Long-Awaited Guidance on Local Counsel Opinions in Real Estate Finance Transactions

By Lydia C. Stefanowicz*

In 2012, the respective opinions committees of the American Bar Association Section of Real Property, Trust and Estate Law, the American College of Mortgage Attorneys and the American College of Real Estate Lawyers jointly published The Real Estate Finance Opinion Report of 2012[1] (the "2012 Report"). The 2012 Report discusses a variety of opinion topics that are commonly the subject of third-party closing opinion letter requests, as well as appropriate assumptions and limitations, in the context of a "lead counsel" opinion in real estate finance transactions.

The 2012 Report expressly does not address issues unique to local counsel opinions, which has left a void for counsel seeking guidance in those circumstances. This year, after three and a half years of additional work, the same committees have produced an additional report titled "Local Counsel Opinion Letters in Real Estate Finance Transactions–A Supplement to the Real Estate Finance Opinion Report of 2012" (the "Local Counsel Supplement"). The Local Counsel Supplement will be published officially in the Fall 2016 issue of the ABA *Real Property, Trust & Estates Law Journal* and will also be posted on the ACMA website after it is published.

As its name suggests, the Local Counsel Supplement is a supplement to, and must be read in conjunction with, the 2012 Report. It includes discussion of the opinions that are the subject of the 2012 Report from the perspective of local counsel, and it addresses certain other opinions that are frequently requested of local counsel in a real estate finance transaction. Like the 2012 Report, the Local Counsel Supplement contains a form of illustrative opinion letter, which provides suggested language that may be used in rendering opinions about entity formation, existence, power, authority, and authorization as well as enforceability and other opinions covering some or all of the transaction documents. There is, however, no single form of local counsel opinion that fits all local counsel opinion situations or requests.

At the beginning of the project, the drafters of the Local Counsel Supplement thought that distinguishing between opinions typically given by lead counsel vs. local counsel would be self-evident. However, it soon became apparent that no such bright line of distinction exists. Opinions of local counsel vary across the board. They can range from opinions given by a local counsel who is retained in the very late stages of a transaction with respect to a client with whom the local counsel has never had any prior dealings, to opinions rendered by a local counsel who has for years represented the client. The local counsel opinion may be limited to one or a few very specific issues or it may cover most of the key opinions requested in the transaction. As noted in the Local Counsel Supplement,

> In themselves, the labels "lead" and "local" have insufficient inherent meaning to determine without more information what opinions each counsel is to provide. The labels more appropriately describe a hierarchy of relationship in the transaction than determine the scope of each such counsel's opinion letter. The legal matters to be addressed in an opinion letter of local counsel often are not as comprehensive as those matters on which lead counsel opines. The menu of opinions is substantially the same, however; and which opinions will be given by lead or by local counsel will depend on the facts and circumstances of each transaction.

The need for a local counsel opinion typically arises in three factual scenarios. First, the borrower or other loan party is located or organized under the laws of the local counsel's jurisdiction. Second, the real estate or other

significant collateral involved in the loan transaction is located in the local counsel's jurisdiction. These are the two most common examples, but any number of combinations of these facts are possible in local counsel situations, especially when several entities may be involved as borrower, guarantor, member, manager, or general partner, and the various entities are formed under the laws of different jurisdictions. The third factual scenario, which is less commonly encountered, is when some or all of the transaction documents are governed by the laws of the local counsel's jurisdiction, although none of the loan parties are organized, and no collateral is located, in the jurisdiction of the local counsel.

The Local Counsel Supplement acknowledges that there is no single form of local counsel opinion or set of opinion requests appropriate in all circumstances. The Local Counsel Supplement contains suggested language to address the most common requests, together with guidance as to when certain language should be used. Opinion practice in a local counsel setting, just as in the case of lead counsel, is subject to customary practice. Sometimes opinion requests involve matters that are better verified by sources other than a local counsel opinion. As noted in the Local Counsel Supplement:

> Local counsel should prepare an opinion letter that addresses the matters that are appropriate in the circumstances under customary practice. If this response is considered inadequate by the recipient, further content should be discussed and agreed upon, again within the bounds of customary practice, respecting the legitimate interests of the parties, including cost effectiveness and the necessity of the opinions and assumptions and limitations under consideration. Some subjects of the request may be answered more appropriately and customarily by service providers other than local counsel or by reliance on commonly accepted alternatives. Examples of such subjects are ownership of collateral (provided by title insurance), litigation (provided by search services, unless the request is limited to matters in which the opinion giver is representing the client), and U.C.C., tax, or similar searches (provided by search services).

The degree of familiarity that local counsel may have with the client can be extremely limited or it may be significant, and it may be anywhere in between. Certain practitioners believe that local counsel with limited knowledge of the client may have somewhat lesser ethical and professional responsibilities than opinion givers who regularly represent the client or have greater knowledge of the client. While this may seem intuitive, there is no basis for this distinction under ethical rules, and no case law has been found that states that ethical rules are applied differently to local counsel than to lead counsel. Therefore, the Local Counsel Supplement takes the position that local counsel has the same professional responsibilities and duties that must be discharged in rendering local counsel opinions that it has in any other legal matter. Accordingly, the Local Counsel Supplement notes that "[t]he formalities of establishing [the lawyer–client] relationship cannot be overlooked even in the face of a request for an opinion to be delivered in a very short time." Ethical obligations to the client are imposed by that relationship even though the local counsel may have no direct contact with the borrower.

In addition, the Local Counsel Supplement recognizes that situations exist in which local counsel are asked to opine on documents that, without modification, may be defective under the law of the local counsel jurisdiction, or to provide changes to documents that will improve them or provide for the best available remedies. Certain of these changes may be contrary to the interests of the borrower but necessary in order for local counsel to render the opinions requested. This can create an ethical dilemma for the local counsel. Some view this dilemma as inherent in the role of local counsel and that client consent is deemed waived or implied in the situation. However, local counsel should be mindful of this. As noted in the Local Counsel Supplement, it may be better in these situations for local counsel to represent the lender, not the borrower, in order to avoid these problems.

A local counsel opinion letter needs to identify clearly at the outset what issues and documents are covered by the opinion. The Local Counsel Supplement offers guidance on how to address the documents that are reviewed or not reviewed by local counsel in connection with the

opinion letter. Often, the transaction documents include documents that are not governed by the law of the local counsel's jurisdiction. Nevertheless, certain of these documents need to be reviewed in order to identify terms that are cross-referenced in documents covered by the local counsel opinion letter. Caution must be exercised in this situation because defined terms in a transaction document may have substantive meanings that are different than the general meanings of the same terms under the law of the local counsel's jurisdiction. In this situation, counsel may need to make appropriate assumptions or qualifications.

The 2012 Report and the accompanying illustrative opinion letter contain a number of customary assumptions. Which assumptions need to be made in a local counsel opinion depends on the nature of the requested opinion. For example, if local counsel is opining about the enforceability of transaction documents in the local jurisdiction with respect to a borrower formed under the laws of another jurisdiction, local counsel needs to include appropriate assumptions regarding the organization and authority of the borrower. Alternatively, if the borrower is formed in the local counsel's jurisdiction, local counsel would not normally take assumptions with respect to entity matters and would be expected to render opinions with respect to the status, power, authority, and authorization of the borrower. The Local Counsel Supplement further provides suggested assumptions with respect to matters involving the execution and delivery of documents and the form of acknowledgments to documents, and includes an assumption about acknowledgements that are taken outside of the local counsel's jurisdiction. Finally, the Local Counsel Supplement includes assumptions with respect to certain Uniform Commercial Code matters as they relate to fixtures.

The 2012 Report discusses and includes illustrative language with respect to 10 core opinions, namely: (1) entity status; (2) power; (3) authorization; (4) execution and delivery; (5) enforceability; (6) form of documents; (7) no breach or violation of organizational documents or other agreements; (8) no violation of law; (9) choice of law; and (10) usury and interest. The Local Counsel Supplement examines each of these opinions and suggests, where appropriate, how the substantive opinion topics may need to be modified or what considerations, assumptions, or limitations may need to be taken when dealing with specific local counsel opinion topics.

In addition to the 10 core opinion topics, the Local Counsel Supplement also discusses other substantive opinion requests that are frequently requested of local counsel in real estate finance transactions, namely: recording and its effect; governmental approvals required; the effect of the exercise of remedies; all customary remedies or specific remedies; recipient party matters such as doing business and taxation; zoning and land use; compliance with laws; and negative assurances. The Local Counsel Supplement analyzes the appropriateness of covering each of these issues in a local counsel opinion and where appropriate, offers suggested language and limitations.

Finally, the Local Counsel Supplement discusses how normal limitations in an opinion may need to be modified in local counsel opinion letters, including matters with respect to the effect of assignment of rents, the scope of the generic enforceability qualifications, and other matters.

The Local Counsel Supplement offers detailed practical guidance and thoughtful analysis to local counsel with respect to third-party closing opinions in real estate finance transactions. This fills a long-standing gap in opinion practice literature. If your practice involves issuing or receiving local counsel opinions in real estate finance transactions, the Local Counsel Supplement will be a useful tool and reference source. ◆

**Lydia C. Stefanowicz is a partner in Greenbaum Rowe Smith & Davis LLP in Woodbridge, New Jersey, and is a member of the Board of Regents of the American College of Mortgage Attorneys.*

Endnotes

1 47 Real Prop. Tr. & Est. J. 213 (2012). The 2012 Report can also be found on the ACMA website and on the ABA Legal Opinion Resource Center website, www.http://apps.americanbar.org/buslaw/tribar/.