

**ABA
SECTION OF
BUSINESS
LAW
COMMITTEE
ON LEGAL
OPINIONS**

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LEGAL OPINION NEWSLETTER

Volume 6 – Number 3

October 2007

In this issue:

Report from the Chair

Annual Meeting Report – “Crossing the Threshold: Why Ask For An Opinion At All?”

Subcommittee on Securities Law Opinions – Update on Negative Assurance

Committee on Audit Responses – Meeting Report and FAS 5 Developments

Working Group on Legal Opinions

Case Law Update

Membership

Next Newsletter

MARTIN BRINKLEY, EDITOR

Report from the Chair

At the ABA Legal Opinions Committee meeting in San Francisco in August, we thanked Carolan Berkley for her three years of service as Chair of the Committee. I summarized her remarkable achievements in the last edition of this newsletter. As of August 20, the membership of the Committee had grown to more than 825, attributable to the excellent programs, newsletter, listserv and other activities under Carolan's leadership.

Statement on Customary Practice

Steve Weise presented to the meeting the Statement on Customary Practice proposed to be co-sponsored by our Committee and other Bar Association groups to promote recognition of the central importance of customary practice in understanding third-party legal opinions. The form of the Statement had earlier been circulated by listserv to Committee members. Steve listed other groups that already have agreed to co-sponsor the Statement and summarized comments and suggestions he has received and the process for collating the suggestions, modifying the Statement, and re-circulating it to the relevant groups. The Committee unanimously approved co-sponsorship of the Statement, delegating to the Chair and immediate past Chair authority to review any changes to the Statement and to approve them or determine that the Statement should be re-circulated to Committee members for further discussion of changes.

Future Projects, Other Committees and Groups

I talked at the meeting about future activities of the Committee, as I did in the last edition of this newsletter, emphasizing the desirability of our undertaking one or more study projects, for example cross-border opinions, ethical issues, reliance issues, issues for recipients, and threshold issues. Since the meeting there have been some conversations about cross-border opinions, and we should have more to report on that soon. If this is a topic that interests you, please let me know (johnpower@earthlink.net).

We also discussed the importance of cooperating with other opinion groups, including the national opinion working group, state and local bar associations, and other committees and task forces of the ABA. The latter category includes the Committee on Audit Responses, the Subcommittee on Securities Opinions, and projects involving legal opinions by the Commercial Financial Services Committee, the Committee on Negotiated Acquisitions, and others.

Opportunities for Involvement by Members: Newsletter and Resource Center

Martin Brinkley has volunteered to help with the Newsletter, and is centrally responsible for publication of this edition. Thanks also to those responsible for various articles. Christina Houston, whom we met at the Committee meeting, has undertaken to add to our Resource Center, on the Committee web site, links to reports by state and local bar associations. Thanks to Martin and Christina for their help.

Future Meetings

November 2007. The Audit Response Committee and the Securities Opinion Subcommittee of the Committee on Federal Securities Regulation will meet in Washington, D.C. on November 16 in connection with the Section of Business Law's fall meeting. You should strongly consider attending these meetings. In light of the presence of many of our members in Washington at that time, we may schedule an informal get-together on that day. If we decide to do that, we will let you know by list serve.

Spring 2008. The spring meeting of the Committee will be in Dallas on April 11, 2008, and we will have plenty of interesting activities there.

– John Power

Annual Meeting Report – “Crossing the Threshold: Why Ask For An Opinion At All?”

The ABA Annual Meeting in San Francisco featured a well attended and spirited program sponsored by the Committee on Legal Opinions, “Crossing the Threshold: Why Ask for an Opinion at All?”, that challenged the attendees to weigh the benefits of requesting a closing opinion in light of its cost..

Committee Chair John Power moderated the program, joined by panelists William Viets, Managing Director and Associate General Counsel of JPMorgan Chase & Co, where he heads the Americas Credit Products Group within the Investment Banking Legal Group; Ann Yvonne Walker, a partner at Palo Alto, CA-based Wilson, Sonsini, Goodrich & Rosati; Professor Jonathan Lipson of the James E. Beasley School of Law at Temple University (who wrote a new article for use as program material); and Don Glazer, advisory counsel to Boston-based Goodwin Procter. Copies of the program materials and audio are available at http://www.abanet.org/buslaw/apps/updatedsearch/index_p.shtml.

Value of Legal Opinions to Recipients

William Viets, whose role within the JP Morgan Chase legal department includes responsibility for syndicated lending activities, identified reasons why closing opinions are valuable to opinion recipients, especially in the loan markets in which his institution is active. He underscored the importance of the third party legal opinion in providing credibility to the diligence process. While acknowledging that a legal opinion is not transaction insurance, he takes comfort when a firm puts its name on the line by giving an opinion. The opinion process brings a necessary level of seriousness to the transaction.

Regarding the remedies opinion, Bill noted that when parties price transactions, the price set by the principals reflects business risks and typically does not factor in legal risks. The purpose of the remedies opinion is to support the decision not to price legal risks into the

transaction. He said he is open, in transactions using standardized loan documentation, to the lender's counsel providing the remedies opinion on its own form documentation (in lieu of an opinion by borrower's counsel) and indeed, in appropriate limited instances, dispensing with the remedies opinion entirely.

Bill underscored the importance of market expectations. In syndicated lending, for example, where there is a broad secondary loan trading market, there is a well established expectation that the loan documentation will include a third-party legal opinion. The absence of a legal opinion may adversely affect the liquidity of the loan. Thus, while the opinion letter may be viewed as pro forma by the secondary loan purchaser, it has a "market signaling" significance: its mere existence, particularly if given by a law firm known to the market, signals the quality of the loan. In other markets, such as middle market real estate lending, the loan documentation may be internally prepared printed forms with no outside counsel involvement, and the secondary loan trading market may not expect a third-party closing legal opinion to have been delivered.

Cost/Benefit Analysis: the California Remedies Report

Ann Walker provided an overview of the "Threshold Report" of the Business Law Section of the State Bar of California (which appears as Appendix 4 to the 2004 Report on Third-Party Remedies Opinions). The Threshold Report addresses the central question "When should a remedies opinion be requested and given" through a series of related questions: (1) What benefits are expected? (2) Can such benefits be realized through a third-party remedies opinion? (3) Do such benefits justify the associated costs? (4) Are there negative consequences that flow from giving the opinion? (5) Are there alternatives that provide the opinion recipient comparable benefits (at a lower cost)?

Ann outlined some of the expected benefits of a third-party remedies opinion identified by the Threshold Report. In key part, the remedies opinion forms part of the opinion recipient's due diligence by helping the recipient evaluate the legal risks of the particular transaction.

If the recipient isn't relying on the opinion in evaluating risk, then the opinion isn't serving its intended purpose and perhaps the recipient should only look to the advice of its own counsel. However, in many situations the advice of the recipient's own counsel will not be enough. These include: transactions involving multiple parties or non-parties (such as government contracting agencies); transactions involving parties in different jurisdictions; transactions involving complex, novel or otherwise unusual structures; transactions involving specialized knowledge (e.g., regulatory opinions) or circumstances particular to the opinion giver's client (e.g., regulated clients); transactions involving rating agency requirements; and transactions in which the recipient does not have separate legal counsel. In addition, in some situations an opinion may be required to discharge the opinion recipient's responsibilities to others (e.g., the opinion of lead underwriter's counsel to other underwriters in an initial public offering) or to satisfy regulatory requirements (e.g., in certain derivative transactions).

On the cost side, Ann identified the legal fees involved in the preparation and negotiation of the legal opinion, typically borne by the client of the opinion giver, along with added risk of

time delay and acrimony in the transaction process. Other, undervalued costs may arise from the potential conflict between the opinion giver's duty to its client and its responsibility to the opinion recipient, including the possible disclosure of negotiating strategy and guarded information.

In evaluating the benefits and costs of a remedies opinion, the California Threshold Report identifies inappropriate reasons for requesting a remedies opinion. These include requiring the opinion (a) simply as a checklist item, (b) as insurance for the success of the business deal, (c) "because it was given in the last deal," and (d) simply because the negotiations are being driven by the egos of the parties and their counsel.

Ann concluded by noting that the trend in certain transaction areas is noticeably moving away from requiring a remedies opinion, such as in public-to-public M&A transactions (where opinions are now uncommon) and in many smaller transactions. In addition, the parties can reduce the cost of the opinion process by (i) requiring only the diligence opinions (e.g., status, power and authority) but not a remedies opinion, (ii) limiting the scope of the remedies opinion to a short list of material documents, (iii) if the covered documents are governed by the laws of a jurisdiction other than that of the opining law firm, accepting an "as if" opinion rather than requiring a separate opinion of special local counsel, or limiting the scope of the opinion to the "choice of law" provision, or (iv) having the recipient's counsel provide the remedies opinion, especially if the documents are forms prepared by recipient's counsel.

Critique of Cost/Benefit Analysis

Professor Lipson summarized his views on the cost/benefit analysis, as expressed in two articles he authored which were included in the program materials, one of which was prepared especially for use in the program. He suggested that a cost-benefit analysis may make the "easy" cases easier and facilitate the division of labor (that is, which party's counsel should give the legal opinion). But it is prone to undercount both costs and uncertain benefits. For example, on the cost side, the analysis tends to focus on the legal fees expected to be incurred in the preparation and negotiation of the opinion letter. But the parties, in determining whether an opinion should be given, rarely factor in imputed costs of the recipient's reliance on the opinion, including the cost of the potential liability of the opinion giver.

Professor Lipson suggests that the benefits of a legal opinion can be measured as procedural and evidentiary. The opinion letter consists of a standardized series of protocols that verify information justifying the opinion giver's legal judgment. The opinion letter is then evidence of the opinion giver's legal judgment. The problem is that unless and until the opinion giver undertakes the underlying diligence, the opinion giver "doesn't know what it doesn't know," and there is little way to measure in advance the benefit of the legal judgment to be obtained from the opinion. Where there is little or no uncertainty as to the information, the analysis as to the benefit of the opinion may be "easy", but in such cases the opinion may be of little value to the recipient (except to perform its "market signaling" role as described above).

Legal Risks to Opinion Givers and Opinion Practice Reform

Don Glazer wrapped up the program by looking at the risks opinion givers have and offering sobering ways to think about those risks that may restore some proportionality to the gap between risk and reward. He noted that historically the risk to opinion givers of incurring litigation was not material, with the result that that risk was not typically factored into the opinion giving process. But the incidence of substantial liability exposure is now on the rise as opinion givers are increasingly taken to court by opinion recipients.

With escape at the motion-to-dismiss stage unlikely and litigation costs high, lawyers and their law firms are seriously at risk, even if they expect to prevail at trial. While litigation is still episodic, does it make sense for law firms to “bet the farm” in giving opinions? Don suggested that lawyers consider limiting risk exposure by scaling back “no litigation” confirmations and by limiting “negative assurance” confirmations to situations where the confirming law firm has performed a substantial amount of supporting diligence.

Don suggested that opining law firms try to value litigation risk in giving an opinion letter. He provocatively proposed that opinion givers consider including a cap on liability in legal opinions, noting that law firms in the United Kingdom are regularly doing so. Dick Howe, an attendee at the program, pointed out, however, that the liability cap amounts being included in United Kingdom opinion letters are very large, undercutting their appeal to American opinion givers. Art Field, also in attendance, asked, equally provocatively, whether opinion givers might obtain third-party opinion insurance whose premium costs would be passed along to the opinion recipient.

This program will be given again in an ABA teleseminar at 1:00 p.m. Eastern time on November 8, 2007.

- Peter H. Carson
Bingham McCutchen LLP

Subcommittee on Securities Law Opinions

The Subcommittee on Securities Law Opinions met on August 13, 2007 in connection with the Annual Meeting in San Francisco. The principal topic for discussion was a draft of a new form of negative assurance, intended to update the illustrative form of negative assurance contained in the Subcommittee’s report on *Negative Assurance in Securities Offerings*, 59 Bus. Law. 1513 (August 2004), to reflect changes in practice in light of Securities Act reform. With the assistance of the ABA, a telephone connection was arranged whereby Subcommittee members who could not be present could dial in and listen to the meeting. The comments on participation by telephone have been extremely positive, and it is hoped that it will be possible to do this again in the future.

The draft form of negative assurance was distributed about a week before the meeting, and many people came to the meeting with thoughts and comments on the draft. There was a

general consensus that the purpose of the revised draft should be to make changes in the illustrative form that are needed after Securities Act reform but that other issues concerning negative assurance should not be addressed. In addition, the report accompanying the text should be updated to include discussion of new issues on negative assurance that have arisen in connection with Securities Act reform.

Based upon the comments at the meeting, a new draft will be prepared and circulated to the members of the Subcommittee before the next meeting, scheduled for November 16, 2007 at 11:00 a.m. in Washington, D.C., after which it is hoped that the report will be ready for publication.

- Richard R. Howe, Chair
 Subcommittee on Securities Law Opinions
 Committee on Federal Securities Law
 Regulation

Committee on Audit Responses

At its meeting on August 12 at the ABA Annual Meeting in San Francisco, the Audit Response Committee discussed a number of topics, focusing primarily on (i) responses relating to pension plans and special issues they raise, and (i) the impact of FIN 48 relating to accounting for income tax positions on audit responses and how to address that impact. The Committee is preparing draft position papers on these topics in order to provide guidance to practitioners. The Committee will be meeting at the Section's Fall Meeting in Washington, D.C.

Subsequent to the Annual Meeting, the following e-mail was circulated to the Committee to alert it to certain action taken by the FASB regarding reexamining FAS 5 - Accounting for Contingencies:

At its board meeting on September 6, 2007, the FASB voted to add a comprehensive project to reexamine FAS 5, Accounting for Contingencies. Separately, the IASB released proposed amendments to IAS 39 to provide additional guidance on hedge accounting. These and other FASB and IASB developments are discussed below.

FASB Votes to Add Comprehensive Project on FAS5/Contingencies . . . Some Want to "Provide Less Wiggle Room for the Bar Association and Preparers"

The project will have three phases, as described in a handout to the FASB <http://www.fasb.org/board_handouts/09-06-07.pdf>. Phase 1 of the contingencies project will address inconsistencies between proposed FAS 141R on Business Combinations and FAS5. The board agreed certain revisions to proposed FAS 141R should be made and the proposed standard should be rebaloted before it is issued. The proposed revisions to proposed FAS 141R will be as follows (similar to language in the board handout):

"Liabilities arising from contingencies [contingent liabilities] would be subsequently measured at the higher of the Statement 5 amount or the acquisition-date fair value and assets arising from contingencies [contingent assets] would be measured at the lower of the acquisition-date fair value and the best estimate of a future settlement amount."

Phase 2 of the contingencies project relates to enhanced disclosures under FAS 5.

Phase 3 of the contingencies project is "a long-term project to comprehensively reconsider all accounting models for contingencies. The scope, timing and potential for convergence would be explored by the staff and presented to the Board at a future date."

There was some interesting discussion on what the goal was for Phase 2 disclosures - and whether the perceived lack of disclosures of contingencies under FAS 5 was really a compliance issue or a standards issue, the latter of which is under the purview of the FASB (the former of which presumably is under the purview of the SEC).

Board member Michael Crooch said, "I believe a lot of noncompliance has crept in."

Another board member, Tom Linsmeier, said there were two possible reasons people aren't applying FAS 5 as FASB intended; he described them as "a notion of element uncertainty," and a "notion of measurement uncertainty."

"Isn't there an 'out' in FAS 5 disclosures that says if you don't have a good clue on the range and best estimate [of a contingency], you don't have to give anything?," asked Linsmeier. Also, he noted there are threshold criteria in the standard, such as "reasonably possible." FASB staff noted some have raised questions about whether certain contingencies were "reliably measurable."

Linsmeier suggested "rewrit[ing] the standard [FAS 5] to leave less wiggle room for the Bar Association and preparers."

This committee will next meet at 2:00 p.m. on November 16, 2007 in Washington, D.C. as part of the fall meeting of the Section of Business Law, and you are urged to attend.

- Stanley Keller, Chair
Committee on Audit Responses

Working Group on Legal Opinions

The national Working Group on Legal Opinions, co-sponsored by the American Bar Association and others, will hold its third invitation-only Legal Opinion Risk Seminar on October 30, 2007.

Case Law Update

Our thanks to Carolan Berkley, Art Field, Bill Freivogel, Don Glazer and Stan Keller for bringing the following cases to our attention:

- **Weiss v. SEC, 468 F.3d 849 (D.C. Cir. Nov. 28, 2006)**

The D.C. Circuit denied review of SEC disciplinary action (suspension) of a lawyer who was bond counsel to a Pennsylvania school district.

The decision found substantial evidentiary support for the SEC's conclusion that the lawyer "was responsible for misrepresentations and omissions in the Official Statement and in his legal opinions" to the effect that interest on the bonds was tax exempt, in violation of the antifraud provisions of the Securities Act of 1933. The court quoted from the National Association of Bond Lawyers' *Statement Concerning Standards Applied in Rendering the Federal Income Tax Portion of Bond Opinions* (1993), observing that both parties had agreed that the applicable standard for rendering unqualified bond opinions was set forth in the Bond Lawyer Statement. The SEC and the court concluded that the lawyer had facilitated a forbidden arbitrage transaction (selling municipal bonds and investing the proceeds in taxables to gain the arbitrage differential) based on generalized factual representations from the school board that he knew were inadequate.

- **First Massachusetts Bank v. Florian, 2007 WL 1829379 (Mass. Super. June 12, 2007) (Van Gestel, J.).**

Judge Van Gestel, who wrote the Dean Foods decision,¹ has authored another decision containing a brief discussion of a legal opinion. A holding company obtained a loan to fund the statutory capital surplus requirements of its wholly owned subsidiary, a Massachusetts insurance company. The borrower's counsel rendered a legal opinion that no governmental approvals or authorizations were required in connection with the loan other than a notice filing with the Massachusetts Division of Insurance. The loan agreement required proceeds of loan advances to be invested in deposits with the lender, and stated that the borrower could not withdraw earnings on the investments following the occurrence of a default. Massachusetts law required this withdrawal provision to be submitted to the Division of Insurance for approval. The lender claimed that borrower's counsel was negligent in failing to communicate in the opinion the need for specific governmental approval of the withdrawal provision in the opinion letter. Judge Van Gestel held that, given the sophistication of the lender and its counsel, the lender could not have reasonably relied on the borrower's counsel's opinion that the notice filing was the only necessary approval. The case brings home the point that recipients cannot blindly rely on

¹ Dean Foods v. Pappathanasi, No. 01-2595, 2004 WL 3019442 (Mass. Super. Ct. Dec. 3, 2004).

opinions without taking into account what they and their counsel know about the legal issues involved.

- **OAIC Commer. Assets, L.L.C. v. Stonegate Vill., L.P., 2007 Tex. App. LEXIS 6533 (Tex. Ct. App. Aug. 16, 2007)**

A Texas intermediate appellate court ruled that the transferee of a limited partnership interest did not acquire any rights against the limited partnership (and thus lacked standing to sue) when the partnership refused to accept a legal opinion tendered by the transferor. The partnership agreement provided that the transferor had to either register the transferred interests under applicable securities laws or deliver an opinion of counsel “satisfactory to the partnership” that the transfer was exempt from registration requirements. The court did not analyze the partnership’s reasons for rejecting the opinion, which appeared (based on quoted language in the court’s decision) to provide the assurance required by the partnership agreement. The decision provides no insight on whether other aspects of the opinion letter (e.g., qualifications, exceptions) were the source of the partnership’s cause for concern.

The decision is straightforward and only remotely has to do with opinion practice. But it offers a useful lesson: A careful buyer would have required the partnership’s approval of the legal opinion prior to paying the purchase price.

- **Divine Tower Int’l Corp. v. Kegler, Brown, Hill & Ritter Co., L.P.A., 2007 U.S. Dist. LEXIS 65078 (S.D. Ohio Sept. 4, 2007)**

This case involved malpractice claims brought by a corporate debtor-in-possession against its former law firm as well as fraud and Section 10(b) claims against the law firm by an equity investor in the corporation. The primary issues stemmed from law firm conflicts of interest that surfaced after the corporation became distressed.

The decision contains a brief discussion of a third party legal opinion rendered by the law firm to an investor in one of the corporation’s equity financings. The opinion recipient (the equity investor) claimed that the legal opinion had failed to disclose existing bank loans and that this constituted a “material misrepresentation[] and omission[]” giving rise to fraud and Section 10(b) liability. The court dismissed this claim, noting that the opinion letter had addressed all the matters called for by the purchase agreement and disclaimed any opinion with respect to the truth or accuracy of financial information supplied to the investor. The decision emphasized that “[a]n attorney who has direct contact with the ‘other side’ in a business transaction has a duty to speak fully on only those subjects on which he speaks.” In this case, those subjects were limited to the opinions called for by the agreement. The decision highlights the continuing vitality of the “four corners” principle (courts should look only to the opinion letter itself and to the documents and matters referred to in the opinion letter). See *Prudential Ins. Co. v. Dewey, Ballantine, Bushby, Palmer & Wood*, 605 N.E.2d 318 (N.Y. 1992).

Membership

If you know someone who would like to join the Committee and receive our Newsletter, please direct them to the ABA Business Law Section website:

<http://www.abanet.org/buslaw/home.html>, click “Committees” and the Legal Opinions Committee. If you haven’t visited the website lately, I recommend you do so. Our mission statement and prior newsletters are posted there.

Next Newsletter

We expect that the next newsletter will be circulated sometime in the winter. Please forward cases, news and items of interest to John Power (johnpower@earthlink.net) or Martin Brinkley (mbrinkley@smithlaw.com).
