In this issue:
Report on Legal Opinion Risk Seminar
Report on Subcommittee on Securities Law Opinions
Spring Section Meeting
Membership
Next Newsletter
Legal Opinion Risk Seminar

The Legal Opinion Risk Seminar held in October was an invitation only seminar sponsored jointly by the American Bar Association, the TriBar Legal Opinion Committee, the Legal Opinion Committees of several major commercial states and law firms. Arthur Field, the Honorable Thomas L. Ambro and Linda Hayman were the prime moving forces behind the Seminar. A Legal Opinion Study Group worked over the course of a year to plan the seminar. The Legal Opinion Study Group included members of various State Bar legal opinion committees as well as in-house counsel and representatives from lawyer liability insurers, rating agencies and others.

The program included panel discussions followed by break-out sessions. The morning panel discussion topics were: Responsibility and Concerns of Opinion Recipients and Their Counsel and Anatomy of a Claim. These were followed by a discussion of the gatekeeper role of transactional lawyers, which included a presentation by former SEC Commissioner Harvey Goldschmid, currently a Professor at Columbia University Law School. Thereafter, four concurrent break-out sessions were held to explore the program topics in greater depth and determine whether further study and reports were warranted. The morning concurrent sessions included: What is the Responsibility of Recipient Counsel to Its Client?, Making Third-Party Opinion Letter Customary Practice Work for Recipients, Gearing Up for Trial: Do’s and Don’ts, and Pre-Summary Judgment. Following the break-out sessions, participants reconvened for two additional panel discussions on Managing Large Firm Opinion Practice and Dealing with Opinion Hot Spots. From these two panels, concurrent break-out sessions were held in the afternoon on Opinions and Side Letters, Dealing with Demands for Assignable Opinions, Internal Policing of Opinion Practices and Managing Opinion Practices in Multi-Office/Multi-Jurisdictional/Multi-Practice Firms.

The participants reconvened for a report on each of the morning and afternoon concurrent break-out sessions. Written versions of those reports will be collected and published in due course. The final item was a report on a special project being undertaken to survey existing Bar reports and identify areas of consistency in descriptions of customary practice.

A follow-up meeting is planned for April where topics will include issues from certain of the break-out sessions.

The first panel on Responsibility and Concerns of Opinion Recipients and Their Counsel started with the questions: what does a recipient client expect of its own counsel, and how does counsel fulfill that responsibility and manage its own risk? Opinions are part of the internal due diligence process and generally counsel for the recipient considers the identity of the opining counsel, the form of the opinion, and whether it covers what the opinion recipient needs to have covered. This requires that the counsel to the opinion recipient knows what items are of importance to the client, requiring consultation between counsel and the recipient to be sure that the client understands what is covered. This is especially important and more difficult where an opinion by foreign counsel is involved. If counsel to the opinion recipient does not understand foreign customary practice, the best technique for assuring client understanding of the foreign
opinion needs to be addressed. Among other things, this may require that counsel to the recipient ask the foreign counsel questions concerning what might be unstated in the opinion based upon the customary opinion practice in the foreign jurisdiction.

Opinion Reports have not addressed in detail the question of what should be done and what is the result if recipients and their counsel are unfamiliar with customary opinion practice. This panel and related break-out sessions addressed and debated this topic, including the issue of responsibilities of counsel to the opinion recipient and the opinion giver, and techniques for making information about customary opinion practice more readily available to inside counsel.

The next session was titled: Anatomy of a Claim. Lori Gordon from ALAS gave an overview of the claims landscape indicating that there are recurring themes and the frequency and severity of claims involving opinions have increased. She will be reprising her presentation at our Committee Forum described below. She reiterated that opinion claims do not, for the most part, involve problems with the legal content of the opinions given, but rather involve an unworthy client, conflicts of interest, inadequate supervision and incorrectness in factual confirmations included in the opinion. She indicated that a jury might be inclined to use as the standard how a best lawyer, not an ordinary lawyer, would handle an issue. She recommended that if a law firm has a policy of having a second reviewing partner, that partner should ask hard questions, and in all cases follow policy. Plaintiffs’ counsel in the opinion cases focus on communication, or the lack thereof, between deal counsel and other members of the firm with responsibility for obtaining factual confirmations.

This concluded the morning panels and prior to the break-out sessions, Harvey Goldschmid talked about lawyers as gatekeepers. He indicated that independent directors are heavily dependent on disclosure by gatekeepers, who include accountants and lawyers. Lawyers are under great pressure in this area as weak state regulation is being increasingly replaced by federal regulation. He indicated that candidates for further rule-making at the SEC include the role of independent counsel in investigations, law firm responsibility versus individual responsibility and special counsel responsibilities in high risk transactions with no legitimate business purpose. Robert Mundheim, who was also on this panel, indicated that he would like to get rid of the term “gatekeeper” and rather use the term “corporate counsel to the corporation.” He felt that if lawyers properly exercise their responsibility to the entity and not to individuals who run the corporation there would be fewer issues.

I attended the break-out session on Gearing Up for Trial: Do’s and Don’ts chaired by Don Glazer, John Villa and Lori Gordon. John Villa, who represents many of the law firms involved in litigation involving opinions, indicated that one cannot effectively explain customary practice to a judge on a motion to dismiss and that it is more likely at that stage in litigation that a judge will look to the plain meaning of the words in an opinion. Until we have a larger body of decisions, it is likely that we will continue to have a hard time impressing upon judges and juries the importance of customary opinion practice. Furthermore, on a motion to dismiss, one cannot bring in experts to testify. He indicated that when clients go bankrupt, lawyers have the greatest risk involving opinion liability. He impressed upon us that in this day of recording everything and keeping it forever, it is increasingly important to keep in mind that sometimes an unrecorded face-to-face conversation is the best way to convey difficult
information. He also indicated that, although technical compliance in delivering opinions is important, it is probably just as important that clients be properly vetted and that intake is critical. The know-your-client rule followed in the European Union should be adopted here. He indicated that the accounting firms are much better at vetting their clients. Although one needs to vet a client properly at intake, one must not become complacent, but continue to evaluate clients over time.

We then reconvened for panel discussions in the afternoon, the first being Managing Large Firm Opinion Practice. The first issue is to define the process that a firm is to follow — that is whether there will be opinion committees, what issues they will address and what opinion issues a firm will not cover, and then to develop a centralized body of expertise, to hold training sessions and to liaise with the risk management function.

Use of intranets for vetting questions among members of an opinion committee and providing lists of who can prepare and review specific questions were recommended. Preparing research memos for new issues was also recommended in that it helps crystallize whether the opinion can be given and can serve as a guide for the future. In terms of routine opinion tasks and issues, checklists can provide good training tools.

Having a litigator on the opinion committee is also useful. Finally, uniformity is to be stressed unless there is a substantive legal reason for saying something in a different way across different practice groups.

Risk management and control are also an important part of lateral hiring.

The final large panel was on Dealing with Opinion Hot Spots and included discussions of factual confirmations, opinions to accountants, assignable opinions and side letters in private equity transactions.

Counsel to the partnership or limited liability company issuing securities is often asked to give enforceability opinions on side letters. This raises issues of authority, although organic documents increasingly contain side letter enabling provisions. It also raises the issue of whether and to what extent duties are owed to others who are not parties to the side letters. In addition, whether or not specifically requested, if an opinion on the enforceability of the partnership or operating agreement is requested, an opinion on side letters may be included by implication depending on how the relevant statute defines the organic document and how carefully the opinion giver defines what it has reviewed in rendering the opinion. Increasingly, side letters are being focused on by the regulators.

We were advised that accountants are now requiring periodic updates under FAS 140 with respect to true sale and substantive consolation opinions because the accountants are required to assess the company’s position throughout the entire period of the transaction.

In the afternoon, I co-chaired the Dealing with Demands forAssignable Opinions break-out session with Mark Adcock who had presented on the panel. Issues that we need to explore in greater detail are oral understandings and the understanding of customary practice by the original opinion recipient as well as assignees. There was a consensus that the assignee should not be in a better position regarding the opinion than the original addressee. The
participants in the break-out session generally favored additional qualifications in provisions in opinions permitting reliance by assignees. Further areas for possible qualifications that were discussed were limiting the time period during which assignees could come into the reliance group, allowing only the agent bank on behalf of lenders and successors and assigns to rely on the opinion, including a stated or unstated assumption that there would be no fraud in any subsequent assignment transactions, consideration of special rules that might need to be addressed for non-U.S. recipients, and adding assumptions with respect to bank loan transactions that all assignees would be banks or entities of the same type as in the original group for purposes of certain opinions, for example usury opinions.

This panel will continue its work and be a presenter at the April meeting.

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**Report on Subcommittee on Securities Law Opinions**

The Subcommittee on Securities Law Opinions, a subcommittee of the ABA Committee on Federal Regulation of Securities, held a meeting at the Ritz Carlton Hotel in Washington, D.C. on December 2, 2006, in connection with the Fall CLE Meeting of the ABA Committee on Federal Regulation of Securities. Despite the meeting time of 7:30 a.m. on a Saturday, there was good attendance. Many members of the Committee on Legal Opinions are also members of the Subcommittee on Securities Law Opinions.

The principal agenda item at the meeting was to review and discuss the draft report on *No Registration Opinions* which had been circulated to the members of the Subcommittee. The report is nearing completion and is expected to be approved at the next meeting, which is scheduled from 2:00 to 3:00 pm on Friday, March 17, 2007 at the Spring Meeting of the Business Law Section in Washington, D.C. The report contains two forms of illustrative opinion letters, reflecting two typical kinds of transactions in which securities are issued without registration under the Securities Act of 1933, and discusses the underlying applicable law and the different kinds of provisions that are typically included in no registration opinions. Members of the Committee on Legal Opinions who are not members of the Subcommittee can obtain copies of the report by subscribing to the Subcommittee’s listserv. This is done by logging in to the ABA website and navigating to the directory of committees of the Section of Business Law (http://www.abanet.org/buslaw/committees/index.shtml) and then moving to the page for the Committee on Federal Regulation of Securities and the page for the Subcommittee on Securities Law Opinions and finally clicking on “subscribe” to the listserv for bl-securitieslawopin. You will then receive copies of communications sent to the Subcommittee on Securities Law Opinions, which will include the revised report on *No Registration Opinions* when it is available.

It was also announced at the meeting that the Subcommittee would undertake to update its Report on *Negative Assurance in Securities Offerings*, which was published in the Business Lawyer in August 2004, 59 Bus.Law. 1513, in order to reflect the changes in practice following the Securities Act reform proposals adopted by the SEC in 2005. Numerous changes in customary practice have developed in order to address issues such as registration statements that contain parts which become effective at different times and “disclosure packages” containing free-writing prospectuses and other documents that are “conveyed” to investors at the time they
decide to purchase the securities. There are enough variations at this point that it appears worthwhile to examine evolving practices and consider whether it is possible to develop a new standard form that could achieve a degree of acceptance. In order to undertake this effort the Subcommittee would like to receive examples of negative assurance letters that lawyers have given in actual transactions during the past year, preferably without information identifying the parties involved. Persons who are interested in participating in this effort are requested to send examples of letters they have given or received to Richard R. Howe, the Chair of the Subcommittee, at hower@sullcrom.com.

Finally, it was reported at the meeting that the SEC Exhibit 5 Opinion Working Group, consisting of David Schwartzbaum, John Huber, Jack Bostelman and Stan Keller, had recently persuaded the SEC staff to accept language to be included in Exhibit 5 opinions relating to shareholder rights plans. This language is reprinted at the end of this newsletter, since the Subcommittee wants to see this language circulated widely. It is anticipated that eventually there will be an Addendum to the Subcommittee’s report on Legal Opinions in SEC Filings, which was published in the Business Lawyer in August 2004, 59 Bus.Law. 1505, to explain this language and discuss this subject in greater detail. In the meantime, any lawyer preparing an Exhibit 5 opinion relating to a shareholder rights plan should be aware of the SEC staff’s acquiescence in the use of this language in opinions.

**Language for Exhibit 5 Opinions on Shareholder Rights Plans**

The Exhibit 5 opinion language below is illustrative. It assumes that the opinion may be limited to the applicable corporate statute (e.g., the DGCL):*

Subject to the foregoing, it is our opinion that, as of the date hereof, the Shares and the associated Rights have been duly authorized by all necessary corporate action on the part of the Company and, upon issuance, delivery and payment therefor in the manner contemplated by the [Merger Agreement] [Underwriting Agreement] and the Registration Statement, the Shares and the associated Rights will be validly issued and the Shares will be fully paid and non-assessable.

* * * *

Opinion givers may, if they choose, make express the following:*

(1) that board members are assumed to have acted in a manner consistent with their fiduciary duties as required under applicable law in adopting the Rights Agreement; and/or

(2) that the opinion does not address the determination a court of competent jurisdiction may make regarding whether the board of directors would be required to redeem or terminate, or take other action with respect to, the Rights at some future time based on the facts and circumstances existing at that time.

Opinion givers also may, if they choose, add clarification to the following effect:*

It should be understood that our opinion addresses the Rights and the Rights Agreement in their entirety and not any particular provision of the Rights or the Rights Agreement and that

* Variations that are to the same effect are also permissible.
it is not settled whether the invalidity of any particular provision of a rights agreement or of rights issued thereunder would result in invalidating in their entirety such rights.

Spring Meeting

TriBar is working on a brief report on the role of customary practice. The intent is to have our committee and other state and local bar associations review the report and consider whether to approve or adopt it. If the draft report is ready for discussion, we will cover it at our meeting which is scheduled from 10 to 10:30 am on Friday, March 17, 2007 in Washington, D.C. As soon as the report is approved by TriBar, I will circulate it to our committee for comment and approval.

Immediately following our meeting will be our committee forum from 10:30 to 12:30. The forum will summarize the Legal Opinion Risk Seminar described above and any projects that are an outgrowth of that seminar.

Arthur Field will report generally on the seminar, future plans and the role of customary practice in giving and receiving opinions. We will continue discussion of the TriBar customary practice opinion report as well as a survey of bar association reports that is being undertaken to determine where there are areas of consistency in descriptions of customary practice.

Lori Gordon of ALAS and Don Glazer will speak on claims against opinion givers and trial do’s and don’ts. John Power will cover the role of the opinion recipient’s counsel, and I will speak about permitting future assignees of transaction documents to rely on the opinion delivered at the time of closing.

Hope to see many of you at the meeting.

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

The next newsletter will be circulated in late March 2007. Please forward cases, news and items of interest to berkley@ballardspahr.com.

Best Wishes for a Healthy and Prosperous 2007