

OUTLINE OF ISSUES FOR REAL ESTATE OPINION GUIDELINES

Robert A. Thompson

Late last year, the Committee on Legal Opinions of the Business Law Section of the American Bar Association ("BLS") adopted and published its Guidelines for the Preparation of Closing Opinions ("BLS Guidelines") (See 57 Bus. Law. 345 (2001)). The BLS Guidelines, which incorporate and attach the BLS' 1998 Legal Opinion Principles, are intended to "reflect developments in customary practice in the decade since 1991." In response to an early draft of the BLS Guidelines, the ACREL Attorneys' Opinion Committee initiated a project for the creation of Real Estate Opinion Letter Guidelines to supplement, and, in large part, to endorse the BLS Guidelines as the same relate to real estate secured transactions. Subsequently, the ACREL opinion committee joined forces with its counterpart ABA Real Property, Probate and Trust Law Section opinion committee to create a joint committee (the "Joint Committee") with the objective of sponsoring the Real Estate Guidelines, just as the two committees had done in the past with respect to the Report on the Adaptation of the BLS Legal Opinion Accord to Real Estate Secured Transactions (the "ABA/ACREL Adaptation") in 1994 and the Inclusive Real Estate Secured Transaction Opinion project in 1998. The Joint Committee hopes to capture and expand upon the wisdom contained in those prior reports.

The following outline sets forth the issues originally identified by the Joint Committee as appropriate subjects to be addressed in Real Estate Opinion Letter Guidelines. Included in boldface type, in each case, are the tentative positions (in concept, if not precise language) resulting from deliberations of the Joint Committee's steering group. The format of the final Guidelines will likely integrate our work product with the existing text of the BLS Guidelines by some method which clearly identifies the additional material. This approach may need to be reconsidered in the unlikely event that the Joint Committee reaches conclusions which are significantly at variance with positions taken by the BLS. After further input from members of the Joint Committee and others, the text of the draft Guidelines will be circulated for further comment and ultimately adoption by the Joint Committee and its two parent organizations. The Joint Committee would welcome questions or comments from the ABA membership.

OUTLINE

I. PURPOSE, SCOPE AND RELIANCE

- A. Role of opinion giver; requests that local counsel represent both borrower and lender. Can local counsel serve in both capacities; what sort of client consent is required?

[Requests that local counsel represent both parties to a loan transaction, through written legal opinions or otherwise, raise considerable ethical issues, including potential or actual conflict of interests and competing duties of primary loyalty *vis a vis* the respective "clients." These conflicts may be waivable in some jurisdictions; however, client consent should be informed by thoughtful consultation and should not be deemed implied from loan documents providing for a third party opinion (cf ¶ II.A below). Where concerns for minimizing transactional costs dictate use of only one local counsel, absent a prior existing relationship between the opinion giver and the borrower, such counsel should be retained by and formally represent the lender.]

- B. Requests for "adequacy of document" opinions (e.g., that loan documents contain "all customary remedial provisions," etc.).

[In rendering a third party legal opinion to a lender, the opinion giver does not give legal advice to a client, but rather provides an "evaluation" of discrete legal issues specifically included in the opinion request. An opinion request addressing matters beyond specific legal issues which are of the nature of the "broader guidance and counsel" that a lawyer provides to one's own client (see BLS Accord § 7) raises ethical concerns comparable to those implicated by dual representation (see ¶ I.A above). Absent express and fully informed consent by the client, the opinion giver should not be expected to give such advice, in an opinion or otherwise.]

- C. "Conduit" opinions in general (i.e., opinions which rely exclusively upon public agency certificates, title policies, architect's certificates, etc.). Are they ever appropriate?

["Conduit opinions" are generally objectionable, as they contain no substantive assurance by the opinion giver and may be misconstrued

by the opinion recipient as reflecting independent evaluation of the underlying source or other due diligence by the opinion giver. As with opinions regarding qualification to do business or good standing in foreign jurisdictions based on public agency certificates (see BLS Guidelines § 4.1), the delivery of the underlying public agency documents, title policies or other primary sources should suffice.]

- D. Avoidance of implied opinions (e.g., land use opinions implied by transactional compliance with laws (see ABA/ACREL Adaptation ¶ 15, etc.).

[A legal opinion should be deemed to speak only to the specific issues which it expressly addresses. (See BLS Accord § 18.) Opinions as to other matters should not be inferred, but rather explicitly requested. Examples of potentially implied opinions in the real estate secured loan context include opinions covering the enforceability of covenants or warranties regarding the condition or maintenance of real estate collateral or the borrower's compliance with laws, each of which can be viewed to imply unintended opinions regarding land use, environmental and other similar matters.]

II. PROCESS AND PREPARATION

- A. Client consent issues: what constitutes implied consent in what circumstances?

[Subject to the need for express and informed client consent when the counsel's role extends beyond provision of a typical third party opinion (see ¶¶ II.A, B above), the Joint Committee concurs with the position taken in the BLS Guidelines § 2.4 (that is, that in ordinary circumstances client consent to a third party opinion under applicable rules of professional conduct may be inferred from a loan commitment or transaction document requiring such opinion as a condition of closing.)]

- B. Presumed scope of opinion giver's:
- (a) Document review
 - (b) Legal research

(c) Factual investigation

[Absent qualification, the opinion giver may be presumed to have undertaken such legal research, reviewed such documentation, and investigated such matters as is professionally appropriate to render the opinions given. (See BLS Accord § 2.) However, any expressly stated limitations as to documents reviewed or the scope of legal and factual inquiry should be given effect. Such limitations may be particularly appropriate where the opinion giver is local counsel without a long-standing client relationship with the borrower or first-hand involvement in the negotiation of transactional documents.]

C. Definition of Knowledge

[The Joint Committee believes that the BLS Guidelines § 3.4 confuses two distinct issues; that is (i) the scope of factual inquiry, and (ii) the definition of the knowledge of the opinion giver (whether an individual or law firm) as to results of such inquiry. As stated above, limitations on factual due diligence are often appropriate and generally should be effective. The definition of the knowledge of the opinion giver is often stated in terms of the actual, psychological awareness of the opinion author and identified other individuals in his or her law firm (e.g., a "primary lawyer group" including the opinion author, lawyers involved in preparing or supporting the opinion and lawyers actively involved in the transaction (see BLS Accord § 6-B)). Such limitations when expressly stated should be given effect.]

III. PREPARATION AND CONTENT

A. Reliance, in general, upon information or statements in loan documents, client certificates, etc.

[The Joint Committee concurs with the view expressed in BLS Principles Section III.A. (i.e., customary practice supports reliance on factual information obtained from third party sources, including company officers, unless such information "is irregular on its face" or such source is "inappropriate.")]

B. Appropriate reliance and due diligence for "no breach or violation" opinions and assurances regarding pending litigation

[The Joint Committee concurs with the position reflected in BLS Guidelines § 4.3 (that is, that an opinion giver should not be asked for an opinion that the client possesses all necessary licenses, permits or approvals and has made all filings required to conduct its business, is not in violation of any applicable laws or regulations or is not in default under any contracts). Any legal compliance opinion should be expressly and specifically requested and limited to specific laws. In some cases (*e.g.*, with respect to land use and environmental matters), such opinions may not be appropriate (see ¶ IV.G below).]

IV. SPECIFIC OPINIONS

A. Enforceability opinions

- (a) Cost/benefits where lender is represented by an attorney in same jurisdiction

[The Joint Committee concurs with the observation in BLS Guidelines § 1.2 n.7 that opinions beyond organizational status and the binding nature of transaction documents may often not be cost beneficial [and notes the growing trend on the part of lenders' counsel not to require enforceability opinions from borrowers' counsel in the same jurisdiction with respect to documents prepared by the lender].]

- (b) Appropriate "generic exception" language

[The inclusion of some form of generic exception is nearly universal in real estate secured loan transaction opinions. The Joint Committee recommends the use of the ACREL formulation of generic exception: that is, that certain provisions of the loan documents may be unenforceable; however, such unenforceability will not render the transaction documents "invalid as a whole" nor preclude judicial enforcement of repayment, acceleration of the note or foreclosure of [real property] collateral in the event of a material breach of a payment obligation.]

- (c) Appropriate additional specific exceptions. See ABA/ACREL Adaptation § 14.

[Given the breadth of most formulations of generic exception and the scope of the generally accepted equitable principles exception, the

typical "laundry list" of additional specific exceptions to enforceability can be considerably shortened. Such specific exceptions should be limited to (i) matters which may not be clearly comprehended by the foregoing general exceptions, and (ii) matters which may be of notable importance to the opinion recipient, such as unusual limitations on judicial or non-judicial remedies of which an out-of-state lender may not be aware (e.g., anti-deficiency foreclosure legislation) or contractual provisions which are known to have been controversial or heavily negotiated during the preparation of transactional documents.]

- (d) Inappropriateness of assurance notwithstanding specific exceptions (e.g. "none of the foregoing [exceptions] will impair the realization of the principal benefits intended to be provided by the Loan Documents."

[Requests for assurance to the effect that, notwithstanding specifically stated exceptions to enforceability, such exceptions will not impair the practical realization of the principal benefits included in loan documents or comparable language are inappropriate. Once identified by the opinion giver, the importance of specific exceptions to enforceability should be evaluated by the opinion recipient.]

- (e) Other issues?

B. Usury opinions

- (a) Should they be deemed implied in an enforceability opinion? See ABA/ACREL Adaptation ¶ 10.9.

[An enforceability opinion includes by implication an opinion that the loan evidenced by transaction documents is not usurious. If it is not intended to be given, it should be expressly excluded.]

- (b) Appropriate assumptions regarding nature of lender, calculation of interest, no other consideration paid, involvement of brokers, etc. Adaptation ¶ 18.1.1.

[When a usury opinion is given, the opinion giver may assume without so stating that the lender will not receive, directly or indirectly, any fees, charges, benefits or other compensation except as set forth in the transaction documents. When a non-usury opinion is based upon an

exemption related to the identity or status of the lender, the involvement of a real estate broker or other special circumstances, the better [and customary] practice is to expressly state such factual understandings as opinion assumptions or qualifications.]

C. Choice of law opinions

- (a) Should they be deemed implied in enforceability opinion?
- (b) Potential concerns. See ABA/ACREL Adaptation ¶ 10.8.

[Loan documents in multi-state transactions frequently provide a choice of law for certain documents (e.g., a note or guaranty) different from the law of the jurisdiction of the opinion giver and from the law specified to govern other transactional documents (e.g., the mortgage, deed of trust and other security instruments). Because of the scope of the typical generic exception, it can be fairly debated as to whether the typical enforceability opinion comprehends the effectiveness of such contractual provisions. In any event, it is common for opinion givers to expressly exclude choice of law opinions; conversely, the better [and customary] practice where such opinions are sought is for such opinions to be expressly requested and separately stated. Choice of law opinions are often given as "reasoned opinions" and based upon factual assumptions bearing on the opinion conclusion and most often can be only a description of the approach likely to be taken by a court applying existing law in the opinion giver's jurisdiction. [Consider inclusion of concerns expressed in ABA/ACREL Adaptation ¶ 9.]]

D. Enforceability of guaranty and indemnity agreements

- (a) Certain express exceptions (e.g., waiver of suretyship defenses, etc.)
- (b) Creditors' rights issues (e.g., upstream, side-stream guaranties)
- (c) Anti-deficiency legislation issues

E. Disclaimer of substantive real property title opinions

- (a) Availability of title insurance
- (b) Appropriateness of "form of document" opinions

[Because of the availability of title insurance, and the existence of difficult factual issues and the need for title searches beyond the capacity and expertise of most real estate attorneys, opinions requested as to the ownership of property, the effectiveness of the lien of security instruments and exceptions to or encumbrances on title to real property are inappropriate. Opinions as to the form of a mortgage or deed of trust necessary to create a lien against real property collateral and a recitation of the procedures necessary to perfect and provide record notice of such lien are, on the other hand, frequently given. [Consider quotation of language in ABA/ACREL Adaptation ¶ 7.] Neither a form of documents opinion nor a general enforceability opinion implies a substantive title opinion and no express disclaimer of such opinion is necessary.]

- F. Personal property security interest opinions
- (a) Cost/benefit considerations -- when is request reasonable?
 - (b) Necessary assumptions and qualifications
 - (c) Alternative of new title insurance product insuring personal property security interests

[Because of the often disproportionate amount of time and effort required and the relatively limited value of the typically heavily qualified opinions on such matters, requests for personal property security interest opinions are appropriate only when the transaction involves personal property constituting a significant part of the loan collateral (e.g., the financing of hotel or hospital projects). Opinions describing the form of documents and procedures necessary to create, perfect and maintain a security interest in real property are frequently requested and given. A substantive opinion, if any, as to the status of the security interest in personal property collateral should be given separately from the general enforceability opinion and is not implied by an enforceability opinion. Such opinions are commonly limited to property covered by Article 9 of the Uniform Commercial Code because of uncertainties as to the status of other types of property.]

- G. Land use and environmental opinions

- (a) What is customary practice?
- (b) Cost/benefit considerations
- (c) Appropriate scope, if given
- (d) Available alternatives

[Opinions on zoning, land use and environmental matters are fundamentally different from the evaluations of other issues typically addressed in opinion letters in that they involve complex, technical matters which are not easily, or sometimes at all, susceptible to separation into factual and legal components. Opinions on such matters are not customary and many lawyers refuse to give such opinions as a matter of policy. Land use and environmental matters are normally considered to be the subject of the lender's due diligence, which frequently includes certificates from architects, engineers and other professionals and communications from relevant public agencies.]

H. Others?