Legal Opinions in Loan Modification Transactions

Economic crises such as the current one arising from the COVID-19 pandemic frequently give rise to the need for amendments to existing loan terms where the assumptions underlying the original loan transaction have been challenged by the unforeseen events. The current economic situation can be expected to spawn a variety of circumstances where the terms of existing loan documents will need to be modified after closing of the original loan transaction (hereafter referred to as a "loan modification"). Lenders view loan modifications as separate transactions and frequently require closing opinions covering many of the same issues that lenders typically require in connection with the original loan transaction.

Another event that is likely to result in the post-closing modification of the original loan documents is an assumption of an existing loan by a person not party to the original loan transaction, typically referred to as a loan assumption. For purposes of this article, the issues implicated by a loan modification transaction and a loan assumption transaction are very similar and will be discussed together (unless otherwise specifically noted) regarding loan modification opinions.

In some cases, loan modifications are effected by amended and restated loan documents and more closely resemble original loan closings. Those types of transactions are outside of the scope of this discussion of loan modification opinions.

Loan modifications are common transactions, and counsel to the borrower(s) and guarantor(s) (referred to herein collectively as "loan parties") are frequently required by lenders to provide closing opinions in those transactions. However, there is little specific guidance to be found in bar reports, treatises or articles in legal publications regarding third-party closing opinions issued in connection with loan modifications. In addition (and perhaps as a result), custom and practice as to what should be covered by such opinions and what assumptions and qualifications are appropriate in such opinions are also not as well developed among parties to loan modification transactions. Loan modifications are further complicated by the fact that they can cover a wide spectrum of issues, from short-term extensions of maturity or minor revisions of covenants, to increases in loan amount or changes in payment terms, to extensive debt restructures. The more material the changes to the original loan documents, and the larger the size of the loan, the more likely the lender is to require legal opinions from the loan parties' counsel and the more extensive those requested opinions are likely to be.

The legal opinions most often required by lenders in loan modification transactions include entity opinions, enforceability opinions and lien opinions.

Entity Opinions

Opinions relating to the legal existence and status of the borrower (or a new borrower, in the case of a loan assumption) or guarantor(s), entity power and authority to enter into the modification transaction, and execution and delivery of the modification transaction documents, will be virtually identical to those same opinions rendered in connection with the closing of the original loan transaction. *See* Real Estate Finance Opinion Report of 2012.[1] The scope of such core opinions, the assumptions and qualifications related to such opinions, and the due diligence underlying such opinions will not differ materially from the way those issues are covered in third party closing opinions delivered with respect to the original loan.

Enforceability Opinion

The issues relating to an enforceability opinion in the context of a loan modification are more complicated. In a loan modification transaction, an opinion frequently requested from loan parties' counsel is to the effect that the loan modification documents are valid, binding and enforceable. Query whether that is sufficient? From the lender's perspective, is the lender not entitled to an opinion that the original loan documents, as amended by the modification documents, constitute valid, binding and enforceable obligations of the loan parties? And in rendering such an opinion, is it reasonable for the loan parties' counsel

1. 47 Real Prop. Tr. & Est. L.J. 213 (2012).

to assume, or to expressly exclude an opinion, that the original loan documents are enforceable? Arguably, without such an assumption or an express statement that no opinion is being given on the enforceability of the original loan documents, an enforceability opinion covering loan modification documents may be deemed to imply an opinion on the enforceability of the original loan documents being modified, particularly if the modification documents contain a reaffirmation of the original loan documents. Should the answer be different if the opinion giver also issued the closing opinion in connection with the original loan documents? There seems to be no uniformly accepted practice in connection with loan modification transactions.

Under what circumstances is it reasonable for the opinion giver in a loan modification transaction to assume that the original loan documents are valid, binding and enforceable? In some circumstances, an assumption about one or more of the predicates to the opinion regarding enforceability of the original loan documents may be more appropriate. For example, in a loan assumption transaction, an assumption that the original loan documents were duly executed and delivered by the original borrower, and further that the original borrower was at the time an entity validly existing and in good standing, with the legal power and authority to execute and deliver those documents, might sufficiently limit the risk to the opinion giver who was not counsel to the original borrower.

What assumptions and qualifications may need to be included to account for the passage of time since the original loan closing? For example, is it reasonable for an opinion giver to assume that the original loan documents have not been previously modified (except as identified in the description of the loan documents being modified or assumed) or that the original loan documents have not been modified by trade usage or course of dealing between the parties?

It would appear to the author that a lender in a loan modification transaction is reasonably entitled to an opinion that the original loan documents, as amended by the modification documents, constitute valid, binding and enforceable obligations of the loan parties. This would be the equivalent of what the lender received in a closing opinion for the original loan transaction. However, it would also be fair to the loan parties' counsel to permit such counsel to assume that the original loan documents are valid, binding and enforceable obligations of the parties, whether or not such counsel issued the closing opinion to that effect in connection with the original loan transaction. This is a reasonable assumption for counsel representing the loan parties in the modification transaction, but not the original loan transaction, to make. However, even if counsel did represent the loan parties in the original loan transaction, it is a reasonable to assume that nothing has intervened since the original closing to impair the enforceability of the original loan transactions, and not to assume the risk that facts may have changed.

In a loan assumption transaction where the transaction modification documents may be limited to an assignment and assumption agreement consented to by the lender, a promissory note from the new borrower and some related ancillary documents executed by the parties, the original loan documents may continue substantially intact. Accordingly, an opinion that the modification documents alone are valid, binding and enforceable does not cover for the benefit of the lender all the issues that were included in the legal opinion delivered in connection with the original loan transaction. Is the lender not entitled to an opinion that the loan documents, as assigned to and assumed by the new borrower, constitute legal, valid and binding obligations enforceable against the new borrower? But is it not also reasonable for the opinion giver to assume, in giving that opinion, that the original loan documents were valid and enforceable before they were assigned? Practice among opinion givers and recipients varies.

As with any enforceability opinion, many of the customary assumptions, qualifications and exclusions relating to enforceability may be equally applicable in the context of a loan modification, e.g. bankruptcy and equitable principles. But others may not be. Query what does the "generic exception" (i.e. that certain other provisions of the transaction documents may not be enforceable) mean in an enforceability opinion limited to the validity and binding effect solely of the loan modification documents? Should not such an exception at least be qualified by the customary practical realization assurance and, if so, how should that assurance be stated in such context?

Lien Opinions

An assurance that an existing mortgage continues to be a valid lien on the mortgaged property, with the same lien priority that it had upon closing of the original loan transaction, can be best obtained by an endorsement to the loan title insurance policy reflecting the mortgage modification and updating the effective date of the policy. An opinion that the loan modification or assumption does not affect the priority of the original mortgage or deed of trust is not an appropriate opinion request for all the same reasons that an opinion relating to the priority of the original lien is inappropriate to request or to give. However, an opinion that a mortgage as modified is in proper form to grant a valid lien to secure the loan may be appropriate. If real property collateral is being added or substituted, additional opinions (as well as related assumptions and qualifications) of the type that may be included in a closing opinion rendered in connection with the original loan closing may be appropriate, e.g. documents in recordable form.

If Article 9 personal property is being added as collateral,

or a new person is being added or substituted as the borrower in connection with a loan modification, opinions relating to creation or perfection of security interests may be appropriate. However, lien affirmation opinions (i.e., opinions that the creation or perfection of a security interest has not been adversely affected by the loan modification) may not be a simple matter. An opinion giver should consider the issue of novation when rendering a legal opinion in connection with a loan modification transaction, and if the facts are ambiguous, it may be prudent to decline to give this opinion.

Conclusion

Although general legal opinion reports and treatises provide useful guidance that can be applied to opinions relating to loan modification transactions, these transactions do present sufficiently unique and different issues from original loan closings to require opinions that are tailored to the loan modification transaction. This article has attempted to identify some of the key issues that should be considered by opinion givers as well as by opinion recipients in the context of a loan modification transaction. Hopefully, it will spark greater discussion on the subject and provide an impetus to interested groups in real estate finance law to undertake an opinion report offering detailed guidance on opinions in connection with loan modifications.

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