NEW JERSEY COMMERCIAL LOAN OPINION LETTERS: THE REMEDIES OPINION, ASSET-BASED SECURED TRANSACTIONS OPINIONS & RELATED EXCEPTIONS, QUALIFICATIONS & ASSUMPTIONS

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I. Introduction

Although many of New Jersey's commercial transaction attorneys may use the ABA Accord[1] as a reference tool, it is apparent that the ABA Accord has not been adopted universally in New Jersey's opinion letter practice.[2] As a result, there is a great need for standardization of opinions and their interpretation as well as a need for generally accepted due diligence procedures for commercial loan transactions in New Jersey.

Lawyers should not request legal opinions from borrowers' legal counsel[3] to obtain an additional potential guarantor of the

[1] Third-Party Legal Opinion Report, Including the Legal Opinion Accord of the Section of Business Law, American Bar Association, 47 Bus. Law. 167 (1991) [hereinafter *ABA Accord*].

[2] The author is aware of only one New Jersey based law firm and one Philadelphia based law firm with offices in New Jersey that have adopted the ABA Accord for all of its opinion letters.

[3] Although loan documents are typically prepared either by the lender or the

loan.[4] Rather, opinion letters given in connection with commercial loan transactions should perform two primary functions.[5] Fundamentally, opinion letters insure that the lender conducted a certain level of due diligence investigation in connection with the transaction to confirm certain basic assumptions made by the lender in evaluating the credit risks undertaken in the transaction.[6] Secondarily, opinion letters act as a tool to assist the lender in evaluating the unforeseen credit risks that may arise from legal peculiarities involved with the transaction.[7]

There is a surprising absence of authority addressing the peculiarities of New Jersey law with respect to commercial opinion letter practice in New Jersey. This article attempts to address issues specific to New Jersey law. Although this article is not intended to establish a standard form of opinion letter, it is designed to help New Jersey lawyers and commercial lenders understand the issues, risks and technical difficulties of giving certain opinions. Attorneys and commercial lenders may use this article as a tool to evaluate

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lender's counsel, the practice of borrower's counsel rendering legal opinions in commercial loan transactions is customary in New Jersey. One reason asserted in support of such a practice is that, due to the attorney-client relationship between the borrower and the borrower's counsel, the borrower is more likely to openly provide its counsel with information which would not otherwise be available to the lender or its counsel. *Report Regarding Legal Opinions in Personal Property Secured Transactions*, 44 BUS. LAW. 791, 793-4 (1989) [hereinafter *California Secured Transactions Report*].

4 A premise of the ABA Accord is that third-party legal opinions are intended as an expression of professional judgment and not as a guaranty of the outcome of legal disputes arising in connection with a particular transaction. *ABA Accord*, *supra* note 1, at 171. *See also* SCOTT FITZGIBBON & DONALD W. GLAZER, LEGAL OPINIONS 8-9 (1992) [hereinafter LEGAL OPINIONS]. The guidelines to the ABA Accord have clearly stated that any opinion request that has the effect of making the opinion more than an expression of professional judgment is inappropriate. *ABA Accord*, *supra* note 1, at 227.

5 There are, of course, many other collateral benefits of receiving a legal opinion in connection with a commercial loan transaction. One such benefit is that it provides the lender with a basis to estop the borrower from taking certain legal positions contrary to the lender in any subsequent dispute arising out of the transaction. LEGAL OPINIONS, *supra* note 4, at 7-8; *California Secured Transactions Report*, *supra* note 3, at 794. In addition, legal opinions evidence that not only the loan officer of the lender, but also the officers and directors of the borrower, have exercised reasonable care and have acted in good faith in entering into the transaction. LEGAL OPINIONS, *supra* note 4, at 8; *1989 Report of the Committee on Corporations of the Business Law Section of the State Bar of California Regarding Legal Opinions in Business Transactions*, 45 BUS. LAW. 2169, 2174 (1990) [hereinafter *California Report*].

6 *See ABA Accord*, *supra* note 1, at 227 ("The proper purpose of a third-party legal opinion is to assist in the Opinion Recipient's due diligence.").

7 *See generally* LEGAL OPINIONS, *supra* note 4, at 6-7 (legal opinions confirm that the "basic elements of the transaction are what everyone expects them to be"); *California Report*, *supra* note 5, at 2173 (one purpose of legal opinions is to "caution the recipient that there are certain legal risks in proceeding with the transaction").

whether certain opinions are necessary in connection with specific transactions. In particular, it suggests and analyzes many commonly negotiated exceptions to opinions under New Jersey law.

This article reviews the laws of other jurisdictions only where there is no New Jersey law on point or where they may be helpful either in interpreting New Jersey law or in identifying trends that New Jersey courts are likely to follow. This article is not intended to serve as a replacement for careful research and draftsmanship,[8] but rather, as a starting point to aid both the business person and the lawyer in identifying the laws and the issues related to the commercial loan opinion letter in New Jersey.

Throughout this article, distinctions will be drawn between opinions given in connection with "mid-market" transactions and those given in "high-end" transactions. "Mid-market" transactions are those involving loans in the $500,000 to $15,000,000 range. "High-end" transactions, on the other hand, are those involving amounts in excess of $15,000,000.

While the specific nature of a loan will determine whether certain opinions are necessary or desirable, there is at least one inherent difference between mid-market and high-end transactions which justifies different treatment of opinion letters given in connection with high-end transactions. By virtue of the dollar amount of the loan, the lender often anticipates either selling participations or transferring the loan to other lenders. Thus, in a high-end transaction, the opinion letter serves in many respects as a marketing tool by which a lender can sell part of its portfolio.[9]

The first part of this article discusses what is commonly referred to as the "remedies" opinion and identifies various formulations of the opinion. It analyzes several exceptions and limitations used in the opinion by New Jersey practitioners. These exceptions and limitations are based upon New Jersey law which limits the enforceability of certain provisions customarily found in commercial loan documents.

The second part of this article identifies other opinions which

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[8] A premise of the ABA Accord was that it did not replace "careful, knowledgeable, transaction-specific legal work" as the foundation for an opinion. *ABA Accord*, *supra* note 1, at 171.

[9] The ABA Accord acknowledges that opinion letters are customarily provided to lending institutions in the course of deciding whether to purchase a participation interest in a loan. *ABA Accord*, *supra* note 1, at 217-18. Opining counsel will customarily include express provisions in their opinions limiting the parties who may rely on the opinion. LEGAL OPINIONS, *supra* note 4, at 26. It is generally accepted that such limitations should limit the liability of the opining counsel. *Id.* at 26-28.

are often requested in connection with asset-based secured transactions in New Jersey. It sets forth and analyzes the numerous exceptions and limitations which are included in such opinions.

II. The Remedies Opinion

A. *Formulation, Meaning & Scope.*

The most commonly accepted formulation of the remedies opinion is that "the agreement is valid, binding and enforceable against the borrower in accordance with its terms."[10] This opinion can be construed in two different ways. The first approach is that each provision of each agreement to which the opinion relates may be enforced against the borrower exactly as it is written. This is the view taken by most New York practitioners[11] and adopted in the ABA Accord.[12] The second approach is to infer that the recipient of the opinion understands that while each provision of the agreement may not be enforceable exactly as written, the provisions of the agreement are generally enforceable in some respect.[13] Under the second approach, the opinion-giver assumes that the scope of the opinion is limited not only to those laws which are customarily and primarily applicable to the type of transaction involved, but also to those laws which would potentially result in the unenforceability of either the transaction, taken as a whole, or some fundamental aspect of the transaction.

Under the first approach, the opining attorney is faced with the substantial task of reviewing the agreement to determine whether the lender would be successful in any suit brought by the lender against the borrower to enforce any particular provision of the agreement.[14] It is necessary to have an intimate knowledge of virtually all state and federal statutes, regulations and case law which may affect the lender's ability to specifically enforce each

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10 *ABA Accord, supra* note 1, at 199.

11 *Special Report by the Tribar Opinion Committee: The Remedies Opinion*, 46 Bus. Law. 959, 961 (1991) [hereinafter *Tribar Remedies Report*]. In fact, this has been the accepted New York approach since 1979. *Report by Special Committee on Legal Opinions in Commerical Transactions, Legal Opinions to Third Parties: An Easier Path*, 34 Bus. Law. 1891, 1915 (1979) [hereinafter *TriBar Report*].

12 *ABA Accord, supra* note 1, at 198-201.

13 It should be noted that the second approach has not been formally adopted by any organized or identifiable group in New Jersey, but is, nonetheless, an approach to drafting opinion letters which is often used by New Jersey practitioners. This approach has been recognized in other jurisdictions. *See, e.g., California Report, supra* note 5, at 2210.

14 *See supra* notes 11-12 and accompanying text.

provision of the agreement.[15] To the extent that the opinion-giver does not intend to review certain law which may arguably be related to the transaction or the opinion giver's client, an exception must be expressly stated in the opinion.[16]

Under either of these approaches, it is important to note that the opining attorney is responsible for the public policy applicable to the agreement.[17] If the applicable jurisdiction has enunciated a public policy contrary to any particular provision of the agreement, the opining attorney must disclose that such provision may violate public policy.

While either approach is reasonable and defensible, the attorney subscribing to the second approach runs the risk that the opinion recipient is relying on him to identify all defects in the transaction.[18] In the event that the enforceability of any one of the provisions of the agreement is ultimately determined to be limited, the opinion giver may be liable to the recipient for any damages

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15 Although on its face it would appear to cover all laws, even under the New York approach, the remedies opinion is deemed to cover only laws that would ordinarly apply to the transaction or the opining counsel's client. *Tribar Remedies Report, supra* note 11, at 966. For remedies opinions rendered in connection with loan transactions, the New York approach would generally exclude from coverage the Securities Act of 1933, the antifraud provisions of the Securities Exchange Act of 1934, Federal Reserve Board margin regulations, regulatory statutues applicable solely to the recipient, the New Jersey Industrial Site Recovery Act (formerly the New Jersey Environmental Cleanup Responsibility Act), and antitrust laws generally. *Id.* at 967-969. Similarly, the ABA Accord enumerates a list of various statutes and general bodies of law that are implicitly excluded from the scope of an opinion adopting the ABA Accord. *ABA Accord, supra* note 1, at 215-17.

16 The ABA Accord provides that law not expressly included in the scope of the opinion is implicitly excluded from the opinion. *ABA Accord, supra* note 1, at 182. However, the ABA Accord also provides that Federal law is not covered by the opinion unless expressly stated. *Id.* This is divergent from the New York approach which would deem all laws normally related to the transaction or the opinion-giver's client to be covered. *Tribar Remedies Report, supra* note 11, at 966.

17 LEGAL OPINIONS, *supra* note 4, at 208; *Report of the State Bar of Arizona Corporate, Banking, and Business Law Section Subcommittee on Rendering Legal Opinions in Business Transactions*, 21 ARIZ. ST. L.J. 563, 591 (1989) [hereinafter *Arizona Report*]; *Report on Legal Opinions To Third Parties in Corporate Transactions, reprinted in Legal Opinions* App. 13:107, §10.04B [hereinafter *Georgia Report*].

18 *See infra* note 138, regarding *Arab African International Bank v. Epstein*, where the court denied recovery to an opinion recipient on the basis that it was not duly qualified as a foreign bank and was therefore barred from using the New Jersey courts in connection with causes of action arising out of transactions that occurred during the period that the opinion recipient was not duly qualified. Arab African Int'l Bank v. Epstein, No. 90-2461, 1992 WL 184362 (D.N.J. July 21, 1992). The court did not address the issue of whether the opinion giver could have been liable for failing to address the New Jersey foreign banking laws in its opinion letter.

arising out of the recipient's reliance on the opinion.[19] Therefore, the more conservative course for the opinion giver is to adhere to the first approach and to attempt to identify each and every type of provision that may be unenforceable under the laws of the applicable jurisdiction(s).

B. Categorizing the Exceptions.

Exceptions to the remedies opinion are based upon concerns of either: (1) equity; (2) public policy; or (3) statutory law or case law. Often, statutory law and case law do not designate whether the law derives from an evaluation of the provision from an equity or from a public policy perspective. Whether a concern implicit in an exception must be separately and expressly addressed or whether it can be included within the scope of a broader exception depends upon which of these three categories forms the basis of the exception. This is particularly true if the borrower's counsel's opinion includes an exception for the application of general principles of equity.[20] If the borrower's counsel's opinion contains such an exception, it is not necessary for other particular exceptions based solely in equity to be separately expressly stated. If, on the other hand, a particular exception may be based in part upon public policy concerns, then it may be necessary to include a separate express exception to address the public policy concerns. Set forth below is a categorization of various exceptions identifying whether they may be based on equitable principles, public policy and/or law.

Exception	*Basis*
Bankruptcy & Insolvency	Equity, Public Policy & Law
Judicial Discretion	Equity & Law
Equitable Principles	Equity
Practical Realization	Equity, Public Policy & Law
ISRA (ECRA)	Law
Attorney's Fees	Public Policy & Law
Dragnet Provisions	Equity, Public Policy & Law[21]

[19] *See generally* 2 M. JOHN STERBA, DRAFTING LEGAL OPINION LETTERS 147-247 (1992) (discussing legal opinion liability).

[20] *See generally infra* notes 29-32 and accompanying text (relating to the equitable principles exception).

[21] Although the New Jersey courts have not expressly ruled on the enforceability of dragnet clauses, other jurisdictions that have addressed such clauses have considered the enforceability of such clauses to be an issue of both public policy and law. *See, e.g.*, Canal Nat'l Bank v. Becker, 431 A.2d 71, 74 (Me. 1981) (indicating under Maine law that dragnet clauses often work forfeitures, which are violative of New Jersey public policy); Akamine & Sons, Ltd. v. American Security Bank, 440 P.2d 262, 268 (Haw.

Compound Interest	Equity, Public Policy & Law
Post-Default Interest	Equity & Public Policy
Late Charges	Equity & Public Policy
Prepayment Penalties	Equity & Public Policy
Powers of Attorney	Equity, Public Policy & Law
Amendments in Writing	Law
Indemnification	Public Policy
Waivers	Public Policy & Law
Laches	Equity & Public Policy

The foregoing analysis indicates that many of the exceptions addressed above may be covered by the exception for equitable principles. Nonetheless, because the provisions addressed by such exceptions may also be held unenforceable for reasons of public policy or law, borrower's counsel rendering an opinion without such exceptions runs the risk that a New Jersey court may hold such provision unenforceable based upon public policy or other legal considerations unrelated to principles of equity.

Although attorneys subscribing to the second approach to opinion letters would find it unnecessary to include most of the exceptions discussed below in their opinions, it should be noted that such attorneys almost always include exceptions for bankruptcy and insolvency laws and for judicial discretion and general equitable principles. By contrast, however, an attorney who subscribes to the first approach of the remedies opinion would include many of these exceptions because they address law that is generally related to commercial loan transactions or may be related to the particular borrower.

C. *Exceptions.*

1. *Bankruptcy & Insolvency.*

In New Jersey, as in most other jurisdictions,[22] the opinion

1968) (holding dragnet clause violative of public policy under Hawaii law) and *In re* Swanson, 104 B.R. 1, 4 (Bankr. C.D. Ill. 1989) (holding dragnet clauses to violate Sections 9-110 and 9-204 of the Illinois Uniform Commercial Code). It is the author's opinion that a New Jersey court may hold such a provision to not only violate law and public policy, but also to be inequitable.

[22] *ABA Accord, supra* note 1, at 202-04; *TriBar Report, supra* note 11, at 1914; *Tribar Remedies Report, supra* note 11, at 960; *California Report, supra* note 5, at 2211; *Arizona Report, supra* note 17, at 591-92; *Report on Standards for Opinions of Florida Counsel of the Special Committee on Opinion Standards of the Florida Bar Business Law Section*, 46 BUS. LAW. 1407, 1437 (1991) [hereinafter *Florida Report*]; *Georgia Report, supra* note 17, at § 10.05; *Special Joint Committee on Lawyers' Opinions in Commercial Transactions*, 45 BUS. LAW. 705, 735 (1990) [hereinafter *Maryland Report*]; Subcommittee on Opinion Writing, Committee on Corporate, Banking, and Business Law, Massachusetts Bar Association, *Omnibus Opinion for Use in Loan Transactions*, 60 MASS. L.Q. 193, 199-200 (1976)

giver is usually permitted to exclude bankruptcy and insolvency laws from the scope of the opinion. The exception usually states that:

> The opinions expressed herein are subject to and may be limited by bankruptcy, insolvency, reorganization, fraudulent conveyance, fraudulent transfer, moratorium or other similar laws of general application, now or hereafter in effect, affecting the enforcement of creditors' rights in general.[23]

It is commonly understood that in the event that any of these laws become applicable, the enforceability of the agreements will be necessarily subject to the law.[24] Except in truly unusual circumstances, opinions as to bankruptcy laws are rarely required due to the difficulty involved in rendering such opinions.[25] Particularly in connection with mid-market transactions, it is unduly burdensome to request a borrower's attorney to render an opinion as to bankruptcy and insolvency laws generally. Further, any opinion which could be rendered would, mostly likely, be subject to so many qualifications and exceptions as to render the opinion of little value.[26]

There are, however, a few limited circumstances (usually in connection with high-end transactions) in which an opinion as to particular bankruptcy or insolvency laws may be justified. For example, in connection with a debtor-in-possession (DIP) or similar bankruptcy financing arrangement, the lender may be particularly concerned as to certain matters affecting the transaction.[27] Simi-

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[hereinafter *Massachusetts Report*]. It has been suggested that the bankruptcy exception should not apply to security interest opinions since such opinions address only the effect of compliance with the U.C.C. . *Special Report by the Tribar Opinion Committee, U.C.C. Security Interest Opinions*, 49 BUS. LAW. 359 (1993) [hereinafter *Security Interest Report*]. Unfortunately, there is no support for this proposition in case law construing opinion letters, and borrower's counsel may be exposed to liability to the opinion recipient where the bankruptcy of the borrower adversely affects the recipient's security interest.

23 The ABA Accord version of the bankruptcy exception does not expressly include fraudulent transfer or fraudulent conveyance in the initial articulation of the exception; however, it goes on to provide that the exception is intended to cover such laws. *ABA Accord, supra* note 1, at 202-3.

24 *Security Interest Report, supra* note 22, at 369. The Tribar Opinion Committee goes so far as to state that the bankruptcy exception together with the equitable principles exception should be understood even if not expressly stated. *Tribar Remedies Report, supra* note 11, at 960-61.

25 *Special Report by the TriBar Opinion Committee: Opinions in the Bankruptcy Context: Rating Agency, Structured Financing, and Chapter 11 Transactions*, 46 BUS. LAW. 717, 723 (1991); *Tribar Remedies Report, supra* note 11, at 962-63.

26 *Id.*

27 For example, a DIP financing lender would be concerned that the procedural requirements of the order approving the financing had been duly observed, that the

larly, in the event that the borrower is known to be insolvent at the time the loan is made or is refinanced, the lender may be unwilling to risk the application of fraudulent transfer laws which may result in the transaction being set aside.[28] In most cases, however, and in all mid-market transactions, the benefits of an opinion as to bankruptcy and insolvency matters is outweighed by the time and expense involved in rendering such an opinion, as well as an ultimate value of the opinion.

2. *Judicial Discretion & Equitable Principles.*

It is difficult for any lawyer to predict how a given court or other judicial body may view a particular factual circumstance. This results from the fact that although judges apply the law, they are given great discretion to interpret the law and determine the appropriate application of the law to the facts. For this reason, another commonly expressed exception to the remedies opinion is an exception for the application of judicial discretion and equitable principles.[29] A common formulation of this exception is:

> The opinion is subject to and limited by judicial discretion and general principles of equity (regardless of whether considered in a proceeding in equity or at law) and we wish to advise you that the remedy of specific performance or injunctive relief (whether considered in a proceeding in equity or at law) is subject to the exercise of judicial discretion.[30]

In reviewing or preparing an opinion, it is important to under-

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order was not subject to appeal or that if the order is subject to appeal that there has been a finding of good faith sufficient to insure the lien priority of the lender for advances made prior to the expiration of the time period for appeals. 11 U.S.C. § 364 (1988).

28 New Jersey adopted the Uniform Fraudulent Transfer Act on August 1, 1988. N.J. STAT. ANN. § 25:2-20 to -32 (West 1940 & Supp. 1994). Similarly, the Bankruptcy Code provides that such transactions may be set aside. 11 U.S.C. § 548(a)(2) (1988).

29 *ABA Accord, supra* note 1, at 204-05; *TriBar Report, supra* note 11, at 1914; *Arizona Report, supra* note 17, at 592; *Florida Report, supra* note 22, at 1437; *Georgia Report, supra* note 17, at §10.05B; *Maryland Report, supra* note 22, at 735.

30 In alternate formulations of this exception, attorneys will sometimes include the following examples of limitations arising out of the application of equitable principles:

> Including, without limitation, principles that (i) include a requirement that a creditor act with reasonableness, in good faith and deal fairly with its debtors, (ii) limit a creditor's right to accelerate maturity of a debt upon the occurrence of a default deemed immaterial, or (iii) might render certain waivers unenforceable . . . .

Such additional text provides examples only and should not be construed as broadening the scope of the exception. However, with regard to waivers, it may be insufficient for the opining attorney to rely solely on the equitable principles exception, since many waivers may be held unenforceable on public policy or statutory grounds. *See*

stand that many of the limitations to the remedies opinion will be addressed by the formulation of the exception set forth above. Much of the New Jersey case law that would render certain provisions of loan documents unenforceable or would limit the enforceability of such provisions is based upon, at least in part, general principles of equity.[31] If this exception is included in the opinion, it should not be necessary to add further exceptions to the remedies opinion to address such cases. Nonetheless, it is not unusual for borrower's counsel to expressly include exceptions addressing specific provisions of the agreement with which he or she may be particularly concerned since, as noted above, such exceptions may address provisions which may be unenforceable due to public policy or other concerns in addition to equitable concerns.

Typically, the types of matters that are covered by the general equitable principles exception are matters that cannot be avoided by careful drafting or by structuring of the loan. This is usually because the lender seeks to obtain the greatest protection permitted by law and will therefore be unwilling to omit terms of an agreement merely because they *may* be unenforceable.[32] Conversely, since the lender either knows or should know that certain terms of the loan documentation may not be enforceable as written, it would be inappropriate for a lender to require that the borrower's counsel give a remedies opinion without including the exception for equitable principles. Since most lenders are aware that the enforceability of certain provisions of the loan documents may be subject to overriding equitable principles of law, this is a risk that is implicit in extending virtually all types of credit. It is, therefore, generally important to lenders that the opinion distinguish between exceptions to the remedies opinion which are based on general principles of equity (which they accept as part of the credit risk) and exceptions to the remedies opinion which are made for other reasons (of which they may otherwise be unaware). In this way, the lender may be better able to evaluate the credit risks involved.

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supra notes 20-21 and accompanying text (relating to a categorization of the exceptions).

[31] *See supra* notes 20-21 and accompanying text (relating to a categorization of the exceptions).

[32] For example, lenders will generally be unwilling to modify contractual provisions which provide for high default rates or interest or late fees, even though such provisions may be unenforceable penalties. *See infra* notes 35-48 and accompanying text (relating to post-default interest and late charges).

3. *Practical Realization.*

One of the most important concerns of the lender is that the remedial provisions of the loan documents are enforceable. To some extent, the equitable principles exception puts the lender on notice that the lender may be unable to exercise certain remedial rights purported to be granted by the loan documents if such exercise should be deemed inequitable. In an effort to give some comfort to lenders that the equitable principles exception is not intended to wholly undermine the remedies opinion, it is not uncommon for lenders to require, and for borrower's counsel to give, the opinion that the remedial provisions of the loan documents are generally adequate for the lender to realize the practical benefits of the loan.[33] This type of exception is commonly formulated as follows:

> Certain remedial provisions in the Loan Documents, in addition to those expressly qualified by the phrase "to the extent permitted by law" or comparable provisions, may be unenforceable in whole or in part, but the inclusion of such provisions does not render the other provisions thereof invalid, and collectively, the Loan Documents contain adequate remedial provisions for the practical realization of the rights and benefits afforded thereby and for enforcing payment of the amounts due thereunder (except for the economic consequences of any delay that arises from such lack of enforceability).

There is a surprising lack of understanding among both attorneys and lenders as to what this exception is intended to mean. This may be due to the lack of precision in the phrase "practical realization."[34] At least two matters should, however, be clear from the plain text of the exception.

First, the exception is intended to address only the remedial terms of the loan documents. Because it is silent with respect to the other terms of the documents (e.g., interest rates, advance criteria, affirmative or negative covenants), the lender is put on notice that it may not be able to enforce certain of the remedial rights which the loan documents purport to grant to the lender.

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[33] LEGAL OPINIONS, *supra* note 4, at 252-53; *Maryland Report*, *supra* note 22, at 739-40. The ABA Accord does not address the interpretation of practical realization provisions except to state that such provisions should not be construed to override the bankruptcy or equitable principles exceptions. *ABA Accord*, *supra* note 1, at 202.

[34] *ABA Accord*, *supra* note 1, at 225-26; *TriBar Remedies Report*, *supra* note 11, at 965; *Arizona Report*, *note* 17, at 592-94; *Maryland Report*, *note* 22, at 739-40; ARTHUR N. FIELD & READE H. RYAN, LEGAL OPINIONS IN CORPORATE TRANSACTIONS 7-5 to 7-8 (1992) [hereinafter FIELD & RYAN].

Second, particular attention is drawn to those provisions which are qualified by the phrase "to the extent provided by law." It is not unusual for loan documents to so qualify remedial provisions that, for example, purport to give the lender the right to exercise self-help remedies or that purport to permit the lender to sell collateral with limited or no notice under specified conditions. The ability of the lender to exercise these remedies will be limited to the extent provided by Article 9 of the Uniform Commercial Code.[35] In certain high-end transactions, especially transactions involving more than one jurisdiction, lenders may be particularly concerned with the lack of enforceability of such provisions and may reasonably request a more specific opinion about such provisions.

What is arguably unclear about this exception is the meaning of the last phrase, which is intended to provide the lender with comfort that it will be able to exercise certain remedies against the collateral in order to be paid. It is, perhaps, just as important to understand what the exception does not mean as it is to understand what the exception does mean. The exception is neither intended to mean that the lender will in fact be repaid and made whole, nor that there are no defenses to the lender's right to be repaid.[36] Likewise, the exception is not intended to mean that the loan documents provide for the maximum protection afforded by law.

It is the author's opinion that the exception is intended to mean: (1) that notwithstanding what the terms of the loan documents purport to provide, the lender may be delayed in its ability to sell collateral upon a default and may lose money as a result of such delays and (2) that the loan documents and the law applicable to the loan documents provide the lender with a legal remedy[37] which, if properly and diligently pursued, will permit the lender to seek repayment from the collateral securing the loan and will permit the lender to pursue any other parties liable for the debt.[38]

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[35] N.J. STAT. ANN. § 12A:9-501 to -507 (West 1962 & Supp. 1994). Many of these remedies and the protections to debtors afforded by their provisions may not be waived. N.J. STAT. ANN. § 12A:9-501 (West 1962 and Supp. 1994).

[36] *Maryland Report*, *supra* note 22, at 739-40.

[37] The practical realization exception should not be construed to mean that every legal remedy purported to be provided in the loan documents will necessarily be available to the lender exactly as written. Rather, it should be construed to mean that some legally meaningful remedy will be available to the lender.

[38] For a further discussion of "Practical Realization" language, see *Special Joint Committee on Lawyers' Opinions in Commercial Transactions*, 45 BUS. LAW. 705, 739-40 (1990); *TriBar Remedies Report*, *supra* note 11, at 964-66.

4. *Industrial Site Recovery Act (formerly Environmental Cleanup Responsibility Act).*

In the past, it was not uncommon for borrower's counsel in asset-based lending transactions in New Jersey to include an exception based on the potential applicability of the Environmental Cleanup Responsibility Act (ECRA).[39] The exception read as follows:

> The opinions expressed herein are subject to the provisions of the New Jersey Environmental Cleanup Responsibility Act (ECRA) in the event there occurs a closing, terminating or transferring of operations within the meaning of N.J.A.C. 7:26-B1.5(b) after the date hereof (which provision may prevent foreclosure of any lien on any collateral pending compliance with the requirements of ECRA).

The concern was that either the granting of a security interest (which is in itself a form of assignment of rights in property) in or a lender's foreclosure sale of the assets of the borrower may be considered a "transferring of operations"[40] which was an ECRA triggering event.[41] Thus, compliance with ECRA would be required before the New Jersey Department of Environmental Protection would permit the consummation of any such sale. The recent revisions to ECRA implemented in the Industrial Site Recovery Act (ISRA),[42] attempted to address this concern. Significant unresolved issues remain, however, with regard to the extent to which ISRA may interfere with a secured lender's exercise of remedies against personal property collateral. ISRA expressly excludes a lender's foreclosure on asset-based collateral as one of the events (change in ownership) triggering compliance with remedial and other requirements under the statute.[43] Accordingly, lenders

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[39] N.J. STAT. ANN. § 13:1K-6 to -35 (West 1991 & Supp. 1994). The New York approach would exclude the requirement for exceptions to an opinion based upon ECRA. *Tribar Remedies Report, supra* note 11, at 968. However, ISRA, like ECRA, is a very unique state statute and is not known to many foreign lenders. Furthermore, it is not uncommon for foreign lenders not to hire New Jersey counsel in connection with loans to New Jersey entities. Such a foreign lender would most likely be surprised to find out that the enforcement of its loan agreement was subject to ISRA, and would consider it to be the duty of the borrower's New Jersey counsel to bring such a peculiar state statute to the attention of the lender.

[40] Under ECRA, a transfer of operations included any "transaction . . . through which an industrial establishment undergoes [a] change in ownership." N.J. STAT. ANN. § 13:1K-8 (West 1991 and Supp. 1994).

[41] N.J. STAT. ANN. § 13:1K-11a (West 1991 and Supp. 1994).

[42] N.J. STAT. ANN. §§ 13:1K-6 to -11.11, 58:10B-1 to -20, and 58:10-23.11g (West 1991 and Supp. 1994).

[43] N.J. STAT. ANN. § 13:1K-8 (West 1991 and Supp. 1994). The definition of

should no longer be concerned that the grant of the security interest or their conduct in exercising remedies on asset-based collateral will, in and of itself, be considered a "change in ownership" triggering ISRA. Notwithstanding this revision to ECRA, however, at least three substantial concerns remain.

First, ISRA requires compliance with the statute prior to any "transfer of ownership or operations."[44] The definition of "transferring of ownership or operations" includes not only a "change in ownership," but also a sale or transfer of more than 50% of the assets of the industrial establishment.[45] Accordingly, the statute appears to require compliance with its requirements not only prior to any change in ownership, but also prior to any sale or transfer of more than 50% of the assets. Although a lender's execution of remedies against personal property collateral will no longer, in and of itself, be deemed a "change in ownership," if the lender forecloses on more than 50% of the assets of the industrial establishment, the lender may be required to comply with ISRA.

Second, a lender may not be safe even where the lender lends only against 50% of the borrower's assets. Under the statute, a transfer of ownership or operations occurs upon a transfer of 50% of the industrial establishment's assets "within any five year period, as measured on a constant, annual date-specific basis."[46] The statute is unclear as to whether both real and personal property are intended to be included in the term "asset." Arguably, personal property should be exempt to the same extent it is exempt in the event of a "change in ownership." In calculating the 50% threshold, the statute would include sales, transfers or other dispositions occurring in the ordinary course of business (e.g., sale of equipment or inventory) over the last five-year period. Furthermore, the method of valuation is unclear.[47] The only guidance provided by

"change in ownership" expressly excludes the "execution, delivery and filing or recording of any mortgage, security interest, collateral assignment or other lien on real or personal property" and "any transfer of personal property pursuant to a valid security agreement, collateral assignment or other lien, including, but not limited to seizure or replevin of such personal property which transfer is for the purpose of implementing the secured party's rights in the personal property which is the collateral." N.J. STAT. ANN. § 13:1K-8 (West 1991 and Supp. 1994).

44 N.J. STAT. ANN. § 13:1K-9(c) (West 1991 and Supp. 1994).

45 N.J. STAT. ANN. § 13:1K-8 (West 1991 and Supp. 1994).

46 *Id.*

47 The statute does not expressly state that the 50% threshold is determined by reference to a *valuation* of the assets. The statute could be read to refer to 50% of the *number* of assets. If this is the correct interpretation, the statute is unclear as to whether assets may be grouped in determining the 50% threshold. For example, are all of the paper clips one asset or is each paper clip a separate asset? The very absurd-

the statute is that the method must be constant, annual and date-specific.[48] Both fair market and book valuations, however, may be performed in a manner consistent with such requirements. Since there is often a substantial difference between the fair market value and the book value of a business's assets, it is almost impossible for borrower's counsel to determine whether a sale of collateral would trigger the compliance requirements of the statute.

Finally, of grave concern to lenders is the fact that any transaction consummated prior to the transferor's compliance with ISRA's requirements may be voided.[49] Even if all of the traditional legal requirements for the transfer of title to property have been fulfilled, the transaction may, nonetheless, be voided if it was consummated in violation of ISRA.

Although it may have been the intent of the legislature to address the concerns of asset-based lenders under ECRA, ISRA still leaves many questions unanswered. While these concerns may be addressed in future regulations issued under ISRA, until then, an exception to the remedies opinion is still required in order for borrower's counsel to avoid rendering an opinion that would be contrary to ISRA.

5. *Attorney's Fees.*

Loan documents generally include provisions which permit the lender to collect attorney's fees as part of its damages in connection with the exercise of its remedies. However, the strict enforceability of such provisions is limited.

First, rules of ethics and common law require that attorney's fees must be reasonable.[50] Accordingly, loan document provisions which purport to provide that the lender may collect a fixed percentage or a fixed amount for attorney's fees may not be enforceable if such a fee would not be reasonable in light of the actual work performed by the lender's attorney.[51]

ity of the example indicates that the intent of the statute was that the calculation be made by reference to a valuation of the assets.

48 N.J. STAT. ANN. § 13:1K-8 (West 1991 and Supp. 1994).

49 "Failure of the transferor to perform a remediation and obtain department approval . . . is grounds for voiding the sale or transfer of an industrial establishment or any real property utilized in connection therewith by the transferee." N.J. STAT. ANN. § 13:1K-13(a) (West 1991 and Supp. 1994).

50 NEW JERSEY RULES OF PROFESSIONAL CONDUCT, Rule 1.5(a) (1994); Alcoa Edgewater No. 1 Fed. Credit Union v. Carroll, 44 N.J. 442, 448, 210 A.2d 68, 72 (1965); Center Grove Assoc. v. Hoerr, 146 N.J. Super. 472, 474, 370 A.2d 55, 56 (App. Div. 1977).

51 *Alcoa Edgewater*, 44 N.J. at 449-50, 210 A.2d at 73.

Second, New Jersey Court Rules contain many provisions which place limitations on attorney's fees.[52] Although many of these rules are not clearly applicable to the exercise of remedies in loan documentation, it is not unreasonable for borrower's counsel to limit the opinion by referencing the New Jersey Court Rules generally. An opinion as to the applicability of each Court Rule addressing attorney's fees would be extremely cumbersome and would add almost no value to all mid-market transactions and would add only little value to high-end transactions. Moreover, lenders generally do not decide whether or not to extend credit on the basis of the amount of attorney's fees that a lender may collect in the event of a default. In high-end transactions, however, particularly where the lenders are based out of state, the lender may require a more extensive opinion as to attorney's fees. This is usually due to the lender's unfamiliarity with New Jersey law.

6. *Dragnet Provisions.*

Dragnet provisions are particular provisions in loan documents by which a lender attempts to provide either that debt is secured by any other property of the borrower, now or hereafter pledged to the lender, or that the collateral pledged to the lender also secures any other present or future debt of the borrower to the lender. Many jurisdictions have held that such provisions are unenforceable unless the cross-collateralization with non-related debt or collateral was expressly contemplated at the time of the transaction providing for the dragnet provision.[53] To date, the

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[52] New Jersey Court Rules generally deny recovery of attorney's fees in all but a few specified circumstances. Current N.J. COURT RULES, R. 4:42-9 (1993). The rule, however, does not preclude attorney's fees "where the parties have agreed thereto in advance by stipulation in a promissory note, power of attorney or other agreement or contract. . . . Such provision will, however, be strictly construed in light of the general policy disfavoring counsel fee awards." PRESSLER, CURRENT N.J. COURT RULES, Comment R. 4:42-9. *See also* Meyner and Landis v. Turtletaub, 248 N.J.Super. 690, 591 A.2d 1043 (Law Div. 1991); *Alcoa Edgewater*, 44 N.J. at 442, 210 A.2d at 68; Cohen v. Fair Lawn Dairies, Inc., 44 N.J. 450 (1965).

[53] Uransky v. First Fed. Sav. & Loan Ass'n., 684 F.2d 750 (11th Cir. 1982) (applying Florida law); Kimball Foods, Inc. v. Republic Nat'l Bank of Dallas, 557 F.2d 401 (5th Cir. 1977) (applying Texas law); *In re* Swanson, 104 B.R. 1 (Bankr. C.D. Ill. 1989); *In re* Hunter, 68 B.R. 366 (Bankr. C.D. 1986); *In re* Bates, 35 B.R. 475 (Bankr. M.D. Tenn. 1983); *In re* Grizaffi, 23 B.R. 137 (Bankr. D. Colo. 1982); *In re* Goodman Industries, Inc., 21 B.R. 512 (Bankr. D. Mass. 1982); Marine Nat'l Bank v. Airco, Inc., 389 F.Supp. 231 (W.D. Pa. 1975); National Bank v. Blakenship, 177 F. Supp. 667 (E.D. Ark. 1959), *aff'd sub nom.* National Bank v. General Mills, 283 F.2d 574 (8th Cir. 1960) (applying Arkansas law); *Ex parte* Chandler, 477 So. 2d 360 (Ala. 1985); Underwood v. Jarvis, 358 So. 2d. 731 (Ala. 1978); Akamine & Sons, Ltd. v. American Security Bank, 440 P.2d 262 (Haw. 1968); First v. Byrne, 28 N.W.2d 509 (Iowa 1947); First Nat'l Bank in Wich-

New Jersey courts have not directly addressed the issue of the enforceability of such clauses. Accordingly, many borrowers' attorneys in New Jersey will include the following exception in their opinions in order to put lenders on notice that such dragnet provisions may not be enforceable:

> We express no opinion as to the creation or perfection of any security interest that purports to secure any present or future obligations or liabilities of the borrower to the Lender that are determined, in the case of obligations or liabilities to the Lender created in the future, not to constitute "future advances" within the meaning of Section 9-204(3) of the UCC, are determined not to have been within the contemplation of the borrower at the time the Loan Documents were consummated, or are determined not to be of the same character or class as the obligations and liabilities to the Lender created or arising under the Loan Documents.

Where the loan is secured by all of the borrower's property and assets and where the loan agreement prohibits the borrower from obtaining any other secured financing, lenders often object to the inclusion of such an exception in the borrower's counsel's opinion. In such circumstances, the exception may be unnecessary.

7. *Interest, Late Charges & Prepayment Penalties.*

Another exception to the remedies opinion is an exception for the enforceability of provisions permitting the lender to charge interest on interest (otherwise known as compounding interest), late charges or post-default rates of interest. The exception is customarily formulated as follows:

> The opinions expressed herein are subject to the non-enforceability of provisions providing for "interest on interest" or the payment of late charges, post-default increased interest rates, liquidated damages or prepayment premiums.

(a) *Interest on Interest/Compound Interest.*

Under New Jersey case law, courts will not enforce compounding of interest by savings and loan associations unless such

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ita v. Fink, 241 Kan. 321, 736 P.2d 909 (1987); Emporia State Bank & Trust Co. v. Mounkes, 519 P.2d 618 (Kan. 1974); First Nat'l Bank and Trust Co. v. Lygrisse, 7 Kan. App. 2d 291, 640 P.2d 1274 (Ct. App. 1982); Canal Nat'l Bank v. Becker, 431 A.2d 71 (Me. 1981); Freese Leasing, Inc. v. Union Trust and Sav. Bank, 253 N.W.2d 921 (1977); First Sec. Bank of Utah v. Shiew, 609 P.2d 952 (Utah 1980); John Miller Supply Co., Inc. v. Western State Bank, 55 Wis. 2d 385, 199 N.W.2d 161 (1972).

provisions are expressly provided in the agreement or unless the agreement contains an express incorporation of the statute permitting such compounding.[54] Loan documents often incorporate provisions providing that the powers and remedies of the lender provided for under the loan documents are cumulative and in addition to any powers or rights permitted by law. Although New Jersey law permits savings and loan associations to charge compound interest,[55] notwithstanding the provisions of loan documents which purport to give a savings and loan association cumulative rights, powers and remedies, such provisions may not be enforceable if such powers are not expressly provided in the contract. Although the current case law is limited to the power of savings and loan associations to charge compound interest, the reasoning set forth in the applicable New Jersey case law is equally applicable to other lenders.

(b) *Post-Default Interest.*

New Jersey courts' analysis of post-default rates of interest and late charges can be likened to the courts' analysis of liquidated damages clauses.[56] Specifically, such provisions may not be enforceable if they are penal in nature and not in the nature of liquidated damages.[57] Increases in interest rates after a default or maturity from 21% to 30%,[58] 17% to 33%,[59] 9% to 24%,[60] and 30.18% to 38.76%[61] have been held to be penal in nature and are therefore unenforceable. Although a New Jersey court has indicated in *dicta* that a 3% increase in interest rate upon default may bear a reasonable relationship to the actual administrative expenses incurred by a lender,[62] it has been held that, under New

54 Crest Sav. and Loan Ass'n v. Mason, 243 N.J. Super. 646, 581 A.2d 120 (Ch. Div. 1990); Shadow Lawn Sav. and Loan Ass'n v. Palmarozza, 190 N.J. Super. 314, 463 A.2d 384 (App. Div. 1983).

55 N.J. STAT. ANN. § 17:12B-48(14) (West 1984 & Supp. 1994).

56 *Crest Sav. and Loan Ass'n*, 243 N.J. Super. at 648, 581 A.2d at 121.

57 Monsen Engineering Co. v. Tami-Githens, Inc., 219 N.J. Super. 241, 530 A.2d 313 (App. Div. 1987); Westmont Country Club v. Kameny, 82 N.J. Super. 200, 197 A.2d 379 (App. Div. 1964).

58 *In re* Tastyeast, Inc., 126 F.2d 879 (3d Cir.), *cert. denied sub. nom.*, Modern Factors Co. v. Tastyeast, Inc., 316 U.S. 696 (1942).

59 Feller v. Architects Display Bldgs., Inc., 54 N.J. Super. 205, 148 A.2d 634 (App. Div. 1959).

60 Stuchin v. Kasirer, 237 N.J. Super. 604 (App. Div. 1990), *certif. denied*, 121 N.J. 660, 583 A.2d 346 (1990).

61 Spiotta v. William H. Wilson, Inc., 72 N.J. Super. 572, 179 A.2d 49 (App. Div. 1962).

62 *In re* Timberline Property Dev., Inc., 136 B.R. 382, 386 (Bankr. D.N.J. 1992).

Jersey law, even a 3% increase in interest rate which is intended as a means to coerce payment by the borrower is an unenforceable penalty.[63]

(c) *Late Charges.*[64]

Late charges are enforceable in New Jersey only if they are administrative expenses intended to compensate the lender for the cost of money wrongfully withheld.[65] Furthermore, upon the acceleration of a loan, the lender cannot collect late charges.[66] Once the loan has been accelerated, the lender is considered to have repudiated the borrower's right to make regular payments and, accordingly, no late charge may be imposed.[67] Furthermore, although no New Jersey court has expressly ruled on the issue, the Administrative Director of the Courts has issued a statement prohibiting the lender from charging more than one late charge for each payment in arrears.[68] While the statement does not have the force of law, it does indicate how the courts are likely to hold. In fact, the statement has been used as support by at least one New Jersey court.[69]

(d) *Prepayment Penalties.*

Generally, prepayment penalties in commercial loan agreements are enforceable in New Jersey[70] to the extent that they are intended to compensate the lender for its future right to interest or other losses (including tax benefits) that may result from prepayment.[71] A lender may not be entitled, however, to impose a prepayment penalty for involuntary prepayments, including payments arising out of the mortgagee's acceleration of the

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63 *Id.*

64 For a thorough general discussion on late payment charges, see 1 NELSON AND WHITMAN, REAL ESTATE FINANCE LAW 515-20 (3d ed. 1994).

65 *Crest Sav. & Loan Ass'n*, 243 N.J. Super. at 649, 581 A.2d at 121 (citing Garrett v. Coast & S. Fed. Sav. & Loan Ass'n, 108 Cal. Rptr. 845, 511 P.2d 1197 (1973)); NELSON AND WHITMAN, *supra* note 64, at 514.

66 *Crest Sav. & Loan Ass'n*, 243 N.J. Super. at 649, 581 A.2d at 122. *See also* State Mut. Bldg. & Loan Ass'n v. Batterson, 77 N.J.L. 57 (1908); Manhattan & S. Sav. & Loan Ass'n v. Massarelli, 42 A. 284, 286 (N.J. Ch. 1899).

67 *Id.*

68 110 NEW JERSEY L.J. 325 (1982).

69 *Crest Sav. & Loan Ass'n*, 243 N.J. Super. at 650, 581 A.2d at 122 (holding that mortgage late charges arising after complaint was filed were unenforceable).

70 Prepayment penalties are unenforceable in connection with mortgage loans secured by a structure containing one to six dwelling units where the interest rate exceeds 6%. N.J. STAT. ANN. § 46:10B-2 (West 1989).

71 Resolution Trust Corp. v. Minassian, 777 F. Supp. 385 (D.N.J. 1991).

indebtedness.[72]

8. *Powers of Attorney.*

There is no New Jersey law specifically confirming that powers of attorney given to lenders in connection with commercial loans are generally enforceable. However, under New Jersey law, powers of attorney which give the agent the authority to "conduct banking transactions as set forth in section 2 of P.L.1991, c. 95 (C.46:2B-11)" provide the agent with a broad variety of banking powers.[73] Although certain financial institutions may not honor a power of attorney which does not incorporate such statutory reference, such a practice is unwarranted. The statute itself expressly provides that it is not intended to be the exclusive method of providing powers of attorney for banking transactions.[74]

One provision relating to powers of attorney found in loan documentation that requires an exception to the remedies opinion is that the power of attorney is irrevocable. Although no New Jersey case has ruled on the issue, most likely a court would not enforce the lender's right to exercise the power of attorney after the loan in connection with which the power was granted had been repaid in full.[75] This is because, implicit in powers of attorney granted in connection with loan documentation, is the fact that the lender will not exercise the powers granted thereunder after the loan has been repaid.[76] Accordingly, where a power of attorney in loan documentation either purports to be irrevocable or

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72 Clinton Capital Corp. v. Straeb, 248 N.J. Super. 19, 589 A.2d 1363 (Ch. Div. 1990); Jala Corp v. Berkeley Sav. & Loan Ass'n, 104 N.J. Super. 394, 250 A.2d 150 (App. Div. 1969). *See also In re* LHD Realty Corp., 726 F.2d 327 (7th Cir. 1984) (applying Indiana law); Landohio Corp. v. Northwestern Mut. Lif. Mortgage & Realty Inv., 431 F. Supp. 475 (N.D. Oh. 1976).

73 N.J. STAT. ANN. § 46:2B-11(2) (West 1989 & Supp. 1994).

74 N.J. STAT. ANN. § 46:2B-11(8) (West 1989 and Supp. 1994).

75 The rationale applied to the enforceability of dragnet provisions is equally applicable to powers of attorney that purport to be irrevocable. Under the line of cases holding dragnet provisions to be unenforceable, the courts' holdings are based on the factual conclusion that the debt which the plaintiff is attempting to enforce was not contemplated at the time of the original transaction. *See supra* § II. C. 6 and accompanying footnote (relating to "Dragnet Provisions"). Since debts other than those which arise under the transaction in connection with which the power of attorney was granted (the "Granting Transaction") may not be contemplated at the time of the Granting Transaction, it is reasonable to conclude that a court would not permit a creditor to exercise a power of attorney to collect a debt not contemplated by the parties at the time of the Granting Transaction.

76 Where a portion of the loan involves revolving credit, the implication should be extended to the fact that the power of attorney will survive until both the loan has been repaid *and* the lender's obligation to make further advances has terminated.

does not provide that it will terminate upon the repayment of the loan, it is not unreasonable for the opining attorney to include an exception to the remedies opinion that states:

> The opinions expressed are subject to the non-enforceability of provisions permitting the Lender to exercise rights under a power of attorney granted in connection with the Loan Documents after the Lender has been paid in full all amounts due in connection with the Loan Documents and the Lender's obligation to make further advances has terminated.

9. *Amendments in Writing.*

It is customary for loan documents to contain a "boilerplate" provision which states that any amendments to the loan documents must be made in writing. Such provisions have been held to be unenforceable in New Jersey.[77] The New Jersey Statute of Frauds was amended in 1991, however, to provide protection for a lender's oral assurances to borrowers or potential borrowers.[78] Under the amendment, actions on commercial contracts[79] or commitments to loan over $100,000 and renewals of such loans cannot be instituted unless evidenced by a writing signed by the party against whom enforcement is sought.[80] It is unclear from the face of the statute whether it applies to all provisions of existing loan agreements or whether it applies only to those portions of existing loan agreements that provide for the lender's commitment to lend money. Because the statute is not clear as to whether it is intended to cover all loan documents, an exception to the remedies opinion should customarily be included in the borrower's counsel's opinion letter. Set forth below is a proposed form of such an exception:

> The opinions expressed are subject to the non-enforceability of provisions requiring amendments or waivers of the provisions of agreements or documents to be written (other than as provided pursuant to N.J.S.A. §25:1-5).

10. *Indemnification.*

Loan documents often contain language in which the lender

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77 Estate of Connelly v. United States, 398 F. Supp. 815 (D.N.J. 1975), *aff'd* 551 F.2d 545 (3d Cir. 1977). *See also* Frommeyer v. L. & R. Constr. Co., 261 F.2d 879 (3d Cir. 1958).

78 N.J. STAT. ANN. § 25:1-5(f) (West Supp. 1994).

79 The amendment to the statute expressly excludes loans primarily for personal, family or household purposes. *Id.*

80 *Id.*

requires that the borrower indemnify the lender for any liability the lender incurs in connection with its performance under the loan documentation. Under New Jersey law, provided that the provision does not violate public policy, the general rule with regard to such provisions is that they are enforceable to relieve the indemnified party of liability for negligence.[81] Such provisions, however, are not enforceable to relieve the lender from liability for willful misconduct.[82] The courts are split as to whether a party may generally contract itself out of liability for its own reckless or grossly negligent conduct.[83] The only two New Jersey courts that have considered the enforceability of provisions intended to exculpate institutional lenders from liability have held that banks may not relieve themselves of liability for negligence.[84] The reason for this variation may be that the courts view institutional lenders, such as banks, as having a special relationship with the public justifying the higher standard.[85] Because the New Jersey courts appear to hold institutional lenders to a higher standard than other entities, it is

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81 Alderney Dairy Co., Inc. v. Hawthorn Mellody, Inc., 643 F.2d 113 (3d Cir. 1981); Farris Engineering Corp. v. Serv. Bureau Corp., 276 F. Supp. 643 (D.N.J. 1967); Mayfair Fabrics v. Henley, 48 N.J. 483, 226 A.2d 602 (1967), *on remand* 97 N.J. Super. 116, 234 A.2d 503, *aff'd sub. nom.* Natell v. Henley, 103 N.J. Super. 161, 246 A.2d 749 (App. Div. 1968); Moreira Const. Co. v. Moretrench Corp., 97 N.J. Super. 391, 235 A.2d 211 (App. Div. 1967), *aff'd* 51 N.J. 405 (1968). *But see* Tunkl v. Regents of Univ. of Cal., 383 P.2d 441, 445-446, 32 Cal. Rptr. 33, 37-38 (1963) (holding indemnity provisions unenforceable even to the extent that they attempt to exonerate a party from liability for negligent conduct).

82 Tessler and Son, Inc. v. Sonitrol Sec. Systems of N. New Jersey, Inc., 203 N.J. Super. 477, 497 A.2d 530 (App. Div. 1985).

83 *Tessler*, 203 N.J. Super. at 485-86 (holding that exculpatory provisions are enforceable to limit a party's liability for gross negligence). *But see* Kuzmiak v. Brookchester, 33 N.J. Super. 575, 111 A.2d 425 (App. Div. 1955); Swisscraft Novelty Co. v. Alad Realty Corp., 113 N.J. Super. 416, 274 A.2d 59 (App. Div. 1971) (holding that exculpatory clauses are not enforceable to relieve a party of liability for gross negligence).

84 Hy-Grade Oil Co. v. New Jersey Bank, 138 N.J. Super. 112, 350 A.2d 279 (App. Div. 1975) (proclaiming that a bank had a public duty with regard to night deposit arrangements and may not relieve itself of liability for negligence); Erlich v. First Nat'l Bank of Princeton, 208 N.J. Super. 264, 505 A.2d 220 (Law Div. 1984) (declaring that a bank could not contract out of liability for negligent conduct in connection with investment advisory services).

85 *Hy-Grade Oil Co.*, 138 N.J. Super. at 118, 350 A.2d at 282. This special relationship may be found even in commercial transactions. For example, it has been held that a bank which acts as an agent in a multibank loan has a fiduciary obligation to the participant banks. Contractual waivers of liability for negligent conduct of such agent banks have been held unenforceable. Chemical Bank v. Security Pacific Nat'l Bank, 20 F.3d 375 (9th Cir. 1994). Often in multibank loans, an agent bank also performs various functions for the benefit of the borrower which could be construed to create a fiduciary obligation from the agent bank to the borrower which would render waivers of the agent bank's negligent conduct unenforceable.

appropriate for borrower's counsel to provide the following exception with respect to such provisions:

> The opinions are subject to the non-enforceability of provisions requiring the borrower to indemnify the Lender or its agents or any of the provisions exculpating the Lender from liability for its actions or inaction to the extent that such indemnification or exculpation is contrary to public policy.

It should be noted, however, that New Jersey courts have considered other factors in evaluating the enforceability of such provisions, including the good faith of the party seeking enforcement,[86] the unconscionability of the contract[87] and equality of bargaining power.[88] In light of the courts' consideration of these other factors, if borrower's counsel includes an exception to the remedies opinion that addresses only the potential unenforceability of an indemnity provision due to violations of public policy, borrower's counsel could be deemed to be rendering an opinion, for example, that such provisions will not be held unenforceable due to any inequality in bargaining power. Indemnification provisions are often included in loan documentation as "boilerplate" types of provisions and such provisions are generally not of substantial importance to the lender in deciding whether or not to extend the credit. Accordingly, even where such other factors may not be of concern, the better approach is for borrower's counsel to include an exception to the general enforceability of such provisions.

11. *Waivers.*

(a) *Waiver of Right to Jury Trial.*

Almost every commercial lender requires that its borrowers waive the right to a jury trial. Generally, such waivers are enforceable to the extent that they are made expressly and with a thorough understanding of the waiver.[89] One New Jersey court has held that

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86 Broadway Maintenance Corp. v. Rutgers State Univ., 90 N.J. 253, 447 A.2d 906 (1982).

87 *Broadway*, 90 N.J. at 270, 447 A.2d 914; Tannock v. New Jersey Bell Telephone Co., 212 N.J. Super. 506, 515 A.2d 815 (Law Div. 1986), *aff'd in part, rev'd in part*, 223 N.J. Super. 1, 537 A.2d 1307 (App. Div. 1986).

88 Mayfair Fabrics v. Henley, 48 N.J. 483, 226 A.2d 602 (1967), *on remand* 97 N.J. Super. 116, 234 A.2d 503 (Law Div. 1967), *aff'd sub. nom.*, Natell v. Henley, 103 N.J. Super. 161, 246 A.2d 749 (App. Div. 1968); *Hy-Grade Oil Co.*, 138 N.J. Super. 112; *Tannock*, 212 N.J. Super. 506.

89 State v. Wyman, 232 N.J. Super. 565, 557 A.2d 1043 (App. Div. 1989); State v. Paolino, 110 N.J. Super. 284, 265 A.2d 398 (App. Div. 1970). The express and thorough understanding standard has only been enunciated in criminal cases. There is little New Jersey case law as to the form and sufficiency of jury trial waivers in civil

a jury trial waiver was unenforceable where it was inconspicuous in an adhesion contract and was entered into without assistance of counsel.[90] This decision is consistent with the standard enunciated in other New Jersey criminal cases.[91] Because the decisions which hold such provisions unenforceable do so on the basis that such provisions violate public policy[92] and because the right to a jury trial is considered a fundamental right,[93] there is understandably a great deal of hesitancy on the part of borrower's counsel in rendering remedies opinions with respect to such provisions.[94] Accordingly, borrower's counsel should be permitted to include an exception for the enforceability of jury trial waivers to the extent that such provisions violate public policy.

It should also be recognized, however, that in connection with high-end transactions, especially those involving lenders unfamiliar with New Jersey law, borrower's counsel may need to render an opinion as to the enforceability of a jury trial waiver. If the opinion is carefully limited to the state of the law at the time the opinion is delivered, borrower's counsel should be able to evaluate whether the waiver was express and thoroughly understood by the borrower. In a situation where there is extremely unequal bargaining power, however, it may be unclear whether the waiver is voluntary.[95] The courts may deem that an opinion as to the enforceability of such a provision includes a qualitative evaluation as to whether the bargaining power of the parties is equal enough for the provision to be considered voluntary and therefore enforceable.

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cases. However, New Jersey civil case law has held contractual jury trial waivers to be enforceable, without identifying separate criteria for enforceability in civil cases. Franklin Discount Co. v. Ford, 27 N.J. 473, 492-93, 143 A.2d 161, 172 (1958); Sexton v. Newark Dist. Tel. Co., 55 N.J.L. 85, 101-02 (1913).

90 Fairfield Leasing v. Techni-Graphics, 256 N.J. Super. 538, 607 A.2d 703 (Law Div. 1992).

91 *Wyman*, 232 N.J. Super. at 568, 557 A.2d at 1045; *Paolino*, 110 N.J. Super. at 284, 265 A.2d at 398.

92 *Fairfield Leasing*, 256 N.J. Super. at 543, 607 A.2d at 706.

93 Johnson v. Zerbst, 304 U.S. 458 (1938); Heyman v. Kline, 456 F.2d 123 (2d Cir. 1972), *cert. denied*, 409 U.S. 847 (1972). David T. Russof, *Contractual Jury Waivers: Their Use in Reducing Lender Liability*, 110 BANKING L.J. 4 (1993).

94 It should be noted that at least one state's highest court has held that all prelitigation contractual waivers of a right to jury trial are unenforceable. Bank South v. Howard, 444 S.E.2d 799 (1994).

95 National Equip. Rental v. Hendrix, 566 F.2d 265 (2d Cir. 1977); Rodenbur v. Kaufmann, 320 F.2d 679 (D.C. Cir. 1963).

(b) *Waiver of Statute of Limitations.*

Opinions as to the enforceability of waivers of statutes of limitations are particularly troublesome in New Jersey. No state court has ruled on the enforceability of such waivers for over 40 years.[96] The weight of the authority in other jurisdictions holds such waivers unenforceable where they are included as a part of the original obligations.[97] The last state court to rule on the issue held against the party attempting to enforce the waiver and cited a Massachusetts Supreme Court case holding such clauses contrary to public policy.[98] Shortly after that case was published, a *Rutgers Law Review* casenote construed the case as demonstrating how such provisions "may be held invalid and void in New Jersey."[99] There is, therefore, a substantial risk that the next court to rule on the issue in New Jersey will hold such provisions unenforceable as violative of public policy.[100] Where mid-market or high-end loan documents contain express waivers of statutes of limitations or, for example, other text waiving "every benefit, exemption or privilege under any law now or hereafter to be enforced,"[101] borrower's counsel should include the following exception to the remedies opinion:

> The opinions expressed herein are subject to the unenforceability of provisions purporting, directly or indirectly, to provide for a waiver of the benefit of any statute of limitations to the extent that such provision violates public policy.

(c) *Other Waivers.*

Various other waivers may also be unenforceable in certain circumstances. Such waivers which are found in loan documents in-

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96 The last case decided on the issue under New Jersey law was decided by a federal district court. Sherwood Jewelers-Newark v. Philadelphia Nat. Ins. Co., 102 F. Supp. 103 (D.N.J. 1952).

97 1A ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS, § 218 (2d ed. 1963 and Supp. 1993); 1 SAMUEL WILLISTON AND WALTER H.E. JAEGER, A TREATISE ON THE LAW OF CONTRACTS § 183 (3d ed. 1961 and Supp. 1979).

98 Hudson County Nat. Bank v. Simpson, 5 N.J. Super. 135, 68 A.2d 542 (App. Div. 1949).

99 Recent Cases, *Contracts-Statute of Limitations-Effect of Waiver*, 4 RUTGERS L. REV. 508, 510 (1950).

100 The court in *Hudson County National Bank* cited the United States Supreme Court's enunciation of the policy favoring statutes of limitations as "practical and pragmatic devices to spare the courts from litigation of stale claims, and the citizen from being put to his defense after memories have faded, witnesses have died or disappeared, and evidence has been lost." *Hudson County Nat'l Bank*, 5 N.J. Super. at 138, 68 A.2d at 544 (quoting Chase Securities Corp. v. Donaldson, 325 U.S. 304, 314 (1945)).

101 *Hudson County Nat'l Bank*, 5 N.J. Super. at 139, 68 A.2d at 544.

clude waivers of moratorium laws,[102] waivers of errors, defects and imperfections in proceedings,[103] waivers of the benefits of any exemption from civil process,[104] waivers of rights to notice,[105] waivers of appraisal or valuation rights[106] and waivers of marshalling of as-

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102 There is no New Jersey case law directly addressing the issue of whether waivers of moratorium laws are enforceable. Nevertheless, because moratoriums are created for the benefit of the public generally, it is likely that any such waiver is either unenforceable as a violation of public policy or is meaningless since the borrower in a commercial loan transaction is not the only party who may assert such rights. For example, the New Jersey district courts did have the opportunity to rule on a similar matter relating to the ability of a German corporation to sue a United States corporation during World War II in *Farbenfabriken Bayer A. G. v. Sterling Drug, Inc.* Farbenfabriken Bayer A. G. v. Sterling Drug, Inc., 251 F.2d 300 (3d Cir. 1958), *cert. denied*, 356 U.S. 957 (1958). In that case, it is unlikely that the district court would have precluded the defendant U.S. corporation from asserting the Trading With the Enemy Act as a defense to the suit, had the plaintiff German corporation asserted that the defendant U.S. corporation had waived its moratorium rights.

103 Errors in service of process can delay a lender in enforcing its rights. The New Jersey courts have not ruled on the issue as to whether such a waiver is enforceable. However, cases that have discussed service of process have indicated that such service is a prerequisite to jurisdiction and that the relevant rules must be strictly observed. Ammond v. Lafayette, 63 N.J. Super. 86, 163 A.2d 721 (App. Div. 1960). Accordingly, it is unlikely that a court would strictly enforce any such waiver that would permit jurisdiction over a party without strict compliance with the court rules.

104 Certain statutes prohibit the exercise of civil remedies against certain types of property. Cemeteries, for example, are exempt from foreclosure by New Jersey courts. N.J. STAT. ANN. § 8A:5-12 (West 1988 and Supp. 1994). Abra-May Cemetery Sales Co. v. Degel Yehudo Cemetery Corp. of New Jersey, 92 N.J. Super. 365, 223 A.2d 507 (Ch. Div. 1966). Similarly, federal statutes that prohibit certain transfers of property may be construed to exempt such property from civil process. The Employee Retirement Income Security Act (ERISA), for example, has been held to prohibit transfer of benefits payable under any employee benefit plan. 29 U.S.C. § 1056(d)(1) (West Supp. 1993); Biles v. Biles, 163 N.J. Super. 49, 394 A.2d 153 (Ch. Div. 1978). Similarly, the Medicare and Medicaid statutes prohibit the transfer of accounts receivable from the governmental agencies implementing the Medicare and Medicaid programs. 42 U.S.C. § 1396a(a)(32)(B) (1988) (Medicaid); 42 U.S.C. § 1395g(c) (1988) (Medicare). In both cases, it is likely that such statutory limitations are not waivable by the person or entity holding the relevant property rights.

105 Certain statutes contain notice requirements that are not waivable. Article 9 of the Uniform Commercial Code requires that the secured party give the debtor notice of any disposition of collateral. N.J. STAT. ANN. § 12A:9-504(3) (West 1962 and Supp. 1994). The Code also expressly states that this requirement is not waivable. N.J. STAT. ANN. 12A:9-501(3)(a) (1962 and Supp. 1994). *See, e.g.*, May v. Womens Bank, N.A., 14 UCC Rep. Serv. 2d 26 (Colo. 1991) (holding guarantor is entitled to all rights and protections afforded to a debtor under the UCC, including non-waivability of notice of a default sale).

106 New Jersey permits obligors on foreclosed real property to dispute the amount of any deficiency with evidence of the fair market value of the property at the time of the foreclosure sale. N.J. STAT. ANN. § 2A:50-3 (West 1987 and Supp. 1994). A mortgagor's ability to waive the right to credit for the fair market value is extremely limited. 30 ROGER A. CUNNINGHAM & SAUL TISCHLER, NEW JERSEY PRACTICE 357-59 (West 1975 and Supp. 1994).

sets.[107] Since most of these types of waivers are not material to the ultimate credit decision of the lender, borrower's counsel should not be expected to opine as to the enforceability of such waivers. This is particularly true in connection with mid-market transactions.

12. *Laches (Failure/Delay in Excersing Rights).*

One of the "boilerplate" provisions found in almost every loan agreement is a clause which provides that any failure or delay of the lender to exercise its rights will not operate as a waiver of such right. New Jersey case law supports the proposition that a party's delay in exercising or failure to exercise certain rights may operate as a waiver of such rights.[108] Although the doctrine of laches is generally considered an equitable doctrine,[109] it may also serve a public interest function similar to that of statutes of limitations. In fact, the most recent case decided by the highest New Jersey state court to address the public policy behind the doctrine of laches indicated that the policy behind the doctrine is to discourage stale claims.[110] A New Jersey court, therefore, may hold a waiver of such rights unenforceable on the basis that it would violate public policy. Borrower's counsel should, therefore, include the following exception to the remedies opinion in any opinion rendered on an agreement containing such a clause:

> The opinions expressed herein are subject to the non-enforceability of provisions to the effect that failure to exercise or delay in exercising rights or remedies will not operate as a waiver of the rights or remedies.

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107 Marshalling of assets is an equitable principle which is customarily applied by one of two creditors of a common debtor. *In re* Elsinore Shore Associates, 91 B.R. 238 (Bankr. D.N.J. 1988). In fact, it has been held that the doctrine is only applicable between creditors. Johnson v. Lentini, 66 N.J. Super. 398, 169 A.2d 208 (Ch. Div. 1961). As such, it appears nonsensical that a lender would require a waiver of marshalling of assets since it is more appropriately asserted by another creditor of the borrower. Since no court has ruled on the enforceability of a waiver to assert marshalling of assets as a defense, it is not a matter on which an opinion may be easily rendered.

108 McLaughlin v. Dredge Gloucester, 230 F. Supp. 623 (D.N.J. 1964); Finley v. United States, 130 F. Supp. 788 (D.N.J. 1955); Pfeffer v. Delran Twp., 159 N.J. Super. 497, 388 A.2d 642 (Law Div. 1978).

109 Pierce v. Int'l Tel. & Tel. Corp., 147 F. Supp. 934 (D.N.J. 1957); Auciello v. Stauffer, 58 N.J.Super. 522, 156 A.2d 732 (App. Div. 1960); Fairken Assoc. v. Hutchin, 223 N.J. Super. 274, 538 A.2d 465 (Law Div. 1987); Pfeffer v. Delran Twp., 159 N.J. Super. at 497, 388 A.2d 642 (Law Div. 1978); Allstate Ins. Co. v. Howard Sav. Inst., 127 N.J. Super. 479, 317 A.2d 770 (Ch. Div. 1974).

110 Gladden v. Board of Trustees of Public Emp. Retirement Sys., 171 N.J. Super. 363, 409 A.2d 294 (App. Div. 1979).

III. Secured Transactions

A. *Types of Opinions.*

There are only three types of opinions with respect to security interests: (1) opinions as to the creation of a security interest;[111] (2) opinions as to the perfection of the security interest; and (3) opinions as to the priority of the security interest. The scope of these opinions in mid-market transactions varies significantly from the scope of these opinions in high-end transactions.

In mid-market transactions, the type of collateral with respect to which the lender requires an opinion is generally limited to property covered by Article 9 of the Uniform Commercial Code (UCC). In this case, the borrower's counsel customarily limits his opinion to specific types of property (e.g. accounts, inventory and equipment). In addition, the opinion is limited to the creation and perfection of a security interest. An opinion with respect to priority is not customarily required.

In high-end transactions, the borrower's counsel may be expected to offer opinions with respect to many more issues. The opinion may cover all of the property of the borrower, including property expressly excluded from coverage under Section 9-104 of Article 9 of the UCC. If so, borrower's counsel must expressly identify those types of property with respect to which he is not rendering an opinion. Even in high-end transactions, it is generally not necessary for the borrower's counsel to give an opinion as to all types of property.[112] This can be extremely difficult and time con-

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[111] *See infra* notes 127-136 (relating to the creation and attachment of security interests).

[112] Set forth below is a list of types of property which are only rarely an important part of the lender's collateral base.

(a) consumer goods, farm products, equipment used in farming operations, crops, timber, the unborn young of animals, minerals and the like prior to extraction (including oil and gas) and general intangibles or accounts arising or resulting from or relating to the sale of any of the foregoing;

(b) uncertificated securities;

(c) documents whether negotiable or non-negotiable and goods covered by documents;

(d) beneficial interests in a trust or a decedent's estate;

(e) letters of credit;

(f) goods, instruments or money held by a bailee;

(g) items which are subject to a statute or treaty of the United States which provides for a national or international registration or a national or international certificate of title for the perfection of a security interest therein or which specifies a place of filing different from that specified in the UCC for filing to perfect such security interest;

(h) items which are subject to a certificate of title under a statute of any state;

suming and would require a careful analysis of the borrower's business. Furthermore, because the collateral in such circumstances usually includes after-acquired property, the borrower's counsel, in drafting his opinion, should realize that the opinion may also cover types of property which the borrower may reasonably acquire in the future.

B. Personal Property Outside UCC Article 9.

In rendering an opinion as to all property of the borrower, it is important to be aware of laws other than Article 9 of the UCC that may apply to the creation or perfection of a security interest in certain types of property. Several other articles of the UCC address security interests, liens or assignments of property either exclusively or coextensively with Article 9.[113] In addition to the UCC, other state law may apply to liens and security interests in certain types of property.[114]

Of particular concern are licenses and permits which are "general intangibles" under Article 9. Most New Jersey law dealing with licenses and permits either does not address security interests or expressly precludes their assignment.[115] Other types of property which may be covered by federal laws include intellectual property (e.g., patents,[116] trademarks,[117] and copyright),[118] aircraft,[119] ves-

(i) after-acquired contract rights to the extent the grant of the security interest therein is restricted or prohibited by the terms thereof or otherwise by law.

To the extent that the opinion relates to the perfection of the security interest by filing, the items listed in (b), (c), (d), (g) and (h) above are expressly identified as items which are not perfectable by filing. N.J. STAT. ANN. § 12A:9-302 (West 1962 and Supp. 1994).

113 Article 2 addresses consignment sales and the rights of creditors in all types of personal property. N.J. STAT. ANN. § 2A:2-326 (West 1962 and Supp. 1994). Article 4 provides for the creation of certain security interests in bank deposits. N.J. STAT. ANN. § 12A:4-208 (West 1962 and Supp. 1994). Article 5 addresses assignments and interests in letters of credit. N.J. STAT. ANN. §§ 12A:5-110, 5-116 (West 1962 & Supp. 1994). Article 7 covers liens in goods covered by a document of title. N.J. STAT. ANN. § 12A:7-209, 7-307 (West 1962 and Supp. 1994). Article 8 governs the creation of liens in both certificated and uncertificated securities. N.J. STAT. ANN. § 12A:8-313, 8-321.

114 *See, e.g.*, Boat Ownership Certificate Act, N.J. STAT. ANN. § 12:7-1 - 7-6 (West 1990) and Motor Vehicle Certificate of Ownership Law, N.J. STAT. ANN. § 39:10-1 - 10-37 (West 1990 and Supp. 1994); *see also* N.J. STAT. ANN. § 6:2-7 (West 1988) (providing for a lien on aircraft causing injury to persons or property).

115 For example, liquor licenses are expressly non-transferable. N.J. STAT. ANN. § 33:1-26 (West 1994).

116 35 U.S.C. § 261 (1988). *See* John L. Mesrobian & Kenneth R. Schaefer, *Security Interests in Intellectual Property*, 125 NEW JERSEY L.J. 336 (1990) (addressing whether federal patent and trademark law preempts Article 9 of the UCC).

117 15 U.S.C. § 1058 (1988 and Supp. V).

sels,[120] rolling stock,[121] certain types of transportation collateral,[122] ERISA plan benefits,[123] Medicare accounts receivable,[124] Medicaid accounts receivable[125] and accounts receivable from federal governmental agencies.[126]

C. *Assumptions.*

1. *Creation and Attachment of Security Interest.*

It is curiously rare for borrower's counsel to be asked to render an opinion as to the attachment of a security interest under New Jersey law.[127] It is commonly accepted, however, for borrower's counsel to render an opinion as to the creation of a security interest.[128] The New Jersey UCC does not clearly distinguish between the terms "creation" and "attachment" as they relate to security interests.[129] It is clear that for a security interest to attach, there must be a security agreement, the giving of value, and the borrower must have rights in the collateral.[130] The UCC does not, however, address the prerequisites for the creation of a security interest. Therefore, the UCC, in and of itself, is unclear as to

118 17 U.S.C. §§ 101, 205 (1988 and Supp. V). *See* Weinberg and Woodward, *Legislative Process and Commercial Law*, 48 BUS. LAW. 437 (1993) (discussing the relationship between Article 9 of the UCC and the Copyright Act of 1976).

119 49 U.S.C. §§ 1301-1542 (1988 and Supp. V).

120 Ship Mortgage Act, 46 U.S.C. §§ 951-53 (1988 and Supp. V).

121 49 U.S.C. § 20(c) (1988 and Supp. V).

122 49 U.S.C. § 11304 (1988 and Supp. V).

123 29 U.S.C. § 1056(d)(1) (West Supp. 1993); Biles v. Biles, 163 N.J. Super. 49, 52, 394 A.2d 153, 155 (Ch. Div 1978).

124 42 U.S.C. § 1395g(c) (1988 and Supp. V).

125 42 U.S.C. § 1396a(a)(32)(B) (1988 and Supp. V).

126 31 U.S.C. § 3727 (1988 and Supp. V); 41 U.S.C. § 15 (1988 and Supp. V). It should be noted that security interests in accounts receivable from the United States Postal Service are not governed by the Federal Assignment of Claims Act. Rather, they are expressly covered by the statutes governing the U.S. Post Office. 39 U.S.C. § 101 - 5605 (1988 and Supp. V).

127 It is unclear why it is customary in New Jersey to request an opinion as to the "creation" of the security interest rather than the "attachment" of the security interest. The fact that the UCC is written in terms of "attachment" makes the rationale for the practice even less clear.

128 *Security Interest Report*, *supra* note 22, at 372.

129 N.J. STAT. ANN. § 12A:9-105(1)(l) uses the term "create" in defining the term "security agreement." In that context it appears that "creates" is intended to be synonymous with the phrase "provides for." This would suggest that an opinion that a security agreement creates a security interest merely means that the security agreement contains a provision expressing the intent of the debtor to grant a security interest to the secured party. Although this may be an accurate literal interpretation of the use of the term "create" under the UCC, New Jersey case law clarifies that this interpretation is too narrow. *See infra* note 135 and accompanying text.

130 N.J. STAT. ANN. § 12A:9-203 (West 1962 and Supp. 1994).

whether a security interest can be created without first having attached.

Certain authority seems to suggest that an opinion as to the creation of a security interest tells the recipient something less than an opinion that the security interest has attached.[131] Experienced New Jersey lawyers, however, will render a creation opinion, but insist that they be permitted to include assumptions that clearly relate to the attachment of a security interest. Such assumptions include assumptions as to the legal right of the lender to perform its obligations,[132] assumptions as to the giving of value[133] and assumptions as to the borrower's title to the collateral.[134] Although there is a lack of clarity in the UCC as to distinctions between creation and attachment of security interests, New Jersey case law has consistently included the UCC criteria for the attachment of a security interest[135] in determining whether a security interest has been created.[136] Accordingly, under New Jersey law, it is misleading to suggest that a creation opinion is somehow different from an attachment opinion.

(a) *Legal Right of Lender.*

In mid-market transactions, borrower's counsel is almost never expected to render any opinion relating to the lender.[137] The se-

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131 FitzGibbon and Glazer state that an opinion as to the creation of a security interest covers the status of the agreement (i.e., that it provides for a security interest, has been duly executed and delivered and is duly authorized), the reasonable identification of the collateral, and that the security agreement is in effect at the time the opinion is delivered. LEGAL OPINIONS, *supra* note 4, at 379-86. They suggest that a creation opinion does not confirm that the debtor has rights in the collateral, but that an attachment opinion does include such a confirmation. *Id.* at 377.

132 *See infra* notes 137-43 and accompanying text (regarding "Legal Right of Lender").

133 *See infra* notes 144-48 and accompanying text (regarding "Giving of Value").

134 *See* infra notes 149-51 and accompanying text (regarding "Title to Collateral").

135 N.J. STAT. ANN. § 12A:9-204 (West 1962 and Supp. 1994).

136 The New Jersey courts have construed the UCC to provide that for a security interest to be created: (1) a security agreement must be entered into; (2) the agreement must be in writing or the creditor must be in possession of the collateral; (3) the debtor must have rights in the collateral; and (4) the secured party must have given value. *In Re* Maple Contractors, Inc., 172 N.J. Super. 348, 353, 411 A.2d 1186, 1189 (Law Div. 1979); Doyle v. Northrop Corp., D.C., 455 F. Supp. 1318 (D.N.J. 1978); New Jersey Bank (Nat. Ass'n) v. Community Association/Farms, Inc., 666 F.2d 813, 818 (3d Cir. 1981). *See also* First County Nat. Bank & Trust Co. v. Canna, 124 N.J. Super. 154, 157, 305 A.2d 442, 444 (App. Div. 1973) (stating in dicta that a security interest cannot be created absent an agreement that it attach).

137 In high-end transactions, especially those involving foreign lenders, it may be necessary for borrower's counsel to render an opinion as to certain New Jersey state laws which may be applicable to the lenders. Under the New York approach, how-

curity interest opinion, as with all other opinions generally, addresses only whether the security interest is enforceable against the borrower. Borrower's counsel should, therefore, expressly assume the power of the lender under all applicable laws and regulations to perform its obligations under the loan documents.[138]

This assumption is customarily accepted by lenders for three reasons. First, under general principles of contract law, in order to form an enforceable contract, there must be mutuality between the parties.[139] Second, the assumption relieves borrower's counsel from evaluating the complex laws and regulations governing the lender and whether or not the lender is in compliance with its own governing regulations.[140] Finally, under the New Jersey UCC, as prerequisites to the attachment of a security interest, the borrower must have signed a security agreement that contains a description of the collateral,[141] and the security interest provided under the

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ever, these opinions would have to be expressly stated and not merely implied by the remedies opinion since, under the New York approach, the remedies opinion would not cover regulatory statutes applicable solely to the recipient. *Tribar Remedies Report*, *supra* note 11, at 967.

138 This assumption is of particular value to the borrower's counsel and of particular concern to the lender where the lender is a foreign bank. Under New Jersey law, foreign banks are generally precluded from transacting business in the state. N.J. STAT. ANN. § 17:9A-316 (West 1984 and Supp. 1994). The statute further provides that foreign banks may not maintain an action arising out of any such prohibited transaction. N.J. STAT. ANN. § 17:9A-330 (West 1985 and Supp. 1994). In *Arab African International Bank v. Epstein*, a New Jersey partnership borrowed $3,250,000 from a foreign bank. The loan documents provided that they would be governed by New York law. When the borrower defaulted on the loan, the foreign bank attempted to commence a foreclosure action. The borrower asserted the New Jersey foreign banking laws as a defense to the foreclosure and was successful in precluding the bank from enforcing its loan. The bank then commenced a suit alleging that the borrower's counsel committed malpractice in rendering an opinion that the loan documents were enforceable. Arab African Int'l Bank v. Epstein, 958 F.2d 532 (3d Cir. 1992). The district court held that the New Jersey foreign banking laws precluded the bank's malpractice action since the action arose out of the prohibited transaction. Arab African Int'l Bank v. Epstein, No. 90-2461, 1992 WL 184362 (D.N.J. July 21, 1992). On appeal, the Third Circuit remanded the case to the district court to determine whether, based on the extent of Arab African's business in New Jersey, the application of the New Jersey Banking Act, N.J. STAT. ANN. § 17:9A-315 - 332 (the "Act") would impose a burden on interstate commerce that outweighs New Jersey's interest in enforcing the Act. Arab African Int'l Bank v. Epstein, 10 F.3d 168 (3d Cir. 1993). Since such an analysis is factually intensive and such facts would ordinarily not be known to borrower's counsel, borrower's counsel is, therefore, well advised to expressly assume in its legal opinion that the lender has complied with all laws required to make the loan.

139 2 ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 152-170 (2d ed. 1963).

140 This is a task which would be unduly burdensome and is usually only the concern of the loan officers representing the lender.

141 N.J. STAT. ANN. § 12A:9-203(1)(a) (West 1962 and Supp. 1994). In the alternative, the New Jersey UCC permits this prerequisite to be satisfied if the collateral is in

security agreement must have become enforceable against the borrower with respect to the collateral.[142]

The remedies opinion with respect to the loan documents containing the security agreement is, therefore, an integral part of the opinion that the security interest has attached. It is important to note, however, that, under the UCC, for the security interest to attach, it is only necessary for the security interest (i.e., the security agreement) to become enforceable against the borrower.[143] The opinion that the security interest has attached does not require that the borrower's rights against the lender with respect to the security interest relationship be enforceable. The assumption as to the enforceability of the loan documents against the lender, and the right and ability of the lender to perform its obligations under the loan documents, does not, therefore, undermine the opinion that the security agreement has attached.

(b) *Giving of Value.*

An unusually customary assumption expressed in security interest opinions is the assumption that value has been given. Under the New Jersey UCC, a security interest cannot attach until "value is given."[144] Although the assumption is often made by borrower's counsel and equally as often tacitly accepted by lenders, such an assumption is unnecessary and could arguably undermine the value of the remedies opinion. Under the UCC, consideration necessary to support a contract is all that is needed for value to have been given.[145] In rendering a remedies opinion, the borrower's counsel is required to make a legal determination that there is con-

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the possession of the secured party pursuant to an agreement. *Id.* If the security interest covers crops or timber, the UCC requires that the description of the collateral also include a description of the real estate where the crops or timber is located. *Id.*

142 N.J. STAT. ANN. § 12A:9-203(2) (West 1962 and Supp. 1994).

143 "A security interest attaches when it becomes enforceable against the debtor with respect to the collateral." N.J. STAT. ANN. § 12A:9-203(2) (West 1962 and Supp. 1994).

144 N.J. STAT. ANN. § 12A:9-203(1)(b) (West 1962 and Supp. 1994).

145 The concept of the giving of value was originally incorporated in Section 9-204(1) of the New Jersey UCC. The New Jersey Study Comment published in connection with the adoption of the UCC in New Jersey stated that "[v]alue as used in this section is defined in § 1-201(44) and includes, *inter alia*, any consideration sufficient to support a simple contract." *New Jersey Study Comment No. 3* to original N.J. STAT. ANN. § 12A:9-204(1) (West 1962 and Supp. 1994). The requirement of the giving of value has since been moved. N.J. STAT. ANN. § 12A:9-203(1)(b) (West 1962 and Supp. 1994). Under Article 1 of the UCC, a person is deemed to have given "value" if he acquires rights in return for any consideration sufficient to support a simple contract. N.J. STAT. ANN. § 12A:1-201(44)(d) (West 1962 and Supp. 1994).

sideration necessary to support a binding contract.[146] If borrower's counsel assumes that value has been given, such an assumption could also be construed to include an assumption that there is consideration necessary for validity of the loan documents,[147] thereby diminishing the value of the remedies opinion.[148]

(c) *Title to Collateral.*

Another assumption often made by borrower's counsel in rendering security interest opinions is that the borrower has good title to the collateral. Under the New Jersey UCC, a security interest in collateral will not attach unless the borrower has "rights in the collateral."[149] Although the issue of whether the borrower owns the collateral may be a legal one, the time-consuming investigation and related expenses which would be necessary to confirm a borrower's ownership of specific property is usually beyond the scope of most mid-market and high-end transactions. For this reason, it is commonly accepted for borrower's New Jersey counsel to assume that the borrower has rights in the collateral. This assumption may take two forms. It may be stated as a "stand alone" provision in the opinion letter or it may be incorporated directly into the security interest opinion.[150]

Although it is customary to permit borrower's counsel to assume that the borrower has rights in the collateral, the express statement of the assumption in the borrower's counsel's opinion may be unnecessary.[151] Loan documents very often contain a rep-

146 *ABA Accord, supra* note 1, at 198; FIELD & RYAN, *supra* note 34, at 4-1, 4-2, 4-9; LEGAL OPINIONS, *supra* note 4, at 200.

147 *See supra* note 122.

148 Although some authority has suggested that an assumption as to the giving of value may be appropriate where the sole value is a commitment to lend which is so illusory as not to support a simple contract, such an assumption in almost all cases will be unacceptable to lender's counsel since the lender will be looking to borrower's counsel to render a remedies opinion as to the other underlying agreements. *Security Interest Report, supra* note 22, at 373.

149 N.J. STAT. ANN. § 12A:9-203(1)(c) (West 1962 and Supp. 1994).

150 The "stand alone" version of the assumption is often stated as follows: "We express no opinion as to the borrower's rights in and title to any of the collateral with respect to which a security interest is purported to be granted pursuant to the loan documents." The assumption can also be expressed as an integral part of the security interest opinion as follows: "The security agreement creates in favor of the lender a valid security interest in all right, title and interest of the borrower in the collateral."

151 The New York practice appears to presume that an opinion as to the creation of a security interest does not include an implication as to the borrower's rights in the collateral. *Security Interest Report, supra* note 22, at 373-74. Unfortunately, there is no case law supporting this presumption and failure to expressly include an exception as to the borrower's rights in the collateral could potentially expose borrower's counsel

resentation of the borrower that the borrower owns the collateral free of liens. It is also customary for borrower's counsel to rely on the representations of the borrower in the loan documents. In such cases, the assumption will be unnecessary since the borrower's opinion incorporates reliance upon the representation of the borrower as to the borrower's rights in the collateral.

2. *Collateral Will Not Become Fixtures.*

In rendering an opinion as to the perfection of a security interest in assets where the collateral does not include fixtures, borrower's counsel will often include an assumption that the collateral will not become fixtures.[152] Such an assumption relates only to the perfection of a security interest. If collateral existing at the time the transaction is consummated later becomes fixtures, the lender may lose its perfection in such items. Under the UCC, in order to perfect a security interest in fixtures, it is necessary to file a financing statement with the county clerk[153] which describes not only the fixtures, but also the property on which the fixtures are located.[154] Although lenders often file financing statements with both the Secretary of State and the county clerk, they may not include a description of the real estate. Accordingly, the county clerk filing would be insufficient to maintain the perfected security interest in goods that became fixtures.

D. Exceptions.

1. *Creation.*

(a) *Rights of Third Parties.*

Article 9 of the UCC expressly permits the assignment of accounts and further provides that any contract provision purporting to prohibit assignment is unenforceable.[155] All accounts, however, are subject to any defenses and other contractual restrictions between the borrower and the account debtor.[156] While such defenses or restrictions may not preclude the creation of a security interest in the accounts, they may affect the lender's remedies or

to liability to the opinion recipient who is relying on borrower's counsel's legal opinion that a valid security interest has been created.

[152] The assumption is customarily worded as follows: "We have assumed that no collateral consisting of goods will constitute fixtures."

[153] N.J. STAT. ANN. § 12A:9-401(1)(b) (West 1962 and Supp. 1994).

[154] N.J. STAT. ANN. § 12A:9-402(5) (West 1962 and Supp. 1994).

[155] N.J. STAT. ANN. § 12A:9-318(4) (West 1962 and Supp. 1994).

[156] FIELD & RYAN, *supra* note 34, at 7-7, 7-8.

even the amount of the account payable to the borrower. Although the concern is most commonly stated with respect to accounts, it is also applicable to other contract rights that are included in the collateral.[157] Therefore, borrower's counsel will sometimes seek to include an exception which provides:

> The opinions expressed herein are subject to the rights of lessees or other account debtors in any of the collateral, the terms of the leases or other contracts between the borrower and such lessees or account debtors, and any claims or defenses of such lessees or account debtors against the borrower arising under or outside such leases or other agreements.

Such an exception is designed to permit the borrower's counsel to render the remedies opinion and the opinions as to the creation and perfection of the security interest without detailed due diligence concerning each contractual relationship. This is appropriate where contract rights are not the basis of the collateral. Even where accounts are a substantial portion of the collateral, it is usually impractical to require borrower's counsel to review every aspect of the borrower's relationship with its account debtors or to obtain estoppel certificates waiving defenses from such third parties.

(b) *Adequacy of Description.*

The adequacy of the description of the collateral is an important aspect to lenders since it is a fundamental element of the creation of a valid security agreement,[158] the formal financing statement prerequisite to filing[159] and necessary to put third parties on notice of the items intended to be covered by the financing statement.[160] New Jersey, however, is almost devoid of case law

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157 As previously discussed, the opinion as to the creation of a security interest is implicit in an opinion that a security agreement is enforceable. *See supra* notes 137-43 and accompanying text (regarding the "Legal Right of Lender"). Accordingly, an opining attorney is well advised to include an exception for the rights of third parties where the collateral includes contract rights. Where the collateral includes accounts, the need for the exception is less clear since the UCC expressly provides that prohibitions against the assignment of accounts are unenforceable. N.J. STAT. ANN. § 12A:9-401(1)(b) (West 1962 and Supp. 1994). Where the collateral includes accounts, inclusion of the exception in the opinion serves to put the recipient on notice that the account collateral may be subject to certain defenses and restrictions and thereby reduces the likelihood that the opinion could be considered misleading as to the rights of the secured party in the accounts.

158 N.J. STAT. ANN. § 12A:9-203(1)(a) (West 1962 and Supp. 1994).

159 N.J. STAT. ANN. § 12A:9-402(1) (West 1962 and Supp. 1994).

160 N.J. STAT. ANN. § 12A:9-110 (West 1962 and Supp. 1994).

construing the UCC description requirements.[161] All that can be gleaned from New Jersey case law is that an accurate serial number type of description will be held to reasonably identify the collateral.[162] Case law in other jurisdictions has indicated that the use of the UCC definitions for "equipment," "inventory" and "accounts" may be sufficient to give notice to third parties of the intended collateral.[163] Although these terms are deemed sufficient in other jurisdictions, they have not been expressly deemed sufficient either under New Jersey case law or under the UCC. Furthermore, other UCC defined terms (e.g., general intangibles) have been criticized as not permitting reasonable identification.[164] Case law in other jurisdictions (and perhaps in New Jersey) has held broad descriptions to be insufficient.[165]

Although it is customary for New Jersey lawyers to use definitions of UCC terms in describing collateral, whether such a practice provides for a sufficient description is arguably unclear in New Jersey. While an opinion is not a guaranty, such an opinion cannot be given on the basis of New Jersey law and can only be given by reference to other law. In order for a description to be sufficient, the UCC requires that it reasonably identify the thing described.[166] It is the author's experience that New Jersey practitioners are split as to whether they will render an opinion as to the sufficiency of a description. While lenders will customarily want assurance that the description of the collateral is adequate,[167] due to the status of New

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161 *See In re* Lake Hopatcong Water Corp., 15 B.R. 411 (Bankr. D.N.J. 1981) (holding New Jersey board of public utility commissioners approval of mortgage on a utility plant was insufficient to authorize security interest in accounts, inventory, contract rights and fixtures); *In re* United Thrift Stores, Inc., 363 F.2d 11 (3d Cir. 1966) (upholding validity of security interest where trust receipts in appliance inventory described appliances); National-Dime Bank of Shamokin v. Cleveland Bros. Equipment Co., 20 Pa. D. & C.2d 511, 74 Dauph. 194 (1961) (holding a serial number type description of backhoe to reasonably identify the collateral).

162 *National-Dime Bank*, 74 Dauph. at 194.

163 *See* FIELD & RYAN, *supra* note 34, at 8-3, 8-4 (citing *In re* Sarex Corp., 509 F.2d 689 (2d Cir. 1975) (equipment); *In re* Varney Wood Products, Inc., 458 F.2d 435 (4th Cir. 1972) (accounts); *In re* Bazaar de la Cuisine Int'l, Inc., 20 U.C.C. Rep. Serv. 1049 (Bankr. S.D.N.Y. 1976) (inventory); Marquette Nat'l Bank v. B.J. Dodge Fiat, Inc., 475 N.E.2d 1057 (Ill. 1985) (accounts).

164 *See* FIELD & RYAN, *supra* note 34, at 8-3, 8-4; LEGAL OPINIONS, *supra* note 4, at 383; *California Secured Transactions Report*, *supra* note 3, at 808.

165 *In re* E.P.G. Computer Servs., Inc., 20 U.C.C. Rep. Serv. 1084 (Bankr. S.D.N.Y. 1976). *See also California Secured Transactions Report*, *supra* note 3, at 808. Similarly, a bankruptcy court sitting in New Jersey has held that the phrase "utility plant" was insufficient to cover accounts, inventory, contract rights and fixtures of the plant. *In re* Lake Hopatcong Water Corp., 15 B.R. at 418-20.

166 N.J. STAT. ANN. § 12A:9-110 (West 1962 and Supp. 1994).

167 FIELD & RYAN, *supra* note 34, at 8-4, 8-5.

Jersey law (except where the collateral consists of property which is specifically identifiable by serial number or another similar method) it is beyond the scope of borrower's counsel's representation to confirm that the description reasonably identifies what the lender intends to take as collateral.

Notwithstanding the foregoing, based on a simple comparison of the documents, borrower's counsel should be able to opine that the description of the collateral contained in the security agreement should not be deemed insufficient on the grounds that it differs from the description in the financing statement.[168]

(c) *Buyer in Ordinary Course § 9-307.*

Section 9-307 of the UCC provides for three exceptions pursuant to which an otherwise secured party's security interest may be defeated: (1) a buyer in the ordinary course;[169] (2) a buyer of consumer goods;[170] and (3) a buyer of collateral subject to security interests for future advances.[171] The buyer in the ordinary course exception provides that a buyer in the ordinary course[172] takes free of the perfected security interest of a secured party, even if the buyer knows of the existence of the security interest.[173] The sec-

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168 In rendering a security interest opinion, a form of compromise exception may read as follows:

> No opinion is expressed as to whether phrases such as "other property," "all property," "all real, personal and mixed property," and similar phrases and the phrase "general intangibles" are sufficient descriptions so as to provide reasonable identification of the property intended to be covered thereby; however, we do not believe that the description of the collateral set forth in the financing statements would be deemed to be insufficient on the grounds that it differs from the description in the security agreement.

This compromise expresses the concern as to overly broad phrases and the use of the term "general intangibles," but provides the lender some comfort that the transcription from the security agreement to the financing statement was done accurately. It must be noted, however, that such a compromise is not necessarily recommended, since New Jersey law is deficient as to the meaning of sufficiency of a description of collateral and since decisions in the other jurisdictions is only of limited value.

169 N.J. STAT. ANN. § 12A:9-307(1) (West 1962 and Supp. 1994).

170 N.J. STAT. ANN. § 12A:9-307(2) (West 1962 and Supp. 1994).

171 N.J. STAT. ANN. § 12A:9-307(3) (West 1962 and Supp. 1994).

172 Persons buying farm products from farmers are excluded from this exception. N.J. STAT. ANN. § 12A:9-307(1) (West 1962 and Supp. 1994).

173 N.J. STAT. ANN. § 12A:9-307(1) (West 1962 and Supp. 1994). The statute references Section 1-201(9) for the definition of "Buyer in the Ordinary Course of Business." Under that section, such a buyer must buy without knowledge of the security interest of the secured party. Section 9-307, however, expressly provides that a buyer in the ordinary course takes free of a perfected security interest even though he knows of the security interest. *Id.* The apparent conflict between the two sections is resolved by reference to the comment to Section 9-307. The comment clarifies that a

ond exception regarding consumer goods only applies to consumer goods in which the secured party holds a purchase money security interest.[174] The final exception permits a buyer (who is not a buyer in the ordinary course) to take free of any security interest in two circumstances. First, if the secured party makes a future advance after becoming aware of the sale of the collateral, the buyer will take the collateral free of any security interest that would otherwise have attached in respect of the future advance.[175] Second, 45 days after the purchase, any future advances made by the secured party are not secured by the collateral sold.[176]

The plain language of the statute provides that the buyer in each of these circumstances "takes free of the security interest."[177] Accordingly, these provisions operate not merely to subordinate the interest of the secured party, but rather to void the security interest altogether. Although, notwithstanding Section 9-307, a security interest may be created and perfected prior to the sale to a buyer in the ordinary course, New Jersey lawyers often include an advisory exception for the rights of buyers pursuant to Section 9-307.[178] By including such an exception, borrower's counsel is notifying the lender that the law provides circumstances under which the lender's security interest will be treated as if it were not created or perfected. This exception is included to prevent the opinion from being misleading.

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buyer takes free of a security interest even if he knows that the security interest exists. However, a buyer who knows that the underlying security agreement prohibits the sale of the property subject to the security interest, then the buyer takes subject to such security interest. *See* § 2 of the 1972 *Official Comment* to N.J. STAT. ANN. § 12A:9-307.

174 In order to perfect a security interest (other than a purchase money security interest) in consumer goods, it is necessary to file a financing statement or to take possession of the goods. N.J. STAT. ANN. § 12A:9-302(1)(a) & (1)(d) (West 1962 and Supp. 1994). It is almost inconceivable that a buyer could buy consumer goods from a debtor where the goods were in the possession of the secured party without obtaining knowledge of the security interest. Accordingly, as a practical matter, the exception for consumer goods will only generally arise as to purchase money security interests in consumer goods.

175 N.J. STAT. ANN. § 12A:9-307(3) (West 1962 and Supp. 1994).

176 *Id.*

177 N.J. STAT. ANN. § 12A:9-307(1) - (3) (West 1962 and Supp. 1994).

178 A "buyer in the ordinary course of business" as defined in Section 1-201(9) does not have knowledge that his purchase violates the security interest of a third party. N.J. STAT. ANN. 12A:1-201(9). A "buyer in the ordinary course of business" under Section 9-307 is one who knows of the existence of the security interest, but presumably does not know that his purchase violates the security interest. N.J. STAT. ANN. 12A:9-307(1). Due to the fact that many secured parties are surprised to discover that a purchaser who is aware of the existence of the secured party's lien can nonetheless purchase the collateral free of such lien, such an exception is often advisable.

(d) *After-Acquired Property § 9-108.*

Almost every security agreement will include a provision pursuant to which the property of the borrower acquired after the consummation of the loan is deemed to be included in the collateral. Borrower's counsel's opinion as to the creation of a security interest in collateral would be deemed, therefore, to include an opinion as to the creation of a security interest in after-acquired property.[179] The UCC provides certain limitations upon when such after-acquired property will be subject to the security interest of the lender.[180] Under Section 9-108, a secured party may take a security interest in after-acquired property only to the extent that new value is given.[181] Under the statute, new value is given if the after-acquired property is obtained by the debtor either (a) in the ordinary course of business or (b) under a contract of purchase made within a reasonable time after new value is given and permitted or contemplated by the security agreement.[182] The commentary under Section 9-108 suggests that a secured party may not be able to create a security interest in after-acquired property which is not the type of property ordinarily acquired by the debtor in the course of its business or is not acquired within a reasonable time after new value is given.[183] For this reason, an exception to the security interest opinion as to creation is necessary to avoid rendering an inaccurate opinion when the collateral includes after-acquired property.[184]

2. *Perfection.*

(a) *Proceeds.*

Where proceeds are included in the description of the collateral or where borrower's counsel is requested to render an opinion

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179 *Security Interest Report, supra* note 22, at 393.

180 N.J. STAT. ANN. § 12A:9-108 (1962 and Supp. 1994).

181 *Id.*

182 *Id.*

183 The commentary indicates that judicial construction had customarily limited the enforceability of after-acquired property clauses to exclude property not acquired in the ordinary course of business. While expressly stating that the statute is not intended to *per se* exclude such property from coverage under an after-acquired property clause, it does make clear that the section is intended to "deny present value status to out of ordinary course acquisitions not made pursuant to the original loan agreement." N.J. STAT. ANN. § 12A:9-108, *Official Comment* (West 1962 and Supp. 1994).

184 The form of exception may be stated as follows: "The opinions expressed herein are subject to the qualification that security interests in after-acquired property are subject to the limitations set forth in section 9-108."

that no additional filing or action is necessary to maintain the perfection of the lender's security interest, borrower's counsel must address issues related to the maintenance of a perfected security interest in proceeds.[185] Security interest opinion concerns as to proceeds relate only to the perfection of the security interest.[186] A secured party may have to take additional action within 10 days after the sale of the property to maintain its security interest in proceeds.[187] Therefore, it is in the best interest, not only of the borrower's counsel, but also of the lender (who may refer to and rely upon the opinion when deciding how to proceed in certain circumstances later), for the opinion to reference the UCC's limitations on perfection of security interests in proceeds.[188]

(b) *Continuation Filings.*

Where borrower's counsel is required to offer an opinion as to the perfection of security interests, borrower's counsel should identify those circumstances where additional action will be required.[189] Generally, these circumstances include the expiration of the five-year period from the date of filing of the financing state-

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[185] To the extent that borrower's counsel's opinion relates only to matters existing as of the date of closing, it may be argued that an exception as to the limitations set forth in Section 9-306 is unnecessary since, as of the date of the opinion, the security interest in any proceeds of collateral sold on that day will remain perfected. *See generally* N.J. STAT. ANN. § 12A:9-306(3) (West 1962 and Supp. 1994) (providing for the continuance of perfection for 10 days from the date of sale). Such perfection, however, exists only for "identifiable" proceeds. N.J. STAT. ANN. § 12A:9-306(2) (West 1962 and Supp. 1994). Furthermore, borrower's counsel's opinion could be misleading to the extent that borrower opines that the lender's security interest in the collateral, including proceeds (which contemplates future sales of the collateral), is perfected. *But see Security Interest Report, supra* note 22, at 395 (suggesting that opinions as to the perfection or priority of security interests in proceeds should not be implied).

[186] The UCC expressly provides that notwithstanding the sale of the collateral, the secured party's security interest continues to exist in not only the collateral, but also in any identifiable proceeds of the sale. N.J. STAT. ANN. § 12A:9-306(2) (West 1962 and Supp. 1994).

[187] A security interest in certain proceeds (e.g., certain non-cash proceeds) may become unperfected 10 days after the debtor receives the proceeds if the secured party does not independently perfect its security interest in such proceeds. N.J. STAT. ANN. § 12A:9-306(3)(c) (West 1962 and Supp. 1994).

[188] The exception is often drafted as follows: "The opinions expressed herein are subject to the qualification that in the case of collateral consisting of proceeds, continuation of perfection of the security interest therein is limited to the extent set forth in Section 9-306."

[189] Certain commentators recommend that the opinion contain such a qualification, but suggest that the failure to include such a qualification does not render the opinion misleading. *California Secured Transactions Report, supra* note 3, at 817.

ments,[190] a change in the name, identity or corporate structure of the debtor,[191] a change in the location of the debtor[192] or a change in the location of the collateral.[193]

The need to include a qualification as to the necessity of filing continuation statements has been questioned.[194] Nonetheless, lenders should not object to the inclusion of such a qualification since it is clearly required by the UCC. One version of such a qualification may be generally stated as follows:

> In order to maintain the perfection of security interests perfected by filing, continuation statements complying with the UCC must be filed not more than six months prior to the expiration of the five-year period following the date of filing of the financing statement, and not more than six months prior to the expiration of each subsequent five-year period after the original filing.

The qualifications relating to other circumstances are generally stated as follows:

> We call your attention to the fact that the perfection of the . . . security interests will be terminated (1) as to any collateral acquired by the Debtor more than four months after the Debtor so changes its name, identity or corporate structure as to make the financing statements seriously misleading, unless new appro-

190 N.J. STAT. ANN. § 12A:9-403(2) (West 1962 and Supp. 1994).

191 N.J. STAT. ANN. § 12A:9-402(7) (West 1962 and Supp. 1994).

192 N.J. STAT. ANN. § 12A:9-103(3)(e) (West 1962 and Supp. 1994).

193 N.J. STAT. ANN. § 12A:9-103(1)(d), (2)(d) (West 1962 and Supp. 1994).

194 *Id.* Where borrower's counsel is required to opine that there are no further filings or actions necessary to maintain the security interest, it is unclear whether failure to include a qualification (at least as to the 5 year continuation statement requirement) may render the opinion misleading. FIELD & RYAN, *supra* note 34, at 8-11 (expressing the opinion that such qualifications and other limitations "should be understood . . . whether or not expressly stated"). Support for the omission of such a qualification is, perhaps, founded in the fact that the requirement that the lender file continuation statements is so widely known by all commercial asset-based financiers as to render notice in opinion letters unnecessary. *Id*; *see also Security Interest Report*, *supra* note 22, at 379. Other qualifications as to changes in circumstances which would require additional action to maintain perfection may be considered advisory in nature and not required since, as of the date of the opinion, such circumstances have generally not arisen. Including qualifications as to such other circumstances, however, puts the lender on notice that changes in circumstances may require further action to maintain perfection. *California Secured Transactions Report*, *supra* note 3, at 817. The New York Tribar Opinion Committee has suggested that where the law of the applicable jurisdiction is non-uniform, the borrower's counsel should include express exceptions to address such non-uniformity. *Security Interest Report*, *supra* note 22, at 379. Such a requirement, however, places the burden on the opinion counsel to survey the laws of jurisdictions in which such counsel is not obligated to opine in order to determine whether the laws of the opining counsel's jurisdiction may be considered by the opinion recipient(s) to be non-uniform.

> priate financing statements indicating the new name, identity or corporate structure of the Debtor are properly filed before the expiration of such four months and (2) as to any collateral consisting of accounts, general intangibles or mobile goods, four months after the Debtor changes its chief executive offices to a new jurisdiction outside the State (or, if earlier, when perfection under the laws of the State would have ceased) unless such security interests are perfected in such new jurisdiction before that termination.[195]

To the extent that the collateral includes money or instruments (for which possession is generally required to perfect a security interest in such items), borrower's counsel may also wish to include the following qualification where possession of the property may not be delivered at closing:

> As to any Collateral consisting of "money" or "instruments" (as defined under the UCC), other than instruments which constitute a part of "chattel paper" (as defined under the UCC), the perfection of a security interest therein will terminate twenty-one days after such security interest attaches, unless the secured party takes possession of such instruments.[196]

This qualification may be particularly relevant in situations where the lender purports to take a security interest in all instruments pursuant to a "lockbox" type of arrangement. If checks are mistakenly sent to the borrower, rather than to the lockbox, the lender's security interest in such instruments may terminate unless the lender obtains possession within 21 days.

In multiple state transactions, where the collateral consists of goods which may be relocated in other jurisdictions or come into New Jersey from other states, borrower's counsel should consider including a further exception in the form stated below:

> Certain additional action may be required under [New York] law to maintain perfection of a security interest in certain goods to the extent provided under Section 9-103 of the UCC.[197]

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195 FIELD & RYAN, *supra* note 34, at 8-11.

196 Field & Ryan propose the following as an alternate variation of the exception:

> [I]n the case of instruments (as such term is defined in Article 9 of the UCC) not constituting part of chattel paper (as such term is defined in Article 9 of the UCC), the security interests of the secured party therein cannot be perfected by the filing of the financing statements but will be [created and] perfected if possession thereof is in accordance with the provisions of [the security agreement] [Article 9 of the UCC].

Id. at § 8.03[1].

197 N.J. STAT. ANN. § 12A:9-103(1) covers circumstances in which the secured party may have to take further action to maintain perfection of a security interest in ordinary goods which are relocated to another jurisdiction. N.J. STAT. ANN. § 12A:9-

3. *Accessions.*

Where the borrower is a manufacturer or is engaged in any business where things are assembled, the UCC provisions concerning accessions[198] should be addressed in the borrower's counsel's security interest opinion. Although most of the UCC provisions addressing accessions deal with the priority of competing security interests,[199] certain provisions deal with the validity of the security interest[200] and impose limitations on the secured party's ability to deal with the collateral.[201]

Generally, a security interest in accessions which attaches after the accessions are incorporated into other goods is invalid against a person who has a preexisting security interest in the whole.[202] This is of particular concern where the borrower manufactures or installs subassemblies.[203] Although no New Jersey court has construed the statute, in such transactions borrower's counsel is well advised to include a qualification to his opinion as follows:

> The opinions expressed herein are subject to the qualification that in the case of collateral consisting of accessions, the validity of the security interest and the ability of a secured party to remove its collateral from the whole is limited to the extent set forth in Section 9-314 of the UCC.

E. Priority Opinions.

Most experienced New Jersey lawyers will not render an opinion as to the priority of security interests[204] which are perfected by means other than possession.[205] Many educational materials ad-

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103(2) addresses the action necessary to maintain a perfected security interest in goods covered by a certificate of title which are brought into New Jersey.

198 N.J. STAT. ANN. § 12A:9-314 (West 1962 and Supp. 1994).

199 N.J. STAT. ANN. § 12A:9-314(1) & (3) (West 1962 and Supp. 1994).

200 N.J. STAT. ANN. § 12A:9-314(2) (West 1962 and Supp. 1994).

201 N.J. STAT. ANN. § 12A:9-314(4) (West 1962 and Supp. 1994).

202 N.J. STAT. ANN. § 12A:9-314(2) (West 1962 and Supp. 1994).

203 For example, where a lender takes a security interest in the inventory of a borrower who installs computer hardware in its customers' computers, at the time of the closing, the lender's security interest in any computer hardware already installed in computers owned by the borrower's customers may be invalid against the holder of a security interest in the computer.

204 LEGAL OPINIONS, *supra* note 4, at 372 ("[E]xperienced lawyers often refuse to give priority opinions on the grounds that the factual questions and legal rights relating to priority are so complex that the exceptions, qualifications, and assumptions required to make an opinion accurate would render it of little value to the opinion recipient.").

205 Where a security interest in identifiable instruments or certificated securities is to be perfected by possession, it may be possible for borrower's counsel to render a priority opinion with respect to such property. Such an opinion, however, should

dressing such priority opinions agree that either such opinions should not be rendered or that any such opinion, if properly given, is subject to so many qualifications[206] that the cost of preparing the opinion outweighs its value.[207] This is true regardless of whether the transaction in connection with which the opinion is rendered is a mid-market transaction or a high-end transaction. Perhaps the most convincing reason for borrower's counsel to refuse to render a priority opinion arises out of the existence of an unknown number of uncommon liens which may arise by operation of law. The Uniform Commercial Code Committee of the Business Law Section of the State Bar of California has, for example, identified 69 such security interests or liens arising solely under California State law.[208] Although no authority has attempted to create a similar list of liens which may arise under New Jersey law, examples of such liens can be found under New Jersey law.[209] Similarly, various

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include assumptions that the secured party takes possession of the collateral in New Jersey in good faith without notice of any adverse claim thereto and retains possession of the collateral. The secured party must take possession of the collateral in New Jersey since, if the secured party takes possession of the collateral in another jurisdiction, New Jersey law would look to the law of the other jurisdiction to determine the manner of perfection. N.J. STAT. ANN. § 12A:9-103(1)(b) (West 1962 and Supp. 1994).

206 Even the "boilerplate" exceptions to priority opinions are numerous. *See* FIELD & RYAN, *supra* note 34, at 8-18 to 8-20; STERBA, *supra* note 19, at 94-99.

207 FIELD & RYAN, *supra* note 34, at 8-13 to 8-18; LEGAL OPINIONS, *supra* note 4, at 409.

208 *California Secured Transactions Report*, *supra* note 3, at 820-21 n.157.

209 *See e.g.*, N.J. STAT. ANN. § 6:2-7 (West 1988) (providing for a statutory lien on aircraft for injuries resulting from damages caused by falling cargo); N.J. STAT. ANN. § 58:10-23.11f (West 1992) (providing for the superpriority of liens arising under the Spill, Compensation and Control Act over preexisting liens); N.J. STAT. ANN. § 2A:42-1 (West 1987) (landlord's lien); N.J. STAT. ANN. § 2A:44-2 (West 1987) (aircraft maintenance lien); N.J. STAT. ANN. § 2A:44-21 (West 1987) (artisan's lien); N.J. STAT. ANN. § 22A:44-51 (West 1987) (agister's lien); N.J. STAT. ANN. § 22A:4-158 (West 1987) (clothing processor's lien); N.J. STAT. ANN. § 14:14-21 (West 1987) (wage lien); N.J. STAT. ANN. § 2A:13-5 (West 1987) (attorney's charging lien). The attorney's charging lien may have superpriority in certain circumstances. *See* Adco Service, Inc. v. Graphic Color Plate, 137 N.J. Super. 39, 347 A.2d 549 (Law Div. 1975) (providing superpriority over federal tax liens); Osborne v. Dunham, 16 A. 231 (1889) (providing attorney's lien on mortgage superior to that of prior assignee). A common law attorney's retaining lien attaches to all papers, books, documents, securities, moneys and property of the client in the possession of the attorney. Brauer v. Hotel Assoc., Inc., 40 N.J. 415, 192 A.2d 831 (1963). There are numerous other liens that arise by operation of law under other portions of the UCC other than Article 9 and would not be uncovered by a UCC financing statement search or other public record search. Under N.J. STAT. ANN. 12A:9-113, liens arising in connection with the retention or reservation of title by the seller of goods (N.J. STAT. ANN. 12A:2-410(1) (West 1962 and Supp. 1994)), the shipment by the seller of goods under reservation (N.J. STAT. ANN. 12A:2-505 (West 1962 and Supp. 1994)), and the rejection of goods (N.J. STAT. ANN. 12A:2-711(3)

federal laws may also create complex priority issues which make the rendering of a priority opinion risky.[210] Furthermore, since security interests in certain collateral may be perfected by possession without any public filing,[211] it may be impossible or impractical for the opining counsel to determine which of those items are in the possession of third parties at the time that a security interest attaches. Accordingly, borrower's counsel may wish to include a qualification to clarify that no opinion is rendered as to the priority of any security interest or lien.

It should be noted that recent New York authority has suggested that an unqualified priority opinion may be reasonably given where the opinion is limited to an opinion based solely upon a review of a UCC search report and such report does not reveal any prior filings.[212] Such an opinion has been referred to as a "Filing Priority Opinion."[213] Although it may be possible to responsibly draft such an opinion under New Jersey law, there is at least one peculiarity of New Jersey practice that could result in a great degree of exposure for the opining attorney.[214] Among other things, a Filing Priority Opinion confirms that "a UCC search report (identifying the correct name and, if necessary, address, of the debtor) was obtained from the appropriate filing office."[215] In New Jersey, a UCC search report obtained against the correct legal name (e.g., as it appears on a certificate of incorporation) of the

(West 1962 and Supp. 1994)) do not require a security agreement, do not require filing for perfection and are governed by Article 2, not by Article 9.

210 *See, e.g.*, United States v. McDermott, 113 S. Ct. 1526 (1993) (holding that recorded federal tax liens have priority over other previously recorded liens in after-acquired property).

211 Security interests in letters of credit, advices of credit, goods, instruments, negotiable documents and chattel paper may be perfected by possession without filing. N.J. STAT. ANN. 12A:9-305 (West 1962 and Supp. 1994).

212 *Security Interest Report*, *supra* note 22, at 380-83.

213 *Id.* at 381.

214 The Tribar Opinion Committee indicates that non-uniform laws of the jurisdiction should be pointed out. *Id.* at 379 n.61, 386 n.74, 388 n.77. Under this approach, the opinion giver is responsible to review the differences between the version of the Uniform Commercial Code adopted in the opinion giver's jursidiction and the "uniform" version of the Uniform Commercial Code. *Id.* Although there have been three "uniform" versions of the Uniform Commercial Code (1962, 1972 and 1977), all states, except Vermont and Louisiana, have adopted the 1977 versions. 1D PETER F. COOGAN, ET AL., SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE 3-6 (Supp. 1993). Further revisions to Article 9, however, are scheduled to be released for adoption by the states in 1995 or 1996. BARKLEY CLARK, THE LAW OF SECURED TRANSACTIONS UNDER THE UCC A-3 (1993). As these revisions are adopted by certain states and not others, it is unclear which "uniform" version of Article 9 the opinion giver should use for comparison.

215 *Securiy Interest Report*, *supra* note 22, at 381.

debtor may not be sufficient to reveal all financing statements filed against the debtor. Currently, the software used by the New Jersey Secretary of State to search for financing statements does not use the complex and expansive boolean logic that is familiar to many attorneys who use CD-Rom search software or the Westlaw® or Lexis® on-line database services. Instead, the algorithms contained in the software used by the New Jersey Secretary of State search by word roots.[216] Furthermore, there is case law in other jurisdictions that suggests that the secured party is responsible for understanding the limitations of the filing office's search software.[217] This would suggest that the debtor's attorney is also responsible for such an understanding. Accordingly, the attorney rendering such an opinion is potentially liable if the attorney did not predict all of the variations on the debtor's name against which other secured parties may have filed.[218]

The New York Tribar Opinion Committee suggests that in jurisdictions that will only fill search requests against a non-corporate debtor at a single address, ordering separate reports for each possible address of such debtor may pose "insurmountable practical problems."[219] In most cases, it will be impossible to determine all of the potential variations and abbreviations of a debtor's name. Even in cases where such a determination is possible, it will likely

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216 For example, a search of "Abbott Distributing, Inc." would not necessarily reveal financing statements identifying the debtor by the names "Abott," "Abbot," or "Abot". Nor would the search reveal financing statements which abbreviated the word "Distributing." For example, such a search would not necessarily reveal financing statements filed against "Abbott Dist., Inc." or "Abbott Distrib., Inc."

217 *In re* Thriftway Auto Supply, Inc., 156 B.R. 300, *aff'd* 159 B.R. 948 (Bankr. W.D. Okla. 1993).

218 The *In re Thriftway* court stated:

> [The prior creditor's] filing was easily retrievable with a minimally expanded search based upon Thriftway's own legal name. Given the commercial reality that financing agreements may be misfiled or misnamed, despite all best efforts, a searcher should be required to at least take advantage of the flexibility offered by a computer system to find all potential filings with similar names.

In re Thriftway, 159 B.R. at 953.

219 *Security Interest Report*, *supra* note 22, at 381. Although the New Jersey Secretary of State will require the inclusion of an address in order to fill a search request at the state level, New Jersey is not a jurisdiction which is currently subject to such a problem. Secretary of State search reports are divided into two sections. The first section identifies financing statements filed against debtors with a name and address identical to the one being searched. The second section identifies financing statements filed against debtors with similar names or the same name but a different address. The address is used to determine what part of the search report on which a filed statement revealed by the search will be disclosed.

be too costly[220] and time consuming to run searches against each such variation and abbreviation.

It remains to be seen how widely accepted Filing Priority Opinions become in New Jersey. It is clear, however, that New Jersey attorneys attempting to render Filing Priority Opinions will be well advised to at least expressly disclose the names searched,[221] include an exception for other filings that may be revealed by other variations of names searched[222] and also disclose the fact that the opinion covers only liens revealed of record by the UCC search and does not address other liens that may exist and have priority by operation of law.[223]

IV. Conclusion

This article has attempted to address issues that are of particular concern to New Jersey attorneys and loan officers. It should also provide a basis for discussion of the business needs and legal risks involved in New Jersey's opinion letter practice. While there are certain exceptions and opinions that can be identified as customary, there is also a great degree of variation in the practical experience of individual attorneys and lenders. There is currently a schism in New Jersey between attorneys who adhere to the more detailed and defensive approach to opinion letters and those who adhere to an approach which presumes that the opining attorney's responsibility should be limited to those laws fundamentally affecting the enforceability of commercial loans generally. As a result of this division, both attorneys and lenders struggle with the role of opinion letters in commercial loan transactions. Attorneys struggle with the risks associated with rendering opinions and including or excluding certain exceptions to their opinions. Lenders struggle with the meaning of opinions and whether there is a business need to obtain certain opinions. Only a more formal consensus of understanding among New Jersey attorneys will provide a common standard for interpretation of opinions and establish generally accepted due diligence procedures for each opinion.

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220 *See supra* note 206 and accompanying text. The search fee for an expedited return on a state UCC search is $35.00. Using the example of a search against a debtor named Abbott Distributing, Inc., a comprehensive search would include all four spelling variations of "Abbott" (i.e., Abbott, Abbot, Abott and Abot) in combination with at least two variations of "Distributing" (i.e., Dist. and Dst.). In this case, eight separate searches would have to be ordered at a total cost of $280.

221 *See supra* note 215 and accompanying text.

222 *See supra* notes 215-17 and accompanying text.

223 *See supra* note 209 and accompanying text.