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Mr. Theodore H. Sprink
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FIDELITY NATIONAL FINANCIAL
925 B Street, 3rd Floor
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Re: **Closing Opinion Letters And UCCPlus Insurance Protection**

Dear Ted:

This letter is written to evaluate the coverage offered in Opinion Letters as compared with that offered under UCCPlus Insurance Protection available from the Fidelity National Financial Family of Companies.

In light of existing procedures for the closing of large and complex loan transactions where the lender is relying on a security interest in personal property (i.e. property other than realty), it is highly likely that a lender's counsel will strongly encourage the lender to purchase and rely upon the UCCPlus Insurance Protection (the "Policy") since, as demonstrated below, it is in *their* self interest as well as their clients' interest to do so. To understand this, one must understand the legal and business relationship between a lender's counsel and the lender insofar as perfection and priority issues are concerned.

The Policy basically offers several services to the insured. First and foremost it insures against loss to a secured creditor as a result of the failure to properly perfect a security interest in collateral. Secondly, the insurer serves as an outsourcer for the search and filing functions attendant to the perfection of security interests. This product is ideal for asset based lenders, factors, mezzanine lenders, venture capitalists, equipment financiers and lessors, and workout departments.

In the enforcement of a loan collateralized by personal (i.e. non real estate) property (a "Secured Loan"), even if the collateral is worth more than the debt, a lender could suffer a substantial write-off if it failed to properly perfect its security interest, or if it finds that its priority is of a lower rank than it understood it to be when it prepared the loan documents. The two risks of (i) perfection of a security interest and (ii) priority of the security interest over the claims of third parties such as competing secured parties, taxing authorities and a bankruptcy

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trustee are to be avoided at all costs, since they could result in a total loss of principal by the lender. Thus, whether the lender documents the loan in house, or with the assistance of outside counsel, every lender will seek to minimize this risk.

With the passage of Revised Article 9 of the UCC, the rules on perfection and priority have all changed. Even under the old law, countless cases appeared where lenders suffered losses due to clerical errors (a slight misspelling of the name, a failure to file in the county in certain states, incorrect identification of the entity type of the borrower, misdescription of the collateral). Obviously had those lenders purchased the Policy for even one of those transactions, the savings would have been higher than years worth of premiums. Revised Article 9, although simplifying some of the UCC filing rules, added many new rules of an unforgiving nature, which, together with the general newness of the law, presents a minefield for the secured lender. Since *legal*, as opposed to *credit* risks cannot be built into the price of credit, since they cannot be predicted, they must be managed in other ways.

Managing priority and perfection risks by a lender can be accomplished in several ways, each of which is described in detail below:

1. Opinion Letters by lender's counsel.
2. Opinion Letters from borrower's counsel.
3. Training of lender's staff that handles UCC matters, so as to minimize or eliminate the risk.
4. Outsourcing the UCC filing function, as a component of obtaining insurance, if the outside contractor fails to properly perform (i.e. purchase the Policy).

As will be seen below, only the purchase of the Policy provides a consistent and cost effective solution.

OPINION LETTER BY LENDER'S COUNSEL

An opinion letter is typically issued by counsel to a borrower or to a lender in a secured lending transaction, and covers those legal issues which could affect the rights of the secured party, including perfection and priority of a security interest, and legal status of the debtor. The opinion would normally protect the lender only against security interests which would be discovered by a UCC search against the borrower.

In general attorneys find the representation of secured lenders to be desirable and

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profitable work, which offers the opportunity to sell attorney hours at market rates. The work is divided between partner-level (usually initial advice on documentation strategy and review of the final work product), associate-level (most of the hours of work are performed by associates) and paralegal level (usually administrative in nature, not especially profitable). The problem is that it is most law firms will delegate the UCC searching and filing function to paralegals, with their lower billing rates, since this task is generally assumed to be administrative. Here is the disconnect. It is fair to say that it is relatively unlikely that counsel will make an error in the documentation itself which will cause a loss (and therefore present malpractice exposure) to the lender. Any loss-causing error will likely be made in the searching and filing function, *the function performed by the lowest level of professional, and the one which is the least profitable to the law firm.*

To mitigate the risk, lender's counsel will often limit their opinion on perfection and priority to only those facts that a UCC search will disclose, essentially ducking the harder and more problematic issues of priority. This offers little protection to the lender.

The error arises when the lender's counsel is required to opine that the documents will afford its client with the anticipated level of perfection and priority respecting its collateral. To minimize this risk, the law firm with either have the filing function performed by attorneys or at least reviewed by attorneys, adding a cost which may not be able to be passed on to the client or the borrower. And the *risk-adjusted* cost of this is very high, although the profit for doing it is very low. A law firm would jump at the chance to avoid performing the least profitable and most risky part of a retention. As will be shown below, UCCPlus Insurance Protection is the answer.

OPINION LETTER BY BORROWER'S COUNSEL

In an effort to avoid the above problems, lender's counsel will seek to have borrower's counsel render the priority and perfection opinion. However for the reasons set forth above, borrower's counsel is equally unwilling to provide such an opinion.

It should be noted that even if an attorney offers a perfection and priority opinion, and even if the opinion proves incorrect, the lender's problems have only just begun. The lender will have to provide, most likely in litigation, how much of the loss was caused by the error. Also, the lender will have to assert claims against its own law firm (never a pleasant situation) or, if borrower's counsel caused the problem, asserting claims against them.

TRAINING OF LENDER IN-HOUSE PERSONNEL

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This is obviously an option, but given the turnover in these relatively low level positions, always problematical. Also, it is inconsistent with the important lender goal of risk management, and amounts to a simple assumption of the risk, rather than protection from it.

UCCPLUS POLICY

UCCPlus Insurance Protection, with its attendant outsourcing of the searching, filing and due diligence offers the only solution to this lender risk which gives all parties to the loan transaction exactly what they need:

Benefits to Lender:

1. Insurance, which is the ideal and most cost-effective method of managing risk.
2. The elimination of the fixed back office cost of the “UCC Department.”
3. A convenient method of recovering claims, without the need to sue. It will be asserting its claim against an insurer, which is the business of paying claims.
4. The protection is far greater than a legal opinion. The following is included in the UCCPlus Insurance protection but not in an attorney’s opinion:
 - Indemnity Protection
 - Attorneys Fees
 - Forgery and fraud protection
 - Assurance of filing in correct jurisdictions
 - Accuracy of search results

Benefits to Lender’s Counsel

1. It will be relieved of the costly risk of filing, search or legal error, with a minor loss in income. Even though the multi-jurisdictional issues are

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diminished under Revised Article 9, secured parties will still have to perform searches on the original Article 9 regime *as well as under the Revised Article 9 regime*, adding yet another area of complexity to this process.

2. It will be able to avoid the possibility of causing a loss to a lender client, damaging or destroying that relationship.
3. It will avoid the often-acrimonious negotiations with borrower's counsel concerning the scope of the opinion letter requested of it.
4. It will be able to effect a savings to the lender (or borrower, if the borrower is paying the fees of lender's counsel) in the likely event that the cost of the UCCPlus Insurance Protection will be less than the legal fees incurred if an attorney were to perform this function.

Benefits to Borrower

1. Since the borrower usually pays the closing costs, it will realize the savings in lower legal fees (only partially offset by the Policy cost).
2. It may be expected that the time spent by the Policy issuer in the search and filing function will result in more prompt closing, which is always of paramount important importance to a borrower.

In summary, until the Policy was available, the parties to a secured lending transaction were faced with several unsuitable methods for managing the risk of perfection errors. None worked. All were too expensive. For all parties, the Policy is the ideal solution and has been welcomed by the banking and legal communities as the ideal solution to what was an intractable problem.

Very truly yours,

BUCHALTER, NEMER FIELDS & YOUNGER

By
Robert A. Zadek