third party is a strong indication that the property is worth \$60,000 less than the buyer is paying. The lender's collateral is also worth \$60,000 less than the HUD-1 represents. The closing lawyer may even receive an invoice purporting to show that the seller owes \$60,000 to the third party. The closing lawyer may think that because it is the seller's money, the seller can direct that it be paid to whomever the seller wishes. However, the lender must be notified and the HUD-1 must reflect the actual recipients of loan proceeds. If the seller and the third party do not want payment to a third party listed on the HUD-1, it is because the payment is not legitimate.

Insta-Flips: A lawyer closes the sale of a house from A to B for \$50,000. Ten minutes or an hour or a day later, the same lawyer closes the sale of the same house by B to C for \$100,000. This is a "flip." The lawyer has undertaken to represent B in the first transaction and to represent C and C's lender in the second transaction. The fact that A was willing to sell the house at noon for \$50,000 is a pretty strong indicator that the property was not worth \$100,000 at 12:10 p.m. This is material information both C and C's lender are entitled to receive from the closing lawyer but which the lawyer conceals. In this situation, the Rules of Professional Conduct would prevent the lawyer from actually representing all of these parties, but by undertaking to do so the lawyer assumes clear duties, one of which is to disclose to his clients all material information about the representation. The lawyer cannot defend criminal charges or charges of professional misconduct on grounds that material information was withheld because it was confidential client information belonging to another client.

Title Opinions Showing Would-Be Owner: In the previous example, the closing lawyer prepares a preliminary opinion of title for the title insurer who will insure the interests of C and C's lender. The opinion falsely states that B is the owner of the property. A is still the owner of the property when the opinion is prepared. The lawyer's final opinion of title fails to disclose B's recent purchase of the property. These omissions are intended to conceal the fact that the transaction is a flip.

False Promises to Occupy the Premises: A lawyer closes the purchase of two or more houses by the same buyer in a short period of time. It is perfectly clear that the buyer does not intend to occupy both or all of the houses simultaneously. However, the lender in each transaction requires the lawyer to obtain the buyer's affidavit swearing that she intends to occupy the premises as her primary residence. The deed of trust in each transaction requires the buyer to use the property as her primary residence. The lender cares about this because it knows a buyer is less likely to default on her mortgage if the consequence of default and foreclosure is to lose her home. Also, interest rates and closing costs are generally higher on mortgages for second homes or investment properties and a buyer who does not intend to occupy the premises as her primary residence would not qualify for the loan the lawyer is closing.

Another red flag is a discrepancy in real estate commissions. When the HUD-1 reflects a purchase price of \$300,000 but the real estate commissions on page 2 are calculated as a percentage of \$225,000, this is a red flag that the actual price the seller is receiving may be \$75,000 less than the "contract sales price" reflected on page 1 and \$75,000 less than the price the buyer is paying, in which case the \$75,000 goes to a third party who is not identified on the HUD-1. A closing lawyer would be wise to require legitimate explanation and documentation of such a discrepancy.

For the past two years, the Office of Counsel and the United States Attorneys in North Carolina have devoted particular attention to investigating and prosecuting fraudulent real estate transactions. A lawyer who knowingly facilitated fraudulent transactions will be disbarred and will also likely go to prison. Materiality of a false statement is not a defense in prosecutions under 18 U.S.C. 1010 and 1014. *United States v. Wells*, 519 U.S. 482 (1997); *United States v. Castro*, 113 F.3d 176 (11th Cir. 1997). It is not a defense to criminal charges or to charges of professional misconduct that the buyer, the mortgage broker or the lender's loan officer knew about the fraud. That information just confirms the lawyer's status as a co-conspirator. A lawyer can be prosecuted for averting her eyes from red flags that a transaction is fraudulent, even when direct knowledge of fraud cannot be proven. In an unpublished opinion, the 4th Circuit Court of Appeals affirmed Frederick Lutz' conviction and sentence of imprisonment on a theory of "willful blindness" to a real estate flipping scheme. *United States v. Lutz*, 237 Fed. Appx. 849, 851 (4th Cir. N.C. 2007). Finally, after forfeiting her livelihood and serving time in prison, the lawyer is liable in civil court for actual and punitive damages. All legal malpractice policies exclude coverage for fraud and other intentionally dishonest behavior. Banks and title insurers no longer feel any reluctance to sue lawyers, whether they have malpractice insurance or not. A lawyer can avoid these disastrous outcomes by simply refusing to participate in any real estate transaction in which she either knows or suspects that the paperwork contains false information.

A quick review of the State Bar's website shows the following lawyers who have been disbarred for their roles in fraudulent real estate transactions: Neil G. O'Rourke of Apex, Anthony G. Young of Charlotte, Dwayne A. Bennett of Virginia, Michael King of East Spencer, S. Allen Patterson of Cary, Frederick Lutz of High Point, Robert Maggiolo of Durham, McArthur Mitchell of Charlotte, Thomas W. Jones of Sylva, Mark Lattimore of Greenville, South Carolina, J. Daniel Pike of Raleigh, Armina Swittenberg of Thomasville, Amy Robinson of Rolesville and Calvin Finger of Forsyth County. Many of these lawyers are also convicted felons and have served or will serve time in prison. We sadly anticipate more disbarments in the near future.

Since this article was published in the Spring 2009 Journal, the following lawyers have been disbarred for facilitating fraudulent real estate transactions: Randy Carpenter, Joseph Dean, David Ferris, Christine Gates, Mathew Marino (misprision of felony), Demetrius Rainer, Rick Shumate, Troy Smith, Victoria Sprouse, Scott Taggart, William Orander and Ivan Walters.