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FROM THE CHAIR

I am happy to forward to you the Fall 2016 issue of “In Our Opinion.” As in the past, we should thank our editors, Jim Fotenos and Susan Cooper Philpot, for their tireless work.

We had a very successful Annual Meeting in Boston in September, including a well-attended (and animated) program on the joint project undertaken by our Committee and the Working Group on Legal Opinions to prepare a statement of customary and other opinion practices. The program focused on the draft “Statement of Opinion Practices (March 31, 2016 Exposure Draft)” (“SOP”) and participants gave the members of the project committee valuable input on a host of issues. The SOP is being reviewed actively by bar groups around the country, consistent with the goal of the joint committee to receive the endorsement of as wide a group of bar associations as possible. Please stay tuned for a draft of a statement of core opinion principles drawn from the SOP but more suitable for incorporation by reference into closing opinions, something designed to serve the function now served by the Legal Opinion Principles (53 Bus. Law. 831 (1998)). I expect that draft will be presented and discussed at our Committee’s meeting on November 18, 2016 in Washington, D.C.

The Survey Subcommittee, under the joint leadership of John Power and Arthur Cohen, is making great progress towards the launch of our Committee’s third survey of opinion practices. This group seems to do its best work very early in the morning and, as noted in this Newsletter, will meet at 8:00 a.m. on Friday, November 18.

Speaking of the Fall Meeting in Washington D.C. on November 18 and 19 at the Ritz Carlton (same venue as in recent years), this issue of the Newsletter details all of our Committee’s activities, which are scheduled for Friday, November 18. These include the full Committee meeting at 9:30 a.m., the Subcommittee meeting referenced above at 7:30 a.m., and our reception at 5:30 p.m. We are fortunate this Fall to have the reception sponsored by Debevoise & Plimpton LLP. We will also host a program focused on legal opinions and practice issues in debt tender offers, where the panel will cover the conclusions of a report nearing completion of the Securities Law Opinions Subcommittee addressing Exchange Act Rule 14e-1 opinions given in such transactions.

Of particular interest in this issue is an article by Stan Keller discussing how lawyers should respond to auditor requests and advise clients on disclosures when a client is subject to a government investigation. A recent SEC enforcement action against a lawyer – an in-house general counsel – for his handling of the disclosure of a government investigation brought home the challenges lawyers face in this area, both in giving advice to the client and in complying with a lawyer’s own legal obligations and professional responsibilities when dealing with disclosure of government investigations. With his customary thoroughness and rigor, Stan covers the application of Accounting Standards Codification (“ASC”) 450-20 (formerly FAS 5) regarding disclosure of a pending or threatened claim, 1976 guidance from the ABA Committee on Audit Inquiry Responses (a predecessor of the Audit Responses Committee) on dealing with a pending government investigation against a client, and the special disclosure challenges of qui tam proceedings where a complaint is filed under seal and is confidential, such that a company is not legally free to disclose the filing of the complaint or the existence of the proceeding.

This is my inaugural piece as chair of our Committee. Let me start with a heartfelt THANK YOU to Tim Hoxie, whose term as chair concluded in September. I am grateful for Tim’s support and example, and it is with great trepidation that I assume the title. Of course anybody who participates in our Committee’s activities knows that a more appropriate title would be “latest additional chair,” because the Committee functions only as a result of the constant and generous contributions of former chairs who, together with many other Committee members, volunteer their time, effort and
wisdom on everything from drafting reports and articles to serving on program panels, from editing this Newsletter to responding to listserve inquiries. I am humbled by the opportunity to take a seat at the round table of our Committee’s leaders. I will do everything I can to deserve it and ask for your advice, as well as constructive criticism, while I settle into the role of chair.

Please forgive me for a moment of reflection on the past few years. Although my discolored beard makes me look ancient, I am a relative newcomer to our Committee. The attacks of IQ deficit syndrome have grown less frequent and severe, but they still come. For a meeting with Boston College Law School students alongside the Annual Meeting in September, I was asked to say what involvement with the ABA has meant for me. I said that I became active with our Committee after over 20 years of practice, when many think their time of steep learning as lawyers is behind them. Not so. I have never in my life learned more, faster and with greater passion than through interaction with leading members of our Committee. I consider their mentorship and guidance among the greatest blessings of my professional life. I was the reporter for our Committee’s cross-border report and for a number of years I was able to observe the working group venture into novel areas of opinion practice with a mastery of substance, a passion for language, a rigor of thought, and a spirit of collaboration that I had never seen before. Debate during our meetings could get intense, but mutual respect, even affection, always hung in the air. That is what makes our Committee, I believe, unique and very special.

As chair of such a group I want to challenge ourselves to think of what we can do next that is as good as or better than what we have done so far. A tough challenge for sure. I hope that in the coming weeks and months you will send me many ideas. Let me start with one of my own: sparking convergence among U.S. and non-U.S. practitioners in cross-border opinion practice.

Our Committee’s cross-border report was published last December (71 Bus. Law. 139 (Winter 2015-2016)). The City of London Law Society and the Toronto Interfirm Opinion Group also have published guidance for English and Canadian lawyers on giving third-party legal opinions. At the Spring 2016 meeting in Montreal we had a program that brought together opinion experts from the U.S., Canada, The Netherlands, England and other jurisdictions to discuss cross-border opinion practice with a goal of making the process more efficient and less contentious. I would like to build on this foundation during my term.

We live in interesting times. Whether because of the globalization of transactional practice, Brexit-related uncertainty, regulatory and political pressure as national regimes swing between integration and confrontation, or an intensely competitive legal profession where firms operate across jurisdictions on an unprecedented scale, we all feel the ground shifting. I was not involved in Silverado, but have learned how the “big thoughts” put forward then fueled decades of creative, productive work on U.S. opinion practice. I believe we are at a similar juncture in cross-border opinion practice. I would like our Committee to be the global leader in bringing bar groups from different jurisdictions together to agree on practical, actionable issues that matter for lawyers everywhere.

The fact that we lack a shared conceptual framework among common law systems (let alone between common law and civil law systems), that Asian markets operate differently from U.S. and European markets, and that language barriers in law are no less troublesome when everybody speaks flawless English need not lead us to throw up our hands and live with a lack of consensus on recurring cross-border opinion issues. I am not suggesting that we strive to develop a body of “supra-national” customary opinion practice. The starting point for the Montreal panel was whether it makes sense to form a working group, drawn from the growing community of lawyers active in cross-border transactions who deal regularly with third-party opinions, to: (i) identify key practices in the most recurring jurisdictions; (ii) define broad archetypes of closing opinions; (iii) define the most common areas of friction; and
(iv) develop a common lexicon and shared guidance to make cross-border opinions more consistent and less costly. The “charter” of such a working group could even extend to opinions that counsel give to clients, or sometimes to customers of clients, which are more prevalent outside the U.S. than third-party opinions. This could be particularly meaningful because many opinion issues are relevant in both contexts and a “gap” in practice can be the source of great danger for lawyers.

I hope to see many of you in Washington in a few weeks.

- Ettore A. Santucci, Chair
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What follows are the presently scheduled times of meetings and programs of the Fall Meeting that may be of interest to members of the Legal Opinions Committee. For updated information on meeting times and places, check here.¹

¹ The URL is http://www.americanbar.org/content/dam/aba/events/business_law/2016/11/fall/alpha_schedule.authcheckdam.pdf.

Legal Opinions Committee

Friday, November 18, 2016

Subcommittee Meeting
(Survey of Opinion Practices):
8:00 a.m. – 9:00 a.m.

Committee Meeting:
9:30 a.m. – 11:00 a.m.
Plaza Ballroom I, Ballroom Level

2:00 p.m. – 3:30 p.m.
Plaza Ballroom II, Ballroom Level

Reception: 5:30 p.m. – 6:30 p.m.
Plaza Ballroom II, Ballroom Level

Professional Responsibility Committee

Friday, November 18, 2016

Committee Meeting:
11:00 a.m. – 12:30 p.m.
Lincoln, Ballroom Level

Audit Responses Committee

Friday, November 18, 2016

Committee Meeting:
3:30 p.m. – 4:30 p.m.
Washington, Ballroom Level

Law and Accounting Committee

Friday, November 18, 2016

Committee Meeting:
4:30 p.m. – 5:30 p.m.
Boardroom, Ballroom Level
Securities Law Opinions Subcommittee, Federal Regulation of Securities Committee

Saturday, November 19, 2016

Subcommittee Meeting:
10:00 a.m. – 11:00 a.m.
Ritz Ballroom Salon II, Ballroom Level
The Business Law Section held its Annual Meeting in Boston on September 8-10, 2016. The Section had a full complement of meetings and programs. The following are reports on meetings held at the Annual Meeting of interest to members of the Committee on Legal Opinions.

**Legal Opinions Committee**

The Legal Opinions Committee met on Saturday, September 10, 2016. The meeting was attended, in person or by phone, by approximately 45 members of the Committee. There follows a summary of the meeting.

*Joint Project on Statement of Opinion Practices.* This is a joint project undertaken by this Committee and the Working Group on Legal Opinions ("WGLO") to prepare a statement of customary and other opinion practices. The joint project committee (the "Project Committee") has now prepared a “Statement of Opinion Practices (March 31, 2016 Exposure Draft)” ("SOP"). The SOP has been posted on the Committee’s website, under “Discussion Documents.” The Project Committee includes Steve Weise as its reporter, Pete Ezell and Steve Tarry as co-reporters, and Ken Jacobson and Stan Keller as co-chairs, as well as representatives of this Committee and, through WGLO, representatives of a number of state bar associations.

Stan Keller and Steve Weise led the discussion of the SOP. The Committee also presented a program on the SOP the prior day, September 9. The SOP has been broadly distributed, and the Project Committee hopes to receive feedback from interested parties and secure broad approval of the SOP by state bar opinion committees and other interested parties. It has asked for feedback and comments by October 14, 2016, or as soon thereafter as possible.

Even though the SOP has been kept succinct, it runs seven pages in length. To provide a statement of opinion practices more suitable for incorporation by reference in or attachment to closing opinions by opinion givers who wish to do so, the Project Committee is preparing for consideration a shorter statement of core opinion principles to serve a function similar to that served by the Committee’s *Legal Opinion Principles* (53 Bus. Law. 831 (1998)). A draft of the shorter statement (which would accompany the SOP as finally approved) will be presented to the Committee at its Fall meeting, to be held November 18, 2016 in Washington, D.C.

*Local Counsel Opinion Project.* Philip Schwartz (of Akerman LLP) and Frank Garcia (of Norton Rose Fulbright US LLP) led the discussion of this project. The intent of the drafting committee (which includes Phil, Frank, and Bill Yemc of Richards, Layton & Finger, P.A.) is to present a concise principles-based report that focuses on issues of particular relevance to opinions given by local counsel. The drafting committee intends to take into account (among other things) the conclusions on local counsel opinions of a joint committee of the Committee on Legal Opinions in Real Estate Transactions of the Section of Real Property, Trust and Estate Law, the Attorneys’ Opinions Committee of the American College of Real Estate Lawyers, and the Opinions Committee of the American College of Mortgage Attorneys (collectively, the “Sponsor Committees”). The joint committee has recently completed a supplement on local counsel opinions to the
Sponsor Committees’ 2012 Real Estate Finance Opinion Report.\(^2\)

An initial draft of the report was prepared in October 2015 and presented to a steering committee of some 17 members for review and comment. Ethical issues that the drafting committee and the steering committee are grappling with include:

- **Client consent.** Can local counsel assume lead counsel has obtained the client’s consent to engage local counsel and rely on lead counsel’s instructions in delivering its local counsel opinion?

- **Who is the client?** Often local counsel opinions are given in complex financings involving a borrower and its affiliated entities. Local counsel may be asked to give an opinion regarding an entity organized or owning property in local counsel’s jurisdiction. In those circumstances, who is local counsel’s client, *e.g.*, the borrower or the affiliated entity covered by the local counsel opinion? While a well-drafted engagement letter may answer this question, are there rules of professional responsibility that provide guidance on this question?

- **Local counsel engagement letter.** Is it reasonable to expect local counsel to obtain an engagement letter from lead counsel’s client before rendering its opinion letter? Or, whether or not an engagement letter is obtained, can local counsel assume lead counsel acts for the client in engaging local counsel to render a local counsel opinion letter?

- **Permitted Reliance.** Absent knowledge of facts that would not warrant reliance, should local counsel be able to rely on factual information provided by lead counsel? May local counsel assume that all information supplied by lead counsel is furnished on behalf of lead counsel’s client? Which agency principles support such reliance?

Additional work needs to be done on the local counsel report, and feedback on the issues highlighted above and on the project more generally are welcome. Future drafts of the report will be presented when appropriate to the Committee for its consideration.

**European Bail-In Legislation.** The Spring 2016 issue of the Committee’s newsletter, *In Our Opinion*, contained an extensive presentation and commentary on the January 1, 2016 European Union Bank Recovery and Resolution Directive. As a result of the Directive, even loan documents not involving European lenders now routinely include references to the Directive and a consent by all parties to abide by the powers granted by the Directive to European bank regulators to modify the liabilities of failing European financial institutions. The article and its commentaries discussed the possible approaches opinion givers might take in addressing bail-in provisions in loan documentation.

Robert Risoleo of Sullivan & Cromwell LLP led the discussion. The consensus of the participants was that opinion givers are dealing with bail-in provisions by excluding them entirely from their legal opinions and that opinion recipients are not objecting to the exclusion.

**Case Law Developments.** The Summer 2016 issue of the Committee’s newsletter, *In Our Opinion*, contains an article on the June 24, 2016 decision of the Delaware Chancery Court (*The Williams Companies, Inc. v. Energy Transfer Equity, L.P.*, 2016 WL 3576682) allowing Energy Transfer Equity, L.P. to back out of its merger with The Williams Companies, Inc. because ETE’s tax counsel could not deliver a tax opinion required as a condition to consummation of the merger.
In Our Opinion

Williams has appealed the Chancery Court’s decision to the Delaware Supreme Court.

Don Glazer led a discussion of the Williams decision. He noted that the decision addresses an issue not raised by a traditional third-party closing opinion on a financing in that the merger agreement called for delivery of a tax opinion from a particular law firm as a condition to each party’s obligation to consummate the merger. In contrast he noted that the intended recipient of a traditional third-party closing opinion is the party on the other side of the transaction and that party can waive its receipt of the opinion as a closing condition.

The Committee discussed whether a firm whose opinion, with its consent, is treated in an agreement as a condition to the other party’s obligation to close might have any liability should it later conclude that it cannot (or will not) give the opinion.

Stan Keller reported on the decision in Macquarie Capital (USA) Inc. v. Morrison & Foerster LLP) by the New York Supreme Court, issued July 14, 2016. Macquarie was the underwriter for the U.S. public offering of Puda Coal, a China-based mining company that failed when it was revealed that the shares of its primary Chinese mining subsidiary had been transferred to Puda’s chairman and major shareholder before the public offering. Macquarie settled an SEC enforcement action and later a securities class action brought against it by purchasers of Puda shares. It brought suit against its own counsel (underwriter’s counsel) for legal malpractice based upon counsel’s alleged inadequate diligence in failing to identify the information showing that the subsidiary’s shares had been transferred. After marketing of the offering began and shortly before pricing, Macquarie received an investigative report it had commissioned from Kroll Inc. that referred to a public filing in China showing the share transfer. A Macquarie employee forwarded the report to underwriter’s counsel with a note that “no red flags were identified.” Neither Macquarie nor its counsel picked up on the share transfer and the offering closed, with underwriter’s counsel giving a standard negative assurance confirmation.

The court did not address the question whether underwriter’s counsel was negligent. Instead, it found that, because Macquarie had access to the same information as its counsel, the failure of counsel to identify the share transfer was not the proximate cause of Macquarie’s loss, with proximate cause being an essential element for a legal malpractice action. (Another way of describing the claim’s deficiency is that the underwriter, because it had access to the same information, could not have reasonably relied on its counsel.) The court did not (and did not have to) get into whether the information had special significance for a lawyer due to a lawyer’s expertise because the significance of the information should have been equally apparent to both the underwriter and its counsel.

Survey of Law Firm Opinion Practices. John Power updated the Committee on the progress in planning and circulating a survey of law firm opinion practices. In 2010, the Committee conducted a survey of law firm opinion practices, the report on which was published in 2013 in the Business Lawyer (68 Bus. Law. 785). The subcommittee updating the survey is co-chaired by Arthur A. Cohen (Haynes and Boone, LLP) and John and has completed preliminary drafts of questions on general firm management of legal opinions and on firm opinion committees. The subcommittee is meeting monthly by telephone. Its next in-person meeting will be at the Section’s Fall meeting.

Incoming Chair. Tim Hoxie concluded by noting that the Committee’s next meeting will be chaired by Ettore Santucci, who will start his three-year term as the Chair of the Committee at the conclusion of this meeting. Tim noted that (as all members of the Committee know) that the Committee will be in good hands with Ettore at the helm. We all look forward to working to support Ettore in his new role!

Next Meeting. The next meeting of the Committee will be held at the Section’s Fall meeting in Washington, DC, on Friday, November 18, 2016.

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Audit Responses Committee

The Audit Responses Committee met on September 10, 2016. The principal discussion points are summarized below.

The SEC’s Disclosure Update and Simplification Proposed Rulemaking

The Committee discussed the SEC’s Disclosure Update and Simplification proposed rulemaking. Specifically, members commented on the discussion in the rulemaking regarding the overlap between Item 103 of Regulation S-K and financial statement footnote disclosure requirements under Accounting Standards Codification (“ASC”) 450. Some members remarked that issuers traditionally provide identical disclosure for both, noting, however, that there are differences between the standards as described in the SEC’s proposed rulemaking. In this regard, the Committee discussed the SEC’s proposed consolidation of the two standards and considered the potential impact on the applicable standards under PCAOB rules and under ASC 450. Some members noted that consideration must be given to the materiality component of ASC 450 and the purposes of Item 103. Others noted that Item 103 best serves as a general disclosure that catalogs all legal proceedings that may need to be disclosed, irrespective of materiality. For purposes of addressing the SEC’s proposed rulemaking, members of the Committee noted that the Section’s Federal Regulation of Securities Committee is in the process of preparing a comment letter to the proposed rulemaking, which would include comments regarding the proposed consolidation of disclosures under Item 103 and ASC 450 requirements.

Reporting Government Investigations in Audit Response Letters

The Committee next discussed the requirements to disclose government investigations in audit response letters in light of the precedents discussed at the Committee’s April 9, 2016 meeting.

Members of the Committee noted that, as a general matter for purposes of audit response letters, members typically treated Wells Notices as an overt threat of litigation and indicative of the SEC staff’s intention to recommend enforcement action. However, in reference to the In re Lions Gate Entertainment Corp. Securities Litigation decision, 165 F. Supp. 3d 1 (S.D.N.Y. 2016), the Committee considered whether the case’s holding suggests otherwise. The Committee noted that the court held that receipt of a Wells Notice regarding an SEC investigation did not amount to a pending proceeding or a proceeding “‘known to be contemplated by governmental authorities’ under Item 103” of Regulation S-K; nor did the Wells Notice constitute “pending or threatened litigation” for purposes of ASC 450.

Members also referenced the recent Indiana Pub. Ret. Sys. v. SAIC decision, 818 F.3d 85 (2d Cir. 2016), and considered the effect of its holding on disclosure requirements under ASC 450. In SAIC the Second Circuit held that with respect to ASC 450, “[t]he ‘probability’ standard applies in lieu of the ‘reasonable possibility’ standard only if the loss contingency arises from ‘an unasserted claim or assessment when there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment.’” 818 F.3d at 93. As it pertains to a
Wells Notice, members posited that, notwithstanding SAIC, a higher degree of certainty regarding the SEC’s intention to bring a claim is presumably necessary before disclosure is required. Members suggested that the facts and circumstances of the situation should be carefully evaluated to determine whether the SEC has manifested an awareness of a possible claim or assessment, particularly before issuance of a Wells Notice.⁵

Confirmation.com

Since the Committee’s April 9, 2016 meeting, a working group has been assembled to work with Confirmation.com regarding the agreement governing use of the company’s electronic audit letter platform and other aspects of the platform. The working group has prepared a short-form user agreement in response to comments that members of the Committee had expressed about the Confirmation.com’s existing user agreement. It was reported that Confirmation.com had indicated that it had also undertaken changes to its user interface following engagement with members of the Committee and with several law firms. Members suggested other changes to the Confirmation.com template to be discussed with Confirmation.com. The Committee also discussed the substance of a Committee statement regarding the short-form user agreement and other matters relating to Confirmation.com. As in the past, it was emphasized that each law firm should make its own decision whether to use the Confirmation.com platform.

Listserve Activity. A summary of recent activity on the Committee’s listserve was circulated and discussed at the meeting.⁶

Next Meeting. The Committee’s next meeting is scheduled for the Business Law Section’s Fall Meeting in Washington, D.C., on Friday, November 18, at 3:30 p.m. EST.

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Law & Accounting Committee

The Law and Accounting Committee met on September 10, 2016. The principal items of discussion are summarized below.

Response to SEC Release re: S-K Item 103. Rani Doyle lead a discussion summarizing the previous day’s meeting of the Disclosure Effectiveness Working Group of the Federal Regulation and Securities Committee, specifically regarding its work on a comment letter in response to the SEC’s proposal regarding redundant disclosures. Committee members then engaged in a discussion regarding some of the pertinent issues in this comment letter.⁷

FASB Update on Credit Loss Damages. Matthew Esposito, Assistant Director of Technical Activities at the FASB, participated in the Committee’s meeting via telephone and Robert M. Walmsey, a partner at the Boston office of Ernst & Young LLP, attended the

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⁵ For an extended discussion of the reporting of government investigations in audit response letters, see Stan Keller’s article, “Dealing with Government Investigations in Audit Responses” in this issue of the Newsletter.

⁶ The listserve summary is published in this issue of the Newsletter following these summaries of the meetings held at the 2016 annual meeting of Business Law Section.

⁷ Comments on the SEC’s proposals (Release No. 33-10110 (July 13, 2016)) are due by November 2, 2016.
meeting in person. Mr. Esposito and Mr. Walmsey led a discussion on the conceptual and implementation issues of Accounting Standards Update 2016-13: Financial Instruments – Credit Losses, issued by the FASB in July 2016.

**FASB Update.** Randy McClanahan gave an update of current FASB developments, including (i) a discussion of the Committee leadership’s telephone conference with James L. Kroeker, Vice Chairman of the FASB and (ii) a discussion of proposed changes to income tax disclosures.

**Committee’s Participation in Corporate Governance Project.** Bruce Dravis attended the Committee meeting as the representative of the Corporate Governance Committee and asked for the Committee’s participation in a project regarding the relationship of equity compensation and share repurchases. Several committee members asked questions and raised concerns regarding this project.

**Next Meeting.** The next meeting of the Committee will be held at the Section’s Fall Meeting in Washington, D.C. on Friday, November 18.

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**Securities Law Opinions Subcommittee**

**Federal Regulation of Securities Committee**

The Subcommittee met on September 9, 2016. The participants discussed comments on a revised draft of a report addressing Exchange Act Rule 14e-1 opinions given in connection with debt tender offers. The revised draft, which was circulated to Subcommittee members by email on August 31, 2016, with a further revised version circulated by email on September 9, 2016, incorporated comments made at the Subcommittee’s April 2016 meeting and comments received after such meeting. The sense of the participants was that the Subcommittee should continue working on this report, which is in near-final form, specifically focusing on use of “Division” as compared to “Staff,” and eliminating the distinction between “formal” and “informal” guidance. Subcommittee members were urged to submit written comments on the revised report.

The next meeting of the Subcommittee will be held at the Section’s Fall Meeting in Washington, D.C. on November 19, 2016. The agenda for the meeting will include a further revised draft of the report on opinions given in connection with debt tender offers.

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**SUMMARY OF RECENT LISTSERVE ACTIVITY**

**APRIL 2016 – AUGUST 2016**

**AUDIT RESPONSES COMMITTEE**

**Editors’ Note:** This summary of listserv activity during the period April 2016 – August 2016 among members of the Audit Responses Committee does not necessarily represent the views of the Committee or authoritative pronouncements regarding audit response letters practice, but rather reflects views of individual members of the Committee on current practice topics. The comments referred to below may be viewed by clicking on...
the “Listserve” item on the Audit Responses Committee’s web page.\(^8\)

1. **Confirmation of Indebtedness.** A Committee member stated that auditors’ request letters sometimes request information as to the amount (i) the client was indebted to the attorney or firm and (ii) of unbilled fees and costs. The member asserted that responding with the amount of outstanding bills (without characterizing them as indebtedness) appears to be appropriate. However, for the reasons described below, neither (a) characterizing the billed amounts as indebtedness nor (b) specifying the amount of unbilled fees appears to be appropriate.

In the member’s view, a response addressing those two issues involves statements of “facts” which may turn out not be accurate, e.g., because of entries to wrong accounts, entries missing or adding decimal places, bills from third parties not yet received, or other reasons. Moreover, including such information seems inconsistent with the ABA Statement. The form response letter accompanying the Statement of Policy contemplates that a response may include information on outstanding bills: “[Insert information with respect to outstanding bills for services and disbursements.]” *See Auditor’s Letter Handbook* (“Handbook”) at 26 (2d. ed. 2013). This form of response language neither (a) characterizes the outstanding bills as indebtedness nor (b) addresses unbilled amounts. Nothing in the ABA Statement suggests that a response as to indebtedness or unbilled fees is appropriate. The form audit inquiry letter (see Handbook at 37) does contemplate, in opaque language, that the auditor may request the client to inquire about certain indebtedness and unbilled charges. However, that form of inquiry letter is not part of the ABA Statement; rather it is part of the First Report of the Committee on Audit Inquiry Responses (1976), which states: “This presentation is not intended to modify in any respect the ABA Statement nor does it constitute an interpretation thereof.” Handbook at 29.

The member asked for views about whether a lawyer should respond by:

1. providing the requested characterization and unbilled amounts (and if so, whether or not qualifying or limiting language should be included to address possible misstatements of fact),

2. ignoring that aspect of the request,

3. expressly disclaiming a response to that aspect of the request, or

4. responding otherwise.

In response to the inquiry, it was pointed out that this question does not involve an issue of conformity with the ABA Statement, because it does not deal with loss contingencies or other confidential client information. For this request, the lawyer is like any other vendor confirming account status (assuming the lawyer is just giving numerical information). All respondents indicated that they provide information regarding outstanding billed amounts. One provided the following example of a response:

> The records of this Firm reflect that, as of the Examination Date, [no statements rendered to the Company by this Firm for legal fees and expenses were unpaid.] [statements for legal fees [and out-of-pocket expenses] in the aggregate amount of $________ [and for out-of-pocket expenses in the aggregate amount of $_______] had been rendered to the Company by this Firm and were unpaid.]

Several respondents indicated that their firms do not provide information regarding unbilled time and expenses. One respondent indicated that his firm would respond if the primary lawyer has reason to believe that the amounts unbilled would affect significantly the client’s financial

\(^8\) The URL is [http://apps.americanbar.org/dch/committee.cfm?com=CL965000](http://apps.americanbar.org/dch/committee.cfm?com=CL965000).
statements. Some firms include an express statement in their responses that they do not provide information regarding unbilled amounts.

2. **Donated Legal Services.** A Committee member raised questions regarding a request from a non-profit client to “include the amount of donated legal services your firm provided during the period under audit.” In addition to asking whether this was an appropriate request, the member asked how to handle the request: “For example, should we provide the number of hours, dollar value of billable hours or both. What if the client receives a discount based on its charitable status? Does the difference get counted as ‘donated’? Does unbilled time get valued at the discounted rate or the regular rate?”

In response, it was noted that non-profits are required to report the value of pro bono legal services as in-kind contributions on their financials (with an offsetting expense item for legal fees). Firms often receive requests for information regarding the value of these services, and sometimes they come in audit letters. Two members indicated that their firms generally run bills as they would for a paying client.

If there is time that would not have been charged, or time written down for a paying client, one member would do the same for this purpose and provide the dollar amount that would have been billed to the client. As to discounts, one respondent suggested that if the charitable organization received a discount, the difference between the discounted rate and the full rate should not be treated as a donation.

3. **Effective Date of Response.** A Committee member has seen an increase in requests that indicate a specific date as of which the audit is to be completed and ask for the firm’s response to be effective as of that date. The firm’s standard form of response says that it speaks as of the date the firm commenced its internal review procedure. While the firm does not wait to commence the review, it would need to update the information if, in order to meet the request, the firm is to say its response is effective as of its date. This places a heavy strain on the audit response process. One member responded that he sees this request frequently; while this request does make the work flow more difficult for preparing the audit response, his firm usually tries to accommodate the request. Sometimes they cannot accommodate the auditors because the auditors ask for impossible timelines, so they just tell the auditors what they can provide. If this trend becomes more prevalent, it may be a subject to address with the accounting profession.

4. **Quarterly Reviews.** A Committee member observed that his firm was seeing audit requests in connection with quarterly reviews, which significantly increase the burdens of dealing with audit responses. These can be treated as either new requests or as updates to the annual response in connection with fiscal year audits. The requests tend to be in the form of new requests and his firm was responding to them as such, although the firm might refer to descriptions of matters in a prior response letter with any necessary additional information.

One question was whether audit requests were required as part of review procedures “or just something the auditor is deciding to do?” Auditing standards do not require the auditor to make inquiries of lawyers as part of their quarterly review procedures unless “information comes to the accountant's attention that leads him or her to question whether the interim financial information departs from generally accepted accounting principles with respect to litigation, claims, or assessments, and the accountant believes the entity's lawyer may have information concerning that question.” PCAOB AS 4105.20 (formerly AU 722.20). However, if the auditor requires its client to make the request in connection with a review, it may be difficult for the lawyer to decline.

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Dealing with Government Investigations in Audit Responses

Dealing with government investigations in connection with responding to audit letter requests, and advising clients on their disclosure obligations in the face of such proceedings, remains a challenging task for lawyers. The consequences of this challenge have taken on greater significance as a result of a recent SEC enforcement action against a lawyer – an in-house general counsel – for his handling of disclosure of a government investigation. Not only is advice to one’s client involved, but a lawyer’s own legal obligations and professional responsibilities are implicated when dealing with disclosure of government investigations.

The SEC’s RPM Enforcement Action

On September 9, 2016, the SEC filed a complaint against RPM International Inc. ("RPM") and its general counsel for failing to disclose a material loss contingency or record an accrual for a U.S. Department of Justice ("DOJ") investigation into an alleged violation of the False Claims Act ("FCA") following a whistleblower qui tam complaint filed under seal alleging that RPM had overcharged the U.S. Government. According to the SEC complaint, RPM and its general counsel became aware of the DOJ investigation in March 2011 when RPM’s subsidiary received a government subpoena. RPM hired outside counsel and conducted an internal inquiry. In August 2012, the qui tam complaint was partially unsealed and provided to RPM. In September 2012, outside counsel met with DOJ and informed it that RPM’s analysis indicated its subsidiary had overcharged the government by at least $11 million. In December 2012, RPM and its outside counsel discussed making a settlement offer of between $27 and $28 million, its then estimate of the amount overcharged (but without any damages multiplier under the FCA usually required by DOJ for a settlement).

Up to that point, RPM had not disclosed the DOJ investigation or accrued a liability in any of its earnings releases or SEC filings. In January 2013, a week after reporting quarterly results and filing its Form 10-Q without any reference to the DOJ investigation, RPM submitted a $28.3 million settlement proposal to DOJ. DOJ countered in March 2013 with a $71 million settlement offer and a week later RPM issued its quarterly earnings release and filed its Form 10-Q, which for the first time disclosed the DOJ investigation and recorded a $68.8 million liability for the violation of the FCA. In July 2013, RPM filed its Form 10-K for the year, which discussed the DOJ investigation and related accrual, indicating that its disclosure had been made timely and failing to disclose any material weakness in RPM’s internal controls over financial reporting. In August 2013, RPM’s settlement with DOJ for $61 million was announced.

The SEC complaint asserts that the general counsel oversaw RPM’s response to the DOJ investigation, knew the substance of the settlement discussions and was furnished a copy of the qui tam complaint by DOJ. Nevertheless, according to the SEC, the general counsel failed to timely inform RPM’s officers, the audit committee and the independent auditors of the results of RPM’s own inquiry regarding overcharging or of the settlement discussions with DOJ. Further, according to the SEC, the general counsel, in responses to the auditors regarding loss contingencies, misled the auditors by telling them that no claims had been asserted even though DOJ sent him the qui tam
complaint and he was aware of the DOJ investigation.

The SEC’s claim is that, at least by September 2012, RPM and its general counsel knew that a material loss was probable and reasonably estimable and that accordingly both disclosure and an accrual was necessary under applicable accounting rules, with the failure to do so until March 2013 being a violation of the federal securities laws. In particular, the SEC charged a violation of Sections 17(a)(2) and (a)(3) of the Securities Act of 1933, which require only a showing of negligence, as compared to a violation of Section 10(b) of the Securities Exchange Act of 1934 (the Exchange Act) and Rule 10b-5 thereunder, which require scienter. It also charged a violation of the books and records provisions of Section 13 of the Exchange Act and failure to disclose a material weakness in RPM’s internal controls over financial reporting. Finally, the SEC charged the general counsel with violating Rule 13b2-2(a), which prohibits misleading the auditors. RPM has stated that it will fight the SEC allegations, which it says are without merit.

**Accounting and Auditing Standards for Loss Contingencies**

Under Accounting Standards Codification (“ASC”) 450-20 (formerly FAS 5), disclosure of a pending or threatened claim is required if a material loss is reasonably possible (i.e., more than remote). The disclosure must indicate the amount or range of possible loss or an explanation of why an estimate cannot be made. If the loss is probable and estimable, an accrual of a liability, in addition to disclosure, is required. Under FASB Interpretation No. 14 (now codified in ASC 450-20), the best estimate of a loss or, in some cases, the minimum amount of a range, is required to be accrued; a settlement offer may be relevant in making this estimate. On the other hand, if a claim is unasserted, disclosure is required only if it is possible that the claim will be asserted and, if asserted, there is a reasonable possibility of an unfavorable outcome.10

The foregoing accounting standard is complemented by auditing standard AU Section 337 (formerly Statement of Auditing Standard No. 12), which recognizes and coordinates with the ABA Statement of Policy Regarding Lawyers’ Responses to Auditors’ Requests (the ABA Statement).11 Under this standard and the ABA Statement, lawyers, in responding at the client’s request to auditors, are to identify overtly threatened or pending litigation to which they have devoted substantive attention. In the case of unasserted claims, lawyers only discuss claims the client specifically requests it to address, but the lawyer confirms to the auditor that it fulfills its professional responsibility to advise its client regarding the client’s disclosure obligations with respect to an unasserted claim.

Applying these standards to the RPM matter, assuming materiality and the facts as alleged by the SEC (RPM and its general counsel have not yet filed answers), the SEC’s position appears to be that at least by September 2012, when RPM was aware of the *qui tam* complaint and informed DOJ of an overcharge of at least $11 million, liability was not only reasonably possible but probable and a minimum amount of liability was clear, thus requiring disclosure and an accrual. Arguably, before then no disclosure was required because when RPM first became aware of the DOJ investigation in March 2011 RPM did not have reason to know that a claim was being asserted or that it was then probable that one would be asserted. Under the SEC’s position, the amount

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10 In *Indiana Public Retirement System v. SAIC, Inc.*, 818 F. 3d 85, 93-94 (2d Cir. 2016), the Second Circuit held that manifestation of awareness of a claim by a claimant moves it from being unasserted and subject to the “probable of assertion standard” to being a threatened claim.

11 Effective December 31, 2016, for audits of U.S. public reporting companies, this standard will be recodified as Public Company Accounting Oversight Board AS 2505. For audits of private companies, the standard has been redesignated AU-C § 501.16–24.
required to be disclosed or accrued increased in
December 2012 when RPM formulated a
settlement offer of at least $27 million and
increased further in March 2013 when DOJ
made a higher counter offer.

**ABA Guidance on Government Investigations**

The subject of government investigations
was addressed in 1976, when the ABA
Committee on Audit Inquiry Responses
provided interpretive guidance on dealing in
audit responses with a pending government
investigation against a client when no charges
have been overtly threatened. That Committee
stated that the existence of an investigation is
not itself an overtly threatened claim and there is
no need for a lawyer to predict whether a claim
will actually be made or whether litigation will
occur. Depending upon the circumstances, there
could be an unasserted possible claim but
disclosure would only be required when it is
probable that a claim will be made or litigation
will occur. The Committee added that “[i]f the
client wishes the lawyer to report such
investigations and similar matters to the auditor
in a manner similar to reports by the lawyer of
pending litigation which the lawyer is handling,
it would not be improper for the lawyer to do so
since a third-party inquiry (which may develop
into the assertion of a claim or assessment)
already will have been commenced.” The
Committee noted that “[i]n most cases, however,
the lawyer will not be able to provide any
information to the auditor concerning the
investigation other than the existence thereof
and the fact of the client’s involvement.” The
Committee advised that whichever approach is
adopted – whether the lawyer regularly reports
such matters or only reports those as to which
the client has determined the matter to involve
an unasserted possible claim considered to be
probable of assertion and to have a reasonably
possible chance of an adverse result — such
“approach should be consistently followed with
respect to such client until the auditor has been
advised of a change in approach.”

In many situations, an investigation evolves
over time and will demand a spectrum of
judgments. Initiation of an investigation may
not indicate to the target company the basis of a
potential claim, especially if the investigation
was prompted by a whistleblower complaint or
involved a confidential *qui tam* proceeding. In
some situations, a company’s own internal
investigation will provide it with critical
information to inform disclosure and accounting
decisions, but this may take some time. A useful
approach is to evaluate a government
investigation with an eye to the future — asking,
based upon what is then known, how is the
matter likely to evolve over time? Realistic
forward-oriented judgment can go a long way to
informing disclosure decisions. In addition,
being mindful of who in the client organization
is best situated to make the final disclosure
decision can be important — often this will be
the audit committee or the full board. For an
outside lawyer, following his or her law firm’s
audit response policy and consulting internally
with appropriate experts will help in dealing
with difficult situations.

**Qui Tam Proceedings**

*Qui tam* proceedings for violation of the
FCA, like those in the RPM matter, present
special disclosure challenges because a *qui tam*
complaint is filed under seal and is confidential.
Thus, without DOJ or court approval, a company
is not legally free to disclose the filing of the
complaint or the existence of the proceeding
even if it becomes aware of it. However, this
does not prevent disclosure of the DOJ
investigation or of the underlying situation that
led to the complaint and investigation. Often, it
is possible to work out an acceptable disclosure

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with DOJ. The SEC complaint in the RPM matter notes that RPM publicly disclosed the DOJ investigation even though the FCA complaint remained under seal, and thus the sealing of the complaint did not prevent disclosure of the investigation.

**SEC Enforcement and Wells Notices**

Another situation involving a government investigation frequently encountered is an SEC investigation. An SEC investigation might involve a Wells notice, which is a notice from the SEC staff that it intends to seek Commission approval to bring an enforcement action. The Wells notice gives the target an opportunity to present a counter argument if it wishes. There is judicial authority that a Wells notice alone is not threatened action requiring disclosure. However, as a matter of prudent practice, many lawyers advise disclosure when there is a Wells notice and, depending upon knowledge of the circumstances underlying the SEC staff investigation, may recommend disclosure even before there is a Wells notice. The need and desirability of disclosure in these situations very much depends upon the particular circumstances and the extent to which facts underlying the investigation have otherwise been disclosed.

**Conclusion**

As the foregoing discussion indicates, dealing with government investigations in responding to audit requests and in advising clients regarding disclosure of these investigations and their consequences present special challenges for lawyers. The recent SEC enforcement action against the general counsel of RPM makes paying careful attention to these challenges even more important. Anticipating how an investigation is likely to play out and getting to the bottom of what underlies the investigation and determining its merits as quickly as possible is critical to exercising informed judgment about the need for and nature of the necessary disclosures by the lawyer to the auditors and by the client in its financial statements.

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13 *In re Lions Gate Entertainment Corp. Securities Litigation*, 165 F. Supp. 3d 1, 12-13, 18-20 (S.D.N.Y. 2016) (holding that an SEC investigation, even after receipt of a Wells notice, is not “pending or threatened litigation” for purposes of ASC 450-20, nor is it a pending proceeding or a proceeding “known to be contemplated by governmental authorities under Item 103 [of Regulation S-K]”); and *Richman v. Goldman Sachs*, 868 F. Supp. 2d 261 (S.D.N.Y. 2012) (issuer did not have to disclose receipt of Wells notice by SEC staff, particularly when there had been prior disclosure of the investigation, since a Wells notice is merely an indication that the SEC staff intends to recommend litigation and a company is not required to predict whether litigation actually will occur).

14 For a decision holding that failure to disclose a private lawsuit was not a violation of ASC 450-20 because the company’s general disclosures about litigation risk and the loss contingency involved was adequate, see *Bank of America AIG Disclosure Securities Litigation*, 980 F. Supp. 2d 564, 575-580 (S.D.N.Y. 2013). See also *Luna v. Marvell Technology Group Ltd.*, 2016 WL 5930655 at *3, *5-*7 (N.D. CA Oct. 12, 2016) (failure to accrue a liability for patent infringement did not violate ASC 450 when judgment was on appeal and disclosure of the matter and the company’s potential liability had been made).
# Chart of Published and Pending Reports

**Editors’ Note:** The chart of published and pending legal opinion reports below has been prepared by John Power, O’Melveny & Myers LLP, Los Angeles, and is current through September 30, 2016.

## A. Recently Published Reports

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<tr>
<th>Organization</th>
<th>Year</th>
<th>Report Title</th>
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<tr>
<td>ABA Business Law Section</td>
<td>2009</td>
<td>Effect of FIN 48 – Audit Responses Committee</td>
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<td></td>
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<td>Negative Assurance – Securities Law Opinions Subcommittee</td>
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<td></td>
<td>2010</td>
<td>Sample Stock Purchase Agreement Opinion – Mergers and Acquisitions Committee</td>
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<td></td>
<td>2011</td>
<td>Diligence Memoranda – Task Force on Diligence Memoranda</td>
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<td></td>
<td>2013</td>
<td>Survey of Office Practices – Legal Opinions Committee</td>
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<td>Legal Opinions in SEC Filings (Update) – Securities Law Opinions Subcommittee</td>
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<td>Revised Handbook – Audit Responses Committee</td>
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<td></td>
<td>2014</td>
<td>Updates to Audit Response Letters – Audit Responses Committee</td>
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<td></td>
<td>2015</td>
<td>No Registration Opinions (Update) – Securities Law Opinions Subcommittee</td>
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<td>Cross-Border Closing Opinions of U.S. Counsel</td>
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<tr>
<td>ABA Real Property Section (and others)</td>
<td>2012</td>
<td>Real Estate Finance Opinion Report of 2012</td>
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<td>2004</td>
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<td>California</td>
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<td>Remedies Opinion Report Update</td>
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<td>Comprehensive Report Update</td>
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<td></td>
<td>2009</td>
<td>Venture Capital Opinions</td>
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<td></td>
<td>2014</td>
<td>Sample Venture Capital Financing Opinion</td>
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<td></td>
<td>2015</td>
<td>Revised Sample Opinion</td>
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<td>Florida</td>
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<tr>
<td>Georgia</td>
<td>2009</td>
<td>Real Estate Secured Transactions Opinions Report</td>
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</table>

15 These reports are available (or soon will be available) in the Legal Opinion Resource Center on the web site of the ABA Legal Opinions Committee, [http://apps.americanbar.org/buslaw/tribar/](http://apps.americanbar.org/buslaw/tribar/). Reports marked with an asterisk have been added to this Chart since the publication of the Chart in the last quarterly issue of this Newsletter.

16 This Report is the product of the Committee on Legal Opinions in Real Estate Transactions of the Section of Real Property, Trust and Estate Law, Attorneys’ Opinions Committee of the American College of Real Estate Lawyers, and the Opinions Committee of the American College of Mortgage Attorneys (collectively, the “Real Estate Opinions Committees”).
<table>
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<th>City of London</th>
<th>2011</th>
<th>Guide</th>
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<td>Maryland</td>
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<td>2010</td>
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<td>Multiple Bar Associations</td>
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<td>Customary Practice Statement</td>
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<td>White Paper- Trust Indenture Act §316(b)</td>
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<td>National Association of Bond Lawyers</td>
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<td>Function and Professional Responsibilities of Bond Counsel</td>
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<td></td>
<td>2013</td>
<td>Model Bond Opinion</td>
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<td></td>
<td>2014</td>
<td>501(c)(3) Opinions</td>
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<td>National Venture Capital Association</td>
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<td>Substantive Consolidation – Bar of the City of New York</td>
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<td></td>
<td>2012</td>
<td>Tax Opinions in Registered Offerings – New York State Bar Association Tax Section</td>
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<td>2009</td>
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<td>TriBar</td>
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<td>2011</td>
<td>Secondary Sales of Securities</td>
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<td></td>
<td>2011</td>
<td>LLC Membership Interests</td>
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<td></td>
<td>2013</td>
<td>Choice of Law</td>
</tr>
</tbody>
</table>
## B. Pending Reports

| ABA Business Law Section | Sample Asset Purchase Agreement Opinion – Merger and Acquisitions Committee  
|                         | Updated Survey – Legal Opinions Committee  
|                         | Debt Tender Offers – Securities Law Opinions Subcommittee  
|                         | Resale Opinions – Securities Law Opinions Subcommittee  
|                         | Opinions on Risk Retention Rules White Paper – Securitization and Structured Finance Committee & Legal Opinions Committee  
| California              | Opinions on LLCs & Partnerships  
|                         | Sample Personal Property Security Interest Opinion  
|                         | Exceptions and Other Qualifications to the Remedies Opinion  
| Multiple Bar Associations| Statement of Opinion Practices  
|                         | Local Counsel Opinions  
| National Association of Bond Lawyers | Update of Model Letter of Underwriters’ Counsel  
| Real Estate Opinions Committees | Local Counsel Opinions  
| Texas                   | Comprehensive Report Update  
| TriBar                  | Limited Partnership Opinions  
|                         | Opinions on Clauses Shifting Risk  
| Washington              | Comprehensive Report  

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17. A joint project of the ABA Legal Opinions Committee, the Working Group on Legal Opinions, and other bar groups.

18. See note 16.
MEMBERSHIP

If you are not a member of our Committee and would like to join, or you know someone who would like to join the Committee and receive our newsletter, please direct him or her here. If you have not visited the website lately, we recommend you do so. Our mission statement, prior newsletters, and opinion resource materials are posted there. For answers to any questions about membership, you should contact our membership chair Anna Mills at amills@vwlawfirm.com.

NEXT NEWSLETTER

We expect the next newsletter to be circulated in January 2017. Please forward cases, news and items of interest to Ettore Santucci (esantucci@goodwinprocter.com), Jim Fotenos (jfotenos@greeneradovsky.com), or Susan Cooper Philpot (philpotsc@cooley.com)

19 The URL is http://apps.americanbar.org/dch/committee.cfm?com=CL510000.