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Inside NY Commercial Mortgage Loan Opinion Practice

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Opinion letters, rendered by borrower's counsel to a third party, are an integral part of any commercial mortgage loan financing transaction. For those inexperienced with drafting and delivering opinions, responding to the expectations of lender's counsel, and having to address the mix of legal opinions and factual opinions customarily expected to be in the opinion letter, the task can be daunting. As a frequent deliverer and recipient of commercial mortgage loan legal opinion letters, I am often asked, "What is the norm?" or "Is this standard or customary practice in New York these days?"

The growing role of custom and practice in the context of opinion letters was recognized in the Real Estate Finance Opinion Report of 2012, which was prepared by a joint drafting committee and approved by the American Bar Association's Real Property, Trust and Estate Law Committee, the American College of Mortgage Attorneys and the American College of Real Estate Lawyers. A task force comprised of lawyers from the ABA, ACMA and ACREL, the Local Opinion Task Force is currently engaged in preparing a follow-up report to the 2012 Opinion Report, addressing the role, scope and issues unique to legal opinions delivered by local counsel when supplementing an opinion letter being delivered by the lead or primary counsel for borrower. Like the 2012 Opinion Report, the report by the Local Opinion Task Force will also inform practitioners by identifying acceptable standards and will focus on the growing role of customary practice in opinion giving.

A legal opinion is considerably more than a "check the box" item on a closing checklist. It is a legal evaluation that serves as a valuable due diligence tool for the lender and its counsel, providing independent third-party confirmation of due formation, good standing and the qualification of borrower to carry on its business, providing further assurance that the loan transaction has been duly authorized and the loan documentation appropriately executed and delivered by borrower.

The customary opinion letter from borrower counsel contains core opinions which address: (1) entity existence; (2) due power and authority; (3) due execution and delivery; and (4) enforceability of loan documents.

The following observations are intended to assist those engaged in commercial mortgage loan opinion practice when faced with a lender's "form opinion" that may, beyond the customary and acceptable opinions, include other opinion paragraphs which arguably may be inappropriate to either request or provide.

Current customary practice in New York commercial real estate loan opinion practice include the following, some of which were addressed in the 2012 Opinion Report, others which I have, as a practitioner, observed to be the norm:

1. Enforceability

The enforceability opinion does not fulfill the due diligence role of other opinion paragraphs which address the borrower or guarantor, or indemnitor (each a "borrower entity"), the execution and delivery of the documents and confirm that the transaction does not violate laws or agreements to which a borrower entity is a party.

In a single state transaction, where both lender and borrower counsel are, for example, admitted in New York, and the property is located in New York, practitioners, especially those who represent borrowers, have long argued, unsuccessfully, that the document enforceability opinion should more appropriately be delivered by lender counsel, the draftsperson of the "loan documents." However a gap continues to exist between what "might be done", and what "is being done." It is unlikely that the enforceability opinion deliverer will switch to lender counsel any time soon.

Under New York Customary Practice, enforceability opinions do not extend to each and every provision due to the numerous limitations universally included in opinions letters. In addition to stating that "certain provisions may not be enforceable," opinion givers often provide that remedies are only available upon a "material breach," or a "breach of a material provision" or "only upon a breach of an obligation to pay principal or interest." Many opinion givers provide a list and opine that the listed remedies will be available to the lender. While not the norm nationally, it has long been the customary practice in New York, albeit not currently as favored as in the past, to avoid a laundry-list approach and to provide a statement to the effect that "notwithstanding the qualification set forth, in our judgment, subject to the other exceptions, qualifications and limitations set forth in the opinion, and the possible unenforceability of any particular provision of or remedy in the Loan Documents, in our judgment, any such unenforceability will not (i) render the Loan Documents invalid as a whole, or (ii) [substantially] interfere with the practical realization of the principal benefits of security intended to be provided thereby." (Although, the qualification of "substantially" may be the subject of negotiation.)

2. What Is the Opinion Giver's Role?

When not engaged as the primary or "lead" counsel, and engaged solely as "special" or "local" New York counsel, perhaps with little familiarity with any borrower entity and therefore involved in the transaction "solely for the purpose of delivering this opinion," the opinion giver will customarily not include "knowledge" opinions. The limiting self-label of special or local counsel should be supplemented by a statement that, "In such capacity we have reviewed only the documents listed and made no further inquiry or investigation," providing the recipient with a more concrete limitation of the due diligence performed and better defining the limited nature of the opinion giver's involvement.

3. Knowledge

Most opinions are delivered with a signature of a law firm, albeit signed by a partner. It is, however, an opinion delivered by the law firm, with knowledge of all firm lawyers imputed. It is common practice to limit knowledge to the "knowledge" of only those lawyers who have worked on the transaction. I prefer to list the lawyers by name.

It is, however, neither customary practice nor appropriate for an opinion giver to attempt to include either a "knowledge" qualifier or a borrower certificate as the basis for opining with respect to: (1) laws or (2) organizational documents.

4. Scope of Review

Most opinion letters include a statement that the opinion giver has "reviewed such matters as are necessary in its professional judgment to render the opinion." Customary practice is to expect an opinion letter to cover such law as a lawyer in the jurisdiction would reasonably expect to be applicable to the transaction with the opinion giver exercising appropriate and customary due diligence. The 2012 Opinion Report indicates that, nationwide, opinion givers are discontinuing to include federal law in their opinions. However when a New York counsel is "primary" or "lead" counsel, opinion letters do usually include both "New York" and "federal" law.

Recently we received an opinion letter which, in a reference to opinion paragraphs addressing: (1) "no violations of laws" and (2) "no government consent or approval required for execution, delivery of document, performance of payment obligations or granting of lien," provided that, "Our opinions in paragraphs __ and __ are based on our review of only those statutes, regulations, rules and orders that, in our experience, are customarily applicable to transactions of the type contemplated by the Loan Documents."

The language appropriately limited the scope and standard of the opinion giver's due diligence and believe it to be a useful addition to any practitioner's form.

5. Reliance

While misleading and unjustified reliance is certainly not permitted, specific reliance, even if contrary to fact, is acceptable in an opinion letter and often made "at the request" or "with the permission" of the lender. For example if the loan documents are governed by the law of another state, an opinion giver may, with lender permission, provided "if [New York] law were to govern, the Loan would [not be usurious]".

6. Companion Opinions from Other Counsel

Customary practice is to avoid conduit opinions, or any reliance on another opinion with respect to issues not covered in the opinion being delivered, but instead, in the opinion letter, to "assume" the matters opined to in the other opinion. In practice, I have found that many opinion givers add gratuitous language acknowledging their "understanding" that the lender is relying on the other opinion with respect to those matters addressed therein and not covered within the opinion giver's opinion letter.

7. Opine as to Borrower Due Execution

Since Fortress Credit Corp v. Dechert, in which the opinion giver specifically "assumed" the genuineness

of all signatures and specifically stated that no independent inquiry was made and the inclusion of that specific limitation helped the opinion giver law firm to avoid liability, lenders have looked to borrower's counsel to "assure" rather than "assume" that the appropriate signatory for the borrower entity has, in fact, duly executed the documents. While this is a difficult burden for borrower counsel in this era of escrow closings by mail and a dearth of a face to face "New York" closings, certainly as between lender counsel and borrower counsel and their respective clients, it represents an appropriate allocation of responsibility and risk.

8. Opinions Based "Solely" on a Certificate

Customary practice allows certain factual opinions, such as those addressing "good standing," to be based solely upon a government-issued certificate. It is appropriate, in such instances, for the opinion giver to include the actual name of the certificate, in lieu of, for example, a generic reference to a "good standing" certificate. Other "pass through" opinions include factual opinions such as "to our knowledge the execution of the documents and payment of the note and completion of the transaction will not violate any documents to which Borrower is a party," with such "knowledge" based solely on a certificate of a signatory from a borrower entity.

9. Brevity Is Welcome

In assumptions, New York customary practice is split, with some opinion givers providing only a general reference to a review of borrower entity "organizational documents" and others providing a list of the documents reviewed. Some lenders require a list. Opining as to current good standing is usually sufficient without any reference to earlier initial entity formation filings. While many opinion givers list all loan documents reviewed, preferred practice is that the loan documents listed be limited to only those loan documents about which the opinion giver is specifically "opining" or which are required to be reviewed in order to render the opinions in the opinion letter.

10. Usury vs. Choice of Laws

Customary practice is that a usury opinion is deemed implicit in an "enforceability" opinion" and/or the "no violation of laws" opinion. However, a separate usury opinion is often sought by the lenders and in New York it is uniformly delivered when a transaction involves the laws of more than one state, as, for example, if the real property is located in Texas, the borrower is a Delaware limited liability company and the note and guaranty and other core documents are governed by the laws of New York. An opinion giver should always provide a specific exclusion of usury, if no usury opinion is intended. On the contrary, a "choice of laws" opinion, which is more prevalent in multistate law transactions, is not implied in a general "enforceability" opinion and therefore is customarily provided in a separate opinion paragraph when the law of more than one state is involved in a mortgage loan transaction.

11. Opinion as of Date Issued

Opinions are not prospective. They are made as of the date the opinion letter is dated and delivered. The 2012 Opinion Report pointed out that words like "will not" or "does not" are not interpreted as being prospective and that splitting hairs over whether a court "would" or "should" reach a certain conclusion is likely not worth the effort, as those words have also been interpreted similarly by courts.

12. Reliance

While the first page of the opinion letter contains an addressee, customary practice is to expand the list of those who may rely on the opinion letter, usually in the closing paragraph of the opinion letter. It is not common practice to allow other opinion givers to rely on the opinion letter. As noted in point 6 above, they should assume what is in the other opinion when providing their opinion letter. The 2012 Opinion Report states that it is also not appropriate or customary practice for lender's counsel to rely on an opinion. When I receive a request from lender counsel to rely on my opinion, even when they drafted the loan documents, I resist it and often cite the 2012 Opinion Report.

13. New York

I am frequently engaged as "special" New York counsel for the sole purpose of rendering local New York law opinions in transactions where the real property is located outside New York and where the borrowing entities were also formed elsewhere.

Many loans secured by "mortgages" encumbering real property located outside New York provide that the loan transaction is intended to be governed by the laws of New York. The loan documents will customarily state that the law of New York governs, except that "creation, perfection and remedies" (or other situs-specific matters) relating to the lien documents are governed by the law of the state in which the real property is located.

When serving as "special" or "local" New York counsel, addressing matters not covered by the borrower's lead counsel's opinion, in addition to including opinions addressing usury enforceability of the New York loan documents, (including perhaps a pledge of an account located in New York), customary practice is for New York counsel to include a choice of laws opinion.

Set forth below is a "pass through" choice of law opinion, which relies exclusively on the wording of Section 5-1401 of the New York General Objections Law, and which has been consistently found acceptable by lender counsel.

Section 5-1401 of the New York General Obligation Law provides that "the parties to any contract, agreement or undertaking, contingent or otherwise, in consideration of, or relating to any obligation arising out of a transaction covering in the aggregate, not less than two hundred fifty thousand dollars, including a transaction otherwise covered by subsection one of section 1-105 of the uniform commercial code, may agree that the law of this state shall govern their rights and duties in whole or in part, whether or not such contract, agreement or undertaking bears a reasonable relation to this state." Based upon such Section 5-1401, we are of the opinion that a New York court will give effect to provisions in the New York Loan Documents providing that the New York Loan Documents are governed by New York law.

Conclusion

Customary practice is, by definition, continuously evolving. Knowledge of current standards, the appropriate parameters of due diligence and "the accepted norm" in opinion giving are all valuable assets to have when representing a client in the world of commercial real estate legal opinion practice.

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Lawrence Wolk is a member of the New York real estate firm Rosenberg & Estis, has an active real estate transactional law practice and is a member of the national Local Opinion Task Force described herein.