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Attorneys as Escrow Agents

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Introduction

If you were asked when an attorney, confronted with conflicting demands from his client and from the other side, should honor the adversary's demand at the expense of his own client's, you would naturally answer "never"—but that would be wrong. However, *Virtanen v O'Connell* (2006) 140 CA4th 688, 44 CR3d 702, reported in this issue at p 357, shows that sometimes that conclusion can be mistaken.

Analysis

If your client is a buyer of property and you are acting not only as his attorney, but also as the escrow agent for him and the seller in the sale/purchase transaction, and your client is demanding that you close the escrow while the seller is demanding that you not close it, then you probably had better obey the seller rather than your own client, and not close that escrow, lest you get into the same kind of trouble as O'Connell and his law firm.

In *Virtanen*, Virtanen, the seller of stock, deposited it in an escrow maintained by the buyer's attorney with instructions to close when three conditions occurred. Before they all happened, he changed his mind and told the escrow agent that he rescinded the deal and demanded return of the stock. Rather than complying, the attorney closed the sale and sent the stock certificates off to the company's transfer agent with directions to register them in the buyer's name. This was stopped by the timely filing of a suit by the seller. The buyer ultimately settled, but the case against the attorney/escrow holder went to trial, ending with a \$2.275 million plaintiff's verdict for conversion.

It was pretty clear that, as a matter of pure escrow law, O'Connell had done wrong: None of the three conditions to which the escrow was subject had occurred when the seller sent his rescission notice to the escrow agent. Maybe the seller was wrong in attempting to back out of the deal at that stage, but the one thing that the escrow agent was *not* entitled to do was to ignore that demand and close the escrow anyway. O'Connell argued that he had no duty to return the stock to the seller in the face of the conflict, but the court responded that there was a significant difference between legitimately refusing to give the stock back to the seller and instead wrongfully turning it over to the buyer, as he did. As escrow agent, O'Connell should have just frozen when the two sides sent him inconsistent demands.

All that is pretty unremarkable escrow law, and any professional agent would be expected to know that. But O'Connell was also an attorney, and his defense was—if I understand the court's somewhat mangled description of it—that he had a professional obligation to act that way for the sake of his client (140 CA4th at 701):

that any duty he owed to Virtanen conflicted with his undivided duty of loyalty to his own clients and that he could not have satisfied both of those conflicting duties.

The court's rejection of that defense held that O'Connell had a "statutorily sanctioned method for dealing with conflicting demands, even when one of those demands came from his own client," *i.e.*, an interpleader action. That is technically true, but not a very comforting strategy for any attorney to follow when his or her own client is involved. Who wants to tell her own client that she won't do what the client wants because the other side has not agreed to it?

There is no doubt that the rule has to be that an attorney acting both as counsel for one party and escrow agent must put any fiduciary responsibilities she owes to both parties with regard to the escrow above any fiduciary duties she may owe to her own client with regard to the underlying deal, or else she will get in the same trouble as did O'Connell. The problem is not with the rule, but with allowing a situation to arise where that rule comes into play. O'Connell's mistake, I think, was in voluntarily agreeing to serve as escrow agent while he was already counsel to one of the parties to the escrow.

In this case, the attorney got in trouble with the seller because as escrow agent she did what her own buyer/client wanted. But what if she had gone the other way and refused to do what her client told her to do because of her overriding escrow responsibilities? She probably would have prevailed in any malpractice action the client may have later brought against her; but I suspect that such a lawsuit would have been brought by her *former* client, who had since lost all trust and confidence in her. It is a terrible thing to do right and lose a client because you did. Is it worth the slight extra compensation to expose yourself to such risk? (Further, since the liability is based on escrow behavior, would it even be covered by a legal malpractice insurance policy?)

Dealing with conflicting instructions is not the only way for an attorney/escrow agent to get in trouble. It is hard to reconcile the fiduciary duties of strict neutrality owed by an escrow agent with the duties of undivided loyalty owed by an attorney. Furthermore, some courts impose on her, as escrow agent, a duty to report fraudulent conduct by one party to the other, which role is hardly compatible with her duties as an attorney representing one party in the same situation. (She surely has a duty to advise her client not to defraud. Jerome Fishkin, a specialist in attorney professional responsibility, advises me that her duty not to assist clients in committing fraud may require her to withdraw from the matter entirely. Still, that does not amount to telling the other side.) As escrow agent, she may also have duties to explain to both sides the nature or effect of documents they are being asked to sign, which is not what she needs to do as a pure attorney.

Conclusion

Some situations are so intrinsically hazardous that attorneys ought to know better than to get into them. We do not need to be told to avoid representing both husband and wife in negotiating a marital dissolution, or even in negotiating the terms of a sale between a coupled but unmarried buyer and seller. All the conflict waivers in the world are unlikely to help in those cases when matters go sour. To this list of perils should be added agreeing to be escrow agent, even when the deal has been negotiated.

California not only allows attorneys to serve as escrow agents, it makes it easy to do so by waiving the license requirements of the Financial Code (in the worst of all possible cases—when the attorney is representing a party to the escrow (Fin C §17006(a)(2)). The best thing we might do for ourselves is to get that exemption repealed.