

## NATIONAL REAL ESTATE BAR GUIDANCE ON U.C.C. OPINIONS IN COMMERCIAL REAL ESTATE FINANCE TRANSACTIONS

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Many state bars and other professional groups have provided reports on opinion practices, including reports related to opinions on matters governed by the Uniform Commercial Code (U.C.C.). Although the Delaware State Bar Association has not yet produced such a report, a recent report written by three national lawyer associations, and approved by a fourth, can be valuable to lawyers in Delaware who issue opinions in Delaware commercial real estate transactions.

The report on Uniform Commercial Code Opinions in Real Estate Finance Transactions (the “U.C.C. Report”) is a joint project of the American Bar Association Section of Real Property, Trust and Estate Law’s Committee on Legal Opinions in Real Estate Transactions, the American College of Real Estate Lawyers Attorneys’ Opinions Committee, and the American College of Mortgage Attorneys’ Opinions Committee.<sup>1</sup> The American College of Commercial Finance Lawyers also reviewed and approved the report. The U.C.C. Report intends to give guidance to lawyers serving as borrowers’ counsel in mortgage loan transactions, but the extensive background material and guidance in the U.C.C. Report are useful to all lawyers involved in the opinion process.

### I. BACKGROUND

The U.C.C. Report project started in 2016 to build on the earlier work that generated the Real Estate Finance Opinion Report of 2012<sup>2</sup> and the Local Counsel Opinion Report of 2016.<sup>3</sup> The U.C.C. Report was undertaken to develop guidance (and an illustrative opinion letter) that reflects current national real estate financing practice on opinions applying the U.C.C. to real estate, real estate-related collateral, and certain personal property typically included in the

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1. Committee on Legal Opinions in Real Estate Transactions, the American Bar Association Section of Real Property, Trust and Estate Law, Attorneys’ Opinions Committee, the American College of Real Estate Lawyers & Opinions Committee, the American College of Mortgage Attorneys (the “Real Estate Opinion Committees”), *Real Estate Opinion Committees, Uniform Commercial Code Opinions in Real Estate Finance Transactions*, 53 REAL PROP. TR. & EST. L.J. 163 (2019) [hereinafter *2019 U.C.C. Report*], [https://www.americanbar.org/content/dam/aba/publications/real\\_property\\_trust\\_and\\_estate\\_law\\_journal/v53/ucc-real-estate-finance-report-v53-02.pdf](https://www.americanbar.org/content/dam/aba/publications/real_property_trust_and_estate_law_journal/v53/ucc-real-estate-finance-report-v53-02.pdf). The 2019 U.C.C. report contains a detailed and thorough analysis of these opinions, including opinions in connection with the pledge of limited liability company interests in a mezzanine loan.

2. Real Estate Committees, *Real Estate Finance Opinion Report of 2012*, 47 REAL PROP. PROB. & TR. L. J. 213 (2012) [hereinafter *2012 Report*]. See also, R. Krapf and E. Levin, *An Overview of the Real Estate Finance Opinion Report of 2012*, 14 DEL. L. REV. 153 (2014).

3. Real Estate Opinion Committees, *Local Counsel Opinion Letters in Real Estate Finance Transactions: a Supplement to the Real Estate Finance Opinion Report of 2012*, 51 REAL PROP. PROB. & TR. L. J. 167 (2016) [hereinafter *LoCo Report*].

security for a commercial real estate loan.<sup>4</sup> The U.C.C. Report is not a comprehensive guide to all opinions related to the U.C.C. but, in the words of the report itself, “presents building blocks for such opinions, the requirements to give them, and example expressions to provide them in typical real estate finance transactions.”<sup>5</sup> It also provides references for closer review of the subject matter.<sup>6</sup>

The U.C.C. Report contains four chapters in addition to introductory material and an addendum. Chapter I is a general discussion of concepts applicable to opinions involving the U.C.C. Chapter II discusses in greater detail key components and issues of an opinion involving U.C.C. collateral for a real estate secured transaction. Chapter III addresses specific issues in opinions involving deposit accounts and investment property as collateral. Chapter IV discusses choice of law rules with respect to U.C.C. collateral and the role of assumptions and limitations in U.C.C. opinions. The Addendum contains an illustrative opinion, designed not to serve as a model opinion but merely to illustrate in opinion language and format the components addressed in the preceding chapters.

The U.C.C. Report may serve as an educational tool and a starting point for discussion and consideration by those involved in the opinion process.

## II. SUMMARY OF ISSUES IN THE U.C.C. REPORT

What follows is a summary of how the U.C.C. Report addresses certain key elements of opinions on matters governed by the U.C.C., with specific reference to the Delaware U.C.C. This article is not a complete survey of the entire contents of the U.C.C. Report, and reference should be made to the U.C.C. Report itself for more detailed guidance. Finally, this article does not intend to advocate any position with respect to such opinions, but merely to reflect the substance of the U.C.C. Report on these topics.

### A. Fixture Collateral

In many routine real estate finance transactions, opinions given on security interests are typically limited to U.C.C. collateral that is comprised of fixtures.<sup>7</sup> The 2012 Report<sup>8</sup> notes that “express opinions on security interests in

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4. 2019 U.C.C. Report at 166.

5. *Id.* at 166.

6. The subject of opinions on security interests in U.C.C. collateral is treated comprehensively in *Special Report of the TriBar Opinion Committee, U.C.C. Security Opinions-Revised Article 9*, 58 BUS. LAW. 1451 (2003) [hereinafter *TriBar U.C.C. Report*]. More recently, the Opinions Committee of the Business Law Section of the State Bar of California has issued a final exposure draft dated October 9, 2017 of a Sample California Third-Party Opinion Letter for Personal Property Secured Financing Transactions based on reports of several bar organizations as noted therein. For a discussion of personal property security in real estate finance transactions, see P. Ebling & S. Weise, *What A Dirt Lawyer Needs to Know About New Article 9 of the U.C.C.*, 37 REAL PROP. PROB. & TR. L. J. 191 (2002).

7. “Fixtures” are defined in 6 DEL. C. § 9-102(a)(41) as goods that have become so related to particular real property that an interest in them arises under local real property law.

8. The 2012 Report and the *LoCo Report* included a discussion of fixtures because that is the subject related to the U.C.C. addressed most commonly by opinion letters in real estate finance transactions.

personal property other than goods that ... are to become fixtures are not appropriate in real estate secured financings unless the personal property is an important part of the collateral.”<sup>9</sup> However, some commercial real estate financings require opinions not only on real estate and certain real estate related collateral but also on personal property<sup>10</sup> when that is an important part of the security for the loan, including deposit accounts and investment securities (which can include entity interests in non-corporate entities pledged in mezzanine financing).

When personal property is included in a real estate financing, a security agreement may be incorporated in a mortgage that is to serve as both a mortgage of real property and a security agreement not only as to fixtures but also as to personal property collateral.<sup>11</sup> Alternatively, the security interest in personal property collateral may be covered in a separate document that is a security agreement focusing more specifically on personal property collateral. Frequently, counsel is asked to provide opinions as to security interests in both real estate collateral and non-real estate collateral under one or both such documents. For convenience, the U.C.C. Report, and this article, refers to both a mortgage and a security agreement as a “security agreement.”<sup>12</sup>

Opinions about creation, attachment, and perfection of U.C.C. collateral security interests usually are expressed separately as opinions in a third-party opinion letter. Importantly, these opinions are not implicit in a typical enforceability opinion.<sup>13</sup> If the opinions are desired by the opinion recipient, and agreed to be given by the opinion giver, the opinions must be stated expressly.

Fixtures are likely present in all real estate transactions involving improved real estate.<sup>14</sup> As laws in most states allow for the creation of mortgage liens in fixtures as real property, the execution and delivery of a sufficient mortgage granting a lien on real property will inherently grant a real property lien on the fixtures.<sup>15</sup> If the security agreement grants

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9. 2012 Report Ch. Three, para. 3.6(c) at 243. See also Attorneys’ Opinion Comm., American College of Real Estate Lawyers & Comm. on Legal Opinions in Real Estate Transactions, Section of Real Property Probate & Trust Law, American Bar Association, *Real Estate Opinion Letter Guidelines*, 38 REAL PROP. PROB. & TR. J. 241 (2003) § 4.0.d at 252 [hereinafter *RE Guidelines*]. Examples of circumstances where personal property collateral might be an important part of the collateral include financings in the hospitality and health-care industries, and financings requiring the use of lockbox and other cash management arrangements in which deposit and securities accounts are elements of the collateral. Another example may arise in the context of mezzanine financing, where the collateral often consists of pledged equity interests in entities that, directly or indirectly, own real estate.

10. The U.C.C. covers many different types of personal property collateral. It generally does not cover real property (such as land, buildings, easements, leases, and (except as to agricultural liens, defined in 6 DEL. C. §9-102(a)(5)) rents or landlord’s liens) other than fixtures and certain other collateral related to real estate for which provision is expressly made. See 6 DEL. C. §§ 9-109(a)(1) and (2) and §§ 9-109(d)(1), (2), and (11).

11. 2019 U.C.C. Report § II.A at 177.

12. 2019 U.C.C. Report § II.A(1) at 178.

13. *TriBar U.C.C. Report* at 1460.

14. Security interests in other real estate related collateral—growing crops, as-extracted collateral, and standing timber to be cut—are discussed in *RE U.C.C. Report* § II.A.6 at 184-186.

15. See 6 DEL. C. § 9-334(b).

a security interest in goods that are or are to become fixtures, then a U.C.C. security interest has also been created.<sup>16</sup> Subject to the U.C.C.'s choice of law rules, the parties may agree that the law chosen to govern the mortgage also governs the creation or attachment of a security interest in fixtures.<sup>17</sup> The law of the jurisdiction where fixtures are physically located will govern perfection of a security interest in fixtures by a fixture filing.<sup>18</sup>

## 1. Perfection

Although sometimes the opinion recipient will request opinions on creation and attachment of the security interest in U.C.C. collateral, typically creation and attachment are assumed by the opinion giver and the focus of the opinion is on the perfection of the security interest.

The opinion recipient sometimes asks the opinion giver to opine that a proposed form of mortgage or a separate U.C.C. financing statement is adequate under applicable Delaware law to serve as a fixture filing upon proper filing. Such an opinion statement does not typically state that the filing of the financing statement effects perfection, but it does state that the proposed financing statement in the form provided is sufficient and is being filed in the correct office for that purpose.<sup>19</sup> This opinion includes by implication an opinion that the financing statement contains all of the information required to serve as a fixture filing.<sup>20</sup> A separate opinion to that effect is unnecessary if the foregoing opinion is given.<sup>21</sup> In this context, the sufficiency and factual accuracy of the legal description of the real property is assumed, implicitly or expressly.<sup>22</sup> The foregoing equally applies to a mortgage intended to serve as a fixture filing.

Lenders sometimes request an opinion on the effect of filing the financing statement as a fixture filing; e.g., a perfection opinion.<sup>23</sup> Such an opinion can be given so long as the underlying facts of creation and attachment are assumed to exist or are otherwise addressed.<sup>24</sup> Likewise, such an opinion includes by implication the foregoing opinion as to the form of filing. When the mortgage serves as a fixture filing, this opinion statement subsumes an opinion that the Delaware U.C.C. (if Delaware is the physical location of the fixtures) recognizes that recordation of the mortgage is effective to serve

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16. 2019 U.C.C. Report § II.A at 177. The utility of granting a U.C.C. security interest in addition to a lien on real estate created by a real estate encumbrance in the mortgage itself is based on the principle that a separate security interest in goods that are or are to become fixtures in limited circumstances will have priority over the interest of a real estate encumbrancer to the extent provided in 6 DEL. C. §9-334. Often a separate security agreement that grants a security interest in goods that are or are to become fixtures provides that the security agreement is to be governed by the law of a jurisdiction other than Delaware.

17. 2019 U.C.C. Report §II.A at 178. See 6 DEL. C. § 1-301.

18. 2019 U.C.C. Report §II.A at 178. See 6 DEL. C. §§ 9-301(2) and (3). Perfection of a security interest in fixtures by the filing of a financing statement that is *not* a fixture filing is governed by the law of the debtor's location. See 6 DEL. C. § 9-301(1).

19. 2019 U.C.C. Report § II.A(3) at 180-181.

20. *Id.* See 6 DEL. C. § 9-502(a).

21. 2019 U.C.C. Report § II.A(3) at 180-181.

22. *Id.*

23. *LoCo Report* § 3.12.

24. 2019 U.C.C. Report § II.A(3) at 182. See 6 DEL. C. §§ 9-310 and 9-502.

as a fixture filing. No opinion is needed on that point alone, or on the subject of a debtor's authorization to file or record the mortgage as a financing statement.<sup>25</sup>

An opinion letter often contains a statement that a certain office is the place to record the mortgage, and it will use a defined term to designate that office (e.g., "Recorder of Deeds"). In view of the possible need to address personal property collateral in the same opinion letter, and in order to avoid confusion, the U.C.C. Report recommends that one term should be used to designate the office for real estate recordings or real estate collateral filings, including fixture filings, and another term (e.g., "Filing Office") should be used for personal property collateral financing statements.<sup>26</sup> Although this terminology reflects general U.C.C. perfection rules, there are some exceptions, such as for transmitting utilities.<sup>27</sup> Use of appropriate terminology in the opinion letter is important.

## 2. Priority

Priority opinions are never implied and should never be requested or given as to real estate collateral security interests, and only rarely as to personal property security interests.<sup>28</sup> The U.C.C. recognizes that there may be competing real and personal property security interests in the goods that are or are to become fixtures, and the Delaware U.C.C. contains detailed provisions concerning when a secured party with a security interest in fixtures and growing crops has priority over a real estate encumbrancer.<sup>29</sup> The granting of a mortgage covering real property including fixtures and the granting of a security interest in fixtures will place the holder of those interests in the position of both a real estate encumbrancer and a secured party.<sup>30</sup>

## 3. Title

Opinions about title to real estate collateral, including fixtures, are not appropriate to be requested or given.<sup>31</sup> Although it is customary practice to assume expressly that the borrower or debtor has requisite title and rights (or, for U.C.C. purposes, the power to transfer rights) in any property involved in the transaction, the assumption is implicit.<sup>32</sup>

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25. *2019 U.C.C. Report* § II.A(3) at 182. 6 DEL. C. § 9-509(b) provides that execution of a security instrument itself authorizes the filing of a financing statement.

26. *2019 U.C.C. Report* § II.A(3) at 182.

27. *2019 U.C.C. Report* § II.A(3) at 183. When the debtor is a "transmitting utility" (defined in 6 DEL. C. §9-102(a)(81) as a person primarily engaged in certain specific business listed in the definition that includes a broader range of activity than typical "utilities"), and if Delaware law governs, the office in which to perfect a security interest in collateral, including fixtures, by filing is the Delaware Secretary of State. 6 DEL. C. § 9-501(1)(b).

28. *2019 U.C.C. Report* § II.A(4) at 183.

29. 6 DEL. C. §§ 9-317 through 9-339 contain the ground rules about priority of U.C.C. security interests.

30. *2019 U.C.C. Report* § II.A(4) at 184.

31. *2019 U.C.C. Report* § II.A(5) AT 184. *See RE Guidelines* § 4.0.c, at 252. *See also TriBar U.C.C. Report* at 1468.

32. *Id.*

In addition, commercially available title insurance will insure attachment, perfection, and priority of a secured party's Article 9 security interest in personal property. Title insurance may be considered in lieu of providing or requesting legal opinions and may provide more comprehensive coverage than a legal opinion.

## B. Non-Fixture Real Estate Collateral

Although usually U.C.C. opinions in real estate financing transactions address primarily fixtures as real estate collateral, the U.C.C. applies to other types of collateral related to real estate, including oil, gas, other minerals that become as-extracted collateral, and standing timber to be cut.<sup>33</sup> Special rules apply to security interests in these other types of real estate collateral that must be considered in providing an opinion relating to the attachment and perfection of a security interest in them. The U.C.C. Report provides further guidance.

## C. Personal Property (Non-Real Estate) Collateral

Opinions as to personal property collateral may be requested and given in real estate finance transactions involving both real estate and personal property collateral. In considering these opinions, the U.C.C. Report cautions the opinion giver to recognize that although a jurisdiction's law may be chosen to govern the security agreement and attachment of a security interest,<sup>34</sup> the U.C.C. contains specific choice of law rules that cannot be modified contractually on the subjects of perfection, the effect of perfection or non-perfection, and priority.<sup>35</sup>

When an opinion on personal property collateral is given, the opinion giver should express a limitation that any opinion regarding security interests in such personal property collateral is given only to the extent that Article 9 of the Delaware U.C.C. governs attachment, perfection, and the effect of perfection or non-perfection of a security interest in that collateral.<sup>36</sup>

Providing an opinion as to personal property collateral requires competence in the law of personal property security interests. The opinion giver should have or gain the competence to give such an opinion, consult with persons having specific competence in U.C.C. transactions, or decline to give the opinion altogether.<sup>37</sup> The report on U.C.C. opinions published by the group of New York-based law firms known as TriBar advises that opinion preparers who do not work with U.C.C. Article 9 regularly should consider whether to involve other lawyers more conversant with the U.C.C.<sup>38</sup>

When giving non-real estate collateral opinions, the opinion giver must consider the facts or assumptions required to support them and applicable limitations necessary to qualify them.<sup>39</sup>

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33. See 6 DEL. C. §§ 9-102(a)(6) and (44). See 2019 U.C.C. Report § II.A(6) at 184-186.

34. See 6 DEL. C. § 1-301.

35. See 6 DEL. C. §§ 9-301 through 9-307.

36. See, 2019 U.C.C. Report § II.B at 186.

37. *Id.*

38. *TriBar U.C.C. Report* at 1454.

39. See, 2019 U.C.C. Report § IV.B at 205.

## 1. Perfection

As discussed above with respect to fixture filing opinions, opinions on personal property collateral typically assume creation and attachment of the security interest. Hence, the focus of the opinion is the perfection of the security interest in personal property collateral by the filing of a financing statement. This assurance about perfection is based solely on filing a financing statement<sup>40</sup> and is intended to exclude fixture filings discussed previously, although the filing of a financing statement covering fixtures at the location of the debtor can perfect a security interest in fixtures even if physically located in another state.<sup>41</sup> In addition to specific provisions concerning the place to file as to certain collateral, the Delaware U.C.C. provides for perfection by means other than filing a financing statement (by possession, control, or automatic), and for some collateral more than one means is applicable, all of which are addressed in the U.C.C. Report with respect to deposit accounts and investment property.<sup>42</sup>

When the borrower is a registered organization organized in a jurisdiction other than Delaware, and Delaware law is therefore not applicable to perfection by filing a financing statement—a situation common to many local counsel opinions—an opinion on the perfection of a security interest in personal property collateral in which a security interest is granted<sup>43</sup> would be inappropriate.<sup>44</sup> Except when perfection of a security interest in the collateral by filing a financing statement is governed by Delaware law, matters of creation, attachment, and perfection of the security interest typically will be governed by other law, and they inherently are not covered by an opinion applying only Delaware law.<sup>45</sup>

## 2. Priority

As is the case with real estate liens, opinions as to the priority of a security interest in personal property collateral should not be given in a real estate finance transaction.<sup>46</sup>

## 3. Title

Opinions about title to, rights in, or power to transfer rights in U.C.C. collateral should be neither requested nor given.<sup>47</sup> It is customary practice to assume that the debtor has requisite title and rights in any property involved in the transaction. The assumption is implicit.<sup>48</sup>

40. *2019 U.C.C. Report* § II.B(1)(b) at 189. This opinion includes and necessarily subsumes an opinion that the financing statement contains all of the additional information required to serve as a fixture filing. *See* 6 DEL. C. § 9-502.

41. *2019 U.C.C. Report* § II.B(1)(b) at 189; 6 DEL. C. §9-501(a)(2).

42. *2019 U.C.C. Report* § III at 197-203.

43. *See* 6 DEL. C. §§ 9-301 through 9-306.

44. *2019 U.C.C. Report* § II.B(1)(c) at 190.

45. *Id.*

46. *2019 U.C.C. Report* § II.B(2) at 190.

47. *2019 U.C.C. Report* § II.B(3) at 190. *See also TriBar U.C.C. Report* at 1468.

48. *2019 U.C.C. Report* § II.B(3) at 191. *See also* discussion of title insurance in Section II.A.3 *supra*.

### **III. CONCLUSION**

The U.C.C. Report is intended to be a resource for lawyers practicing in the area of secured real estate finance transactions by synthesizing the current state of opinion practices. It can guide both opinion givers and opinion recipients in how best to address important opinion issues, and it therefore should make the opinion process more efficient for all. There is presently no comparable report exclusively describing best practices for opinions in secured real estate finance transactions specific to Delaware. Moreover, opinion practice varies among the law firms involved in such transactions in Delaware. As Delaware has no independent opinion reports of its own, lawyers can look to the U.C.C. Report, including the illustrative opinion letter attached to the report, for helpful guidance in navigating opinion drafting and negotiation for those opinions addressing U.C.C. collateral in real estate transactions.