THE 1992 OREGON REPORT

INTRODUCTORY COMMENT

I. Policy/Scope

A. Rationale for a Statement of Policy

A lawyer writing on legal opinions in 1973 stated that there were hardly any cases concerning legal opinions, there was virtually no printed word on the subject in law books or articles, and there were no generally accepted principles governing opinions. James Fuld, *Legal*

Opinions in Business Transactions—An Attempt to Bring Some Order Out of Some Chaos, 28 BUS LAW 915 (1973). Since then, the volume of literature relating to opinion letters in real estate transactions has increased. A number of bars across the country have established committees to adopt principles regarding opinion letters, as was initially urged by James Fuld. Fuld, *supra*, at 945.

Real estate lawyers in Oregon have faced the same lack of case law and written materials apparent in other areas of the country. It has become increasingly evident that some statement of policy regarding opinion letters in Oregon real estate transactions is necessary.

Fuld, in a follow-up article on the subject, suggests that such a statement can serve a number of important purposes: to bring order to a chaotic area, to set standards of conduct for practitioners to act as safe harbors, to furnish continuing education to the bar, to increase certainty of meaning, to avoid the expenditures of unnecessary legal energy in negotiating provisions of the opinion letter, to reduce the possibility of conflict between a client and the lawyer, and to provide the public with a better understanding of the purposes and limitations of legal opinions. James Fuld, *Lawyers' Standards and Responsibilities in Rendering Opinions,* 33 BUS LAW 1295, 1315 (1978).

It was with these purposes in mind that the Real Estate and Land Use Section of the Oregon State Bar directed its Committee on Opinion Letters (the "Committee") to review the literature and case law on this subject and to develop a statement of policy, a standard form of opinion letter, and an accompanying commentary.

> NOTE: This opinion letter and commentary were approved by the executive committee of the Real Estate and Land Use Section of the Oregon State Bar in November 1991.

B. Preliminary Considerations

1. *Purposes for Opinion Letters*. Typically, recent literature on the subject includes a form of sample opinion letter that could be used in connection with a typical loan transaction. It is not unusual in a loan transaction for the Lender (i.e., the lender requesting the opinion letter) to give the borrower's Lawyer (i.e., the lawyer giving the requested opinion) its standard form of opinion letter with the request that the Lawyer furnish the letter in connection with the transaction.

Those who do not regularly practice in the field often fail to recognize that the form of opinion letter should vary, depending upon

the nature of the transaction and the purpose for which the opinion is sought. No form of opinion letter is appropriate for every case. The letter should be tailored to the particular transaction involved.

A Lender may seek an opinion from the Lawyer for a number of different reasons. Among these are the following:

a. The Lender wants assurance from a third party familiar with the formation documents that the corporation or partnership that is the borrowing entity was validly created and is currently authorized to conduct business in the state.

b. The Lender wants confirmation that the parties executing the documents have authority to execute the documents and are the persons they purport to be.

c. The Lender wants assurance that the Lawyer is unaware of any litigation that would materially and adversely affect the Borrower's ability to complete the loan transaction as agreed.

d. The Lender wants assurance that the conditions to be satisfied by the Borrower have been satisfied.

e. The Lender wants to obtain assurances from the Lawyer as to the following items related to enforceability:

(i) That the Lender's rights under the loan documents are enforceable against the Borrower in the event of default;

(ii) That the Lender will have the right to realize upon the security, and that the value of the security will not be impaired as a result of unresolved legal issues; and

(iii) That the transaction is truly as it is characterized in the loan documents.

Each of the last three purported justifications for an opinion letter from the Lawyer has been criticized. *See* M. J. Sturba, Jr., *Drafting Legal Opinion Letters* 136 (1988). Robert A. Thompson, Esq., in his chapter in *Drafting Legal Opinion Letters* (Sturba, *supra,* at 131), points out that the Lender's lawyer is in a better position than the Lawyer to opine as to the enforceability of the loan documents, which were probably drafted by the Lender's lawyer in any event. He goes so far as to argue that,

> On balance, notwithstanding all of the asserted justifications, it can be argued that the requirement for an enforceability opinion from borrower's counsel constitutes a significant, additional, and unnecessary expense for legal work which effectively duplicates the efforts of lender's counsel. Nevertheless, the demand is seldom waived. It

> appears that the insistence on an enforceability opinion from the borrower's counsel continues to be based upon a widespread, but largely unjustifiable, professional custom.

Sturba, *supra,* at 138.

The Committee shares Mr. Thompson's view that the enforceability opinion is an "unjustifiable professional custom" and believes that a request for an enforceability opinion should be refused. Nevertheless, the Committee recognizes that the custom will be hard to break.

In addition to considering the purpose of the specific opinion that the Lender seeks, the Lender's lawyer should consider whether he or she would, if representing the Borrower, be prepared to furnish the opinion requested. This is the so called "golden rule" in negotiating real estate legal opinions. Sturba, *supra,* at 136.

The Committee agrees with the State Bar of Texas Committee on Lawyers' Opinion Letters in Mortgage Loan Transactions (the "Texas Committee") that "gamesmanship" is to be avoided in the opinion letter process. Real Estate, Probate and Trust Section, State Bar of Texas, *Opinion Letters in Mortgage Loan Transactions, Preliminary Draft of a Settlement of Policy Regarding Lawyers' Opinion Letters in Mortgage Loan Transactions*, 23 ST B NEWSLETTER, Real Estate, Probate and Trust Law, No 2, at 20 (Jan 1985) (hereinafter referred to as the "Texas Report"). As stated by the Texas Committee, the Lender should not require the Lawyer to give any opinion that the Lender's lawyer would not also give after full disclosure of the relevant facts; and the Lawyer should not attempt to weaken an opinion in a manner that would be unacceptable if the roles were reversed.

2. *Scope of Opinion Letters.* An opinion letter should address legal, not factual, issues. That is, the Lawyer should not be expected to opine as to facts except as they may be necessary to render a legal opinion on a matter about which the Lawyer has direct knowledge. *See* Section II.C.2. below.

The Lawyer has a duty to provide only the specific opinion requested by the Lender and has no duty to advise the Lender as to matters not expressly addressed in the opinions requested and given. The Lender should not assume that the opinion addresses anything that is not specifically stated in the opinion.

II. Commentary on Form of Opinion Letter

A. Introduction

"We have acted as Oregon counsel to _____ ("Borrower") in connection with that certain Loan Agreement ("Loan Agreement") dated _____, ___, between _____ ("Lender") and Borrower."

Alternate

"We are not Borrower's general counsel, we have not previously represented Borrower, and we have made no investigation of Borrower's legal affairs except as expressly set forth in this letter."

Alternate

"Although we represent Borrower from time to time in connection with specific transactions, we are not general counsel to Borrower, and we did not participate in the formation or organization of Borrower."

Alternate

"This opinion is delivered to you pursuant to Section _____ of the Loan Agreement."

Following the salutation, an opinion letter will normally open with a brief statement describing the transaction and the capacity in which the Lawyer is rendering the opinion. Depending upon the nature of the transaction, the Lawyer may be referred to as "counsel," "special counsel," "local counsel," "Oregon counsel," or in some similar manner. While use of a qualifying term together with "counsel" may be useful to help define the Lawyer's relationship to the parties to the transaction, the Lawyer should recognize that the label itself may have no effect in limiting responsibility or liability. Whether or not such a qualifying term is used, the Lawyer should expressly set forth any limitation on the scope of responsibility on which the Lawyer intends to rely.

B. Documents Reviewed

"In rendering our opinion, we have examined originals, copies identified to our satisfaction as true copies of the originals, or copies certified to us as being execution copies of the following documents:

1. The Loan Agreement [where necessary];

2. Promissory Note ("Note") to be executed by Borrower as maker and payable to the order of Lender in the sum of _____, [draft] dated _____;

3. Deed of Trust ("Trust Deed") to be executed by Borrower as grantor, in favor of Lender as beneficiary, securing the Note, [draft] dated _____;

4. Security Agreement ("Security Agreement") to be executed by Borrower as debtor and naming Lender as secured party, [draft] dated _____;

5. UCC-1 Financing Statement ("Financing Statement") to be executed by Borrower in favor of Lender, [draft] dated _____;

6. UCC-1A Financing Statement ("Fixture Filing") to be executed by Borrower in favor of Lender, [draft] dated _____;

7. Assignment of Rents and Leases ("Lease Assignment") to be executed by Borrower as assignor to Lender as assignee, [draft] dated _____;

8. Guaranty ("Guaranty") to be executed by _____ ("Guarantor") as Guarantor in favor of Lender, [draft] dated _____.

"The documents listed in items 1 through 8 above are collectively referred to herein as the "Loan Documents."

"In addition to the Loan Documents, we have also been furnished with and have examined (1) certificates of officers and representatives of Borrower; (2) certificates of public officials; and (3) other documents and instruments described in these certificates."

NOTE: Be specific if the Borrower's records or court records or your own files pertaining to the Borrower have been reviewed.

"As to questions of fact material to this opinion, we have relied upon statements or certificates of Borrower and public officials and other facts known to us, but we have made no independent investigation of the warranties and representations made by Borrower in the Loan Documents or of any related matters. Except as specifically identified herein, we have not been retained or engaged to perform, and we have not performed, any independent review or investigation of (1) any agreement or instrument to which Borrower may be a party or by which Borrower or any property owned by Borrower may be bound, or (2) any

order of any governmental or public body or authority to which Borrower may be subject.

"The certificates of public officials upon which we have relied are described as follows: [List specifically the certificates relied upon.] Copies of these certificates are enclosed. We disclaim any responsibility for any changes that may have occurred with respect to the status of Borrower from and after the dates of the certificates. We also assume that the certificates and the public records upon which they are based are complete and accurate."

Following the introductory paragraph, the documents reviewed in connection with the opinion are normally listed.

The Lender may also request the Lawyer to state that the Lawyer has reviewed other documents and matters of law as may be appropriate to support the opinion. The Committee believes it is better practice to list specifically any additional documents or matters that the Lender wishes included in the review.

C. Scope of Investigation

1. General Scope

To the extent that the Lawyer and the Lender can agree upon the scope of the Lawyer's investigation and the scope is expressed in the opinion letter, later confusion over the due diligence obligations of the Lawyer can be avoided. Regardless of whether a more generally inclusive representation is given, however, the Lawyer may still be liable if the Lawyer "has actual knowledge of facts contrary to those set forth in the documents or certificates or believes that contrary facts exist or that the facts disclosed are incomplete and do not form a sufficient basis for the opinion." *Legal Opinions in California Real Estate Transactions,* 42 BUS LAW 1139, 1146 (1987) (hereinafter referred to as the "California Report").

It is important to remember that the form and content of the opinion letter should be considered flexible. The scope of the opinion and the extent of the due diligence investigation expected of the Lawyer should be related to the size and complexity of the transaction. Often the Lawyer must enter into substantial negotiations with Lender's counsel, and even with the Lawyer's own client, in order to produce an opinion that satisfies the needs of the Lender and adequately protects the Lawyer from undue risk. The best time to resolve issues concerning the opinion letter is when the loan commitment or agreement between the parties is being negotiated. The Lender will commonly specify the form of letter

required at the outset. The Lawyer should review the letter and negotiate any required changes at the earliest possible time.

2. Factual Issues in Opinion Letters

This section sets forth the Committee's position regarding requests for opinions that are based on factual matters such as title and technical compliance with environmental and land use regulations.

These matters should not be the subject of an opinion by the Lawyer because they are uniquely within the expertise of professionals other than lawyers. The Committee believes that the factual and technical considerations, particularly in the area of environmental concerns, and to a lesser degree in land use and title matters, are too extensive and require too many assumptions based upon the expertise of others.

In the environmental area, examinations and evaluations of the existence of hazardous substances on-site or the efficacy of a prior cleanup require the opinion of experts. Generally, lawyers do not have the requisite training and background to evaluate such opinions. Reviewing the work of these experts and rendering an opinion based on their work is a fruitless and dangerous exercise for the Lawyer. The Lender should look to the expert in the field who has done the examination and has the expertise, not to the Lawyer.

In Oregon, as a matter of custom, Lenders do not expect the Lawyer to render an opinion about title to the property which is the security for the loan transaction. Although real estate lawyers in Oregon are competent to render opinions on the various issues associated with title, because this is not an abstract state, lawyers do not search records or make judgments about the chain of title. Instead, they rely exclusively on the title insurance companies and expect their clients to do the same. The experience of the Committee has been that Lenders are willing to rely on an insurance policy issued by a title insurance company approved by the Lender.

Given this custom in title matters, it makes sense for this to be the custom in the areas of environmental and land use concerns. The Committee recognizes that there may be instances in which the Lender will maintain that it is not able to evaluate those issues on its own and will pressure the Lawyer to give an opinion. In these cases, the Lawyer should suggest that the Lender obtain reports or opinions from those experts whose knowledge is relevant to those areas that are of concern to the Lender. The Lawyer generally should not accept the task of

advising the Lender as to which experts should be consulted, nor should the Lawyer agree to opine or comment on those reports.

In those cases in which the Lawyer feels compelled to agree to state in an opinion letter that reports of other experts on factual matters have been reviewed, the Committee is concerned that the Lawyer may be exposed to a claim of negligence for having identified and included some sources and not others that should have been examined and evaluated in a particular area. In any case in which the Lawyer does agree to cite other experts' reports or opinions in the opinion being given to the Lender, the Lawyer should be careful to state that no independent verification of the reports has been made, that the citations are at the Lender's request, and the reasons for which they are being cited. The Committee believes that as a matter of policy no implied coverage of factual areas should be construed from any statement made in an opinion letter.

D. The Opinions

1. Existence

Domestic Corporation: "Borrower is a corporation duly incorporated and validly existing under the laws of the state of Oregon."

Domestic Limited Partnership: "Borrower is a limited partnership validly existing under the laws of the state of Oregon."

Domestic Partnership: "Borrower is a partnership validly existing under the laws of the state of Oregon."

Foreign Corporation: "Borrower is duly authorized to transact business in the state of Oregon."

Foreign Limited Partnership: "Borrower is duly authorized to transact business in the state of Oregon."

Probably the most significant departure from custom reflected in the above suggested forms is the elimination of the phrase "duly organized" from the opinion. Some commentators have indicated that the use of phrases such as "due organization" and "duly organized" imply very broad opinions on the part of the Lawyer that include, among other things, opinions to the effect that the bylaws have been adopted, that the proper number of officers and directors have been elected, and that the capital stock of the Borrower has been issued and paid for. *See, e.g.*, *Report of the Committee on Corporations Regarding Legal Opinions in Business Transactions*, 14 PAC LJ 1001, 1032 (1983). With respect to

a partnership, the phrase "duly organized" might imply an opinion that capital contributions to the partnership have been funded. The Committee has concluded that the "duly organized" opinion is inappropriate unless special circumstances suggest that the Lender should require it. Many lawyers are not the lawyers responsible for organizing the borrowing entity, and the investigation and due diligence required to support a "due organization" opinion would be time-consuming and costly, while the benefit of the opinion to the Lender might be negligible. In this regard, the suggested opinion follows the form promulgated by the Texas Committee.

The phrase "validly existing" means the corporation has not dissolved or had its term expire pursuant to the articles of incorporation. *See, e.g.,* PAC LJ, *supra*.

The suggested forms do not contain the "good standing" phraseology typically included in opinions. "Good standing" usually is construed to mean that applicable taxes and franchise fees have been paid. *See Legal Opinions to Third Parties: An Easier Path,* 34 BUS LAW 1891, 1906–1907 (1979). Since it appears that those concerns are covered by the "validly existing" opinion and since the Secretary of State of Oregon issues Certificates of Existence and Authorization (which evidence payment of fees and the filing of required reports), and not "good standing" certificates, the Committee concluded that the "good standing" opinion should be eliminated.

The domestic corporation form of opinion provides that the Borrower has been "duly incorporated." Commentators have suggested that the phrase "duly incorporated" means the articles of incorporation have been executed and filed, something less than is connoted by the phrase "duly organized" (which, as noted above, encompasses a broad range of events such as issuance of stock and the conduct of organizational meetings). *See, e.g.,* PAC LJ, *supra,* at 1031–1032. The Committee has concluded that the use of the phrase "duly incorporated" represents a fair compromise of competing interests inasmuch as the chosen format will relieve the Lawyer from examining the organizational instruments other than the articles of incorporation, while providing the Lender with some assurance that the corporation has been properly organized. A Certificate of Existence or Authorization must be obtained from the Secretary of State to support this opinion. ORS 60.027 provides that issuance of a Certificate of Existence or Authorization constitutes conclusive evidence of the existence of the corporation or that the corporation is authorized to do business in the State of Oregon, as the case may be.

The Lender may want an opinion to reflect that the Borrower is duly qualified to do business in each state where it owns or leases property or conducts business. The Committee has concluded that such an opinion is extraordinary and should not be issued unless special circumstances justify its issuance. If such an opinion must be given, it should be limited to the specific jurisdictions where the Borrower is doing business and should be based on the factual representations of the Borrower regarding its activities in other states and on certificates issued by the proper authorities of each of those states. The opinion should also be limited to "material" business activities. Since this opinion is viewed as extraordinary, it has not been included in the suggested form opinion letter; if the Lender has an articulated need for the opinion, then it can be added.

Some forms of opinions that have been promulgated have specifically identified the laws governing formation of partnerships (the Uniform Partnership Act and the Uniform Limited Partnership Act, as adopted in the applicable jurisdiction) when opining regarding the valid existence of the borrowing entity. *See, e.g.*, the Texas Report, *supra*, at 26. The Committee has concluded that the reference to those statutes is unnecessarily limiting and has included no references to them in the proposed opinion formats.

Since trusts present unique concerns regarding their organization and the authority of trustees to bind them, the Committee has suggested no uniform form of opinion for use when the Borrower is a trust. The Lawyer must carefully review all trust instruments in light of applicable law when issuing an opinion on behalf of a trust.

With respect to entities organized in other jurisdictions, the Lawyer should not opine regarding the organization or valid existence of the entity unless the Lawyer is licensed in the subject jurisdiction. Consequently, the suggested opinions for foreign corporations and partnerships deal solely with the authority of the entity to transact business in Oregon.

The principal undertaking required to support any of the above authority and organization opinions is review of the appropriate certificates of governmental authorities and the articles of incorporation and bylaws, or partnership agreement, of the Borrower. A certificate should be obtained from the Borrower that identifies by attachment the articles of incorporation and bylaws of the corporation or the partnership agreement. To issue the organization and authority opinions, the Lawyer should ensure that the activities being conducted by the borrowing entity

are authorized by the purposes and powers set forth in the organizing documents. If special minutes or resolutions are required to document activities that are not specifically treated in the organizing documents, they should be prepared and attached to the opinion. The Borrower's certificates should be delivered to the Lender if they are specifically identified and relied upon by the Lawyer. If the authority and organization opinions are limited to the extent set forth above, the Committee believes a review of the organization documents, of the certificates of the public officials, and of the certificates of the representatives of the borrowing entity is sufficient.

In addition to identifying the organizing documents of the Borrower and any specific resolutions or partnership minutes required with respect to the subject transaction, a certificate should also clearly indicate that no shareholder or partnership actions to dissolve have been submitted or filed. Since dissolution activities conceivably could be underway without notice to the Secretary of State or other governmental authorities, the foregoing certifications may be critical. The Committee also suggests that the representatives of the Borrower certify the authenticity of the certificates of public officials and certify that the status of the borrowing entity reflected in those certificates has not changed since they were issued.

The Committee recommends that the Lawyer not expressly rely on the opinion of local counsel and thus possibly become the equivalent of an insurer of that opinion; however, if the Lawyer is required to expressly rely on an opinion of local counsel, the Lawyer should make sure that local counsel is reputable and competent, and should carefully review the opinion of local counsel to verify that there are no obvious inaccuracies or wrong assumptions therein.

The Lawyer cannot rely on factual representations of the Borrower if the Lawyer knows they are incorrect. Furthermore, the Lawyer should not rely on conclusions of law set forth in the Borrower's certificate such as "Borrower is doing business in [state]"; rather, the certificate should indicate that "the Borrower owns no properties and has no employees in any state other than [listing the specific states that are applicable]."

2. Authority

"Borrower has all requisite [corporate] [partnership] authority to (1) own [, lease, and operate] the property and (2) undertake and perform the obligations of Borrower under the Loan Documents."

This suggested opinion is a variation of the format adopted in the Texas Report. The Texas form at page 27 states:

Alternate

"Borrower has all requisite authority to own [, lease, and operate] the Property, to borrow the proceeds of the Loan, and to execute and perform Borrower's obligations under the Loan Documents."

The phrase "to borrow the proceeds of the Loan" is redundant of the balance pertaining to undertaking and performing the obligations of Borrower. Some writers have indicated that "execute" means "to execute and deliver," and that the Borrower has taken all action necessary to render the Loan Documents effective. *See, e.g.,* Texas Report, *supra,* at 22. Those elements of an opinion are more properly covered by the "due execution" and "enforceability" opinions.

In accord with the Texas Report, the Committee has concluded that the word "power" is unnecessary: "the word 'power,' when used with the word 'authority,' either is merely redundant or implies an ability to perform an act without legal authorization to do so." Texas Report, *supra,* at 22.

The Texas Report does not modify the word "power" with the words "corporate" or "partnership." One writer has suggested that the elimination of those words implies that the Borrower has "power under applicable governmental regulations." Steven V. Weise & John Duncan, Chapter 11, Loan Transactions, October 14, 1985, PLI Corporate Law & Practice. Although the Committee does not necessarily agree with this comment, the Committee sees no harm in including the modifiers "corporate" and "partnership." The suggested format does not imply that the Borrower can perform its obligations under the Loan.

3. Enforceability

The loan documents are the legal, valid, and binding obligations of Borrower [and Guarantor, as applicable,] and are enforceable against Borrower [and Guarantor, as applicable,] in accordance with their terms, except that (a) the foregoing may be limited by bankruptcy, insolvency, reorganization, fraudulent transfer, moratorium, or similar laws, or by equitable principles (regardless of whether such enforcement is considered in a proceeding in equity or at law) relating to or limiting the rights of creditors generally; and (b) the use of the term "enforceable" does not imply any opinion as to the availability of equitable remedies

other than the foreclosure of the liens created by the loan documents in accordance with Oregon law.

The Committee attempted to make the Lawyer's opinions substantially similar to opinions rendered in other states. Accordingly, the portion of the opinion concerning the enforceability of the loan documents conforms to comparable provisions recommended by the bar associations of other states. Nevertheless, the Committee has not endorsed the "practical realization" or the "realization of the principal benefits," *see, e.g.*, Texas Report, *supra*, at 23, formulations of rendering an enforceability opinion, but rather has been persuaded by the "material breach" standard recommended by the California Committee. California Report, *supra*, at 1156–1170.

The opinion that the loan documents are enforceable in accordance with their terms is qualified by the "bankruptcy" and by the "equitable principles" exceptions in a manner that generally is similar to that seen in other jurisdictions. Recognizing the importance of the foreclosure remedy to the Lender, the above language then negates any implication that the exclusion from the opinion of equitable principles includes the foreclosure of liens created by the loan documents and later goes on to state that while an Oregon court may not strictly enforce certain provisions in the loan documents, generally speaking, enforcement against the Borrower would be available following a material breach of a material provision in the loan documents.

In proposing the above language, the Committee rejects differences in meaning arising from different drafting of the "legal, valid, and binding" or the "enforceable in accordance with its terms" phraseology. Opinions that include the term "legally" instead of "legal," that use only the words "valid and binding," that delete any reference to "enforceable," that include "enforceable" rather than "enforceable in accordance with its terms," or that similarly deviate from the suggested language are often understood to be identical to and, in the absence of express language in the opinion to the contrary, should be interpreted identically with the suggested language.

The statement that the loan documents are enforceable "against Borrower and Guarantor as applicable" is meant to clarify that the Lawyer has assumed that the Lender (or any party other than the Borrower or Guarantor) has duly and validly executed the loan documents. The referenced language further clarifies that the opinion does not address the validity, legality, or binding nature of any obligations under the loan documents other than those of Borrower and

Guarantor and that no opinion is expressed as to the rights of any third party under the loan documents or otherwise.

The introductory phrase to subpart (a) that "the foregoing may be limited by" the exceptions thereafter described, is intended to make explicit that the qualifications set forth therein are intended to extend to all aspects of the loan documents, including whether the loan documents may be held to be void or voidable, and therefore may extend to the validity of the loan documents. The Committee rejects limiting the bankruptcy type of exclusions to only the enforceability of the remedies contained in the loan documents as opposed to the validity of those documents. The distinction between enforceability and validity is not a meaningful one because invalid loan documents will also be unenforceable. More significantly, however, the Committee believes that while situations in which the loan transaction are void or voidable as a preference, fraudulent transfer, or otherwise will be rare, more adequate analysis of the issue likely will occur when the Lender is required to request a reasoned opinion on the issue in those instances when these concerns are present.

Consistent with this approach, the enumerated exceptions in subpart (a) have been expanded to include fraudulent transfers. The Lawyer does not often have the facts necessary to determine whether the proposed transaction may constitute a fraudulent transfer. Similarly, the Committee intends that the word "laws" in subpart (a) be interpreted broadly to include constitutional provisions, ordinances, regulations, rules, and court decisions. Notwithstanding the use of the word "generally" after the reference to "creditors," the qualification would also apply to any law, rule, regulation, or judicial decision applicable only to a specific number of creditors or to specific transactions. The exclusion for "equitable principles" is not meant to be limited to principles that apply solely to the rights of creditors generally, but is intended to refer to general principles of equity.

Subpart (b) is meant to negate any implication that the exclusion from the opinion of equitable remedies encompasses the foreclosure of liens in accordance with Oregon law, to the extent such foreclosure is based in equity. In particular, because judicial foreclosure of a deed of trust is the mechanism in Oregon by which a deficiency judgment can often be obtained on foreclosure, and because a judicial foreclosure may have its roots in equity, the proposed language was added and should be interpreted to mean that the Lawyer is opining that judicial foreclosure will be available to the Lender following a material default by the Borrower. Moreover, to the extent that trust deed foreclosure or

foreclosure under the Oregon Uniform Commercial Code is based in equity, the proposed language also opines on the availability of such foreclosure.

(a) Limitations on Enforceability

"In giving this opinion, we advise you that an Oregon court may not strictly enforce certain provisions contained in the Loan Documents or allow acceleration of the maturity of the indebtedness if it concludes that such enforcement or acceleration would be unreasonable under the circumstances then existing. We do believe, however, that subject to limitations expressed elsewhere in this opinion, enforcement or acceleration against Borrower [or Guarantor] would be available if an event of default occurred as a result of a material breach by Borrower of a material provision contained in the Loan Documents."

This paragraph of the draft opinion is also similar to the California sample opinion in that, subject to concerns as to the validity of the Loan Documents discussed above, the Committee believes that the loan relationship is contractually based and that the Lawyer generally should be able to opine that if a breach rises to the level of a material breach, the loan contract, as a whole, is enforceable even though specific provisions in the Loan Documents may not be enforceable.

In proposing this language, the Committee intends that the word "provisions" be interpreted to include any portion of the loan documents, whether constituting a covenant, representation, warranty, or condition. For the reasons discussed above, the Committee also has clarified that the opinion addresses only enforcement or acceleration against the Borrower or Guarantor and does not include other parties to the transaction.

The Committee intends that the term "unreasonable" also encompass other limitations on enforceability, including determinations of whether the Lender's security has been impaired by the default, whether the breach is material, or whether general principles of contract law may otherwise preclude enforcement by the Lender. Rather, the Committee intends by this language, and without endorsing or including any cases or developments in the area of lender liability, to draw specific attention to the impact that the Lender's actions may have on the enforceability of the loan documents and to make express a significant limitation upon the scope and meaning of the opinion being rendered.

In adopting the material breach standard quoted above, the Committee rejected two alternative general formulations of opinions on enforceability, commonly referred to as the "practical realization" and "principal benefits" formulations. Persuasive reasons for rejecting these formulations are cogently stated in the California Report. California Report, *supra,* at 1162–1163.

(b) Exceptions to Enforceability

"The following list is not a complete recitation of matters as to which no opinion is expressed, but we wish to emphasize specifically that we express no opinion as to the enforceability of (a) self-help, rights of set-off, or the right to possession of the real or personal property or collection of rental or other income without appointment of a receiver, or the rights, procedural requirements for, or powers of a receiver; (b) provisions purporting to establish evidentiary standards; (c) provisions relating to the waiver of rights, remedies, and defenses; (d) provisions that permit Lender to collect a late charge, increased interest rate after default or maturity, or a prepayment premium; (e) any reservation of the right to pursue inconsistent or cumulative remedies; (f) any "due on sale" clause to the extent that enforcement is not mandated by applicable federal law and that the security for the loan would not be impaired; (g) any "due on encumbrance" clause in any circumstance in which the security for the loan would not be impaired; (h) the effect of any laws similar to "one action" and "anti-deficiency" rules under applicable trust deed statutes and of any statutory restrictions on obtaining a deficiency judgment after foreclosure, including, without limitation, ORS 86.770; (i) provisions for payment or reimbursement of costs and expenses or indemnification for claims, losses, or liabilities (including, without limitation, attorney fees) in excess of statutory limits or an amount determined to be reasonable by any court or other tribunal, and any provision for attorney fees other than to the prevailing party; (j) provisions pertaining to jurisdiction, venue, or choice of law; (k) provisions purporting to appoint Lender or the trustee as attorney in fact for Borrower; (l) limitations on the liability of Lender or the trustee, or for their indemnification, for their own negligence or misconduct; (m) provisions that purport to establish or maintain priority of the lien; (n) provisions for charging interest on interest; and (o) provisions purporting to impose continued liability following foreclosure, such as environmental indemnity provisions."

While the Committee thus far has been consistent with the approach taken by other jurisdictions, the remaining portion of the draft

opinion has adopted a format that is somewhat different from that seen elsewhere. Rather than concluding the enforceability portion of the opinion with limitations on enforceability as set forth in subsection (a) above, the opinion then attempts to identify for the Lender specific provisions in the loan documents or specific issues under Oregon law for which no opinion generally is or can be expressed. The listing does not supersede or supplant the concepts of reasonableness and materiality that govern the scope of the opinion rendered. Provisions or items not included in the list and not rising to the necessary level of materiality are not encompassed within the opinion being rendered. The identified provisions and issues instead represent the collective current judgment of the Committee as to those common areas for which statutory or judicial guidance is lacking or nonexistent at this time, or for which the currently governing rules (such as those relating to obtaining deficiency judgments) may be unique to Oregon. Specific transactions or developing law, moreover, may require additions to, deletions from, or modification of the listed provisions and issues.

Three objections commonly raised in connection with attempts to create a "laundry list" of issues or provisions on which there may be concern as to enforceability are (1) the listing often promotes unnecessary controversy and debate by opposing lawyers over issues that have no practical relevance to the transaction; (2) the lists make the opinion unduly confusing, long, and cumbersome; and (3) the listing approach subjects the Lawyer to the risk that, by negative implication, all provisions in the loan documents not specifically described in the list are considered to be fully enforceable.

The Committee has not been persuaded that any of these objections outweighs the benefits of specifically identifying for the parties certain potential problem areas in the loan documents so that the parties may better understand the true nature of their bargain. As to the first concern, the Committee believes that by delineating areas of concern and then stating the bases for the concern, a common ground will have been achieved between opposing lawyers, thereby minimizing debate as to whether an area of Oregon law is uncertain or ambiguous. Moreover, such debate as may occur often will benefit from the framing of the issues accomplished by the attempted itemization.

Even though itemization will make the opinion longer and more cumbersome, the Committee believes that this particular detriment is far outweighed by the increased information that is communicated by the approach adopted. The more generic approaches (whether "material breach," "practical realization," "principal benefits," or otherwise)

inherently involve greater interpretive discretion as to what is encompassed by the opinion and may tend to foster greater misunderstanding between the issuer and the recipient of the opinion when the need arises to enforce provisions in the loan documents. Potential confusion as to the meaning of the generic enforceability opinions seems most acute when out-of-state lenders fail to obtain their own local counsel and instead rely upon the Lawyer to disclose problems with the loan documents. The approach adopted should minimize many of the judgments required of the Lawyer in determining whether the identified issues attain the threshold required under the more general formulations and to some extent may reduce concerns as to the ethical appropriateness of having the Lawyer opine as to the enforceability of the Lender's documents. The Lawyer, moreover, is expected to delete those items in the list that clearly are inapplicable to the contemplated transaction.

The Committee rejects the third concern that issues or provisions not addressed may not be fully enforceable. The list is meant to be illustrative, not exhaustive. Not every item or provision mentioned will necessarily rise to the level of materiality if breached by the Borrower. Similarly, not all material provisions of the loan documents raise questions as to their enforceability, nor would all the other provisions of the loan documents be reasonable. The listed exceptions represent only the Committee's cumulative judgment of common issues and provisions in the loan documents for which under current law there is some concern as to enforceability. Viewed properly as a mechanism to educate and to standardize potential areas of concern, the itemization attempted herein should not permit the implication that other provisions of the loan documents are enforceable or would not be subject to any limitation or qualification.

As is the case with the more general formulation of an enforceability opinion, the Committee expects that to the extent the recipient of the opinion has concerns as to the validity of a particular provision or the availability of a particular remedy, the recipient will request a specific opinion concerning the particular provision or will seek guidance from its own local counsel. The itemization advocated herein will enable the Lender to determine more particularly areas that may be of special significance to it. In order to assist in this endeavor, the following is a brief comment as to the concern or uncertainty associated with each itemized area and the likely result under existing law of additional research on these issues. These explanations should allow a prompt and efficient means of resolving many questions likely

to be raised by the Lender. This discussion is not intended to be exhaustive or conclusive. It is intended only to alert the Lawyer to issues that were considered by the Committee as pertinent to negotiating opinion letters in typical real estate loan transactions involving a "true loan" secured by a first trust deed on the Borrower's fee title to real property. Each set of loan documents should be analyzed for additional issues the Lawyer believes would be appropriate to call to the attention of the Lender. Any of the following issues not raised by the specific loan transaction should be deleted from the exceptions to the "enforceability" opinion.

"(a) Self-help, rights of setoff, or the right to possession of the real or personal property or collection of rental or other income without appointment of a receiver, or the rights, procedural requirements for, or powers of a receiver."

The exercise of self-help remedies is restricted by the Oregon Uniform Commercial Code and by common law. Self-help remedies may not be exercised if they are contrary to statute or result in a breach of the peace.

Loan documents may purport to entitle the Lender to set off any liabilities of the Borrower against any funds on deposit with the Lender. Oregon law is not well developed in this area, but the right to exercise set-off is frequently governed by deposit contracts, sometimes by statute, and by common law in other jurisdictions. A provision purporting to allow the Lender to exercise a right to set off for unmatured obligations or against special accounts such as trust accounts is suspect.

A Lender's right to possession of the real or personal property is subject to restrictions on breach of the peace, trespass, and conversion. A Lender's right to collect rental or other income without taking possession or the appointment of a receiver is questionable under Oregon law. *See Investors Syndicate v. Smith,* 105 F2d 611, 619–621 (9th Cir 1939). Cautious lawyers take the position that the right to possession or collection of rents over the Borrower's objection may be safely exercised only through the appointment of a receiver. In Oregon, receivers may not be appointed without notice and may not serve without bond or letter of credit; the entitlement to a receiver and to the powers of a receiver is within the discretion of the court notwithstanding the terms of the loan documents. *See* ORCP 80 and 82 A(2). On this subject generally, see also *The Lender's Rights to Rents and Profits From Real Property After Default,* VIII OREGON DEBTOR CREDITOR NEWSLETTER Number 2 (Mid-Winter 1989).

"(b) Provisions purporting to establish evidentiary standards."

Loan documents often attempt to establish evidentiary standards. For example, the documents may recite that the content of a trustee's deed is conclusive evidence of the matters recited therein. ORS 86.780 establishes that a trustee's deed is conclusive evidence of the matters recited therein only with respect to good faith purchasers for value relying upon them and is prima facie evidence as to all others. Other similar provisions to watch for are those purporting to make the Lender's calculation or determination conclusive.

"(c) Provisions relating to the waiver of rights, remedies, and defenses."

Most loan documents provide that the Borrower and guarantors waive various rights, remedies, and defenses such as the statutory right of redemption, the statute of limitations, the right to require marshaling, suretyship defenses, antideficiency statutes, the right to notice, and sometimes the right to trial by jury. Oregon law on the validity of these waivers is not well developed.

"(d) Provisions that permit Lender to collect a late charge, increased interest rate after default or maturity, or a prepayment premium."

Developing law in Oregon and other jurisdictions suggests that these provisions may be tested under a "liquidated damages versus penalty" analysis. *See, e.g., DiTommaso Realty, Inc. v. Moak Motorcycles, Inc.*, 309 Or 190, 785 P2d 343 (1990); *Illingworth v. Bushong*, 297 Or 675, 688 P2d 379 (1984). *See also Union Cen. Life Ins. Co. v. LaFollette*, 150 Or 455 (1935).

"(e) Any reservation of the right to pursue inconsistent or cumulative remedies."

Oregon statutory and common law governing foreclosure restricts the Lender's freedom of choice of remedy and sequence. See, e.g., ORS 86.770(2), which restricts the right to seek a deficiency judgment or to pursue a guarantor following foreclosure, and ORS 88.070 and 88.075 on purchase money mortgages.

"(f) Any "due on sale" clause to the extent that enforcement is not mandated by applicable federal law and that the security for the loan would not be impaired."

While the Garn-St Germain Depository Institutions Act of 1982, 12 USCA §226, and regulations promulgated pursuant thereto render some aspects of "due on sale" clauses enforceable in certain loan

transactions, Oregon case law is not fully developed as to enforceability of such clauses if Garn-St Germain is not applicable. Dicta suggests that "due on sale" clauses will be enforced even without a demonstration that the Lender's security is impaired, but only strictly in accordance with their terms. *See, e.g., United Savings Bank Mutual v. Barnette*, 72 Or App 46, 52 (1985); *United Savings Bank v. Zandol*, 70 Or App 239 (1984), *rev. denied*, 298 Or 470 (1985). Oregon courts have not ruled directly on "change in control" restrictions and other matters not strictly permitted within existing case law or the Garn-St Germain Act. Cautious lawyers may use this limitation to avoid predicting future law.

"(g) Any "due on encumbrance" clause in any circumstance in which the security for the loan would not be impaired."

The validity of such provisions has not been statutorily or judicially determined in Oregon.

"(h) The effect of any laws similar to "one-action" and "anti-deficiency" rules under applicable trust deed statutes and of any statutory restrictions on obtaining a deficiency judgment after foreclosure, including, without limitation, ORS 86.770."

Loan documents often grant the Lender a right to a deficiency judgment or to pursue the guarantors contrary to ORS 86.770. Under Oregon law, a trust deed cannot be foreclosed while an action is pending on the debt thereby secured. ORS 86.735(4). After a judicial or nonjudicial foreclosure, no action may be brought on the debt itself or on any guaranty to recover a deficiency. ORS 86.770(2). A deficiency judgment can be enforced following judicial foreclosure of a "commercial trust deed" in which a judgment is obtained on the debt. ORS 86.770(3)–(4).

"(i) Provisions for payment or reimbursement of costs and expenses or indemnification for claims, losses, or liabilities (including, without limitation, attorney fees) in excess of statutory limits or an amount determined to be reasonable by any court or other tribunal, and any provision for attorney fees other than to the prevailing party."

Loan documents frequently require the Borrower to pay the Lender's actual attorney fees. ORS 20.096 makes attorney fee provisions reciprocal by providing that the prevailing party will be entitled to attorney fees if a suit or an action is filed on a contract providing for attorney fees to only one named party. Furthermore, ORS 86.753(1) limits the Lender's attorney fees (and trustee's fees) in the event of reinstatement during a nonjudicial foreclosure. In judicial foreclosures, the court will exercise its discretion and award only attorney fees that

it determines to be "reasonable" regardless of contractual provisions to the contrary.

"(j) Provisions pertaining to jurisdiction, venue, or choice of law."

Loan documents sometimes purport to establish subject-matter jurisdiction in states other than Oregon, even if the real property is located in Oregon. The validity of a foreclosure of Oregon real property in a jurisdiction other than Oregon is dubious.

Choice of law provisions may be enforceable if the state chosen has a reasonable relationship to the transaction or the parties, unless the law of the state selected is contrary to the public policy of Oregon. *See Young v. Mobil Oil Corp.*, 85 Or App 64, 69, 735 P2d 654 (1987). Lawyers should resist rendering an opinion on the enforceability of a choice of law provision because it requires a determination based on facts that may not be known to the lawyer.

"(k) Provisions purporting to appoint Lender or the trustee as attorney in fact for Borrower."

There is no law in Oregon directly determining the validity of such clauses, but the law of principal and agent generally provides that an agent cannot act in a way that is contrary to the best interests of its principal, absent fully informed consent. *See generally* 3 AM JUR2D *Agency* §§23–25, 210–211 (1986).

"(l) Limitations on the liability of Lender or the trustee, or for their indemnification for their own negligence or misconduct."

Loan documents may attempt to exonerate the Lender from liability for its own conduct, such as when the Lender is acting as a mortgagee in possession. In Oregon, one party can contract with another for indemnification against its own conduct, if that conduct is not wanton or criminal in nature. However, the court may look to the relative bargaining power and sophistication of the parties, as well as other factors, in determining whether such indemnification will be upheld. *See, e.g., Waggoner v. Oregon Auto Ins Co*, 270 Or 93, 98, 526 P2d 578 (1974); *Southern Pac. Co. v. Layman*, 173 Or 275, 282, 145 P2d 295 (1944). The cautious Lawyer should consider the developing trend in lender liability cases in analyzing the enforceability of such limitations.

"(m) Provisions that purport to establish or maintain priority of the lien."

The Committee believes that the lawyers should affirmatively disclaim any opinion on priority of liens created and should encourage the Lender to rely on its title insurance policy or UCC lien searches. *See* Section II.2.C. above and Section II.D.5. below. Lenders may be willing to rely on title insurance for initial priority but may request an opinion on priority after modification or for future advances. Loan documents often provide that future advances will be accorded the priority of the originally recorded lien and that priority will not be disturbed by modification of the note or trust deed.

With respect to modification, ORS 86.095 sets forth the manner in which trust deeds may safely be modified without affecting the priority of the originally recorded lien. The Lawyer should limit an opinion on priority following modification to those actions specifically described in the statute.

With respect to future advances, ORS 86.155 provides that advances secured by a "line of credit instrument" shall have the same priority whether the advances are obligatory or optional. If the trust deed does not strictly comply with ORS 86.155, the Lawyer should resist giving any opinion on the priority afforded any future advance. *See generally* Robert J. Saalfield, *Maintaining Priority of Mortgages and Trust Deeds*, OSB Section on Real Estate and Land Use, Annual CLE Program Materials 1987.

Even if modifications and advances are not an issue in the loan documents, limitation (m) should be included if the loan documents require Borrower to represent or warrant priority of the lien. Opining on the enforceability of such a representation or warranty may inadvertently constitute an opinion on priority.

"(n) Provisions for charging interest on interest."

There is a continuing debate under Oregon law as to whether "compounding" interest is enforceable. *Levens v. Briggs,* 21 Or 333, 338, 28 P 241 (1891), indicates that "compounding" interest is void as against public policy. *Levens* has never been expressly overruled. *But see Union Cen. Life Ins. Co. v. LaFollette,* 150 Or 455, 464–465, 44 P2d 165 (1935), distinguishing *Levens* and holding that increased interest on maturity does not constitute "compounding." Loans providing for negative amortization (which may constitute "compounding") are routinely made in Oregon; furthermore, loans made in Oregon frequently

provide that, on default, unpaid interest will be added to principal and bear interest.

"(o) Provisions purporting to impose continued liability following foreclosure such as environmental indemnity provisions."

It is not clear whether any liability secured by a trust deed can continue after foreclosure in light of ORS 86.770.

(c) Additional Enforceability Issues

Examples of additional issues to which the Lawyer should be alert are the following:

(1) *Interest Rates:* The priority afforded to liens securing obligations bearing variable interest rates is governed by ORS 86.095. The Lawyer should also consider whether any additional limitations, disclaimers, or exceptions to an opinion are warranted by the description of the interest rate contained in the loan documents. For example, loan documents that provide that the interest rate varies with a "prime rate" without further definition of the "prime rate" have been the subject of litigation in Oregon and elsewhere.

(2) *Leasehold Lending:* Loans secured by interests other than fee title to real property, such as loans on leasehold interests, warrant further analysis by the Lawyer. For example, the Lawyer should consider whether a trust deed on a leasehold that is not of record will create a valid lien against third parties or bankruptcy trustees.

If the Lawyer is asked to opine on the enforceability of a lease, such as a ground lease being mortgaged or a master lease given by the Borrower as credit enhancement on a project, the Lawyer should consider whether additional limitations on the opinion are warranted. For example, the Lawyer should express no opinion on lease provisions such as those authorizing multiple suits for recovery of rent, providing for recovery of rent without mitigation of damages, or authorizing recovery of rent without reasonably discounting future rent to present value. The Lawyer should also question whether pursuant to ORS 86.770 a master lease executed by the Borrower will be extinguished by foreclosure of the trust deed.

The Lawyer may be asked to render an opinion on a "loan" that is structured as a sale/leaseback. The Lawyer should consider whether the transaction is a true lease or a loan and whether the lease may be an "equitable mortgage," which may require foreclosure rather than enforcement of lease remedies. The Lawyer should carefully consider

the possibility of "recharacterization" of the transaction by a court if it is challenged by the Borrower when the "lessor" attempts to enforce its remedies.

(3) *Equity Participation by the Lender:* Financing transactions are sometimes structured to allow the Lender a return on its investment other than traditional "interest." For example, the Lender may be given an opportunity to participate in income from a project or in appreciation in the value of the project, or the Lender may participate as a joint venturer or limited partner in the borrowing entity. Whether these transactions constitute true loans or might be recharacterized as joint ventures or partnerships or as some other relationship is a subject of considerable legal commentary and should be a matter of concern to the Lawyer. *See* Cowan & Eastman, *Debt/Equity Transactions—An Objective Approach to Recharacterization,* PROTECTING THE REAL ESTATE LENDER WORKOUT, BANKRUPTCY AND FINANCING STRATEGIES (PLI 1988).

The Lawyer should also be aware of the possibility of restrictions on enforceability caused by the doctrine of "clogging the equity of redemption." *See* Lawrence Preble & David Cartwright, *Convertible and Shared Appreciation Loans: Unclogging the Equity of Redemption,* 20 REAL PROP PROB & TR J 821 (1985).

(4) *Guaranties:* Affiliated corporate entities are frequently requested to guarantee corporate loans. If the guaranty is given without adequate consideration, the guarantor or creditors of the guarantor may challenge enforceability of the guaranty based on concepts of "consideration" or "fraudulent transfer." This issue is one of the reasons for excluding fraudulent transfers in part (a) of the first paragraph of the sample enforceability opinion. On this issue generally, see David Murdoch, Linda Sartin & Robert Zadek, *Leveraged Buyouts and Fraudulent Transfers: Life After Gleneagles,* 43 BUS LAW 1 (1987), and Kirby, McGuinness & Kandel, *Fraudulent Conveyance Concerns in Leveraged Buyout Lending,* 43 BUS LAW 27 (1987).

The Equal Credit Opportunity Act (Pub L No 93-495, Title V, 88 Stat 1521 (1974)) applies not only to consumer debt but also to commercial loans. The Lawyer should be cautious about opining on the enforceability of a guaranty given by a spouse of a Borrower who is not a coapplicant. 15 USC §§1691a–f, and regulations and interpretations promulgated pursuant thereto.

Lenders frequently ask an individual Borrower to guarantee his or her own debt or the debt of a wholly owned corporation. One purpose

of such guaranties is to ask the Borrower to waive defenses that are not waivable by the maker of a note under the Uniform Commercial Code, but are waivable by a guarantor. It is not clear whether guaranties of a person's debt or that of a person's "alter ego" are enforceable in Oregon.

4. Conflict with Agreements and Litigation

Two additional opinions that are commonly requested are (1) that the execution, delivery, and performance by the Borrower will not conflict with or constitute a material breach or event of default under any other agreement to which the Borrower is a party or is bound; and (2) that there is no pending or threatened litigation or claim against the Borrower or affecting the property that is the security for the loan. While both such requested opinions are factual in nature, the Committee believes that different responses are warranted when such opinions are requested.

Opinions concerning conflict with other agreements are most often found in corporate finance transactions but at times may be requested in a real estate transaction. The California Report suggests, with qualifications on the due diligence requested of the opining lawyer, that such an opinion can be given. The Committee rejects this conclusion and adopts as a matter of principle the position that except as set forth herein, such an opinion should not be given by Oregon lawyers because the opinion "merely results in an almost endless attempt to 'prove the negative,' which produces very little in the way of useful information." California Report, *supra*, at 1189. If a Lender has a specific agreement in mind, the Committee accepts the premise that such an opinion then has a legitimate purpose and may be given. Such agreements may, for instance, relate to a due on sale or due on encumbrance clause, when the new financing is a junior encumbrance, or to the lease when dealing with a leasehold mortgage.

A requested opinion dealing with pending or threatened litigation poses different problems for the Lawyer. In the first instance, what due diligence must be completed before any such opinion can be given? This opinion imposes significant due diligence requirements on the Lawyer. It is imperative that the definition of the Borrower be written so as to define exactly which person or entity is being considered.

If partners, affiliates, or guarantors are also considered, the due diligence requirements obviously expand. The Lawyer must confer with all lawyers in the Lawyer's office to determine whether any action is

pending or whether a threat has been made. Additionally, a certificate from the Borrower should also be obtained. However, absent an agreement between the Lawyer and the Lender to the contrary, court and other public records do not need to be researched for pending litigation prior to giving up a no-litigation opinion. In any case, the extent of the attorney's investigation should be disclosed.

An opinion on litigation or claims affecting the property which is security for the loan poses another difficult problem for the opining lawyer. Such matters may not be disclosed by a title report. For instance, a petition for historic designation may be pending against the property. If the improvements on the property were to be demolished by the Borrower, this clearly would have an effect on the property, but if such a proceeding dealt with the manner in which development was generally authorized, the extent to which the property would be affected is less certain. The scope of an opinion on matters "affecting the property" must be negotiated with the Lender.

As discussed in the California Report, many times an attempt to modify opinions is made by inserting a materiality standard. The Committee adopts the positions expressed in the California Report that "any opinion with respect to the merits or materiality of such litigation should generally be avoided and that once the existence of such litigation has been fully disclosed, the risk of loss should be allocated by the parties and not placed on the lawyer." California Report, *supra*, at 1200.

5. Current Actual Knowledge

"Whenever our opinion herein is based on our current actual knowledge, it is intended to signify that during the course of our representation of Borrower, no information has come to our attention that could give us actual present knowledge of the existence or absence of the fact. Current actual knowledge does not include constructive or inquiry knowledge. Except to the extent otherwise set forth herein, we have not examined Borrower's or our internal files and we do not imply that we have conducted or are required to conduct legal research, and we made no special inquiry of Borrower."

If opinions are based on the knowledge of the Lawyer, the term "knowledge" must be defined. The Committee agrees with the conclusion reached by the California Committee that opinions to the "best knowledge" should be avoided. Such language in general creates ambiguities because "it fails to draw a clear distinction between that

which is actually known and that which should have been known." California Report, *supra,* at 1189.

Both the California Report and the Texas Report recommend use of the concept of "current actual knowledge" and contain similar definitions of these terms. The Committee generally adopts the California definition and recommends that the above statement be included in all opinion letters where the Lawyer has given an opinion based on the Lawyer's knowledge. California Report, *supra,* at 1189–1192.

6. Opinions Concerning Personal Property

Personal property often constitutes a minor portion of the collateral in what is primarily a real estate-secured transaction. As discussed elsewhere in this commentary, a Lawyer generally should not render an opinion with respect to the title to real property or the priority of any liens thereon. The Committee believes that it is even more unusual (and perhaps unreasonable) to request or provide such an opinion with respect to personal property.

If personal property constitutes only a minor portion of the collateral, it should be excluded entirely from the opinion. If personal property constitutes a substantial portion of the collateral, the need for an enforceability opinion, an attachment opinion, a perfection opinion, or a priority opinion must be determined. All four types of opinions must be made subject to certain assumptions that limit their usefulness. Priority opinions are particularly difficult and if responsibly made are of little value because of the necessary assumptions and disclaimers. Accordingly, they should be neither requested nor given. The Committee also believes that perfection opinions should not be given if the collateral is unspecified, broadly described, complex, or extensive.

A complete discussion of legal opinions concerning security interests in personal property is beyond the scope of this Commentary. The following is intended as a basic discussion of certain key concepts and terms that should be considered. This discussion is in large part a summary of the *Report of the Uniform Commercial Code Committee Regarding Legal Opinions in Personal Property Secured Transactions*, issued by the Business Law Section of the State Bar of California, December 31, 1986 (hereinafter referred to as the "California UCC Opinion Report"). For a deeper analysis of the issues involved in personal property opinion letters, see the California UCC Opinion Report.

(a) Enforceability

An opinion that a security agreement is enforceable in accordance with its terms does not include an opinion that the security interest has attached or is perfected, or that the secured party has priority over any other parties. An enforceability opinion with respect to a security agreement does mean that the agreement contains language sufficient to grant a security interest and that some remedy is available if the debtor does not comply with the terms of the security agreement. The Lawyer giving an enforceability opinion must confirm that all prerequisites to an effective security agreement are satisfied. The security agreement must (1) meet the general requirements of contract law (capacity, offer and acceptance, consideration, execution and delivery, mutuality, and legality); (2) contain language granting the security interest (if the security agreement is included in the trust deed, it is important to clarify that the beneficiary and not the trustee is the "secured party"); (3) recite the obligations secured by the security interest; (4) contain an adequate description of the collateral; and (5) be signed by the debtor.

(b) Attachment

In order for a security interest to attach, the following must occur: (1) the grant of security must be evidenced by a writing (i.e., a security agreement) or possession of the collateral by the secured party; (2) the debtor must own or have rights in the collateral; and (3) the secured party must give value.

If a security agreement is used in lieu of possession by the secured party, the attachment opinion necessarily includes an enforceability opinion. The Lawyer must confirm that the prerequisites to enforceability are present.

An opinion about the debtor's rights in the collateral should rarely be given. A comparison to real property in this regard is instructive. As mentioned above, the Lawyer should not give an opinion as to the title of real property, despite the fact that it is possible (although difficult) to search the deed records to determine title. Because no such system exists for determining rights in most personal property, a secured party should be satisfied with the debtor's warranties as to the debtor's rights in the collateral.

Because a security interest does not attach until the debtor has rights in the collateral, an opinion that addresses only the facts at the time the opinion is given would not include the attachment of the security interest to after-acquired property or proceeds. If such an

opinion is required, it must include assumptions as to the occurrence of future events necessary for attachment to occur.

In the absence of personal knowledge that the secured party has given value, the Lawyer should make an assumption in this regard. Generally, the secured party has no reasonable basis upon which to object to such an assumption.

(c) Perfection

All sample opinions concerning personal property set forth herein are from the California UCC Opinion Report, *supra.*

"The financing statement is sufficient in form to perfect the security interest in the collateral described therein, to the extent that a security interest in such collateral can be perfected by the filing of a financing statement in the State of Oregon. The proper place to file a financing statement for collateral of the type described in the security agreement, to the extent that a security interest in such collateral may be perfected by the filing of a financing statement in the State of Oregon, is in the office of the Secretary of State of Oregon.

"Upon taking possession of the collateral, the secured party will have perfected its security interest in the collateral, to the extent that such collateral is of the type described in ORS 79.3040."

A perfection opinion gives assurance that the security interest has priority over unperfected security interests and certain other claimants. It gives no assurance, however, as to the relative priority of the secured party's rights with respect to other perfected security interests and certain other claimants.

A Lawyer rendering a perfection opinion must analyze each type of category involved and determine that the necessary actions have been taken to perfect the security interest, including attachment. The Committee believes it is generally unreasonable to request a perfection opinion. This is particularly true if the collateral, as is often the case, is unspecified, broadly described, complex, or extensive. The benefit received simply does not justify the costs involved.

If a perfection opinion must be given, it should include an assumption that the State of Oregon is the controlling state for perfection purposes. Unless the opinion is stated in such a manner, the Lawyer must determine which state's laws apply based upon the nature of the collateral, the location of the collateral, the events upon which perfection is based, whether any goods or collateral will be moved to

another jurisdiction, the location of the debtor's places of business or chief executive office, and other matters. *See* ORS 79.1030. Making these determinations is often quite difficult.

If perfection is to occur by filing, prefiling should be made or an appropriate assumption used. If perfection is by possession, it is appropriate for the Lawyer to assume that the secured party has possession of the collateral. Such an assumption can be critical in view of the sometimes ambiguous rules concerning possession through a bailee or agent. *See* ORS 79.3050.

Some lawyers include a long, detailed discussion in their opinions regarding future events that may occur and defeat perfection. See ORS 79.1030, 79.3030(2), 79.3060–79.3090, and 79.4020 for subsequent events that can defeat perfection. As long as the opinion expressly addresses only the facts as of the date of the opinion, such a discussion is not necessary.

(d) Priority

A first priority opinion is generally understood to mean an opinion that the secured party will have priority over the holders of other security or similar interests in the collateral.

It is unreasonable for the Lender to require a broad priority opinion. First, a priority opinion necessarily includes an attachment and perfection opinion. As discussed above, it is often extremely difficult for the Lawyer to give a perfection opinion with respect to unspecified, broadly described, complex, or extensive items of collateral. In such instances, a priority opinion is also not warranted. Second, even if the collateral is limited in scope, a determination regarding the existence of competing interests or liens, many of which are not of record or are not of record under the debtor's name, is often impractical or even impossible. For example, a UCC search under the debtor's name will not disclose security interests created by a previous owner of the collateral. Third, even if all competing liens and security interests are known, it is often quite difficult to determine relative priority due to the complex nature of the laws involved. This is particularly true with respect to certain liens granted priority by federal statutes. Due to these difficulties, many lawyers justifiably refuse to provide any form of priority opinion, and the Committee endorses this practice.

If a priority opinion is rendered, the opinion should state that the Lawyer is relying solely upon the particular UCC search that was reviewed and should be limited to specific types of collateral and specific types of competing interests. For example:

"The security interests so perfected are prior to any other security interest in the collateral granted by the debtor that is or would be perfected solely by the filing of a financing statement with the Secretary of State of the state of Oregon."

This form of opinion would protect the Lawyer against financing statements filed in another jurisdiction or locality that may still remain effective. However, it would not protect the Lawyer against misindexed or misfiled financing statements. Accordingly, the Lawyer should consider adding the following disclaimer:

"In our examination of the UCC search certificate described above, we have assumed that all financing statements, other than the financing statements in favor of the secured party described above, have been properly filed and indexed with the Secretary of State of Oregon; that such certificate is accurate and complete; and that you have no knowledge of (1) the contents of any other financing statements covering the collateral or (2) the existence of other security interests (perfected or unperfected) in the collateral."

Similarly, the Lawyer remains exposed to financing statements filed under a previous name of the debtor. Accordingly, the following disclaimer may be appropriate:

"Our opinion as to the priority of the security interest does not apply to security interests in the collateral created by the debtor and perfected by the filing of a financing statement under any name other than the present name of the debtor."

As in the case of perfection, some Lawyers list future events that may affect priority. See ORS 79.3010(3), 79.3100, 79.3120(3), and 79.3140 for subsequent events that can affect priority. As long as the opinion expressly addresses only the facts as of the date of the opinion, such a discussion is not necessary.

In view of the numerous limitations and assumptions that must necessarily be made in connection with a priority opinion, the Committee believes that such an opinion is often not worth the expense and time it entails. It is more appropriate for the Lender to rely solely upon a review of the UCC search made by its own Lawyer.

7. Doing Business/Taxation

Lenders not domiciled in the state of Oregon, especially if they are not using local counsel, may request the Lawyer to provide opinions concerning qualification to do business in the state of Oregon and whether income derived from the loan is subject to Oregon taxation. The Committee adopts, as a matter of policy, the position that the Lawyer should never give such opinions. The basis for this policy is that the Borrower's lawyer is not in a position to conduct the factual investigation necessary to provide such opinions.

This policy is applicable even when the Lender allows an assumption that the loan is its only transaction in the state of Oregon. Even with such an assumption, the Lawyer should not give such opinions because the assumption may or may not be true based on the actual facts concerning the Lender's contacts with the state of Oregon and applicable Oregon law.

The questions of whether a foreign Lender must qualify to do business in Oregon or must obtain a certificate of authority from the Oregon Department of Insurance and Finance, or whether the income from the loan transaction is subject to Oregon income tax are best resolved by advice from the Lender's local counsel. The answers to these and similar questions concerning doing business and taxation in the state of Oregon must be based on the facts as they relate to the specific Lender and transaction.

E. Disclaimer

"1. Regardless of the states in which members of this firm are licensed to practice, our opinion is limited to the laws of Oregon and to applicable federal laws.

"2. This opinion is to be interpreted in accordance with the Report of the Committee on Lawyers' Opinions in Oregon Real Estate Loan Transactions of the Real Estate and Land Use Section of the Oregon State Bar.

"3. This opinion is provided to you as a legal opinion only, and not as a guaranty or warranty of the matters discussed herein. Our opinion is limited to the matters expressly stated herein, and no other opinions may be implied or inferred.

"4. We express no opinion as to any matter whatsoever relating to (a) the value of the collateral; (b) the adequacy of the consideration for the Loan [or Guaranty]; (c) the accuracy or completeness of any

financial, accounting, or statistical information furnished to Lender [or Guarantor]; (d) the accuracy or completeness of any representations made by Borrower [or Guarantor] to Lender; (e) the financial status of Borrower [or Guarantor]; (f) the ability of Borrower [or Guarantor] to meet [its][their] obligations under the Loan Documents; (g) the state of the title to the real property and personal property or the attachment, perfection, or priority of any liens thereon or security interest therein; (h) the adequacy or accuracy of descriptions of real or personal property; (i) compliance with zoning, land use, building, health and safety, or environmental rules, regulations, laws, ordinances, or directives; or (j) whether Lender is doing business in the State of Oregon.

"5. This opinion is rendered as of the date set forth above, and we disclaim any obligation to advise you of any changes in the circumstances, laws, or events that may occur after that date. This opinion has been rendered to you in connection with the transaction described herein solely for your information and is not to be quoted in whole or in part or otherwise referred to, used, or relied upon by any person or entity other than you, your legal counsel, and your successors and assigns."

The Disclaimer section of the sample opinion initially provides that it is based only upon the laws of the state of Oregon and applicable federal law and of no other state. The opinion also indicates that it is to be interpreted in accordance with this Commentary. The disclaimer section of the sample opinion additionally states that the opinion is to be construed as a legal opinion only and not as a guaranty or warranty. The Lawyer expresses conclusions based upon his or her professional judgment. There is no guaranty or warranty of the accuracy of those conclusions.

While no Oregon cases have addressed the liability of any lawyer for negligence in connection with a real estate opinion letter, the Committee believes that the Lender may recover at most only the pecuniary loss suffered by the Lender because of its justifiable reliance on the opinion. This is in accord with Restatement (Second) of Torts §552 (1976).

The sample opinion also provides that the opinion is limited to matters expressly stated in the opinion and that no other opinions should be inferred or implied. Specific mention is made of some of the items that should not be inferred in an opinion letter. For example, the sample opinion indicates that no opinion is expressed as to the accuracy or

completeness of any financial, accounting, or statistical information furnished to the Lender or the accuracy or completeness of any representations made by the Borrower to the Lender. The opinion is intended to alert the Lender to the fact that the Lawyer, by giving the opinion, is not verifying to the Lender the accuracy or completeness of any representations or information furnished by the Borrower to the Lender. As indicated in Section F. below, when the Lawyer knows his or her client is furnishing inaccurate or incomplete information to the Lender so as to perpetuate a fraud, the Lawyer should seriously consider either obtaining the client's consent to alter the opinion to disclose the correct information, or withdrawing from representation.

The disclaimer section also indicates that no opinion is expressed as to the state of the title to the real property and personal property or the priority of any liens thereon or security interests therein, or as to compliance with zoning, land use, building, health and safety, or environmental rules, regulations, laws, ordinances, or directives, or whether the Lender is doing business in the state of Oregon.

> NOTE: The Committee's reasons for not expressing an opinion as to the state of title to the real property or the priority of liens thereon is set forth in Section II.C.2. above. The Committee's reasons for not expressing an opinion as to the state of title to personal property or the priority of security interests therein is set forth in Section II.D.6. above. Regarding environmental rules, see Section II.C.2. above. Regarding doing business in Oregon, see Section II.D.7. above.

The Committee believes the Lawyer should not be expected to update the opinion because of changes in the law or facts after the date of the opinion. The sample opinion thus includes the qualification that it is rendered as of the date of the opinion and that any obligation to update the opinion because of subsequent change in the law or facts is expressly disclaimed.

F. Ethical Considerations

A complete discussion of the ethical considerations with respect to a legal opinion is beyond the scope of this commentary. The following is intended as a basic discussion of the ethical issues that should be considered by the Lawyer in giving a legal opinion.

Disclosure of privileged information is often required in connection with the giving of a legal opinion. For example, lenders may require the Lawyer to include in the opinion letter disclosure of any relevant

pending or threatened litigation. The Lawyer cannot ethically disclose privileged information to the recipient without consent from the Borrower. This raises an issue as to whether waiver of the attorney-client privilege for purposes of disclosure of facts for an opinion waives the privilege in future litigation and to what extent. Would the waiver extend to the entire transaction or just to those facts that have been disclosed to the recipient for purposes of giving the opinion letter?

What if the Lawyer knows facts about the Borrower that prevent the Lawyer from giving all or part of the opinion letter? Disciplinary Rule 7-102 prohibits the Lawyer from assisting the Borrower in defrauding the Lender but does not require the Lawyer to disclose the fraud if it involves privileged information. The Lawyer should seriously consider withdrawing from representation if the Borrower is making false representations to the Lender, and the Lawyer is unable to obtain the Borrower's consent to include the withheld information in the opinion letter.

III. Epilogue

Since the formation of the Committee in 1988, additional work in the area has been completed by bars of other jurisdictions and the American Bar Association. While this Commentary was in draft form, the Committee reviewed much of these other works. *See, e.g.,* Joint Committee Report—An Addendum, Real Property Law Section, State Bar of California, Real Property Section, Los Angeles County Bar Association, March 14, 1990; Mortgage Loan Opinion Report, Newsletter Vol. 18, No. 2, April 1990, Association of the Bar of the City of New York, Real Property Law Committee, New York State Bar Association, Real Property Law Section, Attorney Opinion Letters Committee; Third Party Legal Opinions: The Silverado Press Before the Dawn, American Bar Association Division for Professional Education, 1990. *See also* Exposure Draft, "Third-Party Legal Opinion Report," BUS LAW, Vol. 46, No S1, Dec 31, 1990, and "Third-Party Legal Opinion Report of the Section of Business Law, American Bar Association," BUS LAW, Vol. 47, No 1, Nov 1991. After review, the Committee reaffirmed its earlier determination to identify specific exceptions to the enforceability opinion (the so-called laundry list) and again rejected the "practical realization" or "principal benefits" approaches. *See* Section II.D.3. above. Even though the Committee's work is completed with the publication of this commentary, the Committee will continue to monitor developments around the country in an attempt to ensure that opinion letters written by Oregon lawyers

are accepted by both local and national Lenders. The Committee will request that the Real Estate and Land Use Section publish supplements to this commentary as are necessary to keep Oregon lawyers apprised of future developments on this subject.