

## **SUPPLEMENT NO. 1 TO THE REPORT OF THE LEGAL OPINIONS COMMITTEE REGARDING LEGAL OPINIONS IN BUSINESS TRANSACTIONS**

In the Business Law Section's *Report of the Legal Opinions Committee Regarding Legal Opinions in Business Transactions* (June 1, 1992)<sup>1</sup>, the Legal Opinions Committee of the Business Law Section (the "Committee") of the State Bar of Texas advised<sup>2</sup> that, because of a difference of opinion among Texas lawyers, an Opinion Giver should assume that a Remedies Opinion<sup>3</sup> implies an opinion that a Transaction Document is not usurious;<sup>4</sup> however, the Texas Report also suggested that if an Opinion Recipient in a lending transaction wants comfort on the issue, the Opinion Recipient would be justified in requesting, in addition to a Remedies Opinion, an express usury opinion.<sup>5</sup>

Based upon its experience during the past two years with the Texas Report and the ABA Report, the Committee has concluded that when the State of Texas is the Opining Jurisdiction and regardless of whether the Accord applies, a Remedies Opinion should be understood to subsume an opinion that the Transaction Documents are not usurious contracts.<sup>6</sup> This

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This Supplement was prepared by the Subcommittee on Legal Opinions Regarding Usury (Gail Merel, Chair; Dennis Anderson, David Keyes and Darrel A. Rice) and was approved by the Legal Opinions Committee of the Business Law Section of the State Bar of Texas on September 22, 1994.

<sup>1</sup>*Bulletin of the Business Law Section of the State Bar of Texas*, Vol. 29, Nos. 2 and 3 (June - September 1992) [hereinafter the "Texas Report"].

<sup>2</sup> See the Texas Report at page 77.

<sup>3</sup>This term and the terms "Accord," "Actual Knowledge," "Client," "Opining Jurisdiction," "Opinion Giver," "Opinion Letter," "Opinion Recipient," "Remedies Opinion" and "Transaction" are defined in Part I of the Texas Report, as well as in the Glossary of the ABA's *Third-Party Legal Opinion Report*, 47 Bus.Law.167 (1991) [hereinafter the "ABA Report"]. Those terms are used in this Supplement as defined in the ABA Report.

<sup>4</sup>Tex. Rev. Civ. Stat. Ann. Art. 5069-1.01(d)(1987), defines "usury" as "interest in excess of the amount allowed by law."

<sup>5</sup>Texas Report at page 77.

<sup>6</sup>If federal statutory law limits the rate of interest that the Opinion Recipient may reserve (for example, certain provisions of the National Bank Act limit the rate of interest that some federally regulated financial institutions may take, receive, reserve or charge; see, for example, 12 U.S.C. §85), a Remedies Opinion in which the law of the Opining Jurisdiction includes the federal laws of the United States also may subsume an opinion that the Transaction Documents are not

conclusion is based upon an analysis of the effect on a Transaction of an agreement by the Client in a Transaction Document to pay interest in excess of the amount allowed by law.

The Committee is of the view that, absent compelling circumstances not applicable to this issue, the Texas Report and the ABA Report should take consistent positions with respect to the scope of a Remedies Opinion.<sup>7</sup> The ABA Report states that "if violation of the usury law renders a loan agreement (or its interest provisions) void or voidable by the Client, an express opinion that the loan agreement is enforceable would include, on the basis of an analysis of what is essential and reasonable, an implied opinion that the loan does not violate the usury law."<sup>8</sup> Thus, the Committee's position that a Remedies Opinion subsumes an opinion that the Transaction Documents are not usurious contracts is consistent with the ABA Report's position that a Remedies Opinion implies an opinion that the Transaction Documents do not violate usury laws.

Accordingly, the following replaces in their entirety the introductory language to Part VII, Subpart D.2 of the Texas Report and paragraph (a) of that Section D:

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usurious. Whether such an opinion is subsumed in a Remedies Opinion depends upon the legal consequences of a violation of the statute (that is, whether the violation will offer the Client a defense to its otherwise enforceable obligation to pay interest in accordance with the terms of the Transaction Documents). Nevertheless, it is clear that when the Opinion Recipient's status as a federally regulated lender limits the rate of interest that the Opinion Recipient may contract for, the assumption of § 4(d) of the ABA Report (that is, that the parties to a Transaction, other than the Client, have complied with any legal requirements pertaining to their status to the extent necessary to enforce the Transaction Documents against the Client) does not exclude from the scope of the Remedies Opinion the issue whether a Transaction Document is usurious. See ABA Report at Commentary ¶ 4.4.

<sup>7</sup>The Committee believes that the utility of the Texas Report in multistate transactions will be severely limited if the Texas Report is inconsistent with the ABA Report on issues so fundamental as the meaning of a Remedies Opinion.

<sup>8</sup>ABA Report at Commentary ¶ 18.1.

2. Texas Specific Issues Sometimes Specifically Addressed. Some of the legal issues under Texas law for which opinions are sometimes specifically requested include the following:

a. Usury. If Texas is the Opining Jurisdiction and the Transaction Documents contain an agreement to pay an amount or rate of interest that is usurious, a remedy with respect to that agreement will not be available, with the result that the Transaction Documents will, to that extent, be unenforceable against the obligor.<sup>248</sup> Although the Texas statute that imposes liability for contracting for usurious interest does not state that the obligation to pay usurious interest is unenforceable, the statute provides, in effect, that the creditor will forfeit to the obligor at least three times the excess of the amount of interest contracted for over the amount allowed by law.<sup>248a</sup> Thus, if only the statute is applied to the Transaction, the economic effect to the creditor of a right to collect usurious interest, coupled with an obligation to "forfeit" 300% of the amount of that interest, is a net reduction in the amount of interest payable pursuant to the Transaction Documents. The obligor may also be entitled to the common law remedy of restitution (that is, recovery of the usurious interest) or offset or may successfully assert that the Transaction Documents are void as to interest.<sup>248b</sup> If the obligor is entitled to recover the usurious interest that it agreed to pay in a Transaction Document or if that agreement is void, the Transaction Documents are not enforceable as to that agreement.

In light of the foregoing, a Remedies Opinion, whether or not governed by the Accord, that is based on Texas law should be understood to subsume an opinion that the Transaction Documents are not usurious contracts. Accordingly, if an Opinion Giver is expressing a Remedies Opinion and Texas is the Opining Jurisdiction, an express usury opinion is superfluous. On the other hand, if a Remedies Opinion is expressed and the Opinion Giver does

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<sup>248</sup>The ABA Report, at § 10, states that "[a] Remedies Opinion covering a Transaction Document means a remedy will be available with respect to *each* agreement of the Client in the contract" (emphasis added).

<sup>248a</sup>The statute also provides, in effect, that if a creditor contracts for more than twice the amount of interest allowed by law, the creditor will forfeit to the obligor, in addition to three times the excess interest, *all* principal, interest and other charges. See Tex. Rev. Civ. Stat. Ann. Art. 5069-1.06 (1987).

<sup>248b</sup>See, e.g., *Hardwick v. Austin Gallery of Oriental Rugs, Inc.*, 779 S.W.2d 438, 448 (Tex.Civ.App.--Austin 1989, writ denied), where the remedy of restitution was allowed in addition to the penalty imposed by Article 5069-1.06, and *Steve's Sash & Door Co. v. Ceko Corp.*, 751 S.W. 2d 473 (Tex. 1988), where the remedy of offset was allowed. For further commentary on the remedy of restitution and for an argument that the Transaction Documents may be void as to interest, see Nicewander, Sheehan & West, *Texas Credit Code Handbook*, §§ 19.7 and 19.7A and cases cited at fn.48 (1992 and 1993 Supp.).

not intend to render any usury opinion, the Opinion Giver should include an exception to that effect in the Opinion Letter.

There may, however, be circumstances in which an express usury opinion is appropriately requested because no Remedies Opinion is being rendered. In addition, if an Opinion Letter does not adopt the Accord, although for the reasons stated above the Committee does not believe that such a request is appropriate, the Opinion Recipient may nevertheless request an express usury opinion in addition to a Remedies Opinion on the basis that, prior to the ABA Report and the Texas Report, there was some difference of opinion among Texas lawyers as to whether a Remedies Opinion implied or subsumed a usury opinion.<sup>248c</sup> In those circumstances, the following form of express usury opinion is recommended:

**The Transaction Documents are not usurious contracts.**

This formulation differs from the form of usury opinion originally suggested by the Texas Report, which was: "The loan, as evidenced by the Transaction Documents, is not usurious." The use of the term "loan" in the original formulation could limit its application. In addition, the revised formulation, stating that the Transaction Documents are not usurious, emphasizes that the Opinion does not extend beyond the Transaction Documents and does not address the consequences of charging or receiving interest otherwise than in accordance with the Client's agreement contained in the Transaction Documents.

When usury opinions are rendered, whether expressly or as part of a Remedies Opinion, some Texas lawyers routinely qualify those opinions with various exceptions, such as those listed in subparagraphs (i) and (ii) below. Although some Opinion Givers may choose, for reasons of personal preference and emphasis, to state these exceptions in their Opinion Letters, these exceptions are considered unnecessary because, as more fully discussed below, neither a Remedies Opinion nor a usury opinion expressed in the form recommended above or in a similar manner addresses the issues for which these exceptions usually are taken:

- (i) No Opinion is expressed as to any compensation paid or to be paid (or commitment to pay any compensation), directly or indirectly to or for the benefit of the Opinion Recipient or any affiliate of the Opinion Recipient, whether by the Client or any other person, for the use, forbearance or detention of money, other than as expressly provided for in the Transaction Documents, nor is any Opinion expressed as to the effect that the payment of such compensation may have upon any of the Opinions expressed. Further, in rendering the Opinions expressed, we have assumed that the proceeds of any extension of credit pursuant to the Transaction Documents are and will be free of any requirements not contained in the Transaction Documents for reserves, restricted accounts or

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<sup>248c</sup>It is assumed in this Texas Report that the Opinion Recipient is the creditor and that the Client is the obligor.

similar restrictions affecting the principal balance for interest calculation purposes.

(ii) Because Texas usury laws prohibit charging and receiving (and federal usury laws, when applicable, also forbid taking and reserving), as well as contracting for, interest in excess of applicable legal ceilings, in administering the Transaction Documents, the Opinion Recipient should at all times comply strictly with all applicable laws relating to the calculation, charging, taking, receiving and reserving of compensation for the use, forbearance or detention of money, including, without limitation, Articles 5069-1.04 and 5069-1.07 of the Texas Revised Civil Statutes, and with the usury savings provisions in the Transaction Documents, taking into account all amounts that constitute interest or are required to be deducted from the principal amount of any extension of credit to determine the principal balance for interest calculation purposes.

The exception contained in the first sentence of subparagraph (i) above usually is unnecessary because a Remedies Opinion, by definition, is an opinion that specified Transaction Documents are enforceable.<sup>248d</sup> In other words, a Remedies Opinion, by its own terms, does not address the enforceability of agreements that are not contained in the Transaction Documents specifically identified in the Opinion Letter, nor does it address the legal consequences of actions not required by those Transaction Documents.<sup>248e</sup> Further, the exception contained in the second sentence of subparagraph (i) usually is unnecessary because neither a Remedies Opinion nor a usury opinion expressed in the form recommended above or in a similar manner addresses the effect on the Transaction of any agreement that is not contained in the Transaction Documents specifically identified in the Opinion Letter. This conclusion necessarily follows from the Opinion Giver's qualified right, as stated in § 4(j) of the Accord, to assume that there are no such agreements.<sup>248f</sup> In the Committee's view, this conclusion should be understood by both the Opinion Giver and the Opinion Recipient, even in the case of an Opinion Letter that

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<sup>248d</sup>See the definition of the term "Remedies Opinion" in the Texas Report at p. 7 and in the Glossary of the ABA Report.

<sup>248e</sup>A usury opinion expressed in the form recommended above also does not address agreements outside the Transaction Documents because such an opinion states only that "the Transaction Documents are not usurious contracts."

<sup>248f</sup>That section permits the Opinion Giver to rely, without investigation, upon the assumption that "[t]here are no agreements or understandings among the parties . . . that would . . . define, supplement or qualify the terms of the Transaction Documents." See ABA Report at Accord § 4.

neither adopts the Accord nor states the Opinion Giver's assumption as to the absence of such agreements.<sup>248e</sup>

The exception contained in subparagraph (ii) above also usually is unnecessary. This exception is based upon the fact that charging and receiving, as well as contracting for, usurious interest are separately actionable violations of Texas usury law.<sup>248h</sup> However, neither a Remedies Opinion nor a usury opinion expressed in the form recommended above or in a similar manner addresses the effect on the Transaction of charging or receiving interest otherwise than in accordance with the Transaction Documents specifically identified in the Opinion Letter. If the Opinion Recipient were to charge or receive interest otherwise than in accordance with those Transaction Documents as a consequence of an agreement by the Client that is not contained in those Transaction Documents or as a result of action by the Opinion Recipient or the Client that is not required by those Transaction Documents, then this exception should be unnecessary because of the previously stated principle that a Remedies Opinion does not address the enforceability of those agreements or the legal consequences of those actions.<sup>248i</sup> Furthermore, if charging or receiving interest in excess of the maximum amount allowed by law is expressly prohibited by the Transaction Documents,<sup>248j</sup> this exception is unnecessary for the additional reason that the Opinion Giver should be entitled to assume that the Client and the Opinion Recipient will not take any action that is forbidden by the Transaction Documents.<sup>248k</sup> This

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<sup>248e</sup>Because an Opinion Giver's right to rely, without investigation, on the assumptions contained in § 4 of the Accord is qualified by the "overarching principle" of § 5 of the Accord (i.e., the principle that reliance on a particular assumption is not permitted if the Opinion Giver has Actual Knowledge that the assumption is false), the Opinion Giver's conscious awareness of agreements outside the specifically identified Transaction Documents that would cause the Transaction to violate applicable usury laws may require the Opinion Giver to take additional measures, consistent with the Opinion Giver's professional responsibility to the Client, that are not addressed by this Report.

<sup>248h</sup>See Tex. Rev. Civ. Stat. Ann. Art. 5069-1.06 (1987).

<sup>248i</sup>See the text accompanying fn. 248e.

<sup>248j</sup>Such a prohibition usually would be contained in the Transaction Documents in the form of a so-called "usury savings clause."

<sup>248k</sup>§ 4 of the Accord permits the Opinion Giver to rely, without investigation, upon the assumption that "[a]ll parties to the Transaction will . . . refrain from taking any action that is forbidden by . . . the Transaction Documents." However, it would not be appropriate for the Opinion Giver to rely on a usury savings clause if the Transaction Documents are usurious on their face (for example, if the Transaction Documents were to provide for a stated fixed interest rate in excess of the rate permitted by law). If, however, all of the interest charges called for under the Transaction Documents would, under some circumstances, be permitted by law, then it would be appropriate for the Opinion Giver to rely upon the parties' compliance with a

assumption likewise should be understood by both the Opinion Giver and the Opinion Recipient, even in the case of an Opinion Letter that neither adopts the Accord nor states that assumption.

Some so-called usury savings clauses provide that if the Opinion Recipient receives interest in excess of the amount allowed by law, the Opinion Recipient will refund the excess or credit the excess against the principal amount of the indebtedness outstanding under the Transaction Documents. When a Transaction Document contains such a provision, the Opinion Giver may consider whether to include in the Opinion Letter advice that the enforceability of the Transaction Documents may be limited if, notwithstanding the usury savings clause, the Opinion Recipient receives from the Client interest in excess of the amount allowed by law. This advice usually is unnecessary because a Remedies Opinion is, by definition, an opinion that a specified Transaction Document "is enforceable *against the Client*,"<sup>2481</sup> and this provision constitutes an agreement (whether to refund or credit) on the part of the Opinion Recipient and not the Client. However, if such a provision also contains a stipulation that the refunded excess interest will be deemed never to have been received by the Opinion Recipient or that the refunding or crediting of the excess interest will avoid or cure any violation of the usury laws that otherwise would result, it would be appropriate for the Opinion Giver to qualify the Opinion Letter with an exception such as the following:<sup>249</sup>

No opinion is expressed as to any usury savings provision in the Transaction Documents to the extent that it purports to permit the cure of any violation of applicable usury laws by the rescission of any demand or charge, or the refunding, or the crediting against principal, of any interest that has been charged or received in violation of any applicable usury law.

The foregoing discussion is intended to address usury opinions in those Transactions that do not present special usury issues. Of course, if the Opinion Giver is not satisfied that the Transaction Documents fully address all usury issues, even in Transactions that do not involve

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properly drafted usury savings clause, even in a Transaction where, after taking into account all interest charges, the aggregate amount of interest to be paid could (but for the usury savings clause) under other circumstances (such as a possible early acceleration or prepayment) exceed the maximum permitted by law.

<sup>2481</sup>See the definition of the term "Remedies Opinion" in the Texas Report at p. 7 and in the Glossary of the ABA Report.

<sup>249</sup>If the receipt of the excess interest is a consequence of prepayment by the Client, such a stipulation may be enforceable as a result of the application of Tex. Rev. Civ. Stat. Ann. Art. 5069-1.07(a) (1987), in which event this qualification will also be unnecessary if the stipulation, by its terms, applies only in the event of payment in full by the Client prior to the end of the full stated term.

special usury issues, the opinion can be expected to include exceptions in addition to those discussed above.

If any special issues exist in a Transaction (for example, the inclusion of warrants or other forms of equity participation or profit sharing arrangements, the assumption of another party's debt by the borrower, fees paid in connection with the credit, or the inclusion of involuntary prepayment premiums), further exceptions, assumptions and qualifications may need to be included in an Opinion to take account of these issues. The Opinion Recipient and its counsel will generally want to address all relevant usury issues in the course of drafting the Transaction Documents to correct and avoid usury problems--for example, by limiting contracted-for amounts to applicable legal ceilings, by ensuring that the right to accelerate the maturity of the loan does not include the right to accelerate payment of any unaccrued interest and by including an adequate savings clause. To the extent that usury issues are resolved in the documentation, enforceability and express usury opinions should require fewer exceptions, assumptions and qualifications.