ALASKA BAR ASSOCIATION
ETHICS OPINION 96-2

Ethical Obligation of an Attorney Representing a Seller to Third Persons Purchasing Property Encumbered by a Deed of Trust which Contains a "Due on Sale" Clause

The Committee has been asked whether an attorney representing the seller of property which is encumbered by a deed of trust containing a "due on sale" clause has an ethical obligation to advise the purchaser of that property of the existence and effect of the "due on sale" provision. It is the opinion of the Committee that an attorney representing a seller does not have an ethical obligation to advise the buyer of the property of the existence or effect of a due on sale clause in a deed of trust encumbering the property unless the attorney has expressly or impliedly represented to the buyer that the property is not subject to such a provision, or the attorney is aware of such representation by the seller.

In Ethics Opinion 88-2, the Committee determined that an attorney representing a seller who proposed conveying property subject to a due on sale clause without obtaining the beneficiary's consent, must advise the client of the consequences of a breach of the provisions in the deed of trust, but was not ethically prohibited from preparing the sale documents. As between the owner and the beneficiary under the deed of trust, the committee determined that circumventing the contract term was not fraud or fraudulent conduct. Opinion 88-2 did not address the knowledge of, or disclosure to, the buyer of the due on sale clause, but dealt only with the issue of whether representation of the seller in the transaction would be fraudulent conduct as to the beneficiary under the deed of trust.

A "due on sale" clause in a deed of trust generally provides that if an interest in the property is conveyed or transferred without the written consent of the deed of trust beneficiary the remaining balance due on the underlying debt is, at the option of the beneficiary, immediately due and payable. The beneficiary's decision regarding enforcement of that clause can involve consideration of prevailing interest rates and a number of other factors.

It is reasonable to expect the buyer to become informed regarding the terms of the deed of trust to be assumed before the transaction is concluded.

The deed of trust will generally be a recorded document giving the buyer constructive notice of its terms. Moreover, the typical document for assumption, or sale subject to that deed of trust, provides sufficient information to locate the deed of trust if the document is not otherwise provided during the negotiations for sale. We are not, therefore, dealing in this opinion with a situation in which the terms of the deed of trust are known to the seller and the seller's attorney, but are not available to the buyer.

Because the beneficiary who becomes aware of the sale in breach of the due on sale clause in the deed of trust can insist on full payment of the balance due, and initiate foreclosure if the payment is not made, a question has been raised whether Alaska Rule of Professional Conduct 4.1(b) imposes a duty on the seller's attorney to disclosure to the buyer the existence and effect of the due on sale clause. Rule 4.1, relating to "**Truthfulness in Statements to Others**," provides:

> In the course of representing a client a lawyer shall not knowingly:
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> (a) make a false statement of material fact or law to a third person; or
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> (b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting in a criminal or fraudulent act by a client unless disclosure is prohibited by Rule 1.6.

The COMMENT to that section states in relevant part:

> **Misrepresentation**
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> A lawyer is required to be truthful when dealing with others on a client's behalf, but generally has no affirmative duty to inform an opposing party of relevant facts. A misrepresentation can occur if the lawyer incorporates or affirms a statement of another person that the lawyer knows is false. Misrepresentation can occur by failure to act.
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> . . . .

Fraud by Client

> Paragraph (b) recognizes that substantive law may require a lawyer to disclose certain information to avoid being deemed to have assisted the client's crime or fraud. . . .[1]

It has been suggested to the Committee that the interpretations of fraud contained in Carter v. Hoblit, 755 P.2d 1084 (Alaska 1988) and Mogg v. National Bank of Alaska, 846 P.2d 806, 813-815 (Alaska 1993), impose a duty of disclosure on the seller's attorney which will constitute fraud or assistance of fraudulent conduct if the duty is breached. Carter held in relevant part that fraud results when one not in a fiduciary relationship makes truthful representations to another which the maker knows or believes to be materially misleading because of a failure to state additional or qualifying matter. Mere preparation of documents for a seller relating to sale of property in which the buyer assumes or buys subject to a deed of trust with a due on sale clause does not result in the making of any representations which would be fraudulent under Carter. The request to the committee does not contain, and we will not assume various fact scenarios in which such representations by the attorney or client could or would occur.

Mogg involved a transaction that was negotiated based on a clearly expressed understanding that Mogg, as a lender, would be secured by a second position in collateral. The bank's attorney, who was present in the negotiations, knew that Mogg would be in a third position because of the "dragnet" clause in the first deed of trust. In other words, the fact upon which everyone else was relying as the basis for their agreement was incorrect and the bank's attorney, who was aware of the mistaken assumption, did not disclose that the basic assumption was erroneous. On those apparent facts, the court found there was adequate evidence to establish a prima facie case of fraud sufficient to abrogate the attorney-client privilege and permit full discovery relating to the transaction.[2]

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[1]ARPC 9.1(e) provides that "fraud" denotes conduct having a purpose to deceive and not merely negligent misrepresentation or failure to apprise another of relevant information.

[2] The court made it clear that it was not expressing the view that fraud had been established by the facts presented.

This ethics opinion assumes the attorney preparing documents for a sale involving property subject to a deed of trust with a due on sale clause is not aware of any mistaken assumption on the part of the buyer. The attorney is not, therefore, participating by act or omission in conduct involving a misrepresentation of the substance or effect of the transaction.

While attorneys have an ethical obligation to avoid assisting in criminal or fraudulent misconduct, this Committee is extremely reluctant to create any duty requiring attorneys to advise parties with whom their clients deal. Establishment of such additional duties will also create difficult conflict of interest issues and expose attorneys to claims by parties with whom their clients deal for failure to adequately advise those third parties regarding the transaction. In effect the attorney may then become the guarantor of the fairness and satisfactory result of each transaction for which the attorney provides services. That clearly is not the intent of the Rules of Professional Conduct.

Approved by the Alaska Bar Association Ethics Committee on December 14, 1995.

Adopted by the Board of Governors on January 13, 1996.

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