

Legal Opinions in Loan Assumption and Modification Transactions

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Introduction

One area of opinion practice for which there is little or no specific guidance in the form of bar reports, treatises or articles in legal publications is third-party closing opinions issued in connection with the assumption of a loan by a person not party to the original loan transaction (“loan assumption”) or the modification of the terms of a loan after the closing of the original loan transaction (“loan modification”), although such transactions are common and opinions are frequently required of counsel to the loan parties. 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 in loan assumption and loan modification transactions. Loan modifications are further complicated by the fact that they can cover a wide spectrum of issues, from minor revisions of covenants, to increases in loan amount or changes in payment terms, to extensive debt restructures in a loan workout. 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 borrower’s counsel and the more extensive those requested opinions are likely to be. In addition, some modifications are effected by amended and restated loan documents, which in many cases more closely resemble original loan closings, and thus, are outside of the scope of this discussion of loan modification opinions.

Entity Opinions

Opinions relating to the legal existence and status of the borrower (or the new borrower or new guarantor, in the case of a loan assumption), entity power and authority to enter into the transaction, and execution and delivery of the transaction documents, will be virtually identical to those same opinions rendered in connection with the closing of the original loan transaction. 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. See Real Estate Finance Opinion Report of 2012.¹

Enforceability Opinion

The issues surrounding an enforceability opinion in the context of loan assumptions or modifications are more complicated. In a loan assumption transaction, the transaction documents may be limited to an assignment and assumption agreement, a lender consent to assignment and some related ancillary documents executed by the parties; the original loan

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

documents may continue intact. Accordingly, an opinion that the transaction documents are valid, binding and enforceable does not cover for the benefit of the lender all of the issues that were covered by the legal opinion delivered in connection with the original loan transaction. Is the lender entitled to an opinion that the loan documents, as assigned to and assumed by a new borrower, constitute legal, valid and binding obligations enforceable against the new borrower? Or is it sufficient to opine that the assumption documents constitute valid and binding obligations enforceable against the new borrower (often with the inclusion of an assumption that the original loan documents were valid and enforceable before they were assigned)? Practice among opinion givers and recipients is varied.

Likewise, in a loan modification transaction, is it sufficient for borrower's counsel to opine that the loan modification documents are valid, binding and enforceable, or is the lender entitled to an opinion that the original loan documents, as amended by the modification documents, constitute valid, binding and enforceable obligations of the borrower? And where the opinion is limited to the enforceability of the modification documents, is it reasonable for borrower's counsel to assume, or to expressly exclude an opinion, that the original loan documents are enforceable? Arguably, without 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? Again, there seems to be no uniformly accepted practice in connection with loan modifications.

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

In what circumstances is an assumption that the original loan documents are valid, binding and enforceable a reasonable one? 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 acceptable. For example, in a loan assumption transaction, an assumption that the original loan documents were duly executed and delivered by the original borrower, which 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 offer sufficient protection to the opinion giver. 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?

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 policy reflecting the 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. recordable form.

If new Article 9 personal property is being added as collateral or a new person is being substituted as the borrower in connection with a loan modification or assumption, opinions relating to creation or perfection of security interests may be appropriate. But lien affirmation opinions (i.e., opinions that the creation or perfection of a security interest has not been adversely affected by the loan modification or assumption) may not be simple matter. A recent Sixth Circuit Court of Appeals case² highlighted the need to consider carefully the issue of novation when rendering a legal opinion in connection with a loan modification or loan assumption transaction.

Conclusion

Although general legal opinion reports and treatises provide useful guidance that can be applied to opinions relating to loan modification and loan assumption transactions, these transactions do present sufficiently unique and different issues from original loan closings to require opinions that are tailored to the loan assumption or loan modification, as the case may be. Providing such guidance is an ambitious undertaking, and it is beyond the scope of this Note to do anything but identify some of the key issues that should be considered by an opinion giver in the context of a loan assumption or a loan modification transaction. Hopefully, this Note will spark greater discussion on the subject among opinion givers and provide an impetus to ACREL's Attorneys Opinions Committee to join forces with other interested groups to undertake an opinion report offering detailed guidance on opinions in connection with loan assumptions and loan modifications.

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² Bash v. Textron Financial Corporation (In re Fair Finance), 834 F. 3d 651 (6th Cir. 2016).