

# The Role of the Lawyer When Serving as (Substitute)Trustee

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## A Question of Hats



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## Terminology

- › Trustee = Substitute Trustee
- › Debtor = Borrower, Property Owner, Homeowner, Mortgagor, Grantor
- › Creditor = Lender, Bank, Note holder, Finance Company, Mortgagee, Beneficiary
- › F/C = Foreclosure
- › DOT = Deed of Trust

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## Duties of a Lawyer as Advocate

- Advocate for the lawful objectives of the client.
- Protect confidential information from unauthorized disclosure.
- Be loyal to a current or former client in the same or substantially related matters.
  - Avoid conflicts of interests.
  - Exercise independent professional judgment.

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## What is a conflict of interest?

- Concurrent:
  - Direct adversity to another client
  - Representation materially limited by responsibilities to another client, former client or 3<sup>rd</sup> person
    - Or personal interest of lawyer
- Former client:
  - Representation of new client in the same or a substantially related matter in which new client's interests are materially adverse to former client's.

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## Duty of the Foreclosure Trustee

- “The trustee, vested in a position of power by the debtor and creditor, is bound to act in the interests of *the parties* and exercise its powers accordingly.” [emphasis added]
  - Lynn v. Federal National Mortgage Ass'n, 760 S.E. 2d 372, 376 (2014)
- Fiduciary duty to both debtor and creditor.

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## Role of Trustee

- ▶ “In deed of trust relationships, the trustee is a disinterested third party acting as the agent of both the debtor and the creditor.” [emphasis added]
  - In re Foreclosure of Real Property for 143,600.00, 577 S.E. 2d 398 (2003)

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## Duties of a Lawyer/Trustee

- ▶ 2013 FEO 5: A lawyer/trustee has a duty to act impartially as between the parties and to ensure that the F/C is prosecuted in accordance with the law and the terms of the DOT.

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## Key Principle



Responsibilities and limitations on a lawyer acting as trustee arise out of the fiduciary relationship as opposed to the client-lawyer relationship.

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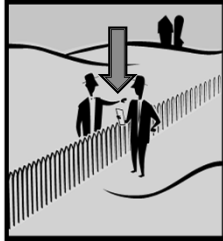
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## On the Fence: Lawyer as Neutral

- › Unique concept in professional responsibility.
- › No duty of loyalty or of confidentiality to either the debtor or the creditor.
- › Therefore, before and after service as trustee, lawyer MAY represent debtor or creditor as an advocate.



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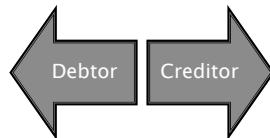
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## BUT

- › Cannot switch from representation of debtor to the representation of lender in matters related to DOT (or vice versa)
- › ...because it is a conflict of interest.



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## It's the same difference...

- › Trustee is a lawyer.
- › Trustee is represented by a lawyer.
- › In either case, the lawyer is subject to the same duties relative to the debtor and creditor.

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## Key Principle



A lawyer/trustee in a **contested** F/C hearing may NOT act as the advocate for the debtor or the creditor at any stage of the F/C proceeding or in **any** adversarial proceeding arising from or connected with the DOT.

2008 FEO 11

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## Contested Foreclosure

- ▶ When debtor, or anyone with standing, seeks to enjoin the proceeding or contests any of the following at the F/C hearing:
  - Jurisdiction
  - Service of process
  - Debt
  - Default
  - Notice
  - Power of sale
  - Certification regarding subprime mortgages (residential property)

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## Not Contested If...

- ▶ Motion to continue
- ▶ Request to postpone sale

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## Applying the Principles

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### Prior Representation of Debtor or Creditor

- ▶ May lawyer serve as trustee?
- ▶ Example: Lawyer closed the purchase of the property.
- ▶ Example: Lawyer sent demand letter for creditor upon debtor's default.
- ▶ Answer:
  - Yes, if prior to appointment, lawyer withdraws from representation of party in matters related to DOT.



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### Representation in Matter Related to Foreclosure

- ▶ May lawyer represent the creditor or debtor?
- ▶ Example: Lawyer/trustee initiates F/C; debtor files bankruptcy; automatic stay on F/C; creditor wants stay set aside.
- ▶ Answer:
  - No, unless the lawyer resigns as trustee. RPC 46 (fiduciary duty to debtor and creditor would be violated if lawyer assumed role of advocate).
  - Answer is same regardless of the stage to which F/C has progressed.



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## And if the stay is set aside?



- ▶ Lawyer may serve as trustee again...
- ▶ if she can maintain her impartiality as between the parties and
- ▶ ensure the F/C is prosecuted in accordance with law and the DOT.

Remember the Fence!

Advocate to neutral and back again!

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## Subsequent Representation of Debtor or Creditor



- ▶ May lawyer represent the creditor or debtor?
- ▶ Example: F/C concludes with sale of property for less than debt; creditor wants to pursue deficiency.
- ▶ Answer:
  - Yes, lawyer's service as trustee has ended. No further duty to be impartial.

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## What about representation in unrelated matters?



- ▶ May lawyer/trustee represent the creditor or debtor in matters that are unrelated to the F/C?

Example: Lawyer/trustee represents creditor on commercial loan closing with third party.

- ▶ Answer: Yes. Lawyer may serve as trustee while simultaneously representing creditor on unrelated matters.

2008 FEO 11 (unlikely that impartiality as trustee will be impaired by duty of loyalty and advocacy for creditor on other, unrelated matters).

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### What about the other lawyers in the trustee's firm?

- ▶ May other lawyers in the lawyer/trustee's firm represent the creditor or debtor in the F/C?
- ▶ Answer: No, if the F/C is contested.
- ▶ May they represent the creditor or debtor in matters unrelated to the F/C?
- ▶ Answer: Yes. 2008 FEO 11 (even if lawyer/trustee withdraws from representation of debtor or creditor in unrelated matters).

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### Other Problems

- ▶ Separate entity created by law firm to serve as trustee on DOTs. Law firm, its lawyers, or their family members have a controlling interest.
- ▶ May lawyer from the firm represent the entity as trustee for the F/C?
- ▶ Answer: Yes BUT, if F/C contested, a firm lawyer may not represent the creditor or debtor in the F/C or related matters.

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### More Problems

- ▶ May lawyer/trustee communicate *ex parte* with the Clerk of Court after the foreclosure is filed?
  - Rule 3.5(a)(3) prohibits *ex parte* communications by litigator with a "judge or other official" except in court, in writing copied to opposing party (OP), or orally on adequate notice to OP.
- ▶ Answer: Maybe. Is lawyer/trustee more like a litigator than a litigant?
  - "Generally, in adversary proceeding, lawyer should not communicate with judge relative to a matter pending before...a tribunal over which the judge presides in circumstances which might have the effect of giving the appearance of granting undue advantage to one party." cmt. [8].
- ▶ May lawyer for the lawyer/trustee communicate *ex parte* with the Clerk?

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### Recap of the Five Stages: Can lawyer serve as trustee?

- Lawyer closes sale of property, including securing of note with DOT.
- Lawyer represents creditor on borrower's default prior to initiation of F/C proceedings.
- During F/C, lawyer/trustee continues to represent creditor on unrelated matters.
- Lawyer/trustee resigns as trustee; represents creditor to set aside stay in bankruptcy.
- Creditor buys property at F/C sale: lawyer (former trustee) asked to close sale of REO property.

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### Special Duties of Lawyer/Trustee



- 2008 FEO 11: Inform debtor that lawyer and members of law firm will continue to represent creditor on unrelated matters.
- 2013 FEO 5: Explain to an unrepresented, unsophisticated party that:
  - Role of trustee to process impartially.
  - Trustee does not represent creditor or debtor.
  - No duty of confidentiality to either party and disclosures may be used in subsequent actions.

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### Key Principle



When in doubt:

Call the State Bar ethics service for advice or recommend that the lawyer call about his or her own professional conduct.

Ethics Hotline:

919-828-4620

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Thank you for your service! »»

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