IN OUR OPINION

THE NEWSLETTER OF THE LEGAL OPINIONS COMMITTEE

ABA BUSINESS LAW SECTION

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James F. Fotenos and Susan Cooper Philpot, Editors

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FROM THE CHAIR

I am pleased to share with you the Spring 2018 issue of *In Our Opinion*. It includes updates about the work of our Committee and the Audit Responses Committee. It also includes an article by Stephen Bigler and Stephanie Norman on proposed amendments to Section 204 of the Delaware General Corporation Law to resolve uncertainty created by the reasoning of the court in *Nguyen v. View, Inc*. and an update by Stan Keller of his Fall 2016 article on dealing with government investigations in audit response letters.

Spring Meeting. I hope those of you who were able to go to Orlando enjoyed the Spring meeting. Our Committee had a packed agenda, starting with an excellent program on cross-border opinions in financing transactions that was very well attended. I want to thank our panel (Truman Bidwell, Sullivan & Worcester; Ian Binnie, Blakes Cassels & Graydon; Sylvia Chin, White & Case; Elizabeth Leckie, Allen & Overy; and Elizabeth van Schilfgaarde, NautaDutilh) for their insightful presentations. Our full Committee meeting was very well attended and we covered a number of practical issues and developments that you can read about in the summary of the meeting published in this issue of the Newsletter. Our task forces on IP opinions and cross-border opinions each had productive meetings which will help my co-chairs (Rick Frasch and Truman Bidwell) chart the path forward – please stay tuned as both projects will be pushed ahead in meaningful ways before the annual meeting in Austin in September.

Membership Participation. Which brings me to the important topic of membership participation and growth. Rick Frasch has agreed to represent our Committee on the Business Law Section's re-energized Membership Committee. During the Mid-Winter Leadership Meeting there was a great deal of focus on ways to reverse declining membership in the Business Law Section as well as the ABA generally. Various committees are hard at work to re-imagine how the Section serves its members, what proves most useful to various segments of the profession, how content can best be created and disseminated, and generally how the ABA and the Section fit in the current line-up of for-profit and not-for-profit organizations serving the needs of practicing lawyers nationally. I want to thank Rick for dedicating time and energy to this important effort.

From my perch as Chair of our Committee, I would like to encourage every member to think about ways to increase not only the number of members of our Committee, but more importantly the level of active participation in our Committee's work. I will spare you a crack about how at my not young age I am probably on the younger side of the median among active members of our Committee. That is a great strength of ours, because we can count on the contribution of titans whose experience, intellect, insight into opinion practice, and dedication to making it ever better are unmatched. You know their names. I trust that each of us is on the lookout within our firms for the next generation of leaders on opinion practice, because we know that getting there takes time and effort. Why not start now by encouraging younger lawyers to participate in our Committee's projects and attend our meetings?

One of the issues Section leadership discussed at the Mid-Winter meeting is how the dynamics of participation in the ABA are changing within law firms, with many younger lawyers no longer being actively encouraged to join the ABA, much less to find time to participate in ABA activities. Analyzing the reasons for that and developing strategies to reverse it are above my pay grade. But I know for sure that each one of us personally can make a difference if one or two individuals whom we know would get as hooked on the substantive work of our Committee as we have. So please make an effort to reach out to those colleagues inside your firms, mentor them as they wade in,

and approach firm management to impress upon them how important long-term involvement in professional activities is to the firm.

Familiarity with Opinion Practice. Many of us get brought into difficult opinion negotiations to break an impasse before clients start screaming at everybody. Often those conversations are with seasoned practitioners who are not fully versed in current opinion practice or younger lawyers who have not yet had the opportunity to become well versed. Please take a moment to share the content that our Committee has created, or just send a link to the Opinion Resource Center, the best source of opinion literature.[1] When I do so with my younger colleagues, I uniformly hear that they found it invaluable and intellectually stimulating. All you have to do to reach that conclusion is look at content in this Newsletter, such as the summary of the recent dialogue on the Committee's Listserve on dealing with closing conditions in opinion letters when agreements are being amended. In addition to these being important topics for practicing lawyers, digging deep into the issues we regularly debate at our meetings has appeal in and of itself. I do understand that in an ever more competitive marketplace many younger lawyers see participating in a committee like ours as a bit of a "luxury," as compared to attending client-rich conferences where business can be generated. But networking with active members of our Committee has proven beneficial to me in my practice, and I have no hesitation to tell my younger colleagues that it will for them as well.

Survey of Opinion Practices. Finally I am pleased to let you know that the sub-committee working on the next survey of opinion practices has almost completed its work. The draft survey was approved by our Committee in Orlando and the plan is to circulate it this Fall. This will be the third such survey. Having available to us data from many firms of all sizes across the nation that is both current and comparable to data gathered over many years is the foundation of everything we do. The sub-committee has worked long and hard to make this latest survey both comprehensive and easy to complete. A great deal of software coding will go into making the completion of this survey efficient. Over the coming months e-mails will go out to identify the right lawyers within firms to complete the survey; please respond and help us make this the best survey ever.

- Ettore A. Santucci, Chair
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FUTURE MEETINGS

ABA Business Law Section
Annual Meeting
Austin, Texas
Fairmont Austin and
Austin Convention Center
September 13-15, 2018

Working Group on
Legal Opinions Foundation
New York, New York
October 29-30, 2018

ABA Business Law Section
Fall Meeting
Washington, D.C.
The Ritz-Carlton Hotel
November 16-17, 2018

[1] The URL is https://www.americanbar.org/groups/business_law/migrated/tribar.html.

BUSINESS LAW SECTION 2018 SPRING MEETING

The Business Law Section held its Spring Meeting in Orlando, Florida on April 12-14, 2018. 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 Friday, April 13, 2018. There follows a summary of the meeting.

Survey of Law Firm Opinion Practices. John Power and Arthur Cohen (Haynes and Boone LLP) are co-chairs of the Committee's Opinion Practices Survey Subcommittee. The Subcommittee has been meeting for several years to prepare the Committee's third survey of law firm opinion practices, the most recent of which was conducted in 2010 and the results of which were published in 68 Bus. Law. 785 (2013). The Subcommittee had met earlier that morning, at which it gave its final approval to a draft of the survey that had been circulated to the full Committee by Chair Ettore Santucci on April 6, 2018.

After discussion, and upon motion duly made and seconded, the Committee approved the draft for distribution to the law firm community with the understanding that it remained subject to editorial revisions to be approved by the Chair.

Once the survey is distributed, the Subcommittee will oversee the process of collecting and analyzing the survey results, with the objective of publishing a report on the survey in a future issue of The Business Lawyer.

Lessons from Gemcap. Don Glazer led a discussion of *Gemcap Lending, LLC v. Quarles & Brady, LLP*, 269 F.Supp. 3d 1007 (C.D. Cal. 2017) (on appeal). In this case, the plaintiff lender had sued borrower's counsel for an allegedly misleading closing opinion. The trial court granted partial summary judgment to the law firm, finding no breach of duty to the plaintiffs. Because the decision is on appeal, Don limited his presentation to two aspects of the case.

The first aspect related to the defendant law firm's knowledge qualifier, which stated:

> ". . . our opinion is based solely on (i) the current actual knowledge of the attorneys currently with our firm who have represented [borrower] and (ii) the representations and warranties of said parties contained in the Loan Documents; we have made no independent investigation as to such factual matters. *However, we know of no facts which lead us to believe such factual matters are untrue or inaccurate*."

269 F.Supp. 3d at 1032 (emphasis added).

Commenting on this disclaimer, Don called the Committee's attention to the highlighted sentence, recommending that, as a general matter, opinion preparers not include it because it could be read to be a separate confirmation of the client's factual representations, even those unrelated to the opinions being given.

The second aspect of the case Don discussed was the firm's confirmation regarding pending litigation. That confirmation, which was in a form increasingly employed by counsel in closing opinions, stated:

> "[T]o our knowledge, there [is] no [lawsuit] pending or threatened against [borrower] that (a) asserts the invalidity of any Loan Document, (b) seeks to prevent the consummation of any of the transactions [therein], [or] (c) . . . might (i) adversely affect the validity or enforceability of any Loan Document . . . ."

269 F.Supp. 3d at 1037.

Don commented favorably on the fact that the confirmation related only to litigation relating to the transaction and not to litigation generally affecting the client. Don went on, however, to recommend that the confirmation be further limited to litigation *in which the firm is representing the client* rather than to other litigation that is known to the firm. (He observed that if the confirmation is further limited in this way, then the "to our knowledge" qualifier could and should be eliminated.)

Discussion followed on Don's recommendations, including the advisability of the limitations he recommended.

Macquarie Decision. Stan Keller updated the Committee on the *Macquarie* litigation. On January 9, 2018, the Appellate Division of the New York Supreme Court reversed the trial court's dismissal of a complaint by an underwriter against its counsel for malpractice in failing to bring to the underwriter's attention information that would have caused the underwriter to refrain from underwriting a registered public offering by a Chinese company. *Macquarie Capital (USA) Inc. v. Morrison & Foerster LLP*, 2018 WL 326391 (N.Y. Sup. Ct. App. Div. January 9, 2018). The trial court had based its dismissal on a lack of proximate cause due to the underwriter's being in possession of the same factual information as its counsel. The Appellate Division ruled that the trial court, rather than dismissing the case, should have determined whether the information, while admittedly in the underwriter's possession, put the underwriter on sufficient notice without counsel's interpretation of the information. The Appellate Division quoted an earlier decision that a law firm may not shift to the client a legal responsibility it was specifically hired to undertake.

Stan emphasized that the case is in the preliminary stages and will now require the trial court to make further factual findings. For a discussion on the decision, see Stan's note, "*Macquarie Decision Reversed on Appeal*," in the Winter 2017-2018 issue (vol. 17, no. 2) of the Newsletter (at pages 22-23).

Proposed Amendments to § 204 of the *DCGL*. Section 204 of the Delaware General Corporation Law (the "DGCL") was enacted effective April 1, 2014 to enable Delaware corporations to retroactively cure defects in their corporate actions and thereby allow their counsel to give unqualified legal opinions as to, among other things, their capitalization. See Don Glazer's discussion of Section 204 in "*Opinions on DGCL Section 204 Stock: A Rose is a Rose is a Rose*," in the Spring 2014 (vol. 13, no. 3) issue of the Newsletter at 9-11.

In *Nguyen v. View, Inc.*, 2017 WL 2439074 (Del. Ch. June 6, 2017), the Delaware Court of Chancery held in a proceeding brought pursuant to Section 205 of the DGCL that Section 204 may *not* be used to ratify a "deliberately unauthorized corporate act" (2017 WL at * 2) so as to "undo a stockholder vote rejecting a transaction proposed by the company's board of directors." 2017 WL at * 10. For an analysis of the Chancery Court's decision in *Nguyen*, see the article by Steve Bigler and Stephanie Norman in the Summer 2017 (vol. 15, no. 4) issue of the Newsletter at 4-7.

The Delaware Corporation Law Council (the "Council") has prepared legislation proposing that DGCL Section 204 be amended to "eliminate any implication from *Nguyen v. View, Inc.* . . . suggesting that an act or transaction may not be within the power of a corporation — and therefore may not constitute a 'defective corporate act' susceptible to cure by ratification — solely on the basis that it was not approved in accordance with the provisions of the DGCL or the corporation's certificate of

incorporation or bylaws." See the Council's March 29, 2018 draft of the proposed legislation, synopsis of Section 3, at 12. John Mark Zeberkiewicz, a director of Richards, Layton & Finger, P.A., led a discussion of the proposed amendments to DGCL Section 204. John Mark pointed to the definitions of "Defective corporate act" and "Failure of authorization" in Section 204(h)) of the proposed amendments, which he noted were broadly drafted so as to include any failure of authorization, including any failure to receive a requisite stockholder vote such as that present in the *Nguyen* case. John Mark noted that the proposed amendments were aimed at the reasoning of the vice chancellor in *Nguyen* that the failure to receive the required stockholder approval removed the act from the acts that may be ratified under Section 204, which could severely limit the utility of Section 204. He further noted, however, that the amendments were not intended to overrule the specific conclusion in *Nguyen* that the ratification not be given effect in light of the facts as found by the vice chancellor.

In response to questions as to the scope of the amendments and the proposed coverage of Section 204, John Mark referred to the equitable powers of the Chancery Court to declare inequitable (and therefore ineffective) conduct even if statutorily permissible. As noted by the Council in its synopsis explaining the proposed amendments to Section 204:

> "The amendments [to Section 204] would not, however, disturb the power of the Court of Chancery to decline to validate a defective corporate act that had been ratified under Section 204, or to declare invalid any defective corporate act, on the basis that the failure of authorization that rendered such act void or avoidable involved a deliberate withholding of any consent or approval required under the [DGCL], the certificate of incorporation or bylaws, nor would it limit, eliminate, modify or qualify any other power expressly granted to the Court of Chancery under Section 205 of the [DGCL]."

In this, the Council reiterated a bedrock principle of Delaware corporate law, articulated 47 years ago by the Delaware Supreme Court in *Schnell v. Chris-Craft*:

> "The answer to that contention [that a board's compliance with legal technicalities is sufficient to insulate its actions from attack], of course, is that inequitable action does not become permissible simply because it is legally possible."

Schnell v. Chris-Craft Industries, Inc., 285 A.2d 437, 439 (Del. 1971).

Broker Non-Votes on Charter Amendments Increasing Authorized Common Stock. The Chair updated the Committee on developments with respect to broker non-votes on proposed charter amendments authorizing additional shares of common stock. As discussed at length at the Fall meeting of the Committee held in Chicago on September 15, 2017 (see the summary of the meeting in the Fall 2017 issue of the Newsletter (vol. 17, no. 1) at 6-8), confusion arose in 2017 over whether such proposals were routine or non-routine under the rules of the New York Stock Exchange.[2] Some issuers stated in their proxy statements that their proposals to amend their charters to increase the number of authorized common shares were non-routine, but Broadridge Financial Solutions, Inc., the leading provider of proxy compilation services, interprets Rule 452 as characterizing proposals to amend charters to

[2] Under NYSE Rule 452, broker member firms of the NYSE may vote on "routine" matters presented by issuers to their stockholders (and where their shares are held in street name by the brokers), but must obtain instructions from stockholders on "non-routine" matters. Rule 452 governs voting by NYSE member firms, regardless of whether the company's shares are listed on the NYSE, the NASDAQ stock exchange, or any other exchange. The Rule, therefore, has a much broader reach than just to stock listed on the NYSE.

increase the number of authorized common shares as routine. The confusion led to litigation challenging charter amendments increasing the number of authorized common shares.

The Chair reported that the confusion has now largely been eliminated by Broadridge's announcement that the NYSE's Rule 452 rules prevail, notwithstanding any contrary disclosure by an issuer in its proxy statement. Broadridge is now including the following message in its communications to its client companies:

> "Recently we [Broadridge] have received several inquiries about the ability of a broker to vote on an increase in common stock and reverse stock splits. The rules of the NYSE, with few exceptions, allow a broker to vote without shareholder instruction on these specific proposals.
>
> Guidance on the increase in common stock and reverse stock split proposals are included in the proxy statement. If an issuer's proxy statement conflicts with the NYSE rules, the NYSE rules prevail even if the issuer is not listed on the NYSE. Unfortunately, if this conflict is not corrected it can result in shareholder complaints and litigation against the issuer. Please be aware that Broadridge will follow NYSE rules to determine if a proposal can be voted by the broker or if shareholder instruction is required."

The Chair closed by noting that his firm is advising its clients, when including in proxy statements the disclosures required by Item 21 ("Voting Procedures") of Schedule 14A, to disclose the effect of abstentions and broker non-votes on each proposal submitted to the stockholders but not to categorize proposals submitted to stockholders as routine or non-routine.

Statement of Opinion Practices. Stan Keller updated the Committee on developments with respect to the Statement of Opinion Practices (the "SOP") since the November 7, 2017 meeting of the Committee in Washington, D.C. The Joint Committee composed of representatives of the Working Group on Legal Opinions ("WGLO") and members of the Committee have held several conference calls with a view to finalizing the SOP, and the SOP has been reviewed at the two most recent meetings of the TriBar Opinion Committee. The issues remaining for discussion are few. Stan and Steve Weise are hopeful that the SOP will be approved by the Joint Committee over the next few months, and that the SOP will then be ready for submission and approval by its sponsors – this Committee and WGLO – at their September and October meetings, with a view to distribution to bar groups and other interested parties for review and adoption.

Stan then summarized some of the remaining issues and how they might be handled.

Twitter Report. Rick Frasch reported that the Committee's Twitter handle (@ABALegalOpinion) now has over 200 followers. In response to a question Rick noted that the Committee's Twitter activity is not intended to replace other means of communication by the Committee to its members, including via the Newsletter, the ListServe, or otherwise, but is simply meant to supplement these other means of communication, with an emphasis on alerting members to developments promptly after they occur.

Other. The Chair reported on the program sponsored by the Committee the prior day ("Convergence of Cross-Border Opinion Practice in Financing Transactions – A Cross-Jurisdictional Approach"). He also invited members to attend the meeting the following day, Saturday, April 14, of the Intellectual Property Opinions Joint Task Force.

Don Glazer reported that the TriBar Opinion Committee's report on limited partnership opinions is nearing completion, and is targeted for publication in The Business Lawyer later this year.

Next Meeting. The next meeting of the Committee will be held at the Section's Annual Meeting in Austin, Texas on September 13-15, 2018.

- James F. Fotenos
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Audit Responses Committee

The Audit Responses Committee met on Saturday, April 14, 2018. The principal discussion points are summarized below.

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Update on Law and Accounting Committee. Jeffrey Rubin provided an overview of the topics discussed during the Business Law Section's Law and Accounting Committee meeting, which immediately preceded the Committee's meeting.

Report on Recent Committee Listserve Activity. Alan Wilson updated the Committee on recent discussion topics on the Committee's Listserve, highlighting the following two topics: (a) non-standard audit letter request language seeking confirmation of client descriptions of loss contingency matters set forth in audit letter requests, and (b) Canadian audit letter requests that direct the delivery of audit responses to the attention of the clients instead of the auditors. A summary of recent activity on the Committee's listserve is included in this issue of the Newsletter.

Report on Menaldi v. Och-Ziff Capital Management Group LLC, 277 F.Supp.3d 500 (S.D.N.Y. 2017) (Menaldi II). Stan Keller reported on the application of Accounting Standards Codification 450-20 in a recent decision in the class action against Och-Ziff, alleging securities law violations in the context of a Foreign Corrupt Practices Act investigation. Providing background on the case, Stan noted that *Menaldi II* includes many of the same claims that were at issue in *Menaldi v. Och-Ziff Capital Management Group LLC*, 164 F.Supp.3d 568 (S.D.N.Y. 2016) *(Menaldi I)*, with plaintiffs first raising their fraudulent financial reporting claim for failure to comply with ASC 450-20 in *Menaldi II*. Stan observed that the *Menaldi II* court made several notable observations regarding ASC 450-20. Noting that ASC 450-20 was no "reasonably simple and straightforward accounting rule," the court stated that the rule "requires many judgment calls in deciding how to respond to contingencies." The court indicated that disclosure (and possibly accrual) would have been required under ASC 450-20:

- If the government had manifested an awareness of a potential claim, *and* there was a reasonable possibility that a loss had occurred; or

- If the government had not manifested an awareness of a potential claim, but it was probable that the government would assert a claim, *and* there was a reasonable possibility that the outcome would be unfavorable.[3]

Based on the plaintiffs' allegations, the *Menaldi II* court concluded that for purposes of Och-Ziff's motion to dismiss, the government had manifested awareness of a potential claim involving FCPA violations by sending detailed subpoenas concerning the subject of the investigation. In describing the court's conclusion, Stan highlighted the court's acknowledgment that the "manifestation here was not as strong as that in *SAIC*,"[4] but it nevertheless found that the "reasonable possibility" standard applied. Stan also highlighted the court's conclusion that, while it was a "close call," the plaintiffs' complaint adequately alleged that a loss was "reasonably possible" and that disclosure of a loss

[3] *Menaldi II*, 277 F.Supp.3d at 514.

[4] *Menaldi II*, 277 F.Supp.3d at 515 (citing *Indiana Public Retirement System v. SAIC, Inc.*, 818 F.3d 85 (2d Cir. 2016)).

contingency related to potential FCPA violations was therefore required. The court, however, dismissed the claim because of plaintiffs' failure to adequately plead scienter. Stan noted that *Menaldi II* did not cite to *Richman v. Goldman Sachs*, 868 F. Supp. 2d 261 (S.D.N.Y. 2012), which held that receipt of a Wells notice from the SEC's staff is not threatened action requiring disclosure, particularly when there had been prior disclosure of the investigation, since a Wells notice is merely an indication that the SEC's staff intends to recommend litigation, and an issuer is not required to predict whether litigation actually will occur.[5]

The Committee engaged in discussion and generally agreed that *Menaldi II* increases the sensitivity around the "manifestation of awareness" determination, particularly when a company has received a subpoena. As Stan and others suggested, and as discussed at prior Committee meetings, companies and their lawyers need to be forward-thinking when evaluating government investigations and to gather as much information as possible to predict future events related to unasserted claims.

Report on PCAOB Staff Research Project on Auditing Standards Regarding Non-Compliance with Laws and Regulations. Tom White reported on a discussion with the staff of the Public Company Accounting Oversight Board in which members of the Audit Responses Committee and the Law and Accounting Committee participated. Tom reported that the discussion was part of the staff's outreach in connection with the staff's research project regarding current auditing standards pertaining to non-compliance with laws and regulations, including PCAOB AS 2405 *("Illegal Acts by Clients"),*[6] which sets forth the nature and scope of the considerations auditors should give to the possibility of illegal acts by a client. The PCAOB staff's research project is focused on whether improvements could or should be made to existing standard AS 2405 with respect to the auditor's obligations regarding the detection, investigation and reporting of an audit client's noncompliance with laws and regulations.

The meeting with the PCAOB was prompted by the addition of the issue to the PCAOB staff's December 31, 2016 research agenda. As reported during the Committee's last meeting, the PCAOB Investor Advisory Group ("IAG") held a discussion during its October 2017 meeting regarding an auditor's consideration of a client's noncompliance with laws and regulations. Among other things, an IAG working group recommended strengthening auditing standards regarding an auditor's duty to identify and report suspected or confirmed illegal acts.[7]

Members of the Committee discussed the recommendations of the IAG working group and noted that the staff project had been prompted in part by revised standards of the International Auditing and Assurance Standards Board that have recently taken effect. As the Committee noted, companies are subject to a myriad of laws and regulations and assessing a company's compliance with particular laws and regulations can require significant judgment and often involves gray areas that would be difficult for auditors to evaluate if affirmatively required to do so. The Committee observed that any consideration of changes to AS 2405 would need to take into account the importance of preserving the attorney-client privilege. An expansion of auditors' existing responsibilities to inquire into potential legal non-compliance also could present concerns about the scope of the lawyers' obligations to discuss such matters with auditors. Members of the Committee pointed to the delicate balance that the ABA *Statement of*

[5] See Stan Keller's article in this issue of the Newsletter addressing the difficulty in dealing with government investigations in audit responses, "Update on Dealing with Government Investigations in Audit Reponses" below.

[6] This subject is often referred to by the rather awkward acronym, "NOCLAR."

[7] The IAG working group's materials are posted on the Committee's website under "Materials for Nov. 2017 Meeting – PCAOB IAG WG Slides and Appendix."

Policy Regarding Lawyers' Responses to Auditors' Requests for Information, 31 BUS. LAW. 1709 (1976) (the "Statement of Policy"), reprinted in the ABA BLS Audit Responses Committee, *Auditor's Letter Handbook* (2d ed. 2013), strives to achieve with respect to the attorney-client privilege and suggested that any proposed changes to AS 2405 would need to take into account the impact on the Statement of Policy.

Looking ahead, members of the Committee noted that the future direction of the PCAOB and the IAG remains uncertain in light of the appointment of five new members of the PCAOB. Members of the Committee reiterated that this matter remains at the research stage but emphasized that it should be closely monitored and the profession should be prepared to participate if the project leads to further actions by the PCAOB.

Next Meeting. The Committee's next meeting is scheduled for the Business Law Section's Annual Meeting in Austin, Texas, September 13-15, 2018.

- Noël J. Para, Chair[8]
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[8] Alan J. Wilson, Esq., of Wilmer Cutler Pickering Hale and Dorr LLP, Content Director of the Committee, served as secretary of the meeting and prepared these minutes.

SUMMARY OF RECENT LISTSERVE ACTIVITY DECEMBER 2017 – MARCH 2018 (AUDIT RESPONSES COMMITTEE)

[**Editors' Note**: This summary of listserve activity during the period of December 2017 – March 2018 among members of the Audit Responses Committee does not necessarily represent the views of the Committee or authoritative pronouncements regarding audit response 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.[9]]

Non-standard Audit Request Letter Language. Members of the Committee discussed how to respond to the following non-standard language, particularly the underlined portion, which appeared in an audit request letter:

> "Please furnish directly to [accounting firm] such explanation, if any, that you consider necessary to supplement the foregoing information, including an explanation of those matters with respect to which your views may differ from those stated, [by the Company] [in a list of matters comprising pending or threatened litigation, claims and assessments presumed to be prepared by the Company, although this procedure is not common,] an identification of the omission of any material settled litigation, claims or

[9] The URL is http://apps.americanbar.org/dch/committee.cfm?com=CL965000.

> assessments relating to the Company, and a statement that the list of such matters is complete."

Members tended to agree that the phrase "foregoing information" referred to client descriptions of loss contingency matters preceding the quoted paragraph in the audit letter request, although another reading could make the "foregoing information" that information to be supplied in a listing of loss contingencies drafted by the attorneys pursuant to the client's request. One member of the Committee confirmed receiving a request with the underlined language during the 2017-2018 audit season, while at least one other member stated he had never received such a request.[10] Another member commented that he had never had to state that "the list of such matters is complete." Of course, only rarely does an audit request letter include such descriptions from clients.

As to including a statement in the audit response letter that the audit request letter included a complete list of such matters, members agreed that such an affirmative statement is not required because there is an inherent assumption that such response letters include all matters that should be reported in accordance with the ABA *Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*, 31 BUS. LAW. 1709 (1976) (the "Statement of Policy"), reprinted in the ABA BLS Audit Responses Committee, *Auditor's Letter Handbook* (2d ed. 2013).

[10] As an aside, that member also flagged that during the 2017-2018 audit season he had received pushback from an auditor where the law firm's audit response letter indicated that the firm was unable to respond to the following nonconforming request from the auditor:

> Please confirm that all information brought to your attention indicating the occurrence of a possible noncompliance with laws and regulations, including illegal acts committed by the Company, or any of its agents or employees, has been reported to those charged with governance and to [Audit Firm].

Members also noted that the reference to settled matters in the request raises an issue that the Committee has discussed before and on which there is a split in practice – whether law firm responses should (a) address matters to which substantive attention was devoted during the period under audit even though not outstanding at the end of the period or (b) cover only matters existing at period-end (or subsequently).

Members briefly provided reasons for such positions. At least two members noted that the former approach aligns with the Statement of Policy's illustrative form of response for use by outside lawyers, which states that the law firm is addressing matters "since [the] date of beginning fiscal period under audit," without indicating any limitation. Describing the latter approach, another member pointed to language under the AICPA form of audit request letter at AU Section 337A.01, which states that the law firm is addressing "matters that existed at (balance sheet date) and during the period from that date to the date of your response." The member also pointed to Commentary to Paragraph 5 of the Statement of Policy, which speaks to the determination of the probability "that an asset had been impaired or a liability had been incurred **at the date of the financial statements**." (emphasis added) Members indicated that firms following the latter approach might consider including language in their audit response letters to make clear that the response follows this latter approach. Another member cautioned that careful consideration should be given to whether such matters truly no longer exist at the end of a fiscal period, such as in the case of dismissals without prejudice, where the matter may resurface, or judgments that are subject to appeal.

Canadian Request Letters. A member inquired how other firms handle responses to audit request letters regarding publicly traded Canadian clients where such letters ask that the audit response letter be marked "Privileged and Confidential" and be addressed to the client with a copy provided to the auditors. The member indicated that his firm had received requests

from Canadian clients in the past but that the latest request was the first request for the letter to be marked "Privileged and Confidential" and be addressed to the client. The member indicated that his firm's past practice in this regard was to refer to the Statement of Policy in audit response letters regarding Canadian clients and to address the audit response letter to the auditors without a "Privileged and Confidential" label.

For context, members noted that such requests are intended to fit the audit response within the privilege position established by Canadian courts, as contemplated by the Canadian Joint Policy Statement (Dec. 2016). Under this position, the privilege may be preserved where the communication is addressed to the client, even though a copy is provided to the auditor. The Committee received a presentation on this topic from Blake, Cassels & Graydon LLP at an April 2016 meeting (summary accessible here).[11] By contrast, audit response letters prepared in accordance with the Statement of Policy typically are addressed to the auditor.

Some members initially flagged possible concerns that addressing a letter to the client under the Statement of Policy framework could cause the audit response letter to fall outside the ambit of the Statement of Policy framework. One member encouraged U.S. lawyers whose response is governed by the Statement of Policy to follow the Statement of Policy and address the response to the auditor, notwithstanding the approach requested in the audit request letter. It was recommended that lawyers should advise their client in advance if the lawyer intends to disregard the client's requested approach. Another member offered that his firm has received such a request in the past and that the firm was able to talk the auditor and client, in that instance, out of having the law firm direct its response to the client and out of including the "Privileged and Confidential" label.

On balance, other members did not see an issue with following a client's instructions and addressing the audit response letter to the client in order to strengthen the client's efforts to preserve privilege under Canadian law, as long as the lawyer sends the letter to the auditor (and presumably shows in the audit response letter that the auditor was copied). Supporting this position, a member analogized to opinion letters attached as Exhibit 5 to SEC registration statements, which typically are addressed to the board of directors of the client even though the opinion letter is filed for the benefit of investors. As a practical matter, members observed that if the audit response letter is provided under the Statement of Policy framework but addressed to the client, certain revisions to the audit response letter would be required, such as making references to the client in the third person.

- Alan J. Wilson, Content Director
Audit Responses Committee
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NOTES FROM THE LISTSERVE (LEGAL OPINIONS COMMITTEE)

[**Editors' Note**: Dialogues on the Legal Opinions Committee's Listserve are not intended to be authoritative pronouncements of customary opinion practice, but represent the views of individual lawyers (and not their respective law firms) on opinion topics of current interest. Members of the Committee may review the comments referred to below by clicking on the Listserve archive under "Listserve" on the Committee's website.]

[11] The URL is http://apps.americanbar.org/webupload/commupload/CL965000/sitesofinterest_files/04092016_minutes.pdf.

Dealing with Closing Conditions in Opinion Letters

TriBar, in its seminal report on third-party closing opinions, had this to say about stated assumptions:

> "Opinion preparers also rely on assumptions that are not of general application [e.g., the legal capacity of individuals, that copies conform to originals, that original documents are authentic, and that the signatures on executed documents are genuine]. Thus, if the opinion preparers have not been involved in all the steps needed to close a transaction, they frequently will be permitted to assume that all those steps were completed, *e.g.*, that a document was filed in a government office. Assumptions of specific application can reduce the cost of preparing an opinion and sometimes permit opinions to be rendered that would otherwise be impractical or impossible. Assumptions that are not of general application require an express statement in an opinion letter."

TriBar Opinion Committee, *Third-Party "Closing" Opinions* §2.3(b), 55 Bus. Law. 591, 615-616 (1998).

Peter Hosinski of Becker, Glynn, Muffly, Chassin & Hosinski LLP, New York, triggered a robust response to his inquiry to the Listserve of April 2, 2018 on an assumption his firm was proposing to take in a closing opinion on an amendment and restatement of a client's existing credit agreement. The amendment and restatement contained numerous conditions to its effectiveness, and Peter's firm was proposing an express assumption to the effect that those conditions had been satisfied. Peter believed the assumption appropriate "since a legal opinion should not serve, explicitly or implicitly, as a confirmation that the [conditions precedent] have been satisfied." But the lender's counsel was refusing to accept the assumption "on the basis that they [lender's counsel] have done other deals where counsel did not include this assumption." Peter asked for the views of the Listserve on the propriety of the assumption his firm was proposing to take.

The views of the responders varied, given that Peter's inquiry covered a lot of ground and the responses varied depending on the context in which an assumption concerning the satisfaction of closing conditions might be stated. Charles L. Menges of McGuireWoods LLP said that he would not normally expect to see, as lender's counsel, or to include in his opinion, as borrower's counsel, an assumption that *all* conditions precedent to the effectiveness of an A&R agreement have been satisfied, noting that such an assumption would be very unusual in a loan transaction.

Several responders (including John L. Koenig, John L. Koenig Law, LLC, Concord, Massachusetts and Arthur A. Cohen, Haynes and Boone LLP) noted that the mechanics of a typical closing moot the question since closing opinions are delivered at a closing and a closing does not occur unless all conditions precedent have been met (or waived). Other responders (Daniel H. Devaney IV, Cades Schutte LLP, and F. Thomas Rafferty, Baker, Donelson, Bearman, Caldwell & Berkowitz, PC) noted that this issue could be addressed by narrowing the assumption (e.g., that the transaction documents are enforceable against the lender) and relying upon a certificate from the client that the conditions to be satisfied by the client had been met. (Peter closed the listserve dialogue by reporting that his firm removed the assumption from its opinion letter and relied instead on a certificate from the client attesting to the satisfaction of those conditions to be satisfied by the client.)

Stan Keller (Locke Lord LLP) focused on the context in which the satisfaction of closing conditions arise in opinion practice. An opinion given on the issuance of shares, for example, is often formulated, without objection, in terms of "when the shares have been issued in accordance with the terms of the [purchase] agreement." Similarly, the relevance of conditions precedent to an opinion on the enforceability of an *amendment* to an agreement may be different than to an opinion on the agreement as *amended*.

Stan noted that it is common, in closings today, for opinion letters to be transmitted to the recipient in advance of the closing for delivery to the recipient only "when all conditions are satisfied." However, if a closing opinion also addresses post-closing matters that are subject to the satisfaction of conditions, then a reference to those conditions may be appropriate.

How opinions on *amendments* to agreements, such as to loan agreements, may differ from opinions on a loan agreement as *amended*, is addressed in a recent note by Don Glazer in the Fall 2017 issue *In Our Opinion* (vol. 17, no. 1, at 12-13). Don addresses the challenges confronting opinion givers when preparing an enforceability opinion on a loan agreement, as amended, versus on the amendment alone.

This distinction was highlighted by Larry Safran (Latham & Watkins LLP). Larry noted that it is not uncommon for amendments to agreements to contain conditions to the effectiveness of the amendment, which conditions may include those that the opinion preparers would not be able to verify, such as the absence of any default or event of default under the loan agreement. In such circumstances, Larry stated that his firm would explicitly assume that such conditions have been satisfied. David Brittenham of Debevoise & Plimpton LLP agreed with Larry, stating "I would tell lender counsel either to fix the agreement so that execution by the lender is deemed acknowledgment of satisfaction of conditions to effectiveness, or accept the assumption, or give the opinion themselves."

Steve Weise (Proskauer Rose LLP) observed, in responding to lender's counsel's justification for rejecting Peter Hosinski's assumption on the ground that other opinion givers did not include the assumption, that such a justification should not be dispositive of whether an assumption is proper or not.

Jennifer C. Blumenthal, McNair Law Firm P.A., Charleston, South Carolina, quoting from an assumption included in South Carolina's third-party legal opinions report, noted that she had not received any pushback when including the assumption in her opinion letters:

> "All conditions to the closing required by the Lender have been met to the satisfaction of the Lender or the time for performance has been extended or otherwise waived by the Lender; . . . ."

Jon Cohen of Snell & Wilmer L.L.P. (Phoenix), stated that the assumption quoted by Jennifer would be a standard implicit assumption in Arizona and that a recipient should not object if an Arizona opinion giver stated it explicitly.

Arthur Field provided an extended commentary on Peter's Listserve request, emphasizing, with Stan Keller, the importance of context. Opinion preparers should first determine if the closing conditions that concern them go to ―

- the effectiveness of the agreement, or
- a condition to making a loan, or
- both.

In the context of a remedies opinion, as it relates to the formation of an agreement, the opinion will not, observed Arthur, be affected by typical conditions to lending since compliance with conditions to the making of an advance or a loan is generally not covered by a remedies opinion on the loan agreement itself.

With respect to opinions on amendments to credit agreements, Arthur observed that an express assumption as to the satisfaction of its conditions seems justified and helpful as a disclosure device.

After the listserve dialogue, David Brittenham (Debevoise & Plimpton LLP), joined by Stan Keller (Locke Lord LLP), observed that the topic of how to address conditions to the effectiveness of a credit agreement amendment

(or any other contract) was more complicated than could be fairly captured in a listserve dialogue and that there were nuances that deserved further consideration.

As always, members are encouraged to raise legal opinion issues on the Listserve and to participate in the exchanges. Members also are encouraged to bring new developments (such as recent case law or newly identified issues) to the attention of Committee members through the Listserve.

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RECENT DEVELOPMENTS

Proposed Amendments to Section 204 of the Delaware General Corporation Law Resolve Uncertainty Created by the Reasoning in *Nguyen v. View, Inc.*

A. Introduction

In 2017, the Delaware Court of Chancery in *Nguyen v. View, Inc.*, 2017 WL 2439074 (Del. Ch. June 6, 2017), held in a proceeding brought pursuant to Section 205 ("Section 205") of the General Corporation Law of the State of Delaware (the "DGCL") that the consummation of a financing by View, Inc. ("View") that required the approval of, but was deliberately rejected by, the founder and then-majority common stockholder, was not a "defective corporate act" subject to ratification under Section 204 of the DGCL ("Section 204"). In so holding, the Court interpreted the definition of "defective corporate act" as requiring the court to take into account the corporation's "operative reality" at the time the act was taken in order to determine whether the corporation would have had the power to take such action at that time. Because View knew that the approval of the financing required the consent of the founder, and because the founder had intentionally revoked his consent, the Court concluded View's operative reality was that it did not have the corporate power to effect the financing without the founder's consent, and thus that the financing was not a "defective corporate act" for which ratification pursuant to Section 204 was available.

Following the *View* opinion, we suggested that, absent facts indicating a corporation proceeded with a transaction it knew that stockholders were required to approve and had intentionally rejected, the *View* opinion should not be read as curtailing (i) a corporation's power to ratify an otherwise void or voidable act or transaction where the transaction had not received the requisite stockholder approval, or (ii) the ability of a lawyer to opine on the ratification of the underlying act or transaction in such a situation.[12] We further noted that in a proceeding brought pursuant to Section 205, the Court of Chancery is expressly entitled to consider, among other things, "whether the defective corporate act was originally approved or effectuated with the belief that such approval or effectuation was in compliance with the provisions of [the DGCL], the certificate of incorporation or bylaws of the corporation." Accordingly, the *View* opinion was a reminder that, as with any action brought in the Court of Chancery challenging any corporate act or transaction, the equities matter, and the outcome of any proceeding under Section 205 necessarily will depend heavily on the particular facts and circumstances at issue, with the Court of Chancery having the authority, on a case-by-

[12] See the authors' article on the View decision, "Nguyen v. View, Inc.: The Delaware Court of Chancery Holds That Acts Deliberately Rejected by Stockholders Are Not Subject to Ratification under Section 204 of the Delaware General Corporation Law," in the Summer 2017 (vol. 16, no. 4) issue of the Newsletter, at 4-7.

case basis, to invalidate a ratification if it concludes the equities favor that result.

On April 6, 2018, the Corporation Law Section of the Delaware State Bar Association (the "DSBA") approved an amendment to the definition of "defective corporate act" in Section 204(h) that would, if enacted, eliminate any implication from the reasoning in the *View* opinion that an act or transaction that was not approved in accordance with the corporation's "operative reality" (*i.e.*, the provisions of the DGCL, the corporation's certificate of incorporation and bylaws, and any plan or agreement to which the corporation is a party) is not susceptible to ratification under Section 204. Importantly, the proposed amendment is not intended to disturb the ability of the Court of Chancery to decline to validate a defective corporate act that was ratified under Section 204 where the Court determines that such act was deliberately rejected by the corporation's stockholders at the time that it was initially taken or that the equities otherwise weigh in favor of invalidating that ratification. The amendment thus is not intended to alter the Court's conclusion in *View* that the ratification that was the subject of that case should not be given effect under Section 205 in light of the facts in that case.

B. The *View* Decision

In *View*, the founder of View challenged the ratification of several financing rounds in which View had raised an aggregate of approximately $500 million. At the time of the first financing round (the "Series B Financing"), the founder held approximately 70% of View's outstanding common stock, and his consent was required to approve the consummation of the Series B Financing. Although the founder had agreed, in connection with a settlement agreement entered into with View, to consent to the Series B Financing, he later rescinded the settlement agreement in accordance with its terms and revoked his consent to the Series B Financing. In an arbitration to resolve claims relating to the rescission of the settlement agreement, the arbitrator determined that the founder had properly rescinded the settlement agreement, including his consent to the Series B Financing, and that the Series B Financing was void. Because the Series B Financing was void, subsequent financings that had been consummated while the arbitration was pending were also effectively invalidated due to the failure to obtain the founder's consent.

After the arbitrator's decision, certain of View's preferred stockholders converted their preferred stock into common stock such that the founder's consent was no longer required to approve a financing (and, by extension, the ratification of the financings under Section 204), and the then common stockholders ratified each of the financings under Section 204. Thereafter, the founder filed suit pursuant to Section 205 challenging the ratification. During the course of the proceeding, the *View* Court considered the "gating issue" of whether the financings constituted defective corporate acts that were eligible for ratification under Section 204. In analyzing the term "defective corporate act" (which is defined in Section 204(h)(1)), in relevant part, as "any act or transaction purportedly taken by or on behalf of a corporation that is, and at the time such act or transaction was purportedly taken would have been, within the power of a corporation under subchapter II of this chapter, but is void or voidable due to a failure of authorization"), the *View* Court acknowledged that View had the power under subchapter II of the DGCL to, among other things, issue one or more classes of stock and rights and options in respect of those classes of stock. Nevertheless, the *View* Court explained that the term "defective corporate act" also required the act to have been within the corporation's power "*at the time such act was purportedly taken*," which it found implicated View's "operative reality" at such time. The *View* Court then reasoned that, because the founder's consent was required at the time of the Series B Financing pursuant to the provisions of the DGCL and because the founder had effectively revoked his consent, View did not have the power to consummate the financing at the time it was consummated. Therefore, the Series B Financing was not a defective corporate act for purposes of Section 204. In so holding,

the *View* Court acknowledged that the failure to give effect to the ratification of the financings would be "problematic if not potentially devastating for View." The *View* Court further noted that, in light of its holding that Section 204 could not be used to ratify the financing rounds, it could not "sustain View's attempted ratification on equitable, rather than statutory, grounds." citing *STAAR Surgical Co. v. Waggoner*, 588 A.2d 1130 (Del. 1991).

Following the denial of a motion for reargument (in which View argued, among other things, that the Court impermissibly carved out "rejected" acts from ratification under Section 204) and the filing of additional claims against View by the founder in connection with a proposed exchange offer (pursuant to which the holders of stock issued in the financings would exchange their current shares and possible claims against View for newly issued shares with identical rights, powers and preferences of the void shares), the parties entered into a settlement agreement. On February 21, 2018, the Court of Chancery entered the proposed order of dismissal and, in connection with the dismissal, validated pursuant to Section 205, among other things, the issuance of all outstanding shares of capital stock and other securities of View listed as outstanding on View's records as of December 21, 2017, including the issuance of all shares that the Court had previously held were not susceptible to ratification. Order of Dismissal and to Validate View, Inc.'s Corporate Acts Under Section 205, *In re View, Inc. Litig.*, Consol. C.A. No. 201-0762-JRS (Del. Ch. Feb. 21, 2018).

C. The Proposed Amendment

The Court's reasoning in the *View* opinion concerning the impact of a failure of authorization on a corporation's "operative reality" created uncertainty regarding the scope of corporate acts subject to ratification under Section 204 and the necessity of additional factual diligence or assumptions relating to whether the failure of authorization was intentional. Because a "defective corporate act" necessarily involves a corporate act that was not taken in compliance with the corporation's "operative reality" at the time of the act (*i.e.*, a failure of authorization), there was some concern among Delaware lawyers that the *View* opinion, read broadly, significantly curtailed the utility of Section 204. Furthermore, the *View* Court's initial conclusion that it did not have the power and authority to validate View's capital structure on equitable grounds in light of *STAAR Surgical* was particularly troubling in light of the fact that the legislative synopsis accompanying the adoption of Section 204 indicated that the statute was intended to overturn, among other decisions, *STAAR Surgical* on precisely those grounds. While in approving the settlement agreement and entering an order that, among other things, validated under Section 205 the issuance of stock and other securities it had previously determined not to be susceptible to cure by ratification, the *View* Court appears to have clarified that its earlier analysis of the financings under Section 204 was based on equitable considerations and not on the failure of the financings to constitute acts that are susceptible to ratification under Section 204 and Section 205. Nevertheless, the Court's "operative reality" analysis with respect to the scope of corporate acts susceptible to ratification under Section 204 was concerning.

To eliminate the uncertainty created by the reasoning in the *View* opinion concerning the defective acts potentially subject to ratification under Section 204, the Corporate Council of the Corporation Law Section of the DSBA and the Corporation Law Section of the DSBA have each approved the proposed amendment to Section 204(h). The proposed amendment, if enacted, would amend the definition of "defective corporate act" to provide, in relevant part, that it "means . . . any act or transaction purportedly taken by or on behalf of the corporation that is, and at the time such act or transaction was purportedly taken would have been, within the power of a corporation under subchapter II of this chapter (*without regard to the failure of authorization identified in [the board resolutions adopted in connection with the ratification of such act]*), but is void or voidable due to a failure of authorization." (emphasis added).

Accordingly, if enacted by the Legislature, the proposed amendment to Section 204(h) will clarify that a "defective corporate act" is any act that the corporation would have had the power to take under subchapter II of the DGCL (essentially any act other than conferring honorary degrees or conducting a banking business) without regard to the failure of authorization (*i.e.*, the failure of the act to have been taken in light of the corporation's "operative reality"). The legislative synopsis to the proposed amendment to Section 204(h) states:

> The amendments to Section 204(h)(1) are intended to eliminate any implication from *Nguyen v. View, Inc.*, C.A. No. 11138-VCS (Del. Ch. June 6, 2017), suggesting that an act or transaction may not be within the power of a corporation—and therefore may not constitute a "defective corporate act" susceptible to cure by ratification—solely on the basis that it was not approved in accordance with the provisions of the Delaware General Corporation Law or the corporation's certificate of incorporation or bylaws.

Importantly, any concerns that a corporation may misuse Section 204 to ratify actions that were deliberately rejected by its stockholders continue to be addressed by the factors enumerated in Section 205(d). Indeed, the proposed amendment to Section 204(h) is not intended to overrule the Court's conclusion in *View* that the ratification that was the subject of its opinion not be given effect in light of the facts of that case. The legislative synopsis to the proposed amendment to Section 204(h) expressly notes that the proposed amendment would not disturb the power of the Court of Chancery to, among other things, "decline to validate a defective corporate act that had been ratified under Section 204 . . . on the basis that the failure of authorization that rendered such act void or voidable involved a deliberate withholding of any consent or approval . . . nor would it limit, eliminate, modify or qualify any other power expressly granted to the Court of Chancery under Section 205."

D. Conclusion

Counsel for Delaware corporations should continue to have confidence in proceeding with a ratification of a defective corporate act under Section 204 and in giving opinions on acts and transactions ratified pursuant to Section 204. Although the Court of Chancery continues to have the power and authority to invalidate any ratification under Section 204 if the equities favor that result, all actions taken by a corporation may be challenged on equitable grounds before the Court of Chancery. As such, we do not believe that the *View* opinion requires that opinions on acts or the issuance of stock properly ratified in accordance with Section 204 need to be qualified in a manner that is different from opinions given on acts or stock that are duly authorized at the outset.

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Update on Dealing with Government Investigations in Audit Responses

In the Fall 2016 issue of *In Our Opinion*, I wrote about the difficulty of dealing with government investigations in audit responses.[13] That article focused on the SEC enforcement action against RPM International Inc. and its General Counsel. Subsequently, a federal court denied the defendants' motions to dismiss the SEC action.[14] *RPM* involved a qui tam complaint against the company for violation of

[13] Stanley Keller, *"Dealing with Government Investigations in Audit Responses,"* In Our Opinion, Fall 2016 (vol. 16, no. 1) at 14-17.

[14] Securities and Exchange Commission v. RPM International, Inc., 282 F. Supp. 3d 1 (D.D.C. 2017).

the False Claims Act. That complaint, although filed confidentially, was shared along the way by the government with the company, but the underlying potential liability was not disclosed by the company until later. The article also discussed the *SAIC* decision, which involved a company's failure to disclose a government investigation regarding the company's overcharging the City of New York following indictment of two employees and threats for recoupment by the Mayor of New York.[15]

In September 2017, the U.S. District Court for the Southern District of New York, in *Menaldi v. Och-Ziff Capital Management Group LLC*, found that Och-Ziff failed to comply with generally accepted accounting principles by not disclosing as required by Accounting Standards Codification 450-20 potential loss contingencies after it received subpoenas from the U.S. Department of Justice and the SEC relating to violations of the Foreign Corrupt Practices Act.[16] Although the court dismissed Rule 10b-5 claims against Och-Ziff for failure to disclose the potential loss contingency, finding that the plaintiff failed to adequately plead scienter, the decision could be read to indicate that receipt of a subpoena is sufficient to show a claimant's manifestation of awareness of a claim, shifting the standard for required disclosure (and potentially accrual) under ASC 450-20, as interpreted by the Second Circuit in *SAIC*, from probable of assertion as an unasserted claim to reasonably possible as a threatened claim. In my view, however, a proper reading of the court's decision in *Menaldi* indicates, as suggested in my article, that whether receipt by a company of a subpoena is sufficient to show manifestation of awareness of a claim depends upon the particular circumstance, including what the subpoena indicates about a possible claim and what the company knows of the underlying basis for that claim.

Menaldi was a securities class action lawsuit against Och-Ziff and certain of its officers and employees alleging various violations of the federal securities law for failure to disclose improper payments and related government regulatory proceedings and investigations involving its mining activities in Africa. After Och-Ziff entered into a deferred prosecution agreement with the Department of Justice admitting violations of the Foreign Corrupt Practices Act and into a settlement with the SEC under which it paid over $400 million as disgorgement, the plaintiff filed a new complaint that included a claim that Och-Ziff engaged in fraudulent financial reporting because it failed to disclose the potential financial impact of the government investigation as required by ASC 450-20.

The court analyzed the requirements of ASC 450-20 and found that Och-Ziff's failure to disclose the FCPA investigation and its potential consequences was a violation of those requirements. The court, citing the *SAIC* decision, began with what it called the "threshold question" of whether there was a manifestation by the government of an awareness of a possible claim, shifting the applicable standard for disclosure from the "probability standard" to the "reasonable possibility standard." The court acknowledged that the manifestation in this case was not as strong as in *SAIC*, but nevertheless found adequate allegations that the detailed subpoenas concerning its African ventures made Och-Ziff aware of the existence of an active investigation that could lead to the government's filing of a claim against it and that a loss was reasonably possible (i.e., in ASC 450-20 terms, that the likelihood of an adverse outcome was "more than remote").

Although the court found that ASC 450-20 had been violated, it ruled that the plaintiff had not adequately pled scienter as a basis for a Rule 10b-5 claim, distinguishing *SAIC* where the defendant company had received the results of

[15] Indiana Pub. Ret. Sys. v. SAIC, Inc., 818 F. 3d 85 (2d Cir. 2016).

[16] Menaldi v. Och-Ziff Capital Management Group LLC, 277 F. Supp. 3d 500 (S.D.N.Y. 2017).

its internal investigation, knew about the kickback scheme and was aware of the potential fines and penalties and loss of contracts. The court, quoting from *Godinez v. Alere, Inc.*,[17] stated that "[T]he existence of a subpoena does not, without more, give rise to a strong inference of scienter on the part of senior management." In finding as well the absence of reckless conduct, the court described ASC 450-20 in terms that should provide some comfort as follows:

> "ASC450 is not a 'reasonably simple and straightforward accounting rule.' … The rule requires many judgment calls in deciding how to respond to contingencies. …[T]this claim involves an omission that is based on a qualitative accounting rule rather than an affirmative misstatement about a pending investigation."

277 F. Supp. 3d at 516.

Thus, although a subpoena can be the basis for having to disclose a loss contingency under ASC 450-20, that is not always the case and a more detailed analysis is required. One lesson from *Menaldi* is that a company is well-advised to look harder at the need for disclosure when it has received a subpoena and to accelerate internal efforts to determine if there is an underlying basis for claims related to the subject matter of the subpoena. A company may take some comfort in the ability to exercise judgment regarding the requirements of ASC 450-20 based upon the court's characterization of that accounting rule. However, for a lawyer responding to an audit request, the effect of *Menaldi* when the company has received a subpoena that may be a harbinger for government claims is likely to be to prompt treatment of a matter as a threatened claim rather than an unasserted claim.

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LEGAL OPINION REPORTS

(See Chart of Published and Pending Reports on following page.)

[17] *Godinez v. Alere, Inc.*, 272 F. Supp. 3d 201, 219 (D. Mass. 2017) (plaintiff adequately alleged that company had sufficient reason to know a product recall was likely so that it should have accrued or disclosed a loss contingency under ASC 450-20).

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 April 30, 2018.**]**

A. Published Reports Available From Legal Opinions Resource Center[18]

ABA Business Law Section	2009	Effect of FIN 48 – Audit Responses Committee
		Negative Assurance – Securities Law Opinions Subcommittee
	2010	Sample Stock Purchase Agreement Opinion – Mergers and Acquisitions Committee
	2011	Diligence Memoranda – Task Force on Diligence Memoranda
	2013	Survey of Office Practices – Legal Opinions Committee
		Legal Opinions in SEC Filings (Update) – Securities Law Opinions Subcommittee
		Revised Handbook – Audit Responses Committee
	2014	Updates to Audit Response Letters – Audit Responses Committee
	2015	No Registration Opinions (Update) – Securities Law Opinions Subcommittee
		Cross-Border Closing Opinions of U.S. Counsel
	2016	Report on the Use of confirmation.com – Audit Responses Committee
	2017	Opinions on Debt Tender Offers ― Securities Law Opinions Subcommittee
ABA Real Property Section (and others)[19]	2012	Real Estate Finance Opinion Report of 2012
	2016	Local Counsel Opinion Letters in Real Estate Financing Transactions
Arizona	2004	Comprehensive Report
California	2007	Remedies Opinion Report
		Comprehensive Report
	2009	Venture Capital Opinions
	2014	Sample Venture Capital Financing Opinion
	2015	Revised Sample Opinion
	2016	Third-Party Closing Opinions: Limited Liability Companies and Partnerships

[18] 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/. 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.

[19] These Reports are 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").

Published Reports Available From Legal Opinions Resource Center (continued)

Florida	2011	Comprehensive Report Update
Georgia	2009	Real Estate Secured Transactions Opinions Report
City of London	2011	Guide
	2017	Guide Update
Maryland	2009	Update to Comprehensive Report
Michigan	2009	Statement
	2010	Report
Multiple Bar Associations	2008	Customary Practice Statement
Multiple Law Firms	2016	White Paper – Trust Indenture Act §316(b)
National Association of	2011	Function and Professional Responsibilities of Bond Counsel
Bond Lawyers	2013	Model Bond Opinion
	2014	501(c)(3) Opinions
	2017	Update of Model Letter of Underwriters' Counsel
National Venture Capital Association	2013	Model Legal Opinion
New York	2009	Substantive Consolidation – Bar of the City of New York
	2012	Tax Opinions in Registered Offerings – New York State Bar Association Tax Section
North Carolina	2009	Supplement to Comprehensive Report
Pennsylvania	2007	Update
South Carolina	2014	Comprehensive Report
Tennessee	2011	Report
Texas	2006	Supplement Regarding Opinions on Indemnification Provisions
	2009	Supplement Regarding ABA Principles and Guidelines
	2012	Supplement Regarding Entity Status, Power and Authority Opinions
	2013	Supplement Regarding Changes to Good Standing Procedures

Published Reports Available From Legal Opinions Resource Center (continued)

TriBar	2008	Preferred Stock
	2011	Secondary Sales of Securities
	2011	LLC Membership Interests
	2013	Choice of Law
	2017	Limited Partnership Opinions

B. Pending Reports

ABA Business Law Section	Sample Asset Purchase Agreement Opinion – Merger and Acquisitions Committee
	Updated Survey – Legal Opinions Committee
	Resale Opinions – Securities Law Opinions Subcommittee
	Opinions on Risk Retention Rules White Paper – Securitization and Structured Finance Committee & Legal Opinions Committee
ABA Real Property Section (and others)[20]	UCC Opinions in Real Estate Transactions
California	Sample Personal Property Security Interest Opinion
	Exceptions and Other Qualifications to the Remedies Opinion
	Sample Real Estate Finance Opinion
	Comprehensive Report Update
Multiple Bar Associations	Statement of Opinion Practices
	Core Opinion Principles
	Local Counsel Opinions[21]
Florida	Comprehensive Report Update
Texas	Comprehensive Report Update
TriBar	Opinions on Clauses Shifting Risk
	Bring Down Opinions
Washington	Comprehensive Report

[20] See note 19.

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

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.[22] 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 July 2018. 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)

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