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Report from the Chair

Here are some recent developments in the opinions world.

Committee Growth

The Committee is now 950 strong and growing. It remains the premier provider of programs and information on legal opinions to the larger national audience of practitioners.

August Committee Meeting

Our Committee meeting on August 10 at the ABA Annual Meeting in New York was quite successful, notwithstanding the partial failure of the conference call mechanism which was supposed to permit members unable to attend in person to join us. Dick Howe gave a summary of the No Registration Opinions report of the Subcommittee on Securities Law Opinions of the Committee on Federal Regulation of Securities, published last fall (63 Bus. Law. 187 (Nov. 2007)). Don Glazer reported on the National Century case, holding that a “no violation of law” opinion in an opinion letter that incorporated the ABA Accord by reference did not cover violations of Blue Sky laws.1

Outbound Cross-Border Opinion Project

In conjunction with the August Committee meeting, our task force on Outbound Cross-Border Legal Opinions presented a forum on this project. See Rick Frasch’s summary elsewhere in this newsletter. The task force is hard at work and hopes to have a draft of the full report ready for distribution and comment in a few months. It is still collecting examples of outbound cross-border opinions that have been given or requested; please send examples to me at johnpower@earthlink.net (they won’t be quoted in the report without your approval).

Survey of Office Practices

Also at the August meeting, the Committee approved a project to update the survey of office practices completed by the Committee under Arthur Field’s leadership (with extensive assistance from Carolan Berkley and Don Glazer) in 2002, the results of which were published as Law Office Opinion Practices, 60 Bus. Law. 327 (Nov. 2004). A task force is actively working on this project. We can use additional participation, so please contact me (johnpower@earthlink.net) if you wish to help.

1 If you were not able to join us in New York, see the “Recent Developments” portion of the July issue of the newsletter, where Don’s comments on National Century are featured. The July issue is available on our website (see “Membership,” below, for the url).
ListServ

The Committee meeting also featured a lively discussion about reinvigorating the Committee’s listserv, under Jeff Rubin’s leadership. In fact, following the meeting we experienced a considerable increase in listserv use by our members. If you do not currently subscribe to the listserv, I urge you to do so. Go to http://www.abanet.org/buslaw/home.html, click “Committees,” and scroll to “Legal Opinions.” Once you are on the Committee website, scroll to “Listservs” and click on “subscribe.” (You must be a member of the Committee to subscribe.) If you have already subscribed, please use the listserv to ask and answer opinion practice questions.

This newsletter inaugurates a new feature, “Lessons from the ListServ,” in which Jim Fotenos reports on a recent listserv discussion on customary practice regarding whether “no breach or default” opinions on a company’s other agreements cover financial covenants in those agreements.

Important Opinion Reports: Committee Resource Center

Three important reports have been or soon will be published:

- The Statement on the Role of Customary Practice in the Preparation and Understanding of Third-Party Legal Opinions, primarily authored by Steve Weise and Bill Nimkin and approved by many bar groups, now available at 63 Bus. Law. 1277 (Aug. 2008).

- Negative Assurance in Securities Offerings (2008 Revision), by the Subcommittee on Securities Law Opinions of the Committee on Federal Regulation of Securities (Committee member Dick Howe, Chair).

- Statement on Effect of FIN 48 on Audit Response Letters, by the Audit Response Committee (Committee member Stan Keller, Chair).

See the reports of Dick Howe and Stan Keller on the work of their respective committees elsewhere in this newsletter. Under Christina Houston’s leadership, we are adding these reports to the opinion resource center on our Committee website.

Other Important Publications

The third edition of Glazer and FitzGibbon on Legal Opinions has now been published and is available for our bookshelves, thanks to authors and Committee members Don Glazer and Steve Weise. Committee member Jonathan Lipson’s article, Cost-Benefit Analysis and Third-Party Opinion Practice, has been published at 63 Bus. Law. 1187 (Aug. 2008). Jonathan presented earlier versions of the article at programs sponsored by our Committee in 2007. We will add a link to Jonathan’s article in the opinion resource center on the website.
Task Force on Due Diligence Reports

Committee member Jim Rosenhauer chairs a recently formed task force on this important topic, with involvement of several committees of the Section of Business Law. I represent our Committee on the task force. See Jim’s summary elsewhere in this newsletter.

WGLO

The Working Group on Legal Opinions will hold its sixth seminar in New York on October 28, 2008. In addition to providing programs and breakout sessions, WGLO sponsors two affiliated advisory boards: the Association Advisory Board, and the Law Firm Advisory Board, both of which will meet on October 27. Steve Hazen, the Secretary of the Association Advisory Board, describes elsewhere in this issue the work of that board. We plan to have a description of the Law Firm Advisory Board in the next issue.

November Committee Meeting

Our next Committee meeting will be at 10:00 a.m. on November 21, 2008 in the Boardroom on the Ballroom Level of the Ritz Carlton Hotel, Washington, D.C., in conjunction with the fall meeting of the ABA Section of Business Law. We will discuss progress on our outbound cross-border opinion project and our update of the office practices projects, and other topics. Jerry Hyman, our ABA Section of Business Law advisor, will be there to join in our discussions.

- John B. Power, Chair

Future Meetings

ABA Section of Business Law Fall Meeting
Washington D.C.
Ritz Carlton Hotel
November 21-22, 2008

Friday, November 21:

- Committee on Legal Opinions. 10:00-11:00 a.m. Boardroom, Ballroom Level.

- Subcommittee on Securities Law Opinions, Committee on Federal Regulation of Securities. 11:00 a.m.-12:00 p.m. Salon IIIA, Ballroom Level.

- Committee on Audit Responses. 2:00-3:00 p.m. Jefferson Room, Ballroom Level.
Saturday, November 22:

- Committee on Professional Responsibility. 12:30-1:30 p.m. Roosevelt Room, Ballroom Level.

*Working Group on Legal Opinions*
New York
October 28, 2008

*ABA Section of Business Law Spring Meeting*
Vancouver, British Columbia
April 16-18, 2009

Friday, April 17:

- Committee on Legal Opinions. 8:30-10:30 a.m.

- Program: Update on Negative Assurance, jointly sponsored by the Committee on Legal Opinions and the Subcommittee on Securities Law Opinions of the Committee on Federal Regulation of Securities. 10:30 a.m.-12:30 p.m.

*Global Business Law Forum*
Hong Kong
June 10-12, 2009

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**Program Summary**

**Outbound Cross-Border Legal Opinions: A Proposed Report**

As noted in the Chair’s Report, at the Committee’s August meeting several members of our task force on Outbound Cross-Border Legal Opinions presented a forum on the project. Participants were John B. Power (moderator), J. Truman Bidwell, Sylvia Chin, Don Glazer, Noel Para and Jim Rosenhauer.

In late 2007, a task force² began studying outbound cross-border opinions (opinions by U.S. counsel to non-U.S. recipients). At our April 2008 Committee meeting in Dallas, a panel³

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² The drafting committee of the task force is currently comprised of Truman Bidwell, Daniel Bushner, Peter Castellon, Sylvia Chin, Ed Fleischman, Don Glazer, Richard Frasch, Noel Para, John Power, Jim Rosenhauer, Ettore Santucci, Larry Safran, and Elizabeth Van Schilfgaarde.

³ Sylvia Chin, Noel Para, John Power, Jim Rosenhauer and Ettore Santucci.
of task force members proposed, and the Committee approved, preparation of a report on this topic. Ettore Santucci agreed to serve as reporter and the task force began work. The August forum summarized progress on the report and issues under consideration by the subcommittee. An early draft of the report was distributed for comment.

Noel Para provided an overview of the factors that frequently complicate preparation and interpretation of outbound cross-border opinion letters: language differences of the parties and their lawyers; dissimilar law school experiences; different legal systems (e.g., civil law versus common law traditions); and different traditions concerning the delivery of legal opinions.

Don Glazer summarized the historical development of U.S. third-party opinion practice. It appears to have started in the 19th century with opinion letters by issuer’s counsel on the legality of newly-issued railroad bonds. Although the practice grew substantially, guidance to those involved was provided only through an oral tradition. In 1973, Jim Fuld wrote an article for *The Business Lawyer* focusing on inconsistencies and confusion in opinion practice. The TriBar Opinion Committee was formed partly in response to the Fuld article, and issued its first report on opinion practice in 1979. During the 1980s several state bar reports were published addressing opinion letters. In 1991, the ABA Legal Opinion Accord was published in an effort to articulate a common set of understandings between opinion givers and recipients that could be incorporated by reference into third-party opinions. In connection with issuance of the Accord, the ABA Section of Business Law issued its Guidelines for the Preparation of Legal Opinions. The Accord has not been used extensively in practice.

During the 1990s, literature on legal opinions began emphasizing the fundamental role of customary practice in preparing and understanding opinions. In 1998, the TriBar Opinion Committee published an updated report on third-party legal opinions, the ABA Legal Opinion Principles were published, and the ALI approved its Restatement on the Law Governing Lawyers. After 2000, many bar association reports were revised emphasizing customary practice, and the ABA issued revised Guidelines for the Preparation of Legal Opinions. Customary practice is now recognized as the guiding principle of legal opinion practice. Don reported that a major premise of the task force’s draft report is that U.S. customary practice governs the diligence for and interpretation of cross-border opinion letters given by U.S. counsel.

Jim Rosenhauer then spoke about threshold issues raised by requests for outbound cross-border opinions. He advocated applying a cost-benefit analysis (whether the cost of the opinion is justified by its benefit to the recipient) in requesting legal opinions, a position (regarding domestic opinions) that was discussed in the Committee’s program at the 2007 ABA Annual Meeting in San Francisco. He also referred to the threshold report contained in the California Bar Business Law Section’s *Report on Third-Party Remedies Opinions*, first published in 2004 and updated in 2007. His conclusion was that the same cost-benefit considerations in

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4 The most recent articulation of this premise is the recently published *Statement on the Role of Customary Practice in the Preparation and Understanding of Third-Party Legal Opinions*, 63 Bus. Law. 1277 (Aug. 2008).

determining the appropriateness of requesting domestic opinion letters should be used in cross-
border transactions. He further suggested that, because non-U.S. recipients often are unfamiliar
with U.S. customary practice and therefore may not understand the meaning of U.S. opinions,
the benefits received by non-U.S. opinion recipients will be dramatically fewer than those
received by domestic recipients. As a result, the cost-benefit analysis should result in U.S. cross
border opinions not being required in many circumstances. This should particularly be true
where a transaction involves other jurisdictions and opinions are not being required with respect
to the laws of those jurisdictions.

John Power discussed “as if” opinions (enforceability opinions given on documents that
choose law not covered by the opinion “as if” the covered law applies). He concluded that such
opinions ordinarily should not be given by U.S. counsel in cross-border transactions, because
the opinion preparers usually know little about the full meaning of the documents under the
chosen law.

Sylvia Chin then spoke on choice-of-law opinions in cross-border transactions. Sylvia
noted that many U.S. states have adopted the choice-of-law position of the Restatement (Second)
of the Law of Conflict of Laws. Many U.S. lawyers give enforceability opinions in domestic
transactions on choice-of-law provisions where the jurisdiction whose law is covered by the
opinion letter has adopted the Restatement position. In the outbound cross-border opinion
context, choice-of-law opinions may be more difficult to give where non-U.S. law is chosen and
the opinion preparers may not understand the meaning of the documents under the chosen law.
There was a lively discussion of the view of the California remedies report that, while California
lawyers generally now give choice-of-law opinions where a document chooses non-California
law (in general, California has adopted the Restatement position), they will not opine on whether
application of the chosen law violates a fundamental policy of California.

Finally, Truman Bidwell spoke on opinions that are often seen in the cross-border context
but are not usually requested in U.S. domestic transactions. He discussed opinions on
contractual provisions regarding service of process, submission to foreign courts, waiver of
sovereign immunity, and enforcement of judgments or awards rendered by foreign courts or
arbitral bodies.

- Richard N. Frasch

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6 A choice of law by the parties will generally be given effect if (1) the jurisdiction whose law is chosen bears a
reasonable relationship to the transaction or the parties and (2) applying the chosen law would not violate a
fundamental policy of the jurisdiction whose law would apply in the absence of an effective governing law provision
or that has a materially greater interest in the issue.
Other Committee Reports

Subcommittee on Securities Law Opinions

The Subcommittee on Securities Law Opinions of the Section of Business Law’s Committee on Federal Regulation of Securities met on August 10, 2008 in New York City to review a substantially final draft of the updated report on negative assurance in securities offerings, which is intended to supersede the Subcommittee’s report on Negative Assurance in Securities Offerings, 59 Bus. Law. 1513 (Aug. 2004).

The meeting began with a review of various comments that had been sent in from members of the Subcommittee prior to the meeting. There was a discussion of these items and of proposed changes to the report to deal with the comments. The principal topics discussed included the practice of not delivering negative assurance letters to an issuer’s directors; whether issuers could be proper addressees of negative assurance letters in unregistered offerings; incorporation by reference of Form 6-Ks; the exclusion of supplemental marketing materials (such as road shows) from the definition of “Pricing Disclosure Package”; and the extent to which lawyers in law firms customarily consult with other lawyers in their firms regarding disclosures in the registration statement and the appropriate definition of knowledge in relation thereto.

The Subcommittee then gave its final approval of the report, with such additional changes as the Chairman believed appropriate. After the meeting, a revised draft dated August 15, 2008 was circulated to the Subcommittee, and various additional comments were submitted. Finally, a “final” draft dated September 29, 2008 was circulated to the Subcommittee, and it is anticipated that this draft will be submitted shortly to The Business Lawyer for publication in the next available issue.

The next meeting of the Subcommittee will be held in Washington, D.C. on November 21, 2008 in connection with the fall meeting of the Business Law Section.

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

Committee on Audit Responses

The Audit Response Committee met at the ABA Annual Meeting in New York on August 10, 2008 with the principal agenda item being finalization of the Committee’s Statement on Effect of FIN 48 on Audit Response Letters. The Committee approved the Statement in substantially the form sent to the members prior to the meeting with such clean-up changes as the Chair, with input from a drafting group, may make. A copy of the Statement in its current form is included in this issue.
The Audit Response Committee also discussed FASB’s proposal to significantly revise the disclosure requirements of FAS 5 and the ABA’s comment letter dated August 5, 2008 on that proposal. Subsequently, FASB approved a plan to field test a scaled back alternative along with its original proposal and a one-year delay in the planned schedule for implementation.

- Stanley Keller, Chair
  Committee on Audit Responses

ABA Section of Business Law Task Force on Diligence Reports

This Task Force is looking at the practice of U.S. law firms with respect to delivery of Diligence Reports (often referred to as document review reports) (“Reports”) in U.S. transactions to prospective lenders and other financing sources. Reports of this kind are often prepared by counsel to a purchaser in connection with the acquisition of a company or its assets, and address specific areas of interest, and with specific scopes of review, as directed by the client. The customary U.S. practice historically has been that law firms that prepare a Report do not permit reliance on the Report by third parties such as lenders to, and investors in, the law firm’s client. There has been growing pressure in recent years, however, for U.S. law firms in U.S. transactions to furnish, or consent to delivery of, these Reports to lenders and other financing sources for review (but not reliance). When law firms have acquiesced, they have generally included a disclaimer of reliance in the Report itself, and typically have insisted on obtaining a non-reliance letter agreement from the lender or other financing source, that makes clear (i) that third parties are not permitted to rely, or justified in relying, on the Report, (ii) that the Report was not prepared or intended for the benefit of such third parties, and (iii) that the law firm has no liability or other responsibility to the third party to whom the Report has been provided. This approach is inconsistent with practices apparently followed in some European transactions, and conflicts can arise from these differing practices in the course of transactions that involve both Europe and the U.S. After additional review of the issues involved, and customary practice, the Task Force intends to prepare a report further exploring the issues raised by the practice of delivering Reports to non-clients.

- James J. Rosenhauer, Chair
  Task Force on Diligence Reports
In prior issues of this newsletter, we have provided summaries of the twice yearly seminars that have been conducted by the Working Group on Legal Opinions (“WGLO”). Organizationally, the WGLO is led by its Steering Committee, whose members represent a cross section of opinion givers, opinion recipients, and bar associations with ongoing programs of publishing opinion reports reflecting customary practice in their respective jurisdictions and educating their members about developments in the opinion arena. The Steering Committee is assisted by two advisory boards: The Association Advisory Board (“AAB”) and the Law Firm Advisory Board. The AAB currently consists of 30 bar associations with active programs on legal opinion practice and five affinity associations serving institutional opinion recipients. Len Gilbert of Holland & Knight LLP is the Chair of the AAB, and I am its Secretary. A list of members of the AAB and persons representing them can be viewed at http://www.abanet.org/buslaw/wglo/aab.shtml, along with agendas and minutes of previous meetings.

The AAB meets twice each year in conjunction with the WGLO seminars. Each AAB meeting includes active discussion of substantive topics. In addition, the AAB serves as a communications bridge, bringing ideas and concerns from the associations and their members to the national dialogue of the WGLO and disseminating ideas discussed and consensus reached in WGLO seminars back to AAB members. A recent example is the article published in the August issue of Atlanta Lawyer by Bob Pannell, providing a historical summary of opinion practice and reporting on topics covered in WGLO seminars. Bob serves as the Atlanta Bar Association’s representative on the AAB and is a member of the ABA Section of Business Law’s Committee on Legal Opinions. For a copy of the article, please e-mail Bob.Pannell@NelsonMullins.com.

The AAB plans to gather data regarding bar association reports on existing and emerging opinion practices. We recently circulated a questionnaire about AAB member association reports, and we expect to play an important role in connection with a new questionnaire that will be used by the ABA Committee on Legal Opinions in updating its report on Law Office Opinion Practices, 60 Bus. Law. 327 (Nov. 2004).

The AAB has been a vibrant part of the WGLO since its formation. It is now actively engaged in efforts to expand its membership, particularly focusing on affinity associations of institutional opinion recipients. Members of the ABA Committee on Legal Opinions interested in proposing affinity associations for membership in the AAB should feel free to use the email link at the AAB webpage (see above).

- Steven K. Hazen, Secretary
WGLO Association Advisory Board

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7 See the summaries of the October 2007 and June 2008 WGLO seminars, which are appended to the January 2008 and July 2008 issues of this newsletter. Both are available on the Committee website. Go to http://www.abanet.org/buslaw/home.html. Click on “Committees,” and scroll to and click on “Legal Opinions.” Once you are on the website, scroll to “Materials” and click on “Newsletter.”
Lessons from the Listserv

[Editor’s Note: Dialogues on the listserv are not intended to be authoritative pronouncements of customary opinion practice, but represent the views of individual lawyers on opinion topics of current interest. Members of the listserv may review the comments referred to below by clicking on the “Archives” link under “listservs” on the Committee’s website.]

Does the “No Breach or Default” Opinion on Material Agreements Include the Financial Covenants of the Material Agreements? How Does the Opinion Giver Address Financial Covenants in Material Agreements If a No Breach or Default Opinion Covers Them?

Jeff Ostrager’s September 24th inquiry about “prevailing practice” as to the coverage of financial covenants in material agreements by no breach or default opinions triggered a lively exchange of views among our members. Specifically, Jeff asked about customary practice as to the “carve-out” of financial covenants from what he refers to as “non-contravention opinions,” and whether opinion givers rely upon officer’s certificates when addressing financial covenant compliance.

The no breach or default opinion, as it addresses material agreements, is stated in one of TriBar’s illustrative opinions (1998 TriBar Report, App. A-2) as follows:

The execution and delivery by the Company of the Credit Agreement and the Note do not, and the performance by the Company of its obligations thereunder will not, breach or result in a default under any agreement or instruments listed on Schedule II hereto . . .

Let’s assume one of the listed agreements includes, among others, the following covenants:

The Company shall maintain the following financial covenants as of the end of each fiscal quarter: (i) a minimum Debt Service Coverage Ratio of 1.25 to 1.00, and (ii) a Consolidated Tangible Net Worth Leverage Ratio of no less than 4.50 to 1.00.

With, of course, each of the capitalized terms carefully defined in the listed agreement.

Four listserv subscribers, Charles Menges, Steve Weise, Alan Beloff, and Bill Bryson, weighed in with the view that a carve-out for financial covenants is customary practice. An example of such a carve-out is the following:

The execution and delivery by the Company of the Credit Agreement and the Note do not, and the performance by the Company of its obligations thereunder will not, breach or result in a default under any agreement or instruments listed on Schedule II hereto, excluding from the scope of this
opinion the financial covenants of any such agreement or instrument compliance with which requires the analysis of financial information . . .

Dick Howe, Stan Keller and Arthur Field emphasized that opinion recipients may legitimately request that the no breach or default/material agreements opinion cover financial covenants. As stated by Dick: “… [T]here are certainly many transactions in which the parties ask for and need a lawyer’s analysis of compliance with financial covenants as a condition to extending credit to the lawyer’s client.” Where such an opinion is given, they agree that reliance upon an officer’s certificate is appropriate. As Stan observes: “… [W]e rely on a certificate we prepare that makes the required computations. Lawyers deal with words not numbers but sometimes numbers are necessary in reaching legal conclusions and we shouldn’t be so fearful about dealing with them when we can get others more conversant with numbers to produce them in a way that we can rely on.” Or, as stated by Art Field,

To be worthy of reliance the certificate would have to grapple with the facts. It would have [to] indicate that the certifier had established the amounts involved in the relevant calculation as of the relevant date. The opinion preparer’s job is then to see whether the certificate examines the correct issues and is therefore worthy of reliance.

In rendering the no default or breach opinion on material agreements, assuming no carve-out is expressly stated, is the opinion giver opining that the company has not breached the financial covenants in the listed agreements?

Don Glazer et al., in the third edition of their treatise, Glazer and FitzGibbon on Legal Opinions (§ 16.3.5), state the view that the opinion giver is covering financial covenants when no carve-out is stated:

… [A]bsent an express disclaimer, the [no breach or default/material agreements] opinion is understood to cover covenants that require financial computations either to determine whether or not they apply or, for covenants that do not apply, whether or not their requirements have been satisfied (‘financial covenants’).

(Footnotes omitted.)
The California Bar, through its Business Law Section, in its Corporations Committee’s 2007 revision of its Report on Legal Opinions in Business Transactions (Excluding the Remedies Opinion), concludes that a no breach or default opinion lacking a carve-out does not cover financial covenants, a modification of the view expressed in the 2005 edition of the Report. See 2007 Report, reprinted as Appendix 22:1 of Glazer and FitzGibbon on Legal Opinions, note 161. That revised position drew less than adulatory comments from Stan Keller and Don Glazer. Dialogue on this topic is likely to continue in some venue.

- James F. Fontenos
Greene Radovsky Maloney Share & Hennigh LLP

Membership

If you know someone who would like to join the Committee and receive our newsletter, please direct him or her to the ABA Section of Business Law website: http://www.abanet.org/buslaw/home.html, click “Committees” and scroll to Legal Opinions. If you haven’t visited the website lately, we recommend you do so. Our mission statement and prior newsletters are posted there.

Next Newsletter

We expect the next newsletter to be circulated in February. Please forward cases, news and items of interest to John Power (johnpower@earthlink.net) or Martin Brinkley (mbrinkley@smithlaw.com).
ABA COMMITTEE ON AUDIT RESPONSES

Statement on Effect of FIN 48 on Audit Response Letters

On July 13, 2006, the Financial Accounting Standards Board issued Interpretation No. 48 ("FIN 48") on Accounting for Uncertainty in Income Taxes, which is an interpretation of FASB Statement No. 109, Accounting for Income Taxes, issued in 1992. It applies to issues involving federal, state, local or foreign income taxes. FIN 48 is effective for public companies for fiscal years beginning after December 15, 2006 and generally is effective for non-public companies for fiscal years beginning after December 15, 2007, although FASB has proposed a deferral for non-public companies to 2008. FIN 48 provides that its guidance governs with respect to accounting for such tax contingencies in place of FASB Statement No. 5, Accounting for Contingencies (“FAS 5”). As discussed below, the Committee on Audit Responses (the “Committee”) of the American Bar Association’s Section of Business Law believes that the issuance of FIN 48 does not change the standards under which a lawyer should respond to an auditor’s request for information regarding such contingencies. The Committee further believes that, although FIN 48 can affect the way a lawyer advises his or her client when income tax matters are involved, it does not alter the lawyer’s professional responsibility to provide that advice when that is required within the scope of the lawyer’s engagement.

Handling Loss Contingencies under the “Treaty”

In 1975 the Board of Governors of the American Bar Association, following approval by the Section on Corporation, Banking and Business Law (now known as the Section of Business Law), approved a Statement of Policy (the “ABA Statement”) regarding lawyers’ responses to an auditor’s request for information that had been previously approved by the Auditing Standards Executive Committee of the AICPA. The AICPA also approved in parallel Statement of Auditing Standards No. 12 recognizing the ABA Statement. This so-called “Treaty” between the legal and accounting professions has operated successfully for over 30 years pursuant to the following ground rules:

- A lawyer will only furnish information in an audit response letter with respect to “loss contingencies” as defined in FAS 5 that may result in incurrence of a liability or impairment of an asset, if the lawyer has devoted substantive attention to and consulted with the client with respect to the following loss contingencies:
  - overtly threatened or pending litigation, whether or not specified by the client;
  - contractually assumed obligations that the client has specifically identified and upon which the client has specifically requested comment to the auditor; and
  - unasserted possible claims or assessments that the client has specifically identified and upon which the client has specifically requested comment to the auditor.
• A lawyer will not express any opinion in the audit response letter on the outcome of a loss contingency or the extent of possible exposure unless the lawyer concludes that liability is either probable or remote.

• A lawyer should not be requested to comment on unasserted claims unless the client has determined that it is probable (i.e., likely to occur) that a possible claim will be asserted, that there is a reasonable possibility that, if asserted, the outcome will be unfavorable, and that a resulting liability will be material to the financial condition of the client.

• A lawyer should confirm, as contemplated by the Treaty (see Paragraph 6 of the ABA Statement), that, when the lawyer, within the scope of his or her engagement, has formed a professional judgment that the client must disclose or consider disclosure of a possible claim in its financial statements, the lawyer will so advise the client and consult with the client regarding such disclosure. The auditor may assume that in these circumstances the lawyer has advised the client regarding disclosure of unasserted claims that may call for financial statement disclosure. If the lawyer’s advice regarding disclosure is disregarded by the client, the lawyer, as a matter of professional responsibility, may need to consider withdrawal from the engagement or other remedial action.

Just as a lawyer should be familiar with FAS 5 in responding to auditor’s requests for information about loss contingencies and advising the client on its disclosure obligations, a lawyer should be familiar with FIN 48 when that is relevant to the lawyer’s engagement.

The adoption of FIN 48 raises a number of issues with respect to audit response letters.

Dealing with FIN 48’s “more likely than not” requirement

FIN 48 requires the client to account in its financial statements for income tax loss contingencies (FIN 48 speaks in terms of “income tax uncertainties”) based on the client’s assessment under a two-step process: first, determining whether it is more likely than not that its position will be sustained upon examination, and second, if so, measuring and recognizing the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. The unrecognized tax benefit is a liability and, if the client cannot reach the “more likely than not” conclusion, the entire tax liability must be recognized. In making the determinations under FIN 48, the client may choose to seek legal assistance regarding its tax position, but the required assessment and corresponding measurement is that of the client, as the Treaty specifically recognizes that a lawyer is not required to make determinations of what should be disclosed in financial statements.

For purposes of preparing an audit response letter, a lawyer should continue to follow the usual practice under the Treaty regarding whether or not to comment on the expected outcome of asserted and unasserted claims disclosed in the audit response letter under the “probable” or “remote” standard, leaving it to the client to determine for financial reporting purposes whether its position will be sustained and the amount of the tax benefit, including whether the “more likely than not” determination can be made. Accordingly, because it would be a departure from
the ABA Statement, a lawyer, if requested to do so, may appropriately decline to comment in the audit response letter on the determinations required to be made under FIN 48.

**Dealing with unasserted income tax claims**

Paragraph 38 of FAS 5 (which is quoted in the Commentary to the ABA Statement) discusses when assertion of an unasserted claim is to be considered probable, and leaves to the client to determine whether assertion of the claim is probable (i.e., likely to occur). If the client determines that assertion is not probable, then no accrual or disclosure is required under FAS 5, and so long as the lawyer believes the client has a reasonable basis for its determination, the lawyer may deliver an audit response letter without the unasserted claim being disclosed.

FIN 48 has made Paragraph 38 of FAS 5 inapplicable to income taxes, and proceeds on the assumption that, in assessing whether the client satisfies the “more likely than not” criterion for success, it is to be presumed that the client’s tax position will be examined by the relevant taxing authority that has full knowledge of all relevant information (see Paragraph 7a of FIN 48). Thus, the client’s judgment that a claim is not likely to be asserted by a taxing authority ceases to be applicable in determining what the client may need to disclose in the financial statements with respect to unasserted contingencies relating to income taxes. In cases where the lawyer has rendered substantive advice to the client with respect to a material unasserted contingent liability relating to income taxes, the lawyer, in responding to the auditor’s request for information, should be aware of FIN 48, and if the lawyer has concluded that financial statement disclosure of the income tax contingency is required but is not satisfied that the auditor has been or will be made aware of the contingency, the lawyer should consider what action is appropriate as a matter of professional responsibility. Such action might include, depending on the circumstances, refraining from providing the audit response letter and possibly withdrawing from the engagement.

**Addressing asserted income tax claims**

Overtly threatened and pending income tax claims should continue to be handled in the audit response letter pursuant to the Treaty, as summarized above.

**Effect of FIN 48’s amendment of FAS 5 on the Treaty**

The last paragraph of the standard form of audit response letter included in the ABA Statement indicates that it is limited by, and in accordance with, the ABA Statement, and confirms that whenever a lawyer has formed a professional conclusion that the client must disclose or consider disclosure concerning an unasserted possible claim or assessment, the lawyer, as a matter of professional responsibility to the client, will so advise the client and will consult with the client concerning the question of such disclosure “and the applicable requirements of Statement of Financial Accounting Standards No. 5.” Notwithstanding that FIN 48 makes Paragraph 38 of FAS 5 inapplicable to unasserted claims for incomes taxes, the Committee believes, as indicated above, that this change to FAS 5 does not alter the professional responsibility of a lawyer to advise its client on financial statement disclosure with respect to income tax matters when that is required in connection with the lawyer’s engagement.
CORRECTION TO OCTOBER 2008 NEWSLETTER

To Recipients of the October 2008 newsletter of the Legal Opinions Committee:

The October newsletter included an article entitled “Lessons from the Listserv”, summarizing a September 2008 listserv exchange about the coverage of financial covenants in material agreements by no breach or default opinions. A typographical error appeared in a quotation from *Glazer and FitzGibbon on Legal Opinions*, incorrectly adding the word “not”. Following are the corrected final two paragraphs of the article, marked to show the change.

Best, John Power, Martin Brinkley, and Jim Fotenos

**Corrected Text**

In rendering the no default or breach opinion on material agreements, assuming no carveout is expressly stated, is the opinion giver opining that the company has not breached the financial covenants in the listed agreements? Don Glazer *et al.*, in the third edition of their treatise, (§ 16.3.5), state the view that the opinion giver is covering financial covenants when no carve-out is stated:

… [A]bsent an express disclaimer, the [no breach or default/material agreements] opinion is understood to cover covenants that require financial computations either to determine whether or not they apply or, for covenants that do apply, whether or not their requirements have been satisfied (‘financial covenants’).

(Footnotes omitted.)