Questions and Answers on the SEC’s Opinion Guidance

On October 14, 2011, the SEC’s Division of Corporation Finance issued Staff Legal Bulletin No. 19 (the “SLAB”) providing guidance on Exhibit 5 legality opinions and Exhibit 8 tax opinions required in registered offerings. Lawyers who prepare these opinions should read the SLAB and familiarize themselves with its guidance. This article answers some questions under the SLAB based on the authors’ understanding of explanations provided by members of the SEC’s staff. The answers are solely those of the authors and do not represent official positions of the SEC or its staff.

1. Question: The SLAB states that an opinion that the stock of a corporation is legally or validly issued includes an opinion that the corporation is validly existing under the laws of its jurisdiction of incorporation. In the case of non-corporate equity securities, such as LLC interests, note 6 of the SLAB states that a LLC is “validly existing” if it has been duly formed. In practice, opinions that state only that the entity is “validly existing” frequently are given and accepted for both corporations and LLCs based on a certificate of legal existence from the secretary of state, without the need to review statutes and actions at the time of incorporation or formation, which would be necessary for a “duly formed” opinion. Is this acceptable in the case of a LLC?

Answer: The SEC staff does not inquire as to the diligence required to support an opinion. That is a matter to be decided by counsel based upon applicable law and practice.

2. Question: The SLAB states that corporate stock is “fully paid” if, among other prerequisites, the consideration received satisfies the requirements of “any other applicable agreement.” As a matter of customary opinion practice, lawyers giving fully paid opinions do not necessarily review subscription agreements. Is the SLAB fairly read to mean that an agreement is applicable only if it is relevant as a matter of state corporation law to the fully paid status of the shares, such as when the authorizing resolution states that the shares shall be sold for the consideration set forth in a subscription agreement it incorporates by reference?

Answer: Yes, what is required to satisfy state corporation law requirements for “fully paid” stock is the determining factor.

3. Question: The SLAB does not address it directly, but is the formulation suggested in note 43 of the 2011 TriBar Report on Opinions on LLC Interests acceptable?1

Answer: Yes, that formulation is acceptable.

---

1 66 Bus. Law. 1064, 1072 (2011) (“Upon issuance by the LLC against payment as contemplated by the Registration Statement and Prospectus, the LLC Interests will be validly issued, and holders of LLC Interests will have no obligation to make any further payments for the purchase of the LLC Interests or contributions to the LLC solely by reason of their ownership of LLC Interests.”).
4. **Question:** May a “validly issued” opinion be based on an assumption that action will have been taken to price the securities covered by the opinion if, instead of referring to a pricing committee of the board as mentioned in the SLAB, the assumption refers to another procedure permitted under applicable state corporation law for pricing adopted by the board resolution approving the issuance, such as compliance with a formula in the case of a dividend reinvestment plan or the setting of option prices by an authorized officer as permitted by the Model Business Corporation Act?

**Answer:** Yes, the reference to a pricing committee is only illustrative and an assumption that the shares will be issued at a price set in accordance with a procedure established by the board will be acceptable so long as the necessary board authorization has been obtained and the procedure for pricing is permissible as a matter of state corporation law. If the resolution remains in effect and the procedure referred to in the assumption is followed, no further opinion will be required to be filed when the shares are issued.

5. **Question:** The SLAB indicates that if corporate actions, such as a charter amendment to increase the number of authorized shares or to create the class or series of shares to be issued, need to be taken before the transaction is completed or if a reincorporation is contemplated prior to completion of the transaction, a qualified opinion can be filed without preventing the registration statement becoming effective. Is this a change in the staff’s position?

**Answer:** Yes, but it is premised upon an unqualified opinion being filed before the closing of the transaction and disclosure being made in the prospectus of the actions required as a condition of the transaction.

6. **Question:** The SLAB recognizes that the inclusion in Exhibit 5 opinions of assumptions that are understood as a matter of customary practice whether or not stated is acceptable. In the case of exceptions, it recognizes that the standard bankruptcy exception and equitable principles limitation, although not required to be stated, may be stated expressly. This includes stating expressly any of the recognized aspects of the equitable principles limitation. The ABA Report on Legal Opinions in SEC Filings states that exceptions that are not material should not be objectionable or require prospectus disclosure. Is this still correct?

**Answer:** Yes, whether prospectus disclosure is required is a question of materiality. Practitioners should be aware, however, that including nonstandard exceptions or assumptions in “validly issued” opinions or expressing those exceptions and assumptions in unconventional ways could result in staff questions and thus affect the processing of the registration statement.

7. **Question:** Is an approach similar to the approach that is acceptable for LLCs, stating in plain English what the opinion means, acceptable for foreign corporate securities when the “duly authorized, validly issued, fully paid and nonassessable” formulation does not fit?

---

Answer: Yes, this approach is acceptable.

8. Question: When a legality opinion is given on shares being sold by selling stockholders, what shares are covered by the opinion?

Answer: If the shares can be traced to their original issuance, as they often can be in an initial public offering, the opinion covers those shares. However, that is not always possible, especially when the shares are held in the DTC clearing system, in which case the opinion may practically have to be treated as an opinion on all the outstanding shares.

9. Question: In stating that counsel may not deny that it is an “expert,” the SLAB indicates that counsel need not expressly admit in the consent that it is an expert. Does this mean that the traditional express disclaimer that “counsel by filing this consent does not admit that it is an expert” continues to be acceptable?

Answer: Yes, the disclaimer continues to be acceptable.

10. Question: Will the SEC staff accept opinions that speak as of the date of the opinion letter without requiring an update absent developments that arise that affect the opinion?

Answer: Yes, although counsel needs to be mindful of the liability provisions that require a registration statement to be true and correct as of its effective date, and so would likely want to be comfortable that the opinion is accurate as of that date even though the opinion letter is dated earlier.

11. Question: When more than one counsel’s opinion is involved (e.g., when local counsel is required to opine on the law of a jurisdiction primary counsel is not in a position to cover), what is the difference between the assumption model and the reliance model?

Answer: When counsel assumes a matter covered by another counsel's opinion, that other opinion must be filed and the other counsel must consent to its filing. When counsel gives an opinion on a matter in express reliance on another counsel's opinion, the other opinion must be filed but the other counsel need not consent to the filing. Under the assumption model, both primary counsel and local counsel are potentially subject to liability under Section 11 of the Securities Act because both have consented to be named in the registration statement. Under the reliance model, only the primary counsel is potentially subject to liability under Section 11 because Securities Act Rule 436(f) does not require the local counsel to provide its consent.
12. **Question:** The guidance on Exhibit 8 tax opinions sets out detailed requirements, including what is required for a so-called “short-form” opinion and, when counsel gives a “should” opinion, requiring counsel to explain why a “will” opinion cannot be given. Does this represent a change in practice?

**Answer:** No, the SLAB’s guidance on tax opinions is not intended to change current practice.

Donald W. Glazer  
dglazer@goodwinprocter.com

Stanley Keller  
stanley.keller@edwardswildman.com