In My Opinion
'No-Litigation' Assurance Redux

by Lydia C. Stefanowicz

In March 2017, Quarles & Brady, LLP, a prominent AmLaw 200 law firm, was sued for damages allegedly arising from a third-party closing opinion issued in connection with a loan closing.[1] In 2007, the firm had represented the borrower, a corporate guarantor and two individual guarantors, in a $4.3 million mezzanine loan transaction relating to a condominium development project in Chicago. At some point after the closing, the borrower and guarantors defaulted on the loan and, as a result, the lender obtained a $10 million judgment. Subsequently, the borrower and certain guarantors declared bankruptcy, rendering the judgment uncollectible. The lender then targeted counsel for the borrower and guarantors—a classic deep pocket—on the basis of its legal opinion.

The opinion letter, which was a closing condition to the obligation of the lender to make the loan, contained the following 'no-litigation' assurance: *"To our knowledge, there are no legal or administrative proceedings pending or threatened before any court or any governmental agency against Borrower or any Guarantor, except as disclosed in the Certificate of Manager attached hereto as Exhibit C."*

The legal opinion also contained the following qualification regarding knowledge of the law firm: *"Wherever we indicate that our opinion with respect to the existence or absence of facts is based on our knowledge, our opinion is based solely on (i) the current actual knowledge of the attorneys currently with our firm who have represented Borrower and Guarantors in connection with the transactions contemplated by the Loan Documents and of any other attorneys presently in our firm whom we have determined are likely, in the course of representing any of said parties, to have knowledge of the matters covered by this opinion, (ii) the representations and warranties of said parties contained in the Loan Documents, and (iii) the attached Certificate of Manager, executed by Richard S. Gammonley; we have made no independent investigation as to such factual matters. However, we know of no facts which lead us to believe such factual matters are untrue or inaccurate."*

According to the complaint, at the time the opinion was issued the firm was representing the two individual guarantors in connection with a default to another lender in an unrelated transaction arising from the individual guarantors having breached liquidity covenants under a guaranty agreement in favor of the lender. This existing, unrelated default was not disclosed by the "Certificate of Manager" referred to in the opinion. Interestingly, the complaint fails to assert that this unrelated default was the subject of any pending or threatened legal proceedings at the time the opinion was issued. Thus, the complaint appears to equate the mere existence of a default with threatened legal proceedings.

Judging solely from this complaint, the case against Quarles & Brady appears weak and is likely to be dismissed (unless there exist additional adverse facts not stated in the complaint). However, the damage was done when the complaint was filed. Even if the claim is without merit, it will take anywhere from several months to (more likely) a few years to have the complaint dismissed. The best opinion letters are those that are expressly limited by their terms in a way that does not invite litigation in the first place.

Without knowing what concessions the negotiations in connection with the issuance of the Quarles & Brady opinion letter may have produced, and understanding that hindsight is always 20/20, there are a few things that may have prevented this lawsuit. First, the 'no litigation' assurance should have been limited to pending litigation and excluded threatened legal proceedings. At a minimum, it should have been limited to legal proceedings threatened *in writing*. Second, the firm's 'knowledge' in connection with the no-litigation assurance should have been limited solely to the current actual knowledge of the attorneys currently with the firm who have represented the loan parties in connection with the transactions contemplated by the loan documents. While it is not clear from the complaint whether the same attorneys were involved in both the loan transaction and the unre-

lated default matter, the broad definition of knowledge created an obligation to make inquiry of attorneys other than those involved in the subject loan transaction. Third, the assurance should have been limited to litigation that would adversely affect the subject loan transaction, not all litigation. And finally, the assurance should have been limited to pending litigation in which the firm represented the loan parties.

The "Illustrative Opinion Letter"[2] contained in the Real Estate Finance Opinion Report of 2012 offers the following example of a negative assurance related to litigation: "*In addition to the foregoing opinions, we inform you that, based solely on a review of our litigation docket, to our knowledge, [except as set forth in Schedule [__] to [____],] we are not representing the Borrower or the Guarantor in any pending litigation in which either is a named defendant, in which the pleadings request as relief that any of the obligations of the Borrower or the Guarantor under the Transaction Documents be declared invalid or subordinated or that the performance by either of the Borrower or the Guarantor of the Transaction Documents be enjoined.*"

The foregoing assurance should be paired with a reasonably limited definition of the firm's 'knowledge.' Consider, for example, the following formulation: "*Statements made herein "to our knowledge" are based solely on information actually known to those attorneys currently practicing with this firm who are engaged in the representation of the Borrower and the Guarantor in connection with the Transaction Documents, and mean that such attorneys have no actual knowledge, without any independent investigation, of facts which are contrary to the opinions rendered.*"

Bear in mind that a 'no-litigation' assurance is not a legal opinion. It contains no legal conclusions; it is merely a factual confirmation of matters of fact with respect to which the loan parties themselves have made representations to the lender in the loan documents and in closing certificates. Both the Real Estate Finance Opinion Report of 2012[3] and the Real Estate Opinion Letter Guidelines[4] take the position that it is inappropriate to request negative assurances from borrower's counsel in a loan transaction. Nevertheless, a deeply ingrained custom of receiving these assurances from borrower's counsel often causes lenders to insist on a negative assurance regarding litigation in a loan closing opinion letter. In that case, the expedient alternative is to carefully consider what statement borrower's counsel can comfortably make and to craft the language accordingly. ■

Lydia C. Stefanowicz is a partner with the law firm of Greenbaum, Rowe, Smith & Davis LLP who concentrates in practice on corporate, commercial and real estate financing transactions.

Endnotes

1. *SFH Company, LLC v. Quarles & Brady, LLP*, Circuit Court of Cook County, Illinois, County Department, Law Division, Case No. 2017-L-002520.
2. 47 *Real Prop. Tr. & Est. L.J.* 213 (Fall 2012), at 268.
3. *Id.* at 249.
4. 38 *Real Prop. Probate & Tr. J.* 241 (Summer 2003), at 255.